

Report No. 9352-TA

11/11/1991 10:00 AM

Country Operations Division
Southern Africa Department

Tanzania Economic Report Towards Sustainable Development in the 1990s

(In Two Volumes) Volume I: Main Report

June 11, 1991

Country Operations Division
Southern Africa Department

FOR OFFICIAL USE ONLY



Document of the World Bank

This document has a restricted distribution and may be used by recipients only in the performance of their official duties. Its contents may not otherwise be disclosed without World Bank authorization.

Currency Unit = Shilling

Average
Fiscal Year Exchange Rates (July/June)
(Tsh/US\$)

<u>1965/66</u>	<u>1966/67</u>	<u>1967/68</u>	<u>1968/69</u>	<u>1969/70</u>	<u>1970/71</u>	<u>1971/72</u>
7.143	7.143	7.143	7.143	7.143	7.143	7.143
<u>1972/73</u>	<u>1973/74</u>	<u>1974/75</u>	<u>1975/76</u>	<u>1976/77</u>	<u>1977/78</u>	<u>1978/79</u>
7.143	7.014	7.143	7.976	8.368	8.059	7.873
<u>1979/80</u>	<u>1980/81</u>	<u>1981/82</u>	<u>1982/83</u>	<u>1983/84</u>	<u>1984/85</u>	<u>1985/86</u>
8.221	8.207	8.647	9.762	12.645	17.875	18.646
<u>1986/87</u>	<u>1987/88</u>	<u>1988/89</u>	<u>1989/90</u>	<u>1990/91</u>		
51.163	82.286	119.424	173.505	201.801		

Average
Calendar Year Exchange Rates
(Tsh/US\$)

<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>
7.143	7.143	7.143	7.143	7.143	7.143	7.143
<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>
7.021	7.135	7.367	8.377	8.289	7.712	8.217
<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
8.197	8.284	9.283	11.143	15.292	17.172	32.698
<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>		
64.260	99.292	143.377	195.056	230.0		

COUNTRY: Tanzania

TITLE: Tanzania Economic Report -- Towards Sustainable Development in the 1990s
Volume I: Main Report
Volume II: Background Papers

REGION: Africa

SECTOR: Country Economic

<u>REPORT</u>	<u>TYPE</u>	<u>CLASSIFICATION</u>	<u>LANGUAGE</u>
9352-TA	ERA	Official Use	English

DATE: June 11, 1991

ABSTRACT: This report analyzes the achievements of Tanzania's economic reform program since the mid-1980s and identifies constraints to continued economic recovery. Building on the directions set forth in the Government of Tanzania's Economic Recovery Program and Economic and Social Action Program, the report considers the key elements of a strategy for attaining sustainable economic growth and renewing social progress -- reducing poverty -- within Tanzania. Chapter 1 assesses the performance of the economy over three distinct policy regimes during the past two to three decades, thus providing a framework for evaluating, particularly, the results of change and growth over the past five years. Chapter 2 analyzes the period of reform from the perspective of the impact on and welfare gained by a range of economic agents. Chapter 3 focuses on the impact of public sector performance on macroeconomic stability and discusses the financial and public sector reforms required to achieve greater macro stability. Chapters 4 and 5 analyze the impact of recent adjustment efforts and the agenda for further reform of the agriculture and industrial sectors, respectively. The requirements of parastatal reform are discussed, as are important infrastructure / real sector linkages. Chapter 6 assesses the stalled social progress of the past decade and suggests a strategy for restoring momentum toward social goals. Chapter 7 consolidates the report's analysis and recommendations, provides a framework for projections and argues that a deepening and a hastening of the reform process is required if Tanzania is to achieve its longer term objectives for the economy.

Tanzania Economic Report
Towards Sustainable Development in the 1990s

Volume I: Main Report

Chapters

	Acknowledgement	
	Executive Summary	i
1.	Performance of the Economy	1
2.	Impact of Reform on Key Economic Agents	17
3.	Public Sector Performance and Macroeconomic Stability	31
4.	The Agricultural Sector: Performance and Linkages	59
5.	Industry and Small-Scale Enterprise Development	89
6.	Accelerating Social Progress	111
7.	Sustainable Growth in the 1990s and Beyond: Scenarios and Conclusions	131

Volume II: Background Papers

Papers

1.	The Tanzanian Recovery, 1983-89	1
2.	National Income Estimates in Tanzania: Methodological and Empirical Issues	37
3.	Private Sector Development in Tanzania: Obstacles and Opportunities	99
4.	Enhancing Aid Effectiveness in Tanzania	119
	Statistical Appendix	133
	Bibliography	143

ABBREVIATIONS

AIDS	Acquired Immune Deficiency Syndrome
BIS	Basic Industrial Strategy
BOP	balance of payments
BOS	Bureau of Statistics
BOT	Bank of Tanzania
CCM	Chama Cha Mapinduzi
CDC	Commonwealth Development Corporation
CMS	Central Medical Stores
CPI	consumer price index
CRDB	Cooperative and Rural Development Bank
DRC	domestic resource cost
ERP	Economic Recovery Program
ERR	economic rate of return
ESAP	Economic and Social Action Program
FIS	formal sector industrial survey
GDP	gross domestic product
GDY	gross domestic income
ICD	Institute of Curriculum Development
IFC	International Finance Corporation
IFS	International Financial Statistics
IMF	International Monetary Fund
KILIMO	Ministry of Agriculture
MDB	Marketing Development Bureau
MOF	Ministry of Finance
NBC	National Bank of Commerce
NDC	National Development Corporation
NGO	non-governmental organization
NMC	National Milling Corporation
ODA	official development assistance
OGL	Open General License
PEM	protein energy malnutrition
PER	Public Expenditure Review
PEs	public enterprises
PSAP	Priority Social Action Program
PSM	public sector management
QRs	quantitative restrictions
SAR	Staff Appraisal Report
SDR	Special Drawing Right
SGR	strategic grain reserves
SMEs	small scale enterprise
TAC	Tanzania Audit Corporation
TANU	Tanzania African National Union
TCMB	Tanzania Coffee, Cotton or Cashew Marketing Board
TDFL	Tanzania Development Finance Co., Ltd.
TIB	Tanzania Investment Bank
TOT	terms of trade
VAT	value added tax
VCRs	value-cost ratios

Acknowledgement

1. This report was prepared and discussed on a collaborative basis with officials of the Government of Tanzania. In particular, a team from the Planning Commission, headed by Solomon Odunga (Director of Macroeconomic Planning), coordinated and contributed to the report's design and preparation.

2. We recognized from the outset the existing data weaknesses in many areas. Thus a World Bank and Central Bureau of Statistics team worked specifically on national accounts methodological and data issues. The objective went beyond more robust data analysis for this report; it also aimed towards a longer term institutional collaboration on methodological and data-gathering improvements. Furthermore, to complement published and unpublished data already available, during report preparation selected micro-surveys were carried out, and these data sources provide part of the basis for the analysis in the report.

3. This report focuses on a wide range of issues with significant intersectoral and macroeconomic implications to Tanzania's adjustment effort. The objective of examining these and other linkages has been to provide elements for a unified framework of analysis of the alternative strategic and policy choices for the future. No attempt has been made to present every issue exhaustively. Many topics which are central to development of Tanzania, such as a detailed sectoral analysis of transport, population, nutrition and health, women in development and public sector management, are not covered in detail here. Recent comprehensive reports are available in these areas, and where appropriate these are cross-referenced in the text. In addition, the government has identified a number of medium and long-term issues on which it is already undertaking or plans more detailed work than presented here. This collaborative effort is an input to that longer-term process. Thus, where appropriate, the report has attempted to identify additional areas for future study.

4. The report was prepared as a result of two main missions to Tanzania during late 1989, which were led by Daniel Kaufmann, and other subsequent work. The report's principal authors have been Daniel Kaufmann and Chris Hall (deputy mission leader), Southern Africa Country Operations Division. Other Government of Tanzania officials, World Bank staff and consultants who contributed to this report include Vargha Azad, Mboya Bagachwa, Benoit Blarel, David Cieslikowski, Paul Collier, Brian Cooksey, Peter Fallon, Roger Grawe, Jan Gunning, Mukwanason Hyuha, John Komba, Brian Levy, Robert Mabele, Rose Mang'anya, Darius Mans, Fidelis Mtatifikolo, Benno Ndulu, Ian Porter, Mataro Sabai, Roy Southworth, Brian Van Arkadie, Samuel Wangwe, and Michael Ward. Michael Walton commented extensively during the report's preparation. Valuable comments and suggestions were also received from Nisha Agrawal, Steen Jorgensen, Michael Mills, David Phillips, Enrique Rueda-Sabater, and Moina Varkie. Further assistance in putting the report together was gratefully received from Clara Amsel, Trini Angeles, Rita Attia, Anne Dronnier, Rosalie Ferraro, Huba Mannoro, Mary-Anne Mwakangale, Ligia Murphy, Norah Rusobya, Betty Sakaya, and Raj Stephen.

5. The analysis and recommendations in the final version of this report reflect the many and valuable comments received during two sets of discussions with the government in March and May 1991. Extensive comments and suggestions from Joshua Doriye, Charles Kimei, Jonas Kipokola, Peniel Lyimo and Solomon Odunga have enhanced the quality of this collaborative report.

TANZANIA ECONOMIC REPORT

TOWARDS SUSTAINABLE DEVELOPMENT IN THE 1990s

Executive Summary

I. Introduction

1. This report analyzes the achievements of Tanzania's economic reform program and identifies the constraints to continued economic recovery. Building on the directions set forth in the Economic Recovery Program and the Economic and Social Action Program, this report then considers the key elements of a strategy for attaining sustainable growth and renewing social progress – reducing poverty – within Tanzania.

2. The effects on the Tanzania economy of inadequate policies and external shocks during the late 1970s and early 1980s, combined with a weak productive structure, resulted in economic stagnation and per capita income decline lasting almost a decade. Consequently, the substantial achievements since independence in building economic and social infrastructure not only could not be sustained, but were substantially eroded. However, an improvement in the performance of the Tanzanian economy has taken place since the mid-1980s. The government's economic restructuring program, as embodied by import liberalization measures begun in 1984 and the Economic Recovery Program (ERP), adopted in 1986 and expanded by the Economic and Social Action Program (ESAP) in 1989, has encompassed far-reaching reform measures across a broadening range of sectors and policy instruments. Assisted by relatively good weather and additional aid inflows, Tanzania as a result has enjoyed five consecutive years of positive per capita GDP growth and improved welfare in sharp contrast to the preceding period.

3. In the first years of reform, the most successful adjustment measures have been in areas of economic liberalization, where demands on Tanzania's limited institutional and administrative capacity have been relieved by the reforms – e.g., in the substantial real exchange rate movement, external trade liberalization, domestic trade deconfinement and price decontrol, and at present the Tanzanian economy largely relies on market signals for pricing and allocative decisions. In a continuing effort to improve the prospects for the Tanzanian economy, the government has, in addition, broadened its reform program to include comprehensive restructuring programs in agricultural marketing (e.g., by liberalizing marketing arrangements, reforming the cooperative system), in infrastructure (e.g., by beginning the implementation of the integrated roads program), and most recently the financial sector (e.g., by allowing entry to new banks, granting autonomy to and initiating restructuring of existing banking institutions). In addition, the government has taken some initial steps in public and parastatal reform (e.g., through public enterprise restructuring) and in the social sectors (e.g., by incorporating social concerns fully into the reform program).

4. While many conditions for further recovery are present, there are several factors of significance that continue to hinder economic response in Tanzania – and could even halt it. As discussed in this report, deepening the reform process and wherever possible accelerating the pace of implementation will be crucial if Tanzania is to consolidate gains made to date, sustain

growth and development and achieve poverty reduction. In particular, it will be crucial to address successfully the objectives of:

* **achieving macroeconomic stability:** in the past excessive credit requirements of agricultural parastatals and cooperatives have been readily met by directed credit from the government-controlled, non-competitive banking sector; this contributed to continuing high inflation, crowded out other borrowers from the financial system, and effectively bankrupted the financial sector. In addition to agricultural marketing inefficiencies and continuing transport and processing constraints, these contributed as well to Tanzania's precarious balance of payments situation.

* **spreading the benefits of reform more widely:** during the reform period agricultural output and peasants' living standards have risen substantially – due in large part to increased availability of goods and inputs in rural areas, the result in large part of trade liberalization. However, the benefits of the past exchange rate devaluation, which should have reached farmers through substantially greater real price increases, have largely been taxed away by an inefficient export crop marketing system. Raising production further will thus depend on implementing further reforms of the agricultural marketing system and addressing critical longer-term productivity concerns.

* **undertaking public enterprise reform:** the government recognizes that it does not have the financial or manpower resources required for new investment or to manage public enterprises adequately. Thus to reduce budgetary costs and improve efficiency in the industrial sector and throughout the economy the government needs to adopt a comprehensive program of parastatal reform and actively pursue private participation and outright sale of government-owned enterprises.

* **rehabilitating and maintaining infrastructure:** the lack of adequate infrastructure impedes economic growth. As one of the government's core responsibilities it will be important to improve Tanzania's basic infrastructure in roads, railways, ports, telecommunications, power and water so that it contributes to improved economic and social prospects. In this context it will be important for government to consider how best to ensure delivery of these services in the future.

* **improving social service delivery systems:** long term sustainability requires building indigenous capacity, raising labor productivity and augmenting poverty reduction efforts. This calls for budgetary restructuring, improved financing arrangements, and the development of alternative systems for service delivery and management.

* **raising productivity of the public sector:** results will require greater budgetary emphasis on government's core responsibilities (e.g., infrastructure, social services, agricultural services); raising civil service productivity and capacity; reducing the drain on public resources from parastatals; and raising the efficiency of tax and revenue policies to promote greater domestic resource mobilization.

5. This report first analyzes the impact of the reform program to date. It points to (i) the common features underlying the achievements of the past five years of reform, (ii) the

common denominator in the areas of remaining constraints to continued recovery, accelerated growth and social progress, and (iii) the key linkages between the sectoral and macroeconomic determinants of performance in the Tanzania economy. Building on the directions set forth by government in the ERP and ESAP, this report then considers the key elements of a strategy for attaining sustainable growth and a renewal of social progress.

II. Determinants of growth in Tanzania

6. As set forth in Chapter 1, external factors, such as terms of trade losses, the war with Uganda and variable weather conditions, while important in explaining economic performance in some years, cannot alone fully explain the persistence and extent of the economic decline in the late 1970s and early 1980s, the development of a parallel market economy in Tanzania or, later on, the economic recovery from the mid-1980s onwards. Rather, the evidence suggests the centrality of policy-related factors in determining Tanzania's economic performance. The exchange rate, trade and pricing regimes have been significant determinants of growth performance, mostly via the efficiency by which investments, imports and other resources have been allocated in different periods.

7. Donors share with the government the responsibility for many of the policy mistakes and disappointing economic outcomes of the past two decades. With the benefit of hindsight it appears that external assistance in earlier years supported inappropriate policies and programs. Economic growth in Tanzania could have been substantially higher if aid programs had been designed appropriately and implemented more effectively. The statistical evidence suggests that in contrast to the past, aid levels have been more effective in determining economic performance during the years of the ERP -- a period of increasingly market-based allocative mechanisms and aid channeled to support recurrent imports rather than large expansions in installed capacity.

III. How have key economic agents fared since reform began?

8. The improved policy framework in Tanzania has contributed to economic growth rates exceeding 4 percent per annum for almost 5 years--an impressive achievement in the aggregate, particularly given weak institutions and debilitated infrastructure. An analysis of sector and micro-level performance of economic agents (peasants, workers and firms), within the limitations of the data, confirms that not all agents have shared similarly in the achievements of the ERP. As expanded upon in Chapters 2, 4 and 5, this conclusion points to further actions in the policy agenda related to those three categories of agents.

9. The peasant. Since 1985, agricultural production has increased by approximately 5 percent per year. Per capita food consumption in rural areas has risen substantially since the ERP began, as has availability of non-food consumer goods. Peasants have thus consumed a much improved commodity basket, in contrast with the large decline in peasants' living standards experienced during the 1977-1984 period. However, prices received by producers for agricultural output have overall not risen in real terms since reform began, and farmers' real cash incomes have only slightly increased during this period. Thus, the large peasant supply response and their improvement in welfare have not resulted from price change. Rather, it appears that improved production and welfare gains have in large measure been the outcome of the much improved availability of consumer goods and inputs in rural areas, in turn the result of import

and domestic food crop marketing trade liberalization. These, aided by good weather, have led to large increases in production and marketed volumes.

10. The break from past trends in the peasants' living standards has thus been significant. But it could have been more impressive, if it were not for the increasing level of implicit taxation imposed on farmers by the export crop marketing institutions (Chapter 4). While farmers received nominal price increases during this period, the large exchange rate movements of recent years were not fully passed on to peasants through equivalent real price increases.

11. Farmers now face an improved marketing situation for food crops and non-traditional exports, the result of liberalized marketing of these crops. In turn, production has increased. By contrast, output production of traditional export crops -- which are central to rural incomes and to Tanzania's overall export effort -- has not grown significantly. Partly, this could be due to the required time lag between new investment, which may be taking place, and output response. In addition, until very recently marketing of traditional export crops remained monopolistic and agricultural marketing efficiency deteriorated severely. Throughout the decade official exports of traditional agricultural products performed poorly: by 1990 they were 22 percent below their 1981 level in current dollar terms, and the value of these exports continued to fall even after 1986. By contrast, official estimates of liberalized non-traditional exports, show these exports to have risen by almost 30 percent in value over the same time period.

12. The urban worker. Per capita food consumption by the urban population has increased significantly since 1984 as greater production and liberalized foodgrain marketing has brought greater supply to urban areas. Non-food consumption has also increased significantly in the urban areas since the mid-1980s, the outcome of external trade liberalization, additional aid and increased industrial production. As real cash incomes grew in urban areas, and the availability of goods improved markedly throughout the country, overall urban consumption improved significantly -- in sharp contrast to the years of stagnation and empty shelves in the early 1980s.

13. Not all urban inhabitants have fared equally well, however. Those engaged in trading, construction and the informal sector appear to have done (relatively) better than others. Also, those with preferential access to the banking sector and those involved in extra-income activities have continued to benefit as the volume of resources available in the economy has increased markedly. In contrast, young, unskilled, underemployed workers, as well as public sector employees with little access to non-salary income, have benefitted much less. More broadly, all urban inhabitants (as well as their rural counterparts) have continued to face inadequate delivery of social services -- e.g., primary health care, basic education and training.

14. The firm. Average industrial production has increased by over 5 percent per year since 1985, the year when capacity utilization and production volumes reached their lowest levels. As the analysis in the report indicates, a restructuring and reallocation of resources is also underway. According to a limited survey carried out for this report, efficient formal sector enterprises appear to have increased production by an estimated 20 percent since 1985, while output of inefficient enterprises has declined. Expanding firms are utilizing a much lower share

of foreign exchange than contracting enterprises, suggesting an incipient shift towards higher domestic resource utilization. However, a large segment of the industrial sector, comprised mostly of large-scale and import-intensive parastatals, has not yet streamlined their operations.

15. In contrast to the limited restructuring of larger-scale enterprises, the smaller scale sector is undergoing a dramatic change. Multiple smaller scale production and trading activities have emerged since the mid-1980s. A three-fold increase in such activities has been estimated since then. The positive response of the Tanzanian entrepreneur to the more market-oriented policy environment, in spite of the serious remaining constraints faced by the entrepreneurs (e.g., inadequate financial services and infrastructure, continuing regulatory obstacles), is indicative of this sector's dynamism and the enormous potential for future expansion.

16. The aggregate contribution of farmers, urban workers, and entrepreneurs has led to an official GDP growth rate averaging over 4 percent per annum since the ERP started. This has resulted in positive consumption per capita growth -- in sharp contrast to the declines of the early 1980s. Factoring in the expansion of the informal economy -- whose share in overall GDP is estimated to be around 30 percent and growing -- actual GDP growth (and its level) is higher than the official figures suggest.^{1/} In many respects, urban and rural inhabitants appear to be better off now than five years ago, although the overwhelming majority of the population, with an average income per capita estimated at less than US\$220 per year, is still very poor, remains at great risk from malnutrition and other health problems, and faces inadequate access to education, health and other social services.

IV. Achievements and Constraints during the ERP: The "Institutional" Common Denominator.

17. The changes in the positions of the various economic agents reflect both the achievements and limitations of the ERP. In particular, successful implementation of the reform program has primarily taken place in areas where the demands on Tanzania's limited institutional and administrative capacities have been relieved by the reforms themselves, rather than the reforms placing additional demands on the existing institutional framework. Notable examples of institutional constraint-relieving reforms have been import liberalization through own-funded imports and the Open General License Facility (OGL), foodgrain marketing liberalization, distribution deconfinement of virtually all consumer goods and inputs, price decontrol, and a more realistic exchange rate regime. In turn, these reforms have been associated with (i) the significant increase in foodcrop production and per capita consumption, (ii) the ongoing reallocation of resources within industry; and (iii) the emergence of many new informal and small-scale activities. Common to all these developments, and to the relaxation of institutional constraints, has been the much-improved environment in which the private sector can operate in agriculture, industry and services.

^{1/} One must exercise caution when using GDP per capita estimates. The World Bank calculates per capita incomes using atlas methodology -- they are based on officially reported GDP, exchange rates and price deflators. Income estimates using purchasing power parity estimations would show relatively higher incomes in Tanzania than the official figures. See "National Income Estimation in Tanzania", background paper number 2 in Volume 2 of this report for further discussion of national income accounting methodology used in Tanzania and Chapter 6 which presents international comparisons of economic and social indicators using PPP.

18. The government has been courageous in undertaking these politically difficult measures. Once political consensus has been reached, implementation of these "institution-relieving" reforms has been relatively straightforward. In contrast, the areas where full implementation of reform has not yet taken place -- and on which government plans to focus in the coming months and years -- are those areas where the institutional demands imposed by the required reforms are high. For example, the non-competitive agricultural export marketing system has been partly responsible for lower-than-expected agricultural export growth. The government has now embarked on further marketing liberalization (i.e., allowing competition in marketing by deconfining marketing for the traditional export crops), but in addition major institutional changes are required, since export marketing boards and the cooperative system need to be restructured institutionally and financially. The role of the marketing boards is already being reduced. In addition to financial restructuring, cooperatives will also be based on voluntary participation, implying that farmers will be free to market goods through alternative channels.

19. Other examples of reform measures that will continue to tax Tanzania's institutional capacity are in the financial, government, parastatal and social sectors. In the case of the social sectors, the slow response to the ERP has been directly related to institutional and budgetary constraints. In addition to the social and productivity-enhancing effects of a reformed incentive structure, social progress and poverty reduction will depend on: (i) extending and creating greater participatory (community-based schemes) and private sector channels for service delivery and management -- improving effectiveness in delivery and relieving public sector capacity constraints; (ii) promoting public sector management reform, including allocating additional public expenditures to social sectors for essential inputs and supportive infrastructure; and (iii) implementing this strategy will require an improved capacity in government plan and implement targeted interventions -- including improving self-financing of social services (i.e., through cost recovery and other resource mobilization). Local government must figure prominently in this approach as social service delivery primarily takes place at this level of government.

V. Assessing Macroeconomic Stability: Consolidating Fiscal Accounts.

20. As discussed in Chapter 3, the excessive credit requirements of agricultural parastatals, cooperatives and some public industrial enterprises, have been met without adequate economic or financial review and have not been fully repaid by the borrowers. The state-controlled banking sector, however, has continued providing credit to many large borrowers (as in the case of agriculture) as alternative marketing channels have not existed. As a result, the consolidated fiscal deficit of the public sector (the government deficit plus financial sector financing of quasi-fiscal expenditures) has been very high over the ERP period -- even though fiscal targets for the government budget alone have generally been met or even surpassed over the period of reform. The consolidated deficit has been a critical factor in explaining the money supply growth of about 30 percent per annum over the first four years of the ERP. This contributed to the persistent monetary imbalances and relative macro-instability: until recently, the inflation rate has been about 30 percent per annum. Inflation, in turn, necessitated larger and politically-painful nominal exchange rate devaluations. During 1990, the official inflation estimates fell to just below 20 percent for the first time in over a decade. However, in the first quarter of 1991, following a year of decline, inflation rose again to an annual average of 27 percent, due in part to poorer weather conditions and the effects of the Gulf crisis.

21. In addition to having become an impediment to macroeconomic stability, the performance of the financial sector has had an increasingly adverse impact on resource allocation throughout the real economy. As the price of foreign exchange has come closer to a market-determined rate, and has been allocated increasingly through non-administrative mechanisms, domestic liquidity has become a binding constraint. Credit by the financial institutions has been allocated primarily to large parastatals, particularly to marketing institutions, often on subsidized terms (through preferential interest rates, grace periods, inadequate repayment enforcement, increasing arrears, etc.). Credit to other potentially more efficient borrowers has therefore been severely constrained, and total supply response has been less than it could have been. The government has recognized that future economic growth and development will require financial sector reform and has taken the steps to begin this process by issuing a policy statement and enacting legislation establishing the objective of competition within the sector, allowing market entry for private banks and instituting commercial banking principles.

VI. Public Sector Management: The Need for Institution-Intensive Reforms

22. A productive economy requires an efficient public sector. The task over the coming years will be to significantly improve productivity of this sector. Accomplishing this will require institutionally-intensive measures. Critical is the restructuring of public expenditures -- determining priorities within a constrained resource picture, allocating expenditure toward core activities to provide basic physical and social infrastructure and services to the population, streamlining parastatal financing, broadening the tax base, and improving revenue collection efficiency. Such restructuring would have to be accompanied by programs to address the institutional and management weaknesses which have been compounded by the deteriorating structure of compensation. Monthly salaries in the public sector represent one-fifth of their real levels of the late 1970s and on average are insufficient to feed and provide for an average household. As a result, workers morale and discipline at all levels have suffered and many civil servants are forced to divert considerable official time to private venture activities. Absenteeism is therefore high, and civil service productivity is low.

23. Inadequate compensation has also lowered Tanzania's ability to meet its social objectives, as approximately half of Tanzania's civil service are teachers and health workers. Continued productivity decline of these professionals and other workers in response to inadequate and often very late pay, as well as inadequate funds and distribution channels for complementary inputs, will continue to constrain Tanzania's social prospects.

24. As the Public Expenditure Review (PER, 1989) and this report point out, medium-term budgetary planning and restructuring and revenue enhancement have begun, but much more remains to be done. Initial steps taken recently include increased allocations of public resources directed toward rehabilitation and maintenance and incipient development of alternative (private sector) delivery systems. Despite the importance the government attaches to the social sectors, the priority attached to those sectors as evidenced by budgetary allocations has been mixed. The objective for the future should be to focus a greater share of the government's limited financial and manpower resources on these key sectors.

25. Correcting the problems in public sector management will be capacity-intensive and require decisive action over a considerable period of time. It will also require government to

continue to redefine the role of the public sector in the economy in response to a realistic assessment of comparative advantage and resource capacities. Government should also consider which public services are necessary and which could better be provided through private sector delivery systems or other alternatives. As government has already recognized, hard decisions of reducing the size of the public sector will have to be taken, and some actions have been initiated.

VII. Parastatals: Restructuring a Large Sector of the Economy

26. Parastatal restructuring is a major item on the future agenda for Tanzania because of the need to reduce budgetary costs and improve efficiency in the agricultural and industrial sectors. To date, Tanzania has relied primarily on changes to the overall macroeconomic framework to stimulate restructuring. Recently, however, the government has initiated some parastatal- and subsector-specific restructuring to counter sectoral inefficiencies and persistent financial losses. In the case of NMC for example, a major restructuring, including sale of assets, has already taken place. In the case of the leather subsector, the government has decided to seek joint venture partners in the subsector's enterprises.

27. Restructuring an expanded array of subsectors and enterprises needs to proceed. However, the step-wise, subsector or firm-specific approach presently being followed in Tanzania cannot encompass the many systemic problems affecting parastatals as a whole. Thus the future strategy of government should include adopting a comprehensive program of parastatal-wide reforms aimed at: (i) eliminating budgetary subsidies; (ii) ensuring parastatal autonomy and accountability through the adoption of performance contracts; (iii) increasing the commercial orientation of the enterprises; and (iv) allowing competitive pressure through further reforms in trade, regulatory and industrial policies, easing entry of new firms and competition in all sectors. Furthermore, the government recognizes that it does not have the financial or manpower resources which would be required for new investment, to put all state enterprises on a sound footing or to manage public enterprises adequately. Consequently, Tanzania's parastatal reform program now includes the possible outright sale of public enterprises -- an option which needs to be actively followed up on without regard to whether the enterprises are presently loss-making or profitable. In addition, the parastatal restructuring program will need to facilitate the exit and liquidation of non-viable concerns.

VIII. Balance of Payments and Institutional Factors

28. A variety of factors has influenced the critical condition of the balance of payments (BOP) experienced after the mid-1980s -- including, inter alia, continued infrastructure and processing bottlenecks, declining export (coffee) prices, and increase in the price of oil. Yet the 'institutional' factor appears to be critical in this area of macro-performance as well. The poor performance of the cooperative unions, marketing boards, and transport parastatals (e.g., railways), and in some cases their parent ministries, have contributed to crop procurement and processing inefficiencies. They have also reduced the pass-through to the farmer of higher prices resulting from exchange rate changes and have constrained access to inputs. The result has been lower production and exports of traditional export crops than would otherwise have been the case.

29. Exchange rate policy has had a greater impact on non-traditional exports than on the traditional exports, since the marketing system for the former has been liberalized further, providing higher incentives to the producers. However, even for non-traditional exports growth could have been more significant if exporters had faced a more appropriate real exchange rate. Notwithstanding the very dramatic realignment of the nominal and real exchange rate over the ERR period, the real level of the exchange rate had not yet reached an appropriate level by early 1991. Since May 1991, however, further devaluation in real terms have taken place. Maintaining an appropriate real exchange rate level through complementary fiscal and monetary policy, combined with continued flexibility in exchange rate management, will be very important in enhancing balance of payments viability.

30. Import use efficiency has improved substantially since the mid-1980s. However, it is likely to continue below potential as long as subsidies are still provided to importers. Donor assistance allocated to particular recipients or tied to particular procurement arrangements contributes to this situation. Tanzania's low creditworthiness has also meant that the country at times has had to pay very high prices for its imports, and on occasion has had to secure its imports through tied deals.

IX. Sustainable Growth in the 1990s and Beyond: Deepening and Accelerating Reform – An Agenda for the Future

31. Continued efforts to resolve the critical sectoral and institutional constraints afflicting the Tanzania economy are essential if Tanzania is to attain sustainable and equitable growth within a stable macroeconomic framework. Resolution of these constraints requires, foremost, an effort to create an efficient, well-functioning economy, through: (i) implementation of the government's plans for financial sector reform, (ii) further agricultural marketing liberalization, and (iii) further parastatal restructuring. These are key elements of a strategy to promote a more dynamic private sector, and reflect the limitations on public sector resources and capability. They will need to be supported by other policy and institutional reforms. Public expenditure and investment restructuring and civil service reform to continue to rebuild and enlarge infrastructure, capacity-enhancing actions through education and training, and targeting particular groups (e.g., the poor, women) with specific poverty alleviation interventions are equally important.

32. In setting priorities for the future reform effort, this report distinguishes between (1) measures which are constraint-relieving in terms of their institutional demands, and could be expected to be taken in the near term, and (2) measures which are capacity-intensive in terms of their institutional demands. In this latter category, institutional reforms should be begun now, but may take longer to effect, or to see the full results of, as they will place great demands on Tanzania's implementation capacity (Matrix 1 at the end of this Executive Summary summarizes these actions). Both sets of measures are essential to the overall program of structural reform, and neither would be effective without the other. Some of these actions are already in the process of implementation or decisions have already been taken.

33. Constraint-relieving actions would encompass, inter alia, measures to attain and maintain an appropriate exchange rate system; reform agricultural export marketing by deconfining marketing for all crops; continue liberalization in industry and services by further deconfinement and decontrol of prices and allowing freedom of market entry by domestic and

foreign investors; eliminate parastatal subsidies; close non-viable public enterprises; allow competition in the financial sector between domestic and foreign-owned banks; and allow the private sector and other agents a greater role in service provision. The institutionally demanding (capacity-intensive) reforms identified include restructuring and strengthening of financial sector institutions and their clients, including the cooperatives; parastatal restructuring and public sector management reform.

34. An important objective of the report's agenda for policy and institutional reform is to promote unification of the parallel and official economies in Tanzania. Unification is important to reduce inefficiencies associated with rent-seeking, encourage greater resources to flow through the official economy and increase the government's ability to manage the Tanzanian economy through indirect measures. An incentive-led unification of these markets requires an integrated approach, including continued flexibility of exchange rate management (reflecting an appropriate premium between the parallel and official markets, underlying movements in the trade account) supported by prudent monetary and fiscal policies. Equally important to bring more economic agents into the official economy are trade, regulatory and financial sector reforms. The response of economic agents will unavoidably be gradual as confidence builds, but government can certainly influence the pace of parallel and official economy unification through the speed and breadth of overall reform implementation.

35. Since the beginning of economic reform five years ago, the economic growth and higher per capita consumption attest to the capacity of Tanzania's economic agents to respond to economic incentives. Given Tanzania's economic potential and the evident supply response capacity of farmers, firms and workers, there is little reason to doubt that with suitable incentives, an improved institutional and infrastructural framework, the population would benefit from sustained economic advancement over the coming years.

36. The lessons from the recent experience of Tanzania, coupled with the identification of key constraints that are beginning to be addressed, provide room for cautious optimism. The projections contained in Chapter 7 suggest that the reform strategy outlined here would have a positive economic impact. Over the coming two decades, Tanzania could continue to achieve economic growth between 4 and 5 percent per annum and per capita consumption growth of between 1 and 2 percent per year. Such growth would particularly reflect strong agricultural production and export response to the further liberalization of agricultural export marketing, institutional reform and improved infrastructure. Continued strong performance in the informal sector and small scale industry would be an important contributor. More efficient allocation of imported and domestic resources within medium and larger scale enterprises would also promote private investment and greater output and export growth in that sector. Export performance, though vibrant, would remain substantially less than total import requirements, the result of the much smaller base of the former. This means that the balance of payments would improve but would remain difficult for the foreseeable future. The role of donors and their response to the intensification of economic reform would remain crucial for Tanzania's external viability. Donors would need to maintain if not increase real aid levels. Both fast-disbursing balance of payments support, particularly in the short to medium term, and well-targeted project aid would be required. In addition, donor commitment to untied import support to the OGL system will be essential if market unification is to succeed.

37. The public sector restructuring program would have a positive social impact in alleviating poverty and ill-health, and result in an increased ability to invest in its people's health and education. Specifically, relatively greater emphasis and allocation of more financial and human resources toward the social sectors would assist Tanzania to better address the critical health threats now facing the country, such as the continuing problems of malnutrition, of malaria and other long-standing diseases, and the new challenges posed by AIDS.

38. There are some costs and risks to the strategy set forth here. In large part, economic and social costs normally associated with stabilization were borne during the years of stagnation and deprivation and during the period preceding the ERP when prices for most consumers already reflected scarcity value. In the future, however, the reform will result in transitional costs, largely the expected outcome of civil service retrenchment and lay-offs from parastatals. Government and donors will need to devise programs to ameliorate these costs (such as compensatory and retraining mechanisms, etc.) as an integral part of public and parastatal reform.

39. There may also be political risks to reform, though Tanzania has shown preparedness to take them on. In the cooperative sector, for example, the government has taken difficult decisions, declaring that cooperative membership will in the future be based on voluntary association and individual societies and unions will have to maintain their own viability. In April 1991 the government enacted the necessary legislation to effect these changes. When fully implemented these reforms will result in full liberalization of marketing to allow multiple private channels and in the restructuring of cooperatives and removal of political and administrative interference. The government has also announced that private domestic and foreign banks will be allowed to operate in Tanzania and enacted necessary legislation.

40. Key questions addressed by the report are whether the growth seen during the initial years of the ERP can be sustained and whether social progress can be achieved by maintaining or only incrementally extending the existing liberalization measures. The report concludes that this incremental approach would be unlikely to be sufficient. Rather, the ongoing reform program needs to be deepened and the pace of decision-making and implementation accelerated to better ensure achievement of sustainable and equitable development over the longer term.

41. There are a number of reasons why a reform program which is not broadened and deepened would most likely be unviable. First, recent growth performance has greatly been the outcome of one-time gains due to trade liberalization which led to the increased availability of goods. Now that liberalization in many sectors has substantially taken place, fewer additional welfare gains and supply response can be expected from this source alone. Second, sustained growth is unlikely to take place if macroeconomic balance were to remain elusive -- if reform were not undertaken in agricultural marketing, financial, public and parastatal sectors -- and if public infrastructure (e.g., transport and social services) were not improved. Third, there would be clear limits to the replicability of donor aid funding increases in the future, as aid even at present levels is contingent on continued progress on economic reform. Finally, many gains during the ERP were due to increases in underutilized capacity. In the future, many activities, particularly in industry, will face effective capacity constraints as a result of their expansion in output and their high level of obsolescence and disrepair. Thus, although reallocation of recurrent inputs can still result in supply response for a number of years, efficient new investment

will be critical to determining growth performance in Tanzanian economy. As the public sector lacks both the resources and the comparative advantage to undertake the required investment economy-wide, attaining acceptable levels of efficient investment will require an enabling policy and regulatory environment conducive to private sector investment from domestic and foreign sources. In addition, public sector investments will be required in economic infrastructure, particularly where the private sector is unlikely to enter. A restructured public sector and budgetary framework would be necessary to facilitate the implementation of key public investments in physical infrastructure, basic health and education, and to address poverty issues.

X. The Role of Donor Assistance

42. The report emphasizes that donors have a major role to play in assisting the government with the major reforms required. Maintaining and even increasing somewhat the already high levels of assistance will be important in the coming years to support Tanzania's policy reform and restructuring program. The effectiveness of this assistance also needs to be improved further. Increased collaboration and improved coordination of donor assistance, including some concentration of donor assistance according to sector and expertise will be important, and the report suggests a number of means of instituting this (see Chapter 7). In particular, the report suggests that collaborative work programs among government and donors be developed, that analytical reports and other work be discussed more widely and that donors base decisions concerning involvement and financing on this joint work.

43. With regard to resource requirements of Tanzania over the coming years, the report stresses that continued high levels of import support will be critical. The report also recommends that donors further shift assistance currently tied to specific enterprises or activities to support for the OGL. In the context of the Special Program of Assistance, donors with funds tied to source should also work to untie assistance, and all donors should strive to eliminate the earmarking of counterpart funds. Both these actions will contribute to increase the scope for effective economic management in Tanzania. Conventional project assistance will also be very important, but the government and donors will need to review very carefully the preparation and design of such projects to ensure that an appropriate overall policy framework is in place and the projects take full account of the need to make use and strengthen local capacities and institutions.

XI. Dynamism and Growth through Private Sector Development

44. The country's strategy for productivity improvement, economic development and social progress over the coming years must have as a central component the realization of the potential dynamism of the private sector. The analysis of Tanzanian economic agents attests to the substantial unrealized potential for dynamism and growth through private sector development. There is ample evidence that the vast majority of Tanzanians respond significantly, through increased production and exports, to the environment of appropriate economic incentives. These, coupled with improved public institutions and infrastructure would fuel economic growth for the coming years.

45. The agents for dynamism and growth are diverse. Peasant farmers, due to their numbers, are central to the process of securing extensive indigenous participation in economic growth and establishing a strong income base in rural areas. This group has raised production

as a consequence, inter alia, of improved availability of incentive goods, inputs and the overall economic liberalization which Tanzania has undertaken to date and should respond similarly to the incentives, marketing and support system reforms which government has planned and which are outlined in this report. Larger-scale ventures have recently begun to produce and market non-traditional crops: there are many agriculture-based entrepreneurs who, in the incentive environment of the early 1980s (especially the exchange regime), could not have succeeded, but who now export large quantities, employ a substantial and growing work force and who are diversifying their activities, a process which should be encouraged. Small sector industrial and service sector activities, including informal sector participants, will continue to contribute significantly to growth. There are also larger industrial groups, who have begun to develop different types of enterprises. All these agents are expected to respond to the reform of incentives and regulations, removal of excessive regulation and improved physical and financial infrastructure.

46. The emphasis on the dynamic entrepreneurship potential of the private sector has implications for the role of government and donors. Complementary to the requirement of establishing the right environment of incentives, institutions and infrastructure, the success of this will require the accelerated investment in Tanzania's human resources, men, women, and children. Investments in education, health and nutrition will underpin the achievement of sustained and equitable growth in the longer term.

Matrix 1

Strategic Agenda for the 1990s

Sector/ Objective	Constraint-Relieving Action	Near-term	Capacity-Intensive Action Medium-term	Government Initiatives
<p><u>1. Financial sector</u> - to improve resource mobilization and allocation, eliminate quasi-fiscal expenditures, improve macro stability, provide better services through entry of private banks and strengthen existing financial institutions and clients</p>	<p>Allow entry of domestic and foreign private sector banks</p> <p>Establish autonomy and independence of government-owned banks</p> <p>Eliminate directed credit -- allow banks to determine extent and to whom they will lend, based on creditworthiness criteria</p> <p>Decontrol interest rates</p>	<p>Identify financial burden and shift financing of uncreditworthy but potentially viable concerns, which have restructuring plans, to the budget on an interim basis</p> <p>Implement discount policy so that BOT is lender of last, not first resort</p> <p>Strengthen BOT to act as independent monetary authority and supervise commercial banks effectively</p>	<p>Restructure existing banks</p> <p>Restructure major clients of banking sector</p> <p>Decide on ultimate structure of government-owned banking institutions</p> <p>Institute money, bond and equity markets</p>	<p>Policy decisions taken and announced and legislation enacted to allow new banks and grant independence/autonomy to government banks. Work progressing on other priority issues. Implementation will be undertaken over substantial period of time.</p>

Sector/ Objective	Constraint-Relieving Action	Capacity-Intensive Action Near-term	Medium-term	Government Initiatives
<p>II. Public sector</p> <p>A. budgetary restructuring</p> <p>- to determine priorities and focus resources on highest priority programs</p>	<p>Incorporate annual plan into medium term financial framework (rolling 3-5 year plan), which would be consistent with current year budget</p> <p>Shift greater recurrent and development budget expenditures toward priority sectors (social sectors, infrastructure)</p> <p>Implement infrastructure rehabilitation, upgrading and reform programs in roads, railways, ports</p>	<p>Review functions and role of government vis-a-vis efficiency and resource capacities</p> <p>Integrate recurrent and development budget processes to, inter alia, take account of recurrent implications of capital expenditures</p> <p>Encourage alternatives for delivering public services</p> <p>Ensure adequate and timely new infrastructure investment (e.g., in telecommunications, power)</p>	<p>Expenditure emphasis shifting toward infrastructure. Work about to begin to review ministerial functions.</p>	

Sector/ Objective	Constraint-Relieving Action	Capacity-Intensive Action		Government Initiatives
		Near-term	Medium-term	
<p>II. <u>Public sector</u> (cont).</p> <p>B. <u>civil service reform</u> - to improve incentives for productivity and improve morale within the civil service</p>	<p>Decide on objectives and actions to reform civil service</p>	<p>Establish reliable database on civil service, control additions to the payroll and rematch civil servants and payroll</p> <p>Improve incentives / compensation with substantial real pay increase</p> <p>Remove already-identified overstaffing</p> <p>Monetize allowances and benefits and integrate into salary</p>	<p>Reduce staffing levels in line with review of functions and role of government and budgetary constraints</p> <p>Provide compensation / retraining schemes for civil servants affected by staff reduction measures</p>	<p>Some work ongoing to develop reliable systems for monitoring and controlling payroll. Studies ongoing to review alternatives for compensation schemes. Time-frame agreed over which decisions on implementation of staff reductions will be taken.</p>
<p>C. <u>tax policy and administration reform</u> - to improve efficiency of tax system and improve administration</p>	<p>Implement simplified tax system with the objective of achieving a low, unitary sales tax rate with a limited number of excisable goods</p> <p>Reduce tariffs and make more uniform</p> <p>Eliminate discretionary tax/tariff exemptions</p>	<p>Reform customs service through higher remuneration, rewards for uncovering fraud, etc.</p> <p>Eliminate arbitrariness and institute equal and transparent tax treatment for all small/large, public/private enterprises</p>	<p>Develop and implement tax credit system as prelude to VAT</p>	<p>Maximum tax rates substantially reduced. Tax Commission preparing final report.</p>

Sector/ Objective	Constraint-Relieving Action	Capacity-Intensive Action Near-term	Medium-term	Government Initiatives
<p>III. <u>External trade liberalization / exchange rate policies</u> - to enlarge non-allocative foreign exchange system and strengthen appropriate incentive framework with objective of unifying official and parallel markets</p>	<p>Continue own-funds scheme Achieve and maintain appropriate exchange rate and foreign exchange management system Shorten OGL negative list to goods with health and security concerns only Eliminate "free resource" allocation of foreign exchange for merchandise imports, shifting those resources to the OGL Maintain unification of all export retention rates and harmonize export retention and OGL lists Streamline licensing and other export procedures</p>	<p>Establish mechanism to increase transparency of aggregate foreign exchange market (e.g., foreign exchange bureaus) Improve system for repatriation of profits, other service payments, etc.</p>	<p>Unify official and parallel exchange rates</p>	<p>Substantial exchange rate realignment to date and agreed understanding of need to achieve and maintain appropriate exchange rate. OGL has been expanded progressively.</p>
<p>IV. <u>Domestic trade liberalization (goods and services)</u> - to open alternative channels for production and trade</p>	<p>Decontrol remaining prices Deconfine remaining goods</p>	<p>Restructure trading companies</p>		<p>Most prices decontrolled and goods deconfined. Decisions on further actions already taken.</p>

Sector/ Objective	Constraint-Relieving Action	Capacity-Intensive Action		Government Initiatives
		Near-term	Medium-term	
V. <u>Agriculture sector</u> - to relieve institutional constraints and strengthen agricultural services to promote long-term productivity	Liberalize/deconfine all crops at all levels	Develop mechanisms for financing agricultural producers	Revise national land use policy and legislation	Principal of multi-channel marketing accepted. Legislation to reform cooperatives movement enacted. Marketing board restructuring initiated.
	Remove government-mandated prices and replace with indicative prices for all crops	Reform coops to make them grassroots, voluntary associations	Reorient and rehabilitate research and extension services and develop alternative delivery systems, including private sector involvement	
		Downsize/restructure all marketing boards	Continue to implement major infrastructure rehabilitation programs	

Sector/ Objective	Constraint-Relieving Action	Capacity-Intensive Action		Government Initiatives
		Near-term	Medium-term	
VI. <u>Parastatal and industrial reform</u> - to promote greater, more efficient production, financial discipline, efficient resource utilization and macro stability	<p>Eliminate all budgetary subsidies to commercial, non-strategic PEs (subject to interim financing arrangements) including short-term bridging loans and longer-term lending from Treasury</p> <p>Eliminate enterprise-specific import support, shifting all those resources to the OGL</p> <p>Shift granting of credit for counterpart funds payment to financial system</p> <p>Abolish SCOPO and SCOPO-like controls over PEs</p> <p>Close or shift non-commercial parastatals to the budget</p> <p>Close / liquidate non-viable enterprises</p>	<p>Classify all PEs into strategic/non-strategic, commercial/non-commercial, viable/non-viable</p> <p>Initiate restructuring -- including physical, financial and ownership (partial or full privatization) -- of commercial, viable enterprises</p> <p>Define respective roles, responsibilities, autonomy of line ministries, finance ministry, boards of directors, management</p> <p>Develop effective system for monitoring PEs</p> <p>Reform licensing and registration procedures</p> <p>Rationalize National Investment Act incentives and widen scope of sectors</p>	<p>Reform corporate legal and regulatory system to ease entry, operation and exit of firms -- and to deal better with enforcement of contracts, bankruptcy, liquidation, takeovers</p> <p>Develop strategies and plans for improving efficiency of remaining PEs (e.g., performance contracts, introducing performance-based incentive schemes)</p> <p>Reform land allocation, occupancy and development (zoning) regulations</p>	<p>Public enterprise restructuring has begun with leather industry whereby joint ventures are being sought. Decisions made in principle that similar arrangements would be sought for all other non-strategic enterprises. Decision made to shift non-commercial parastatals to budget.</p>

Sector/ Objective	Constraint-Relieving Action	Capacity-Intensive Action		Government Initiatives
		Near-term	Medium-term	
VII. <u>Social sector reform</u> - encourage more effective delivery systems of priority social services	<p>Encourage private sector and NGO participation in delivery systems</p> <p>Deconfine medical and educational supplies and personnel</p> <p>Ensure adequate expenditures in core programs</p>	<p>Decentralize responsibility for supply decisions to implementing units to use locally-generated funds (user charges) for local needs</p> <p>Restructure central supply delivery systems</p> <p>Ensure social sectors integrated with overall civil service reform</p>	<p>Restructure expenditure allocation system to consolidate ministerial responsibilities and reflect overall decentralization objectives</p> <p>Better integrate capital and recurrent expenditures to establish uniform sectoral expenditure programs that can mobilize donor/ NGO/community support</p>	<p>Efforts made to encourage community and NGO participation in service delivery. Decisions taken to restructure central medical supply system.</p>

CHAPTER 1

Performance of the Economy

1.1 **Introduction.** The 1980s have been characterized as a "lost decade" for Africa. Whatever the merits of such a characterization for the continent as a whole, the reality for Tanzania has been much more complex. Performance of the economy has differed dramatically in different time periods and in the various policy and sectors of the economy.

1.2 Following rapid growth during the mid-1960s and early 1970s, the Tanzanian economy began to slow down in the mid-to-late-1970s. Two major oil price increases, fluctuating international prices for traditional export commodities, variable weather conditions, the break-up of the East African Community and the war with Uganda imposed a number of significant external shocks during that decade. Inadequate policy response to these shocks, coupled with the institutional and productive structure of key sectors of the economy – agriculture and industry in particular, whose structural and policy weaknesses and overall fragility became exposed by the external imbalances – magnified and lengthened the severe economic decline that set in after 1978.

1.3 By 1982 the economy was in a serious crisis, per capita GDP was declining at about 3 percent per annum and the impressive gains achieved in the preceding decade on education and health were being eroded. Faced with the deepening crisis, and in the aftermath of initial attempts to implement partial policy adjustments in the early 1980s, the government embarked on a comprehensive reform program in the mid-1980s. The positive response to the trade liberalization program of 1984 paved the way for a broad package of structural adjustment measures initiated in 1986 under the Economic Recovery Program (ERP). The first phase of the gradual adjustment path implemented by the government lasted until late 1989, when the authorities unveiled the second phase of the recovery program, the Economic and Social Action Program (ESAP), which has broadened the scope of the reform effort.

1.4 How did the economy perform during the 1980s? In what ways do incentives, institutions and structural characteristics of the Tanzanian economy interact? What are the key lessons for government policy and donor assistance for their roles in the economy for the coming decade which emerge from this analysis? What are the prospects for Tanzania's sustainable development? These ambitious questions frame the analysis and structure of this report. An important objective in preparing this report has been to complement the government's own policy papers and studies, for instance the ESAP. Our aim has not been to provide definitive and complete answers to each question, but rather to provide tools and elements for analysis, discussion and debate on the issues confronting the economy today and to outline strategic options for deepening the reform process in the future.

A. The Economy since Independence: Economic Performance Under Various Regimes

1.5 At independence in 1961, Tanzania was one of the poorest countries in the world. Largely dependent on subsistence agriculture, the country had a very small industrial base and a limited number of educated and trained personnel. The direction of economic policy in the first

six years thereafter relied largely on market forces, stressing the objectives of per-capita income growth and national self-sufficiency in skilled manpower, and viewing foreign investment as the major instrument of industrial development. The policy regime for trade and capital movement was largely non-restrictive, and economic policy was essentially neutral -- was not biased for or against any particular sector.

1.6 Tanzania's economic history since the mid-1960s, however, has been fundamentally influenced by three major policy events: (i) the Arusha Declaration in 1967, (ii) adoption of the Basic Industrial Strategy in 1976, and (iii) initiation of reform as signified by the 1984 expansion of the own-funds import scheme and, particularly, adoption of the Economic Recovery Program in 1986. Three distinct policy regimes have followed from the implementation of these declarations and policies. While economic performance itself must be viewed as a transition between these regimes, this analytic framework is useful for evaluating that performance, the difficulties facing the Tanzania economy, the consequences of the changes which have taken place over the past half decade -- which is the time period of primary focus of this report -- and for considering future prospects.

1.7 Growth and increasing controls: mid-1960s to mid-1970s. The period from the mid-1960s to the mid-1970s, which represents the first regime, was one of a growing though also an increasingly controlled economy. The Arusha Declaration of 1967, the policy action which signalled the beginning of this regime, called explicitly for the establishment of a socialist society, with greater emphasis on rural development, self-reliance in development efforts, and the development of a more universal education system. A leading role was given to the state, especially in the reform and creation of appropriate institutions. This led to the nationalization of major commercial and financial institutions and some private agricultural estates, the creation of numerous parastatal bodies, and the initiation of a concerted program of collectivization of peasant agriculture, including the formation of communal villages.

1.8 During this period, an increasing proportion of Tanzania's resources began to be directed toward developing the public enterprise sector, particularly with the objective of industrialization based on import substitution and creation of heavy industry. The Tanzania government also attached substantial priority to providing resources to the social and human resource sectors during this period as well. Indeed considerable gains were made in providing such services -- particularly in access to education, literacy, infant survival, access to safe water and health care in general. In fact, access to education and adult literacy rates were among the highest in all of Africa, and donor assistance increased rapidly over the period as many donors identified strongly with the government's strategy.

1.9 Even with the rapid consolidation of control over major aspects of the economy and the major institutional changes, real GDP grew at just under 5 percent per annum between 1966-73 (Table 1.1), and gross investment rose to above 20 percent of GDP. These aggregates concealed, however, the emerging structural weaknesses within the economy. These weaknesses included declining productivity of investment in industry and agriculture, declining export volumes, dwindling domestic savings, parastatal inefficiencies, and an overly ambitious public expenditure program which could not be maintained. These reflected as well a policy environment which was biased against agriculture through, inter alia, increasingly excessive levels

of protection for import-substituting industries. Over time, these weaknesses had deleterious consequences for the Tanzanian economy.

Table 1.1: TANZANIA: Growth of Selected Macro-indicators – 1966-1989
(percent)

Annual Growth	Regime 1		Regime 2		Regime 3
	1966-75	1976-80	1981-83	1984-85	1986-90
GDP <u>a/</u>	4.7	2.0	0.5	2.7	4.5
GDY per capita <u>a/</u>	1.5	-4.7	-1.6	0.9	0.2
Exports <u>a/</u>	-6.8	-5.7	-8.1	-2.4	10.2
Imports <u>a/</u>	0.6	2.1	-7.0	-11.3	1.3
Current Account Deficit <u>b/</u>	35.6	62.5	-12.9	0.9	23.0
Terms of Trade (rate of change)	3.9	-5.7	-1.0	3.8	-7.9
Domestic Inflation (rate)	12.1	16.5	29.4	33.2	25.0
Gross Dom. Inv. / GDP (avg)	20.7	24.7	18.4	15.5	21.1
Nat'l Savings / GDP (avg)	15.5	15.6	11.4	8.6	-0.2

Source: Tanzania National Accounts, mission estimates

Notes: a/ In constant terms

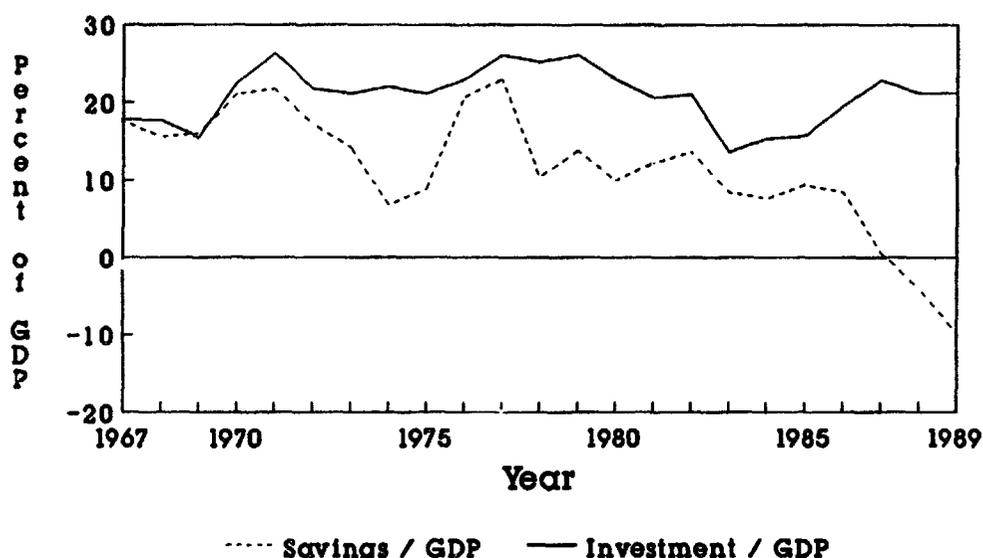
b/ In current terms

1.10 In particular, following two decades of impressive growth, the volume of agricultural exports stagnated in the mid-to-late 1970s. Moreover, although a centerpiece of Tanzanian policy at this time was self-reliance in generating domestic financial resources for development, very little was accomplished in this regard. Domestic savings reached a peak of 18 percent of GDP in 1970, but dropped to less than 10 percent by the mid-1970s (Graph 1.1). During this period, private savings were dampened due to the uncertain climate for private investment; parastatal savings did not keep pace with the increased investment in that sector; and government savings declined as a result of an explosive increase in government consumption expenditures. Tanzania's external accounts reflected this widening gap between investment and savings: current account deficits were already growing significantly in the late 1960s and early 1970s as the real exchange rate appreciated, exports declined and imports increased. By the early 1970s, the trade deficit reached 6-7 percent of GDP, in contrast to the balanced trade situation in the late 1960s. By this time the share of total capital formation financed by foreign savings - essentially foreign aid -- had risen to over one-half of the total -- up from one-third during 1973 and less than 10 percent during the latter half of the 1960s. However, in many cases the returns to these investments were very low because of the inadequate macroeconomic policy environment, including policies such as cost-plus pricing, and exogenous shocks, and also due to failures in project design and implementation.

1.11 In 1974 Tanzania experienced its first serious economic crisis, the immediate cause of which was a combination of two years of drought and the first oil shock. During 1974 and

1975 Tanzania's current account deficits averaged 14 percent of GDP, and international reserves fell by nearly 70 percent. The government was able to moderate the immediate adverse impact of the resulting imbalances by restraining public sector wages, tightening import and capital account restrictions and mobilizing large inflows of concessionary financing. In addition, the government delayed the full introduction of its basic industrial strategy (BIS), which had been announced in 1974, with the result that the government was able to weather the immediate poor resource problems for a short period of time.

Graph 1.1
Tanzania - Investment and Savings
1967-1989



1.12 **Economic decline: the mid-1970s to the beginning of reform.** Pressures on external accounts eased considerably in 1976 and 1977 with the recovery of domestic food production and the arrival of the coffee boom. Fiscal pressures eased as well, given that the government chose to tax away most of the windfall in export proceeds. In this relatively favorable external and fiscal climate, in 1976 the government initiated full implementation of its third five year development plan and the BIS. It is this event which inaugurated the second regime, which went on to encompass the period until the mid-1980s.

1.13 While the Arusha Declaration changed the pattern of ownership of industry and reversed, in principle, dependence on foreign investment for industrial development, by the mid-1970s it had not yet directly affected the structure of industrial production. Thus the BIS was significant because it attempted to implement government's objectives of restructuring economic output and eliminating external dependence. Industry was seen as the principal agent of structural transformation and self-reliance, and thus the import-substituting manufacturing sector was to have priority over other productive sectors.

1.14 In 1978, in the aftermath of the coffee boom and with donor advice and support, the government initially relaxed somewhat its stringent import controls. However, about the same time the country's terms of trade began to decline due to the collapse of the coffee boom. The import liberalization without complementary exchange rate management and appropriate fiscal and monetary policies resulted in a large and increasing balance of payments deficit. Later in 1978 the country was hit with the second oil price increase and with the war with Uganda. These events raised the current account deficit to above 15 percent of GDP. In contrast to the earlier crisis, when Tanzania managed to maintain per capita consumption through increased inflows of external capital, adjustment to the economic shocks of 1978 and 1979 required substantial cutbacks in both consumption and investment. In addition, the 1979 Uganda war resulted in a further dramatic fiscal deterioration: the fiscal deficit rose from 10 percent of GDP in 1977/78 to nearly 20 percent in 1979/80. Inflation doubled between 1978 and 1980, to about 30 percent per annum, a level at which it remained throughout the 1980s. Domestic savings continued to fall. Concessional financing was sought and increased to a level equal to about 75 percent of exports, but this was not sufficient to achieve external balance. Tanzania thus resorted to external borrowings on harder terms, which led to a steep rise in debt service, reserve drawdown and, later, increases in arrears. In spite of expansive monetary and fiscal policies, exchange rate policy was passive, involving maintenance of a constant rate against the SDR, which was sustained by an elaborate system of import licensing and foreign exchange allocation, and price controls; the associated policy of confinement was reintroduced and tightened. These controls fell particularly heavily on intermediate goods and actually drove down capacity utilization in manufacturing at the precise time when government and donor priorities were supposed to be focussed on increasing manufacturing capacity. Together with the direct compression of consumer imports, this produced a severe shock to the supply of goods.

1.15 By the early 1980s the import contraction was particularly severe because exports continued to fall, commercial lending dried up and aid flows declined. The latter occurred as donors had become concerned about the low returns to aid-financed investments and had realized that maintaining high levels of external support only allowed the government to sustain inappropriate macroeconomic policies. Consequently, total external assistance (excluding technical assistance) declined from US\$ 470 million in 1981 to US\$ 300 million in 1985. As a result, goods and inputs which were available were often allocated according to non-market mechanisms, and prices deviated from market determination even more. The acute shortages of basic consumer goods from the official market -- particularly in the rural areas -- a reduction in real producer prices and increasing overvaluation of the exchange rate accelerated the decline in export volumes during the early 1980s (see Table 1.1). Investment growth took place until the early 1980s, though at that time it began to fall. The productivity of investment, however, continued its steady decline initiated during the 1970s. Over the 8-year period from 1975 to 1983, official figures report that Tanzania's per capita income fell by 3-4 percent. Certainly, as discussed in more detail in Chapter 2, there are some indications that the actual drop in living standards was as large as 40-50 percent. Per capita income did not begin to rise again until 1986.

1.16 During this time there emerged a parallel economy, involving both legal and extra-legal operations and transactions, in addition to the formal one, in order to cope with the shortages and the administrative rationing which were taking place. Overall, accounting for the domestic and external trade components, the parallel economy is now estimated to have reached

30 percent of GDP and is not captured in the official national accounts.^{1/} In effect, the emergence and past growth of the parallel economy was the result of the government's policy response to the various external crises -- the imposition of greater external and internal controls while having a passive exchange rate policy -- as well as the philosophical stance supportive of greater reliance on direct rather than indirect measures to achieve economic goals. This policy environment was characterized by (i) official controls -- regulating production, instituting an extensive system of licensing, raising import, sales and excise taxes to prohibitive levels, and attempting to control economic "sabotage" by statute and (ii) official marketing arrangements -- setting administered prices and confining marketing and distribution through single channels. At the same time Tanzania infrastructure was deteriorating, as were the marketing arrangements, thus encouraging producers to seek their own marketing outlets outside the official systems. Finally, there emerged shortages of basic goods and services -- which required that households acquire even basic necessities through informal channels.

1.17 In brief, the Tanzanian economy of the late 1970s and early 1980s had the following features: (i) stagnant and declining output; (ii) passive exchange rate management in the face of large fiscal and external imbalances; (iii) declining exports and reduced import capacity; (iv) continued dependence on traditional exports for foreign exchange; (v) demands on foreign exchange resources for the expansion of government and for investments in the import-substituting manufacturing sector; (vi) quantitative restrictions on all categories of imports, implemented through direct government allocation of foreign exchange, increased government control over external and internal trade and distribution, and de facto rationing of most traded goods; (vii) widespread domestic price controls on traded and non-traded goods; and (viii) a growing parallel market for exports, imports and other rationed goods.

1.18 This was also a time when many early successes in providing basic education and health services began to be eroded. Central government expenditure priorities were shifted away from these sectors, and these manpower-intensive sectors suffered as well from the general decline in public sector salaries and productivity. Responsibility for delivering these services began to be shifted more and more to local government, which did not have the financial capacities or other resources required for effective delivery. Social service physical facilities were also hampered by lack of maintenance and the overall deterioration in Tanzania's infrastructure.

1.19 **Partial liberalization: the beginning of reform to the present.** By the early-to-mid-1980s it was evident that recovery from the economic decline which had set in from 1979 could only come about with changes in economic management and the policy framework affecting economic incentives. During the early years of the 1980s, the government had initiated a number of attempts at policy reform (including small devaluations and producer price increases), but these were not accompanied by a consistent policy environment, fell short of the adjustment required, and failed to achieve their objectives.

1.20 The transition to the third regime -- the primary focus of this report -- began in 1983/84 with the inauguration of the own funds import scheme and of other measures in the

1/

see Bagachwa, 1989.

budget to reduce subsidies and institute greater cost sharing. The own funds scheme was considerably widened during 1984. Aimed at alleviating the severe shortages of goods available within the economy, this critical policy reform eased significantly the import compression of the early 1980s and provided a major impetus for resumption of economic activity. This action was followed in June 1986 when the government launched the Economic Recovery Program (ERP), which is the umbrella program under which the reforms since that time have been undertaken. The ERP had as its primary objectives raising the rate of output growth, reducing inflation and restoring external balance. The main features of the ERP at that time included actions to (i) reduce overvaluation of the exchange rate; (ii) put in place a supportive macroeconomic framework of appropriate fiscal and monetary policies; (iii) improve the incentives for agricultural production; (iv) reform the government's trade policies. With the launching of the ERP, donor assistance (excluding technical assistance) increased significantly from \$490 million in 1985 to \$ 850 million in 1989, with around \$ 400 million of that amount provided in the form of balance of payments assistance to support the process of policy reform and to ease the balance of payments constraint on economic activity.

1.21 The cornerstone of ERP policy change to date has been the adjustment of the exchange rate as this is central to the process of unification of markets and removal of the rationing which had become prevalent in the Tanzanian economy. As can clearly be seen in Graph 1.2, beginning in the late 1970s, the Tanzania shilling's real exchange rate^{2/} appreciated significantly through 1985. In early 1986 the government began to adjust the nominal exchange rate, and since that time the observed real exchange rate has depreciated significantly: moving from an index of 2.07 in 1985 to 0.33 in 1990 (Graph 1.2), a depreciation of over 80 percent. The extent of adjustment to date can also be gauged by observing the ratio of the parallel to the official exchange rate. The parallel:official ratio reached a peak of 9:1 by the end of 1985 and has dropped to about 1.5:1 by end-1990.

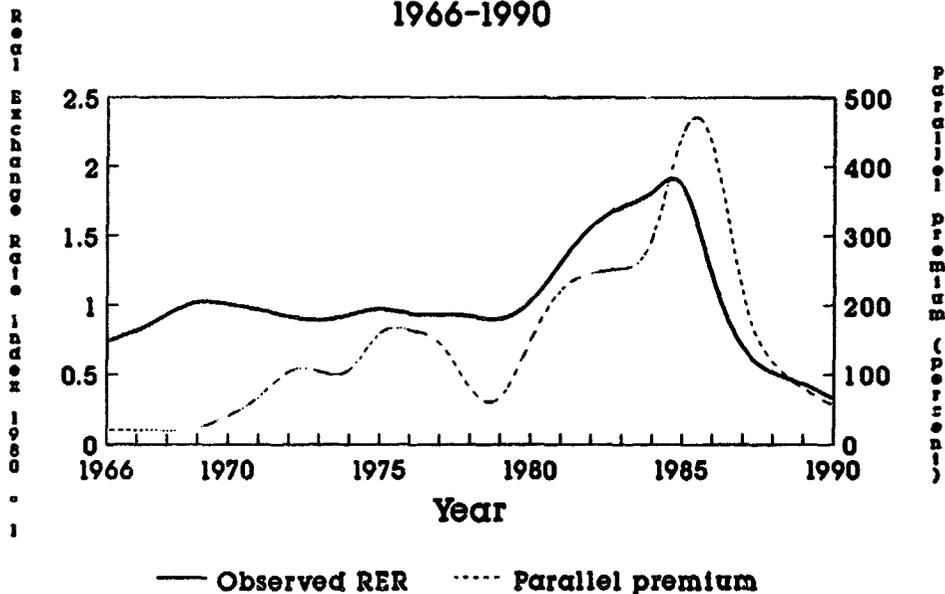
1.22 Although government has begun the process of liberalization and reduced some controls over the economy, the parallel economy continues to thrive even under this new regime. While the parallel premium has fallen from previous levels, it still remains at 50 percent, and thus exchange rate incentives continue to favor at least to some extent remaining outside the official economy. In addition, continued administrative allocation of foreign exchange, the continuing need for regulatory reform and improvements to the enabling environment with respect to private sector development, continuing inadequate public sector service provision, and an evident low level of confidence in the ability of government to enforce rules and regulations have encouraged the institutionalization of the parallel economy. Certainly, unifying Tanzania's dual economy will be a gradual process over the medium to longer-term.

1.23 Under this third regime the economy has seen a gradual liberalization of economic policies and a resulting economic recovery which arrested and reversed the per capita income declines of previous years. Both GDP per capita and trade volumes began to rebound in 1986

2/ as observed from nominal exchange rate and relative price comparisons of a basket of currencies representing Tanzania's major trading partners. This calculation does not speak to the issue of an appropriate exchange rate as it does not take other factors (e.g., structural shifts in the economy, productivity declines, etc.) into account. The base is 1980 = 1.

after reaching their lowest points in 1985. Real GDP growth averaged about 4 percent from 1986 through 1990, with even higher growth evident in the burgeoning informal sector (which may not even be fully reflected in the official aggregate figures). The most notable source of growth, however, has been the agricultural sector, where overall production increased between 4 and 5 percent in both 1987 and 1988. This has particularly reflected sustained increases in foodgrain production and the production of non-traditional export crops, though also includes improvement in some traditional export crops.

Graph 1.2
Real Exchange Rate and Parallel Premium
1966-1990



Rise in index represents appreciation.
Rise in premia: greater divergence
betw parallel and official exch rate.

B. Performance of the economy since the mid-1980s

1.24 With regard to performance since the initiation of reform,^{3/} in addition to policy change, the economy has been affected by four favorable external shocks, two of which were

^{3/} The nature of the changes in the economy requires the analysis to have an appropriate sectoral disaggregation. In particular, since there was a series of large devaluations, those parts of the economy which stood to benefit (manufacturing and agricultural exports)—the sectors producing internationally tradable goods—need to be distinguished from the rest of the economy. Given a program of substantial trade liberalization, those tradable activities which had benefitted from protection (broadly captured by manufacturing) need to be distinguished from those which had not (i.e., export agriculture). The changes in activities which produce output not readily tradable internationally, namely foodcrop agriculture, public administration and services are also important to distinguish. Finally, large changes in both public and private investment are identified through purchases of capital goods and distinguished between those which are tradable and those which are non-tradable. The latter is captured by construction.

temporary and two of which are likely to be longer-lasting. First, there was a temporary improvement in terms of trade due to the coffee boom in 1986. In addition, in response to the own-funded imports scheme there appears to have been some repatriation of capital which had previously fled the country. Of a longer-lasting nature has been the drop by two-thirds in the real price of petroleum and products experienced since 1982 -- notwithstanding the high oil prices during the latter half of 1990 due to the Gulf crisis. Finally, as a result of the policy reforms, donor aid has increased significantly from around US\$300 million per annum (excluding technical assistance) during the early to mid 1980s to over US\$800 million each year in the late 1980s (plus additional debt relief).

1.25 The combination of these external shocks and the policy changes implemented since 1984 largely account for the observed changes in economic performance over the past half-decade. As shown by Table 1.2, since 1983 there has been a modest increase in per capita GDP, reversing the rapid decline from 1976 to 1983. The declining trend in GDP from 1976 to 1983 (and the acceleration in the decline itself experienced in the early 1980s) suggests that in the absence of policy changes the economic stagnation would have continued -- and most likely the decline would have accelerated.^{4/} Consequently, the subsequent improvement must be seen as even more impressive than the aggregate GDP growth indicates.

^{4/} See for instance, Bevan, et al., 1987. During the early 1980s farmers reacted to inadequate incentives and shortages by reducing the production of export crops, which affected the amount of foreign exchange available for imports and which further reduced the availability of consumer goods and inputs in rural areas. Hence a (downward) multiplier effect was at play.

Table 1.2: The Performance of the Economy: Index of Output 1983-90
(1983 = 100)

	1976	1983	1984	1985	1986	1987	1988	1989	1990 est
GDP ^{a/}	108.3	100	103.4	106.1	109.3	113.5	118.2	123.4	128.9
GDP per capita	111.0	100	100.6	100.4	100.6	101.6	103.0	104.6	106.4
Exports ^{b/}	180.3	100	104.6	106.3	101.3	105.6	104.3	113.9	n.a.
Manufacturing value-added ^{a/}	133.7	100	102.7	98.7	94.7	98.7	104.0	109.6	116.7
Public administration etc. ^{a/}	66.1	100	100.2	102.1	91.0	91.5	94.4	n.a.	n.a.
Capital goods: Traded ^{c/}	103.6	100	164.3	221.0	200.0	192.9	168.9	n.a.	n.a.
Non-Traded ^{d/}	161.0	100	120.2	109.5	128.4	131.3	137.0	n.a.	n.a.
Non-tradables:									
Agriculture (all) ^{a/}	91.2	100	104.0	110.3	116.6	121.7	127.2	132.9	140.2
Services Etc. ^{e/}	95.0	100	103.0	104.6	112.7	116.7	121.5	125.8	133.2
GDP per capita excluding public administration ^{a/}	119.4	100	101.2	101.3	104.0	105.3	106.9	n.a.	n.a.

^{a/} Bureau of Statistics, unpublished data.

^{b/} From Foreign Trade Statistics, 1987, Tables 28 and 29, for 1983-86. 1987 and 1988 from Unit Value Indices of Table 1 and dollar values of agricultural exports and imports (TET Vol. 1(4) Table 6).

^{c/} Source National Accounts of Tanzania, 1976-87, Tables 13 and 15, "equipment".

^{d/} Non-tradable capital goods is construction value added. Source as in Footnote a.

^{e/} Sources as footnote (a); sectors are wholesale and retail trade, restaurants and hotels; transport and communication; finance, insurance, real estate and business services. All are value added.

n.a. Not Available.

1.26 In the export sector through 1988 there was only a minor recovery in performance (Table 1.2) despite the real devaluations of the exchange rate which have taken place. Official estimates for 1989 indicate that faster export growth occurred in that year, primarily in traditional exports. Output in the protected tradable sector, manufacturing, declined until 1986, the result of the initial negative impact of trade liberalization initiated through the own-funded imports scheme, which reduced protection to industry. Since then manufacturing output has recovered rapidly, at about 5 percent p.a. This is a major reversal of the trend from 1975-1985 during which manufacturing value-added declined by 3.4 percent per annum. The public administration sector has behaved in an opposite fashion: there has been a significant decline from 1985 which reversed the previous decade of rapid growth. Furthermore, Tanzania has experienced a large increase in investment since 1983. The two components of investment, capital goods imports and production of non-traded capital goods, though, have behaved very differently. There was an early surge in imports of capital goods in 1984 – initiated by imports under the own funds scheme, which then gradually tapered off, being replaced by growth in the construction sector. This represents the classic feature of an investment boom: capital goods imports would generally increase quickly, lagged by expanding construction activities. Finally, output in both the non-tradable sectors (food and services) has grown rapidly over this period.

1.27 Supply response since the early 1980s. The relative profitability of the various sectors, as reflected by the behavior of relative prices, has undergone significant shifts since

1983. Supply response has been a function of these changes and other factors. Table 1.3 presents relative price series for Tanzania's economic sectors.^{5/} As seen in that table, the external TOT index for agricultural exports peaked in 1986 due to the coffee boom, then declined thereafter to a level slightly below that in 1983 but still somewhat above the 1984 level. From this perspective alone one might expect some production increases to occur, as has happened since 1984.

Table 1.3: Prices Relative to the Domestic Currency Cost of US\$1 of Imports

	1983	1984	1985	1986	1987	1988
Agric. Exports (FOB Price) g/	100	89.8	105.2	115.1	79.8	93.0
Export Crop Producer Prices h/	100	119.4	130.4	85.7	64.3	60.6
Manufacturing value-added g/	100	112.6	115.5	66.1	39.6	33.4
Capital Goods: Non-trade g/	100	104.8	125.1	69.7	42.9	40.5
Non-Tradables:						
Agriculture (all production) g/	100	115.2	141.2	78.9	61.7	65.9
Services, Etc. g/	100	116.0	131.2	66.5	50.6	44.8
Memorandum item: shilling cost of US\$1 (index) d/	100	105.3	120.1	279.3	491.9	650.1

g/ From TET Vol. 1(4) Table 6(a) a price index for the main six agricultural exports can be derived in US dollars. This has been converted into shillings at the mean export exchange rate.

h/ From data used for Graphs 4.1 - 4.3 in Chapter 4.

c/ Bureau of Statistics, implicit GDP deflators derived from unpublished National Accounts data in current and in 1976 prices. Construction is used for non-traded capital goods.

d/ The shilling cost of US\$ 1 of imports is derived from the Economic Survey 1988, Tables 10 and 12.

1.28 However, the TOT index for agricultural exports is not the appropriate price index for measuring the returns to agricultural producers. Since producers (farmers) in Tanzania sell to the various marketing boards and do not face international price equivalencies, a more appropriate measure is that of actual prices received by producers from the marketing boards. The index of these relative prices shows a substantial fall (40 percent) between 1983 and 1988. Thus much of the increased incentive for export production provided by the exchange rate devaluations has not been transmitted to producers. Those gains have accrued rather to the marketing institutions, which benefitted from higher f.o.b. prices but did not pay to producers significantly higher prices in real terms. In addition, although the f.o.b. price of exports rose by almost 5 percent relative to foodcrop agricultural prices, the price of export crops to producers

^{5/} The numeraire for these indices is the shilling cost of US\$1 of imports. This represents the shilling cost of imports in each year divided by its dollar cost. For example, the relative price of exports (f.o.b.) is therefore an export unit value index, i.e., a terms of trade (TOT) index.

fell relative to agricultural prices generally. Thus over this period producers have had an incentive to switch out of production of export crops into other agricultural activities.^{6/}

1.29 If relative price changes were thus not a sufficient explanatory factor in the positive supply response of the past few years, what was responsible? As described in more detail in the background paper "The Tanzanian Recovery, 1983-89" in Volume II, the evidence indicates that during periods of shortages (e.g., the early 1980s) agricultural producers reduced their crop sales and production since there was such a scarcity of goods. When the shortages were eased after 1983, the situation was reversed and producers once again had incentives to raise their incomes by selling crops even in the absence of price increases. Indeed, during this period, the real producer price of export crops fell by 26 percent, yet the sudden increase in availability of goods created the incentive to raise overall incomes leading to a significant increase in production.^{7/}

1.30 With regard to supply response in the manufacturing sector, the other key tradable sector, trade liberalization (through own-funded imports) and devaluation eroded substantially the overall level of protection. Thus the relative price of manufactures has fallen significantly, which appears to have accounted for the contraction in output between 1983 and 1986. Subsequently, liberalization of internal trade and the foreign exchange allocation system, price decontrol and aid inflows have facilitated the expansion of those segments of the manufacturing sector which had not been beneficiaries of the system of protection in the past – and which were largely efficient (see Chapter 5). In fact, the estimated 5 percent per annum manufacturing growth rate since 1986 most likely understates the true recovery of this sector since the series misses the effects on output of the entry of new firms.

1.31 In sum, since the beginning of the reform period, performance of the real economy has improved. It appears that the improvements have been in part associated with the relative price changes induced by the policy changes made during the reform period, and in part by improvements in the supply of goods to the economy. The reforms have halted the overall stagnation and decline of economic activity in Tanzania and have initiated a recovery of output. GDP per capita has increased modestly since 1986, and agriculture production, and overall exports have seen some expansion during the reform period. The non-tradable sectors have expanded considerably, and the manufacturing sector is now growing following a long and marked decline which began in the late 1970s.

^{6/} This issue with respect to agricultural exports is analyzed in considerable detail in Chapter 4.

^{7/} An additional determinant of crop sales has been the need to achieve a particular level of cash balances. (See The Tanzanian Recovery, 1983-89, Background Paper 1 in Volume II of this Report). The level of cash balances maintained by producers is related to the requirements for purchasing goods and to the overall level of inflation. High inflation, as experienced in Tanzania in recent years, has tended to erode real money balances held by farmers, and farmers have needed to offset this effect by raising crop sales. During the late-1980s, as shortages were cleared, agricultural production was raised, first, by increased availability of goods (which prompted greater crop sales and income generation) and, then, inflation itself.

C. The Determinants of Growth in Tanzania: 1968-1988

1.32 The empirical evidence and discussion of economic regimes above suggest the importance of policy-related factors in explaining Tanzania's economic performance over the past 25 years. External factors, such as terms of trade losses, the Uganda war and variable weather conditions, while often important in explaining the performance of selected economic indicators in some years, cannot explain either the persistence or extent of the economic decline from the late 1970s to the early 1980s, or the recovery from the mid-1980s onwards.

1.33 To contribute to a better understanding of the importance of domestic policies in affecting performance under the various regimes, GDP growth was regressed against a number of "external" (terms of trade), "input" (investment, aid, imports and exports), and policy-related variables (the exchange rate and trade reform), utilizing a number of alternative specifications. The main results of this analysis, which needs to be used with caution -- as suggestive rather than proof -- are summarized in the Table 1.4.^{8/}

1.34 Regression results showing coefficients significantly different from zero for export growth, real exchange rate depreciation and trade reform point to the importance of those variables in determining GDP growth. Conversely, imports, investment and overall terms of trade are not estimated to be significant in explaining growth performance in this econometric analysis. These findings are consistent with the existence of an economic environment where the highly variable efficiency of allocation of imports and investments affected the GDP growth rate more than the magnitude of imports or investments themselves.

1.35 Finally, the statistical findings suggest that the level of aid^{9/} has had a positive impact on GDP growth during the ERP period in contrast with the preceding decade. This in turn is consistent with the importance of a complementary policy framework in making that aid effective. Although based on a small number of observations, a similar pattern on aid effectiveness is suggested by analyzing the performance of World Bank projects. As an illustration, Graph 1.3 provides ex post economic rates of return on World Bank project lending (evaluated after project completion) to Tanzania and to all of Sub-Saharan Africa for the time periods of the three regimes discussed above. Average rates of return for Africa as a whole have exceeded 10 percent. For these time periods economic returns to Tanzania have stood below those for the rest of Africa, falling from about 10 percent during the 1970s to 2 percent during the early 1980s. Since then the rates of return have risen somewhat to just over 6 percent. While the sample on which these data are based is small, the graph is consistent with the conclusion that the policy environment has been important in determining the productivity of investment projects. There is no evidence that other donors' projects produced any greater economic returns. Thus these findings at the micro level, coupled with the aggregate evidence,

^{8/} The regressions are based on 1968-1988 national accounts and balance of payments data. The drawbacks associated with OLS regression analysis are well known. Further, the number of observations is limited and the robustness of the results often varies depending on the particular specifications used. Thus it is important to use the findings with caution and only as complementing other evidence and analysis--not as proof of any particular hypothesis.

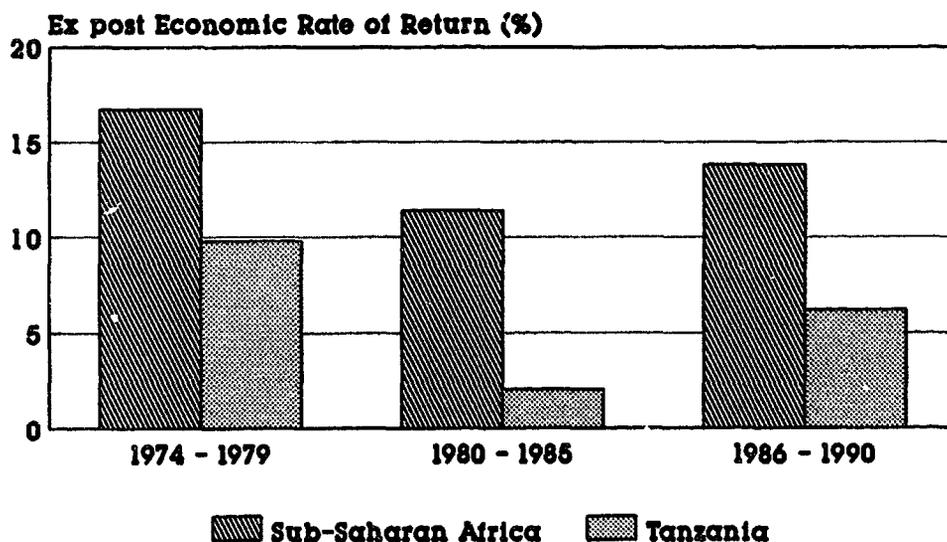
^{9/} The analysis did not distinguish between type of aid -- e.g., import or investment support.

illustrate as well how donor aid generally may have contributed to the outcomes of the past two decades.

D. Conclusion

1.36 Despite the improvements which have been noted to date, and as the next chapters will demonstrate in detail, the post-1985 recovery is still tentative in a number of respects. The necessary environment of economic incentives, institutions and infrastructure has not yet been fully put into place by the government. Agricultural production, though improving, still lags below its potential, as does industrial production. The government budget, investment and import capacity continue to be excessively dependent on high aid levels, and while consumption overall has improved, substantial incidence malnutrition continues to exist within the economy. Thus the economic growth which has been experienced to date, while impressive, cannot be characterized as being self-sustaining.

Graph 1.3
Economic Rate of Return on
World Bank Projects



ERR as calculated about one year after project implementation has been completed.

1.37 In addition, the ERP has had very little effect yet on improving Tanzania's capacity for and delivery of social services. While budgetary allocations to these sectors have increased in real terms, the evidence of outcomes is ambiguous at best. For example, primary school enrollment has been dropping since 1984, apparently due to the perceived low quality of public education. At the same time, there has been a shift toward community-based schooling, particularly at the secondary level, but this has not been fully exploited as a means of delivering these or other services. The health system also has continued to show decline. Facilities in urban areas are in much worse condition than those in rural areas, but both suffer from the poor

financial resource position of the sector and continued low productivity of government workers. These issues are covered in greater detail in the chapters which follow.

Table 1.4: Summary Matrix: Regressing GDP Growth, 1968-1988

Independent Variable	Impact on GDP Growth		
	Positive and Significant	Positive but Not Significant	No Impact whatsoever
Exports	8% export growth raises GDP growth rate by half a percentage point.		
Aid	Only post-ERP aid has had a significant impact.	Aid does not have a significant impact until the mid-1980s.	
Imports			No correlation found between import growth and output growth.
Investment			No correlation found between investment growth and output growth.
Exchange Rate	Overvalued exchange rate reduces exports significantly, in turn reducing GDP growth.	Overvalued exchange rate reduces growth also when controlling for exports, although less significantly.	
Trade Reform	Own-funds trade liberalization very significant.		
Inflation			No correlation found.
Terms of Trade			No correlation found.

CHAPTER 2

Impact of Reform on Key Economic Agents

2.1 The preceding chapter provided a brief historical perspective of the policy regimes which have characterized Tanzania's economy since independence and the macroeconomic and sectoral outcomes. That review suggested how the external and internal imbalances that arose in Tanzania during the 1970s eventually led to the severe economic decline of the early 1980s. While overall performance of the economy has improved since the beginning of reform in the mid-1980s, and Tanzania's general economic decline has been arrested, not all economic agents have shared to the same extent in this economic progress. This chapter analyzes performance under the third regime -- the period of reform -- from the perspective of the impact on and welfare gained by various economic agents. This background then provides a further basis for analyzing the successes of the ERP -- and in determining where further reform of incentives, institutions and infrastructure is required for the benefits of reform to be distributed more widely and for the economy to attain a sustained development path. In particular, this chapter reviews the impact of reform on workers, peasants, firms and small-scale entrepreneurs. To analyze the implications of the economic developments of the 1980s on Tanzanian workers, a brief review of Tanzania's labor markets is presented first -- mirroring the "regimes" analysis in Chapter 1, with emphasis on the last regime.

A. Trends and Structure of Tanzania's Labor Market

2.2 As one would expect for a country at Tanzania's level of development, the country's labor force remains concentrated in rural areas, though there was a minor reduction in rural concentration between 1978 and 1988 -- from 88 to 85 percent of the labor force (Table 2.1).^{1/} Rural employment remains dominated by the smallholder sector. Only 6 percent of the rural labor force are in wage employment, and most of these workers are not part of the formal sector. Within urban areas, the informal sector currently absorbs an estimated 61 percent of the labor force. Formal wage employment thus accounts for a lesser, although important, share of the labor force, even in urban areas. The labor force participation rate^{2/} is estimated to have declined by about two percentage points between 1978 and 1988 -- a consequence of a shift in the population age distribution and net rural-urban migration.

1/ Much of the data presented in the table for 1988 are estimates given the paucity of more recent statistical information.

2/ Labor force participation rate is defined as the total labor force as a percent of total population.

Table 2.1: Labor Force (millions) by Economic Status, 1978 and 1988

	1978			1988		
	Rural	Urban	Total	Rural	Urban	Total
Formal Wage Employment	0.20	0.34	0.54	0.18	0.52	0.70
Informal Sector Employment						
- own account	6.40	0.47	6.87	7.82	0.77	8.59
- employees	0.24	0.10	0.34	0.29	0.16	0.46
Unemployed	n.a.	0.04	0.04	n.a.	0.06	0.06
Total Labor Force	6.84	0.95	7.79	8.29	1.52	9.81
Total Population	15.10	2.41	17.51	19.28	3.89	23.17
Participation Rate	0.45	0.39	0.44	0.43	0.39	0.42

Sources: Population Census 1978, Population Census 1988, Bureau of Statistics, Dar-es-Salaam, and World Bank Staff Projections
n.a.: Not Available.

- Notes:
- (1) Population, labor force and unemployment for 1978 are taken from the 1978 Population Census.
 - (2) Total population for 1988 is from the 1988 Census. We estimate rural and urban population growth rates from a fitted regression of the form: $P_{88i} = aRP_{78i} + bUP_{78i}$; where P_{88i} is the 1988 population of the i th district, and RP_{78i} and UP_{78i} are the corresponding rural and urban populations in 1978. The estimated equation predicts 1988 total population to a high degree of accuracy. Labor force for 1988 is estimated from the participation rates.
 - (3) Formal sector employment for 1978 was supplied by the Bureau of Statistics. The 1988 estimates are based on Ministry of Labor projections. Unemployment is calculated using unemployment rates taken from the 1978 Census. Informal sector employment levels are calculated residually.

2.3 As a result of net rural-urban migration, both urban labor force and population growth rates are substantially higher than the corresponding estimates for rural areas (Table 2.2). However, there is evidence that rural-urban migration has proceeded at a slower pace between 1978 and 1988 than during the previous decade. Census information indicate that the annual rates of population growth from 1968 to 1978 averaged 9.3 percent and 1.3 percent in urban and rural areas, respectively. These compare with corresponding estimates for 1978 to 1988 of 4.9 and 2.5 percent. Similarly, the population census of 1988 indicates that the annual population growth rate between 1978-88 in Dar-es-Salaam averaged 4.8 percent, compared with 7.8 percent between 1968-78.

2.4 Over the decade as a whole, there are only modest differences in the growth rates of formal and informal sector employment levels. In urban areas, informal sector employment grew slightly faster than that of the formal sector, while in rural areas, formal sector employment declined absolutely. However, this overall picture obscures the out-turn of each half decade. Thus labor market trends in the period 1978-84 (the "dualism and decline" regime) and the period 1984 to the present (the "partial liberalization or reform" regime) are reviewed below.

Table 2.2
Average Annual Percentage Change in Labor Force by Activity, 1978-1988

	Rural	Urban	Total
Formal Wage Employment	-1.05	4.34	2.63
Informal Sector Employment			
- Own Account	2.02	5.06	2.26
- Employees	n.a.	n.a.	3.00
Total Labor Force	1.94	4.80	2.33
Total Population	2.47	4.91	2.84

Sources: See Table 2.1

n.a.: Not Available.

2.5 The period of recession and control – 1978-84. The key determinants of labor market allocation during this period were: (i) the nature of government expansionary employment policies and their regulations over employment hiring and firing practices in the parastatal and private sectors; (ii) strict controls on private sector activities; (iii) the decline in real agricultural producer prices; and (iv) the overall economic decline, which reduced demand for labor. During this period, while overall GDP was essentially stagnant, formal sector employment, excluding agriculture and mining, grew by 4.1 percent per annum (Table 2.3). In manufacturing, while output declined by over 20 percent, employment grew by 16 percent. At the same time, government employment increased by 62 percent. The fact that employment levels rose in spite of the drop in output was due to: (i) Tanzania's determination to provide extensive public services; (ii) government's practice to offset increased public employment with real wage declines; (iii) the decentralization of the civil service recruitment process, which made administrative control of government employment levels more difficult; and (iv) the imposition of cost-plus pricing as the criterion for fixing producer prices, which gave firms whose output levels were constrained by foreign exchange allocations an incentive to raise employment levels and thus unit costs.

Table 2.3
Formal Sector Employment ('000s) by Sector, 1978 to 1988

	1978	1984	1988	Average Annual Change, 1978-88 (%)
Agriculture, Forestry, etc.	123.4	108.1	117.6	-0.48
Mining and Quarrying	4.9	5.4	5.7	1.52
Manufacturing	100.1	115.9	125.0	2.25
Electricity, Gas, etc.	21.9	27.1	29.0	2.85
Construction	42.3	34.4	26.5	-4.64
Wholesale and Retail Trade	34.3	46.7	49.4	3.72
Transport, Storage, etc.	59.2	61.3	71.2	1.86
Financial Services	8.9	16.6	20.6	8.75
Other Services	141.0	217.9	258.8	6.26
Total	535.9	633.4	703.7	2.76
of which: Private Sector	150.1	145.7	n.a.	n.a.
Government	186.2	302.1	n.a.	n.a.
Parastatals	199.6	185.6	n.a.	n.a.

Sources: Data provided by Bureau of Statistics, Dar-es-Salaam.
n.a.: Not Available.

2.6 While overall employment levels in the formal sector rose during the period of economic decline, the fall in real wages between 1978 and 1984 was very pronounced. In 1984, the average real wage in the urban formal sector (using the CPI as a deflator) equalled only one third of its 1978 value. This may actually understate the true fall in the real wage, as many goods were obtainable only at black market prices or just not available – thus lowering further the true purchasing power of the workers' income. In the public sector, real wages per worker declined as the government attempted to maintain high employment levels and faced a shrinking fiscal base. In the private sector the real wage decline reflected the decline in overall economic activity and in productivity for firms that continued to operate under institutional and regulatory pressures to maintain or increase employment levels.

2.7 In contrast with employment in the formal sector, the informal economies were not a major source of employment expansion during this period, given the enforcement of legal constraints on such operations. Both the storing of goods in unlicensed premises and the transport of goods in private vehicles were illegal. Further, falling aggregate activity, coupled with the increasingly limited access to foreign exchange, resulted in a decline in the number of small scale manufacturing enterprises employing less than 50 workers by more than a half between 1978 and 1981.^{3/} Although hard data are lacking, it is also likely that urban unemployment rose sharply during the period. The Dar-es-Salaam Census carried out in December 1984 found an overall unemployment rate of about 20 percent (18 percent among men

3/

Tanzania: An Agenda for Industrial Reform (World Bank, 1986).

and 29 percent among women), which suggests an absence of informal sector employment opportunities for a large segment of the urban labor force.

2.8 In spite of high unemployment, restrictions on urban informal opportunities, and a substantial decline in real wages, there is no evidence of reduced rural-urban migration during this period. Clearly, a deterioration in rural labor incomes was taking place as well. As indicated above, the availability of consumer goods dried up and, in line with the appreciating real exchange rate, real prices for cash crops declined. On average, real income per household fell by 48 percent over the period 1977-83, slightly faster than those of urban households (Table 2.4). Real rural wage rates also declined substantially over the period. The average off-farm wage in 1980 was about Tsh 36 per day, compared to Tsh 42 per day in 1983 – a fall in real terms of 29 percent.^{4/} Furthermore, there was a significant shift in the composition of rural household income between 1977 to 1983. The inadequate incentives to produce marketable crops resulted in an increase in non-farm income as a proportion of household income, while subsistence crop production rose relative to cash income from farm sales. In fact, although comprising a very small share of overall rural income, migrant remittances were the only income source to rise consistently in real terms over the period. As real urban formal wages were declining rapidly, this would suggest that the number of migrants from peasant households was increasing as a ratio to the rural population (Table 2.4).

Table 2.4
Rural Household Income and its Composition, 1977-83

	Percentage Composition			Percentage Change in Real Value	
	1977	1980	1983	1977-80	1980-83
Subsistence	53.2	49.0	44.9	-56.0	-7.0
Farm sales	19.4	23.5	17.5	-53.0	-24.5
Business	19.0	n.a.	26.3	-27.9	n.a.
Wages	6.4	n.a.	6.4	-47.8	n.a.
Bus. & Wages	n.a.	23.1	n.a.	n.a.	+43.5
Remittances	2.0	4.3	4.8	+27.3	+13.8
Total	100.0	100.0	100.0	-47.9	+1.4

Sources: Bevan, Collier and Gunning (1989)
n.a. Not Available.

Notes: (1) Deflated by National Consumer Price Index

2.9 **The period of decontrol and recovery: 1985 onwards.** During this period, the government reversed many of its earlier policies, and the labor market responded to the new

signals received. From the perspective of labor markets, the most relevant measures which were introduced were: (i) the progressive abolition of price controls and confinement policies; (ii) the introduction of own-funded imports; (iii) the reversal of government policy towards the informal sector; (iv) the substantial devaluation of the real exchange rate; (v) a cessation of growth in government employment; and (vi) a growing degree of trade liberalization.

2.10 The most striking feature in the labor market over this period has been the rapid growth of the urban informal sector. Evidence collected for this report from 20 informal sector establishments in Dar-es-Salaam suggested that these establishments had, on average, doubled their employment levels between 1984 and early 1990. Further, the number of licenses issued to establishments in the informal sector doubled between 1986 and 1990. It can thus be estimated that informal sector employment has at the very least doubled since 1984. This would imply that following a decline from around 570,000 in 1978 (Table 2.1), to about 460,000 in 1984, by 1988 informal sector employment may have neared or exceeded 1 million.

2.11 The rapid growth in informal sector employment in recent years has been supported by a number of related developments. On the labor demand side, the government has reversed its previously prohibitive stance toward informal sector activities. When combined with increased demand for the goods and services they provide -- ranging from small sector metal works to pick-up transport to trading in own-funds imports -- and coupled with the improved availability of inputs, this has had an enormous impact. On the labor supply side, the sector has drawn its workers from a number of sources: (i) the existing reservoir of open unemployment; (ii) increased female labor market participation following the lifting of prohibition on informal activities; and (iii) the growth in the urban labor force resulting from population growth and rural-urban migration.

Civil Service Wages

2.12 The major effects of wage policy on both the structure and real value of government salaries was analyzed in detail in the Public Expenditure Review (PER). The central findings were that: (i) real wages of government employees have fallen drastically over time -- the real value of the average civil service wage in 1986 was less than 18 percent of its real value in 1975, a salary sufficient to cover only about one-quarter of the required expenses of a typical household; and (ii) substantial compression had taken place in the salary structure: the ratio of the top salary to the average civil service wage declined from 18.2 in 1968 to 7.2 in 1975, and finally to 5.7 in 1986. The PER concluded that this labor policy encouraged public workers to look to outside sources of income, prompted government managers to tolerate below-average efforts by employees and resulted in deteriorating service levels in the public sector.

2.13 The analysis of the civil service wage structure is updated in Table 2.5. That shows the ratios of the starting salaries of a number of grades to the lowest unskilled wage in government employment. Two conclusions emerge. First, the ongoing erosion of the real value of civil service wages has begun to be reversed, though it has not yet moved near to past levels, when public sector productivity was higher. The salary levels of four out of the five categories shown have experienced a substantial real increase since 1987/88. Second, with the exception of university graduates, a mild degree of decompression in the salary structure has taken place over the period.

Table 2.5
Ratios of Some Civil Service Salaries⁽¹⁾
to the Unskilled Wage, 1987/88 and 1989/90
and Changes in Real Value

	1987/88	1989/90 ⁽⁴⁾	Change in real value (%) ⁽³⁾
Top Salary	5.18	5.35	+22.8
Graduate ⁽²⁾	2.36	2.06	+3.8
Form VI ⁽²⁾	1.41	1.46	+23.9
Form IV ⁽²⁾	1.19	1.29	+29.5
Unskilled ⁽²⁾	1.00	1.00	+19.0

Source: Published government salary scales.

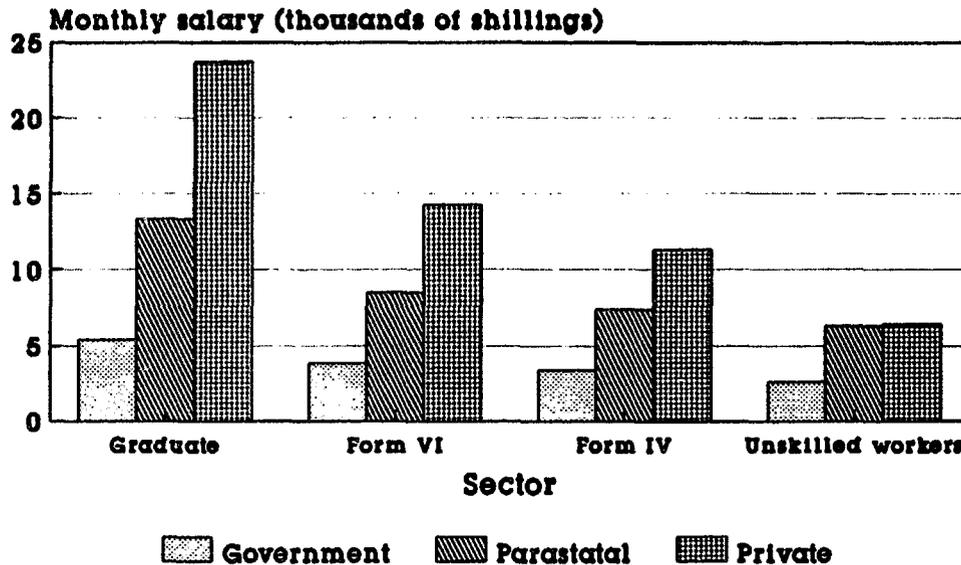
- Notes: (1) Salaries refer to the starting point for each grade.
(2) Newly qualified with no experience.
(3) Deflated by Retail Price Index for goods and services consumed by urban dwellers.
(4) Including transport and housing allowances.

2.14 Wage Comparisons between the Civil Service, Parastatals and the Private Sector. A detailed comparison of public, parastatal and private wage structures is currently being undertaken by the government. As no other recent data exist, a comparative survey was undertaken for the purposes of this report.^{5/} While the results cannot be regarded as definitive, they suggest that for every employment grade, government employees earn less than half of the corresponding wage paid by parastatals and considerably less again when compared with the private sector (see Graph 2.1). Further, the salary structure is most decompressed in the private sector, and least in government. The wage level of unskilled workers is quite similar in parastatals and private enterprises, but 60 percent less in government. Total emoluments for newly-qualified university graduates in government employment are less than one quarter of comparable earnings in the private sector. Further, the gap between parastatal and private sector wages on the one hand, and those of civil servants on the other was even larger in 1987, as both the private and parastatal enterprises sampled reported lower percentage increases in wages and other allowances between 1987 and 1989 than had been enjoyed by government employees. These results contrast sharply with the early 1970s,^{6/} when public sector workers earned a substantial premium over those employed in the private sector.

^{5/} Salary differentials (inclusive of visible allowances) that prevailed between the civil service and both parastatal and large privately-owned enterprises operating in the manufacturing sector at the end of 1989. The data on the parastatal and privately-owned enterprises were collected by both direct interviews and by a postal questionnaire circulated to firms in the Dar-es-Salaam region.

^{6/} Lindauer and Sabot (1983).

**Graph 2.1
Public and Private Sector Pay
in 1989/90**



- (1) starting salaries
(2) including allowances

2.15 Interviews conducted with the sample of 20 informal activities in Dar-es-Salaam indicated that even the most humble street-trading activities generate average earnings well above the levels of remuneration received by unskilled workers in the civil service. For instance, the purchase of small fish for resale in a local market generates a net profit to that individual of about Tsh 450 per day, or 9,000 to 11,000 per month, yet no skill or significant capital is involved. This is about 4 times higher than the government salary of unskilled workers. Thus involvement in the informal sector has been a rational response by many workers whose formal sector earnings have been contained by government policies.

2.16 Comparisons of wage levels alone ignore non-monetary compensation (e.g., access to housing at rents substantially below economic levels, free utilities, cars and drivers, travel allowances, etc.) received by some government officials. When non-monetary compensation is factored into such comparisons, the structure of total compensation within Tanzania's civil service is at present *de facto* highly decompressed: the ratio of top-to-unskilled compensation could be a many-fold multiple of the more visible wage ratio. Despite this, however, the problems of low wages and low overall compensation affect staff at all levels within government.

2.17 Low compensation levels are offset to some degree by the stability of income and the relatively low effort demanded in public sector jobs. It is often implicitly understood that absenteeism and extra-curricular activities while in the office are essential to secure additional sources of income -- which are in turn critical to make ends meet. These often include rent-seeking and outright corruption, which have increased significantly since the early 1980s hand-in-

hand with the decline in real salaries of civil servants. Absenteeism and rent-seeking, in turn, have gradually lowered morale and productivity in the public sector. Furthermore, there has been a steady loss by the public sector (including the university) of some of its best qualified people, including brain drain to jobs abroad. The vacancy rate appears to be concentrated at relatively higher grades in central government. Almost one-half of established, high level positions were vacant in 1986/87, compared with a vacancy rate of 21 percent in central government as a whole, suggesting declining management capacity.

B. Welfare gains by peasants since the beginning of reform

2.18 During the period of economic decline and stringent controls, rural incomes fell by about one-half.^{7/} Unfortunately for rigorous comparison, there is no direct survey evidence of incomes or expenditures in the post-1983 period in Tanzania. Thus, it is not possible to evaluate directly how peasants have fared since the beginning of reform. Several indirect measures and approaches to trends in peasant living standards were derived for this report, instead, for the period 1983 to the present, using the various data which are available.^{8/} These measures confirm that the substantial declines in incomes and living standards of the pre-reform period have been arrested. In fact, on average peasants' welfare appears to have improved significantly. However, the measures also indicate that over the period of reform cash incomes of peasants do not appear to have increased substantially. The welfare increase has been the result of greater food consumption and improved availabilities and varieties of goods, not of higher incomes. As the effect of improved availabilities of goods may represent only a one-time welfare gain – trade liberalization being a one time change – the analysis implies that further change in peasant incentives would need to take place to induce sustained improvements in peasant incomes and living standards.

2.19 Background Paper 1 in Volume II of this report contains a full description of the measures derived to gauge the evolution of peasant incomes through most of the 1980s. Table 2.6 summarizes the analysis by looking at the four different approaches: (i) per capita real cash balances held by peasants – indicative of the trend in peasant incomes; (ii) per capita estimates of peasants' real income from crop sales; (iii) estimates of per capita availability of consumer goods in the economy; and (iv) per capita food consumption by peasants.

7/ Bevan, et al., 1987.

8/ Several measures are presented given the limitations on survey data in Tanzania and thus the need not to rely on any single measure. This analysis comes from "The Tanzanian Recovery, 1983-1989", Paul Collier and Jan Willem Gunning, November 1989. See Volume II.

Table 2.6: Trends in Peasant Living Standards, 1983-1989
(1983 = 100)

Indexes	1983	1984	1985	1986	1987	1988	1989
1. Per capita real cash balances held by peasants ^{2/}	n.a.	n.a.	72	68	70	70	70
2. Per capita peasant incomes from sales of crops	100	114	130	114	107	114	n.a.
3. Per capita consumption of consumer goods ^{2/}	100	135	120	108	101	121	n.a.
4. Per capita food consumption by peasants	100	n.a.	n.a.	n.a.	150	n.a.	n.a.

Sources: Collier and Gunning, "The Tanzanian Recovery, 1983-1989", 1989.
n.a.: Not Available.

Notes: (a) Index of real cash expenditure in 1977 = 105.
(b) Per capita consumption of consumer goods reflects both rural and urban consumption.

2.20 Under circumstances of unchanged liquidity preferences (and velocity of money), changes in money balances can be suggestive of trends in peasant incomes. However, as liquidity preference of peasants can differ over time given different economic conditions (e.g., the existence of commodity shortages distorts the level of money holdings), it is essential that comparisons only be made of like years. Thus, in Tanzania, cash balances in recent post-liberalization years should only be compared with pre-shortage years, e.g. 1977. As the index of cash balances shows, money held by peasants in 1989 was 33 percent lower than in 1977. During 1986-89 no significant increase in real cash balances per capita has occurred. Under assumptions of similarity in liquidity preferences between both years, these data imply that real incomes in the peasant economy have not recovered to the levels of pre-shortage years, or even in any substantial measure since the beginning of the reform period.

2.21 A second approach measures peasants' real income from crop sales -- including agricultural income from sales of export crops, food crops through official channels, and food crops through unofficial channels. Aggregating these sales reveals a large temporary increase in real income between 1983 and 1985, but little overall real income growth between 1983 and 1988. On a per capita basis between 1983 and 1988, real income appears to have risen at an annual average of 2.6 percent, with all the increase concentrated at the beginning of the period - and no apparent increase during the ERP.

2.22 The third measure is an estimate of changes in the availability of consumer goods - both from domestic manufactures and imports.^{2/} As a result of a large increase in consumption

^{2/} This measure reflects per capita consumption of consumer goods by rural and urban populations.

imports due to the own funds scheme, per capita national consumption of non-food consumer goods increased significantly during the early years. However, there was no apparent increase between 1985 and 1988.

2.23 The fourth approach to estimating the welfare impact of reform measures food consumption by peasants. This indicates that rural food consumption has increased about 50 percent -- implying a substantial welfare gain. This finding would be consistent with the substantial decline in the price of food commodities relative to urban-supplied goods which has been measured in Tanzania (see background paper, "The Tanzanian Recovery, 1983-1989", Volume II). In sum, none of these measures appear to point to a significant increase in incomes or expenditures by the average rural inhabitant. However, no evidence of a continuation of any decline -- which had been so dramatic -- in the post-1983 period is apparent either. Equally important, overall welfare of the rural population appears to have increased significantly over the period, as reviewed next.

2.24 Availability and Choice of Consumer Goods and Improved Standard of Living. Cash incomes are insufficient to measure standard of living, particularly in an economy where substantial rationing of goods prevailed. For completeness of analysis, two additional measures of changes in standards of living are: (i) increased availability of goods not present during the years of shortages and (ii) greater availability of varieties of goods.^{10/} Between 1978 and 1983 the range of choice of consumer goods narrowed as part of the general contraction in consumer good supply. Since 1984 the range of choice in consumer goods has widened again (Graph 2.2), resulting in peasants improving their standards of living. The graph shows indicators for availability of goods and varieties in Tanzania during the 1983-88 period. On the basis of the improved availability of varieties, a conservative estimate of (the order of magnitude of) improvement in peasant welfare was almost 30 percent between 1983 and 1988.^{11/}

2.25 Measuring availability of goods (Graph 2.2, "goods") reveals a marked improvement in the range of goods accessible to Tanzanians: between 1983 and 1988 goods available increased by 54 percent. In fact, quarterly data decomposition reveal an even more dramatic turn-around: availability deteriorated sharply between the first and third quarters of 1983 (from 6.1 to 3.8) and continued at this low level until the second quarter of 1984. Thereafter there was a rapid and continuous improvement. Following the same welfare measurement procedure,^{12/} the improvement in availability between 1983 and 1988 implies a welfare increase for a given level of expenditure of about 20 percent. The combined impact of both types of wider choice is

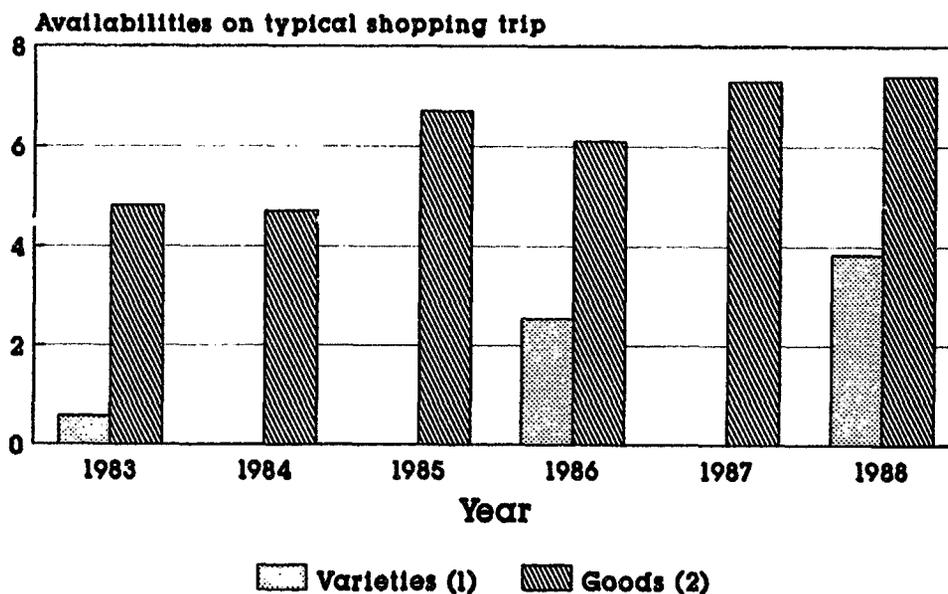
10/ For example, soap, a relatively standardized product, is differentiated by scent, quality and function (e.g., laundry, toilet, etc.)

11/ This calculation is based on the above mentioned data utilizing the theoretical framework developed by Dixit and Stiglitz (1977). That framework shows how, for a given total expenditure, a consumer will obtain greater welfare as variety is increased--or how for a given level of welfare a consumer will need to spend less as variety is increased (in other words, widening choice lowers the cost of living). The estimates will depend on the assumed elasticities of substitution between goods and between varieties. In order to arrive at conservative estimates, high elasticities were assumed.

12/ Assuming a high elasticity of substitution between goods of 2.5.

equivalent to an estimated fall in the cost of living of 43 percent or, similarly, a 75 percent welfare improvement for a given level of cash expenditure. While these figures are only illustrative,^{13/} the order of magnitude of these gains, which are ignored in usual standard of living analyses, appears to far outstrip any gains in cash incomes by farmers.

Graph 2.2
Improvements in Consumer Choice
1983-1988



- 1/ Refers to how many varieties of soap were available on the typical shopping trip. Data for soap varieties is available only for 1983, 1986 and 1988. See footnote 2 for definition of shopping trip. Based on Central Bureau of Statistics samples of 16 varieties of soap in twenty urban centers for each quarter over the period.
- 2/ Refers to eight goods: cooking oil, margarine, toilet soap, laundry soap, matches, khanga, kerosene and cigarettes. Figure refers to how many of these eight goods were found to be available on the average "shopping trip" by an enumerator of the Bureau of Statistics. A good was considered available if at least one of its varieties was available. The number is the unweighted average of eighty shopping trips per year; one per quarter for each of twenty regions.

Source: Derived from unpublished data gathered by the Bureau of Statistics for the construction of the CPI.

^{13/} In spite of the conceptual rigor of this methodological approach, this estimate is illustrative given the nature of the data and assumptions made. However, care has been taken to err on the conservative side. Thus these estimates suggest substantial welfare gains (and cost-of-living improvements) derived from wider availability of goods.

2.26 Consolidating the measures. Since there is no direct survey evidence for the post-1983 period, there are limitations on individual measures. However, the various measures confirm that the dramatic declines of the early 1980s in terms of income, expenditure, and output have been arrested. In addition, food consumption has increased, and availability of goods and varieties has improved. Nonetheless, the various measures suggest that, despite large increases in peasant crop sales since 1983 (see Volume II), real incomes of peasants have not increased substantially since reform began except in the initial year or so after liberalization. The decontrolled trade regime now existing in Tanzania, which permits the import of virtually all categories of consumer goods, has thus provided substantial welfare gains to the Tanzanian populace. However, there are limits to any additional welfare gains which can be expected from improved availability of goods per se. Future welfare gains will have to come from income growth.

C. The impact of reform on large and medium firms and on small-scale entrepreneurs

2.27 The impact of reform on firms and entrepreneurs is reviewed in detail in Chapter 5 (Industry and Private Sector Development) and is only briefly summarized here. From a survey which was undertaken as part of the preparation of this report and which updated a similar review done in 1985,¹⁴ and on the basis of official data of the government, it is evident that since reform began major changes have taken place in the structure of production of medium and larger scale manufacturing firms, and for urban smaller scale productive ventures.

2.28 For firms in the formal industrial sector, our updated survey indicated that efficient firms, which tend to be medium scale and relatively labor- and domestic resource-intensive, have expanded production significantly (28 percent cumulative growth between 1985-90). In contrast, inefficient operations, which tend to be large and import-intensive, contracted output by 22 percent over the period. Among these, firms which were operating at negative value added in 1985 contracted output by 28 percent over the period. However, while production of inefficient firms has generally contracted, these enterprises continue to be in operation and receive preferential access to finance and foreign exchange in spite of continuing economic and financial losses, and for many of them the efficiency of operations does not appear to have improved (Chapter 5).

2.29 In the smaller scale and informal sectors, the changes since the mid-1980s have been unambiguously positive. As seen in the labor market analysis, an explosion of small scale production and trade activities has taken place in the aftermath of the own-funds imports scheme and the ERP measures. It is estimated that small scale sector activities have at the very least doubled, and may have very well trebled, since the mid-1980s (see also Chapter 5).

D. Conclusion

2.30 The analysis in this chapter focussed on the microeconomic agents: how have workers, peasants, firms and entrepreneurs fared during the 1980s? Peasants' standards of living appear to have improved on average, and they are producing more, but cash incomes have not

^{14/}

"Tanzania: An Agenda for Industrial Recovery", 1986, World Bank.

increased significantly in real terms, except in the initial year or so of the reform period. As discussed in much greater detail in Chapter 4, this appears to be due in large measure to inefficient marketing channels in agriculture. In contrast with cash income, peasants' overall welfare has increased significantly since the mid-1980s because of the dramatic increase in the availability of goods and increased food consumption. Some of these are one-time gains, however, indicating that improved cash incomes will be central for improved rural welfare and production in the future. Industrial firms are performing somewhat better on the average, and are beginning the restructuring process (which is detailed in Chapter 5): small and informal sector activities as well as relatively efficient medium sized firms are increasing production significantly, while many inefficient large-sized activities, particularly parastatals, have contracted.

2.31 Urban inhabitants have benefitted from a large increase in food production and the greater availability of consumer goods since 1984. The analysis of the recent evolution of the labor market suggests that urban employment and the incomes situation may have particularly improved since the mid-1980s for participants in the informal and smaller scale sector -- as evidenced by the rapid growth of that sector in recent years. On the other extreme of the spectrum, until 1987 real wages of government employees continued the deterioration that had begun in the late 1970s. Since then, a modest reversal has taken place. Salaries of public sector employees -- particularly those just under the top level -- are still, however, a small fraction of what they were 10 years ago, of what their counterparts in the parastatal and private sectors receive, and that required for minimum subsistence. As a result, public sector productivity has declined dramatically during the 1980s and the incidence of rent-seeking has increased.

2.32 The micro-evidence has thus pointed to some significant achievements since the mid-1980s. Food production and consumption, the availability of basic goods throughout the country and enhanced income-generating opportunities in the informal, trade and agriculture sectors indicate that welfare gains have been attained for the population at large. However, the evidence also points to the critical constraints affecting rural and urban inhabitants' welfare which remain. These are intimately linked to serious institutional deficiencies in civil service and parastatal management, the financial system, agriculture marketing and systems for social service delivery, which are subjects of the remainder of this report.

CHAPTER 3

Public Sector Performance and Macroeconomic Stability

A. Introduction

3.1 This chapter begins by analyzing the structure and aggregate performance of the government budget during the 1980s, focussing on the developments in the structure of expenditures, revenues and the central government's fiscal deficit. The first section summarizes and extends the substantial analysis of the government expenditure program presented in the Public Expenditure Review.^{1/} Consistent with the role played by Tanzania's financial sector in de facto channelling public expenditures to parastatals and other public institutions, the chapter presents an analysis of total government expenditures based on a consolidation of expenditure through both the central government budget and the financial sector. This in turn provides a means of assessing inflationary developments during the 1980s. This analysis provides evidence that the inflation experienced throughout that decade, particularly in more recent years, was the product of the government's financial sector and fiscal policies. The chapter concludes with a discussion of financial sector reform required if macro stability is to be achieved in the future and if Tanzania is to have the appropriate financial services environment for growth in the real sectors to take place and with a discussion of public sector management reform required.

B. Fiscal Performance of the Central Government.

3.2 **Fiscal Performance during the early 1980s.** The period from 1980/81 to 1985/86 was one of enormous strain for the government budget. Total expenditures, which began the decade at 31.5 percent of GDP, fell to a nadir of 23.1 percent of GDP by 1985/86. This drop in total expenditures represented a fall of over 19 percent in real terms over the period. It was largely the outcome of the major retrenchment in foreign-financed development expenditures (Table 3.1). Development budget expenditures were over 10 percent of GDP in 1980/81, reflecting the substantial expenditures on parastatal industrial projects (stemming from the basic industrialization strategy of the 1970s) and on social infrastructure. However, by 1985/86 capital investment expenditures by government had fallen to 3.9 percent of GDP, a 58 percent drop in real terms over the 5-year period. Recurrent expenditures, which fell by only 2 percentage points of GDP, were significantly more protected than development budget expenditures during this period.

3.3 The main determinants of the reduction in overall expenditures in general and in development expenditures in particular were the import compression in the early 1980s, the decline in foreign aid (due to donor fatigue) and the lack of access to commercial financing (due to the balance of payment crises, Tanzania's repayment difficulties and the resulting crisis of confidence). At the same time, debt service, from the debt contracted during the 1970s and early 1980s, was rising substantially, from 9.2 percent of the total budget to 19.2 percent in 1985/86 (Graph 3.1). In addition, total domestic revenues had fallen to 14.9 percent of GDP by 1985/86

from the 19.2 percent level in 1980/81 (Table 3.1). This represented a deterioration in collections from each major type of domestic tax revenue (i.e., import duties, consumption and income taxes), and a drop in real terms by 15 percent over the period. This drop reflected both the decline in economic activity (and imports) and the erosion in the collection base.

Table 3.1: Central Government Budget - Selected Years: 1980 - 1990
(as percent of GDP)

	1980/1	1983/4	1985/6	1988/9	1989/0	1990/1	Average		Real growth from	
							80/81 to 85/86	86/87 to 89/90	80/81 to 85/86	85/86 to 89/90
				est.	est.	projection				
Total Revenue	19.2	18.1	14.9	19.9	20.5	23.1	17.8	18.6	-14.5	58.9
Tax Revenue	17.8	17.2	14.2	17.5	17.7	20.6	16.7	16.6	-12.0	42.8
Non-tax Revenue	1.3	0.9	0.6	2.4	2.9	2.5	1.1	1.9	-48.3	430.0
Total expenditure and net lending	31.5	26.2	23.1	28.3	24.7	27.6	28.3	25.9	-19.2	23.2
Recurrent expenditure	21.2	20.3	19.2	21.6	21.2	21.6	21.3	20.2	0.0	27.0
Wages and Salaries	n.a.	n.a.	5.7	5.6	5.8	5.8	n.a.	5.2	n.a.	17.1
Interest payments	n.a.	n.a.	2.0	4.1	3.6	3.9	n.a.	3.8	n.a.	106.6
Other goods and services	n.a.	n.a.	9.1	7.0	6.8	11.9	n.a.	7.4	n.a.	-13.5
Transfer payments	n.a.	n.a.	2.4	5.0	4.9		n.a.	3.9	n.a.	137.9
Devel. expenditure & net lending	10.3	5.9	3.9	6.6	3.5	6.0	7.1	5.6	-58.4	4.2
Overall deficit (checks-issued)	-12.3	-8.1	-8.2	-8.4	-4.2	-4.5	-10.5	-7.3	-26.4	-41.3
Adjustment	-1.3	0.0	2.3	-1.0	-1.1	0.0	0.6	-1.1		
Overall deficit (checks-cleared)	-13.7	-8.1	-5.9	-9.4	-5.3	-4.5	-10.0	-8.3	-52.1	2.6
Financing	13.7	8.1	5.9	9.4	5.3	4.5	10.0	8.3	-52.1	2.6
Foreign	5.9	1.8	1.6	7.1	4.3	5.9	3.5	6.3	-70.5	214.3
Import support	n.a.	n.a.	n.a.	5.0	2.9	2.0	n.a.	4.2	n.a.	n.a.
World Bank	n.a.	n.a.	n.a.	2.7	3.7	4.5	n.a.	2.8	n.a.	n.a.
Project loans and grants	6.1	2.2	3.1	3.8	1.5	2.5	4.1	2.7	-44.2	-45.2
Amortization	-0.2	-0.4	-1.5	-4.3	-3.7	-3.0	-0.6	-3.4	905.2	184.9
Domestic (net)	7.8	6.3	4.4	2.2	1.0	-1.4	6.5	2.0	-38.0	-74.3
Bank	6.4	5.6	3.7	1.5	0.2	n.a.	5.5	1.1	-35.6	-95.0
Nonbank	1.4	0.6	0.6	0.7	0.8	n.a.	1.0	1.0	-49.6	49.9

n.a.: Not Available.

3.4 The cumulative result of the larger decline in expenditures than in revenues was that the government budget deficit of 13.7 percent of GDP progressively declined to 5.9 percent by 1985/86. This decline in the government budget deficit was the result of the government's efforts to control its expenditure program. In addition, it was consistent with a fall of similar magnitude in the share of both foreign and domestic financing. Net foreign financing, which totalled 5.9 percent of GDP in 1980/81, was only 1.6 percent of GDP by 1985/86, while domestic borrowing was cut almost by one-half at the end of the period (4.4 percent of GDP).

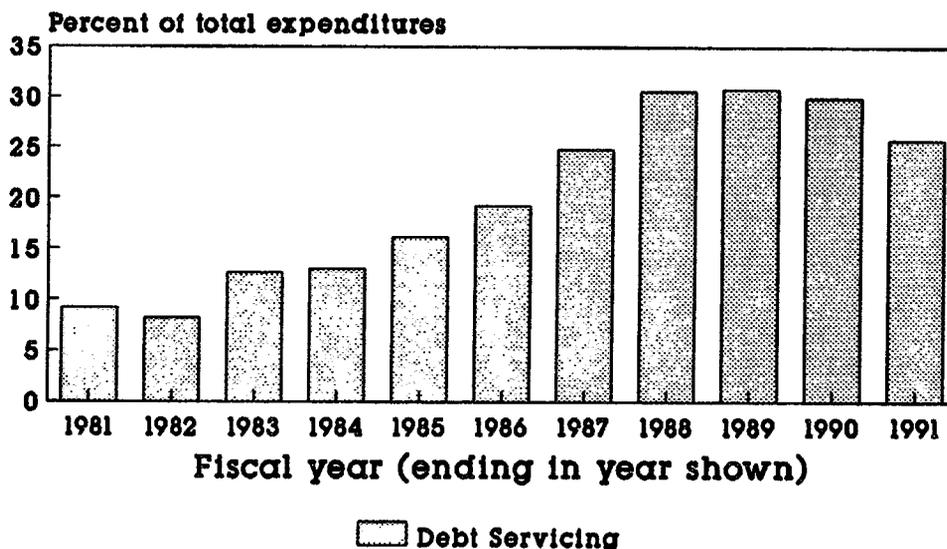
3.5 Fiscal Performance after the Mid-1980s. In 1986 the government announced the ERP, which provided the framework for the beginnings of economic recovery and some improvement in the budgetary situation of the central government. The ERP measures also resulted in increased donor aid. But as indicated below, despite some improvement in the government's fiscal performance since 1985/86, the strain on public expenditures continues.

Furthermore, the apparent improvements in the central government's budget since the mid-1980s mask the deterioration in the overall public financial performance, once expenditures channelled through the financial sector are taken into account (section E below).

3.6 Budgetary Expenditures. In aggregate, recurrent expenditures have risen from the 1985/86 levels of 19.2 percent of GDP to an estimated 23.1 percent of GDP in 1990/91. During the early years of the ERP, development expenditures increased from their 3.9 percent level in 1985/86 to over 6 percent of GDP through 1988/89. In 1989/90, however, actual development expenditure fell to only 3.5 percent of GDP.

3.7 These changes do not reflect any major expenditure restructuring program by the government. First, the increase in recurrent expenditures reflects the build-up of domestic and foreign-denominated debt contracted in the late 1970s and early-1980s and the real depreciation of the Tanzanian shilling which has taken place since mid-1986. Between 1985/86 and 1990/91 budget, interest payments doubled as a percent of GDP and accounted for virtually the entire (80 percent) increase in the GDP share of the recurrent expenditure budget. Debt servicing rose from 19.2 percent of the total budget in 1985/86 to 30.8 percent in 1988/89 before declining to 29.9 percent in 1989/90 and an estimated 25.7 percent in 1990/91 (Graph 3.1).

Graph 3.1
Debt Servicing in the Budget
(as percent of total expenditures)

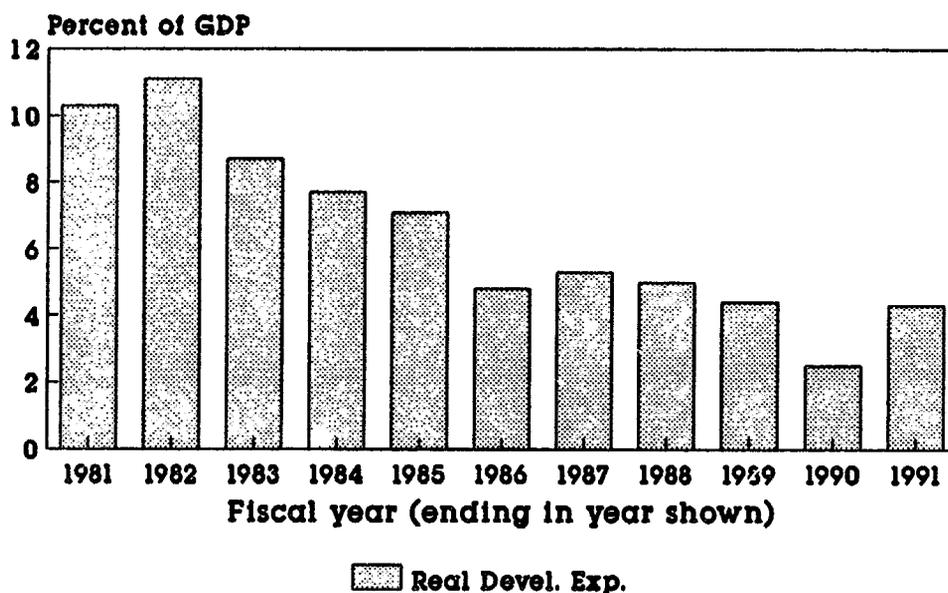


Debt represented by consolidated fund services budgetary expenditure (1990/91 - budget estimate)

3.8 Second, the development expenditure increases since 1985/86 have primarily resulted from real depreciation of the exchange rate and the relatively large foreign exchange component to the government's investment budget. Development expenditures began the decade equalling 10 percent of GDP. Properly accounting for the price increases in both the foreign and domestic components, development expenditure levels halved in value and relative to GDP during

the first half of the decade (Graph 3.2).^{2/} While this would be expected given falling aid levels during that time, between 1985/86 and 1989/90 real investment expenditures appear to have almost halved again: from 4.5 to 2.5 percent of GDP. This level of investment expenditure appears extremely low and is reflected in the deteriorating infrastructure and other services evident in Tanzania.

Graph 3.2
Real Development Expenditures
by Government, 1980/81 - 1990/91



(1990/91 - budget estimate)

3.9 Third, in its programs the government has indicated that it wishes increasingly to shift emphasis and budgetary allocations toward four priority sectors: education, health, works (infrastructure maintenance) and agriculture (research and extension). Looking at budgetary shares in 1990/91 compared with 1988/89 (Table 3.2), for three out of these four sectors (education, health and agriculture), actual allocations have fallen as a percent of total supply, rather than increasing. Only the recurrent allocation for works has increased over this time — primarily as a result of the requirements of the integrated road project essentially begun in 1990.

2/

Deflating foreign-financed development expenditure by the index of real exchange rate.

Table 3.2: Budgetary Allocations
(recurrent budget as a percent of total supply)

	1988/89	1989/90	1990/91
Finance	15.4	22.0	20.6
Local Government	15.6	13.8	15.3
o/w: Education	10.5	9.4	10.1
Health	3.8	3.2	3.8
Defense	12.7	9.7	9.3
Home Affairs	9.5	10.0	9.6
Education	9.0	9.2	9.2
Health	4.7	4.8	4.6
Foreign Affairs	4.1	3.1	3.0
Communications			
& Works	3.4	3.4	6.3
Agriculture	3.4	3.3	3.2
National Service	2.5	2.3	2.2
Prime Minister	2.5	0.7	1.9
Other	9.9	11.3	7.8
Regions	7.3	6.4	7.0
o/w: Health	2.9	2.3	2.5
Education	0.2	0.2	0.3
Total Supply and Regions	100.0	100.0	100.0
Priority Sectors (incl allocations from central, regional and local government)			
Education	19.7	18.8	19.6
Health	12.8	10.3	10.9
Works	3.4	3.4	6.3

3.10 Over the period since the mid-1980s, total revenues have risen to 20.5 percent of GDP through 1989/90 (Table 3.1), up from the lowest level of 1985/86 (14.9 percent), reflecting increased collections in tax and non-tax revenue (e.g., cost recovery). Through 1988/89 the increase in revenues was less steep than the rise in expenditures,^{3/} and as a result, the budget deficit rose from 5.9 percent of GDP in 1985/86 to 9.4 percent in 1988/89. In 1989/90, primarily as a result of the drop in development expenditures, the overall budget deficit fell to 5.3 percent of GDP.

^{3/} Particularly when accounting for the check float from the previous year, which was significant in 1985/86 (see Table 3.1).

C. Revenues and Financing

3.11 **Revenues.** There have been substantial shifts in the composition of domestic revenue between the period preceding the ERP and thereafter (Table 3.3). The share of income taxes in total revenue has fallen from an average of 29.5 percent before 1986, to 22.4 percent thereafter, reflecting a decline in income tax collections in real terms between 1980/81 to 1989/90 of 8 percent. The overall share of consumption taxes in total revenue fell from 53.5 percent to 47.7 percent, although a small increase in real terms has taken place. Trade taxes continuously fell as a proportion of total revenues during the early 1980s, and have increased significantly since the mid-1980s as the real exchange rate has undergone a major adjustment and as substantial import growth has occurred. However, import duty collections have continued to fall, a result of both tax policy and administration failings. As a percent of total imports, duty collections were 7.4 percent in 1980/81 and 5.5 percent in 1989/90. As the scheduled average tariff rate has remained roughly constant at approximately 30 percent, the actual collection figures suggest increasing collection erosion through, for example, granting of exemptions, under-valuation of imports, misuse of collected taxes, etc.

Table 3.3: Central Government Revenues by Source
(in percent)

	1980/81	1983/84	1985/86	1988/89	1989/90	1990/91	Period Averages	
							80/81 to 85/86	86/87 to 89/90
I. Revenues as percent of Total					Est.	Prog.		
Tax Revenue of which:	93.1	95.0	95.8	87.9	86.1	89.3	94.5	88.7
Customs duties	7.5	6.6	7.0	11.8	12.0	13.5	7.1	12.3
Sales and excise taxes	50.0	54.8	53.2	47.6	45.0	48.7	53.5	47.7
Income taxes	31.5	28.3	29.6	23.1	21.3	19.2	29.5	22.4
Other taxes	4.1	5.3	5.9	5.3	7.1	7.9	4.3	6.2
Non-tax Revenue	6.9	5.0	4.2	12.1	13.9	10.7	5.5	11.3
Total Revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
II. Other Indicators								
Total Revenue as percent of GDP	19.2	18.1	14.9	19.9	20.5	23.1	17.8	18.6
Import Duties as percent of Imports	7.4	9.8	6.6	6.1	5.5	5.8	8.6	6.4

3.12 Financing. Since 1980/81 significant changes have occurred in how the government's budget has been financed (Table 3.4). In 1980/81 total domestic revenues covered 58 percent of budgetary expenditures, net domestic borrowing (primarily bank borrowing) covered 24 percent, and net foreign financing contributed 18 percent of total funding required. By 1985/86 the contribution of domestic revenues had risen to over 71 percent of total expenditures, mainly the result of the drop in foreign financing to only 7.6 percent of total. After the beginning of the ERP, consistent with the fiscal objectives of the program and agreements with the IMF, net domestic borrowing by the government has been reduced significantly and was 3.8 percent of total expenditure in 1989/90. The government is programmed to repay domestic lenders during 1990/91. Conversely, recent budgets have increased reliance on foreign financing: counterpart donor aid financing, generated in support of the ERP, averaged almost one-fourth of total resources required to cover budgetary expenditures.^{4/} This may increase somewhat in coming years -- foreign financing is tentatively forecast at one-third of total expenditures during 1991/92. However, over time it is inevitable that foreign financing, even if it remains constant in real dollar terms, will decline as a proportion of total. The implications of this for domestic resource mobilization are critical issues to be addressed by government.

3.13 Domestic revenues need to be mobilized in much more effective ways: (i) by expanding the revenue base; and (ii) reducing evasion, exemptions, harassment and graft by revenue officials. These objectives could be achieved through instituting moderate rates of import duties, sales and income taxes in a context where the tax net would be broadened and exemptions reduced. In this context, the completion of the ongoing tariff and sales tax reform is essential, with the objectives of attaining a more compressed tariff structure with most duty rates between 20-30 percent, a uniform sales tax rate of between 10-15 percent, and uniform excise taxes covering only a few products. Equally important, institutional reform of the customs and tax department is required, which would include staff and salary restructuring, a transparent system of accountability, swift penalties for corruption and continuation of staff training. From this perspective, the tax commission's interim findings will be incorporated into the 1991/92 budget. The commission is due to report on a final basis around September 1991.

^{4/} Of gross inflows of foreign aid financing, about one-half is provided as import support (commodity import support programs by donors and adjustment lending by the World Bank) and one-half for development projects.

Table 3.4: Sources of Funds for the Budget as percent of Total Expenditure and Net Lending

	80/1	83/4	85/6	88/9	89/90	90/1	Average	
							80/1-85/6	86/7-89/0
					Est.	Prog.		
Total Revenue as percent of Total Expenditure	58.4	69.1	71.4	67.9	79.5	83.7	65.1	69.1
Net Domestic Financing as percent of Tot Expenditure	23.6	23.9	21.0	7.7	3.8	-5.2	22.9	7.6
Net Foreign Financing as percent of Tot Expenditure	18.0	7.0	7.6	24.4	16.8	21.5	12.0	23.4

Note: Percentages normalized to total 100 to allow for adjustment due to check float.

D. Public Enterprises and the Budget.

3.14 A large component of the public sector in Tanzania, which has received substantial resources from the government, is the public enterprise sector. This sector comprises over 400 separate entities representing 24 percent of non-agricultural wage employment and generating 13 percent of the economy's total value added.^{5/} The largest concentrations of these enterprises are in the industrial, agricultural, mining and energy sectors. The activities and problems of this sector have been analyzed by many studies, most recently by a World Bank study of parastatals in Tanzania. That study documented the poor performance of public enterprises in Tanzania over the years, the financial and economic inefficiency of their operations and the resulting drain from the government budget. The government has generally accepted that the public enterprise sector has not fulfilled its goals for this sector.

3.15 Parastatal performance in the most recent years has continued to be weak (Table 3.5). In the last year for which data are available from the Tanzania Audit Corporation (1989), of the 364 parastatals (including commercial and non-commercial public enterprises) audited,^{6/} 175 reported a pre-tax profit totalling Tsh 16.2 billion while 189 enterprises reported losses of Tsh 32.9 billion. Of the commercial industrial parastatals, 49 enterprises reported profits totalling Tsh 3.0 billion while losses from 61 parastatals totalled over Tsh 13.0 billion (Table 3.5).

^{5/} Parastatals in Tanzania: Towards a Reform Program, Report 7100-TA, July 27, 1988. See also Hamad Commission Report (1983); Annual Reports of Tanzania Audit Corporation; Report of the Presidential Implementation Team (1987); Nsekela Commission Report (1987); and others.

^{6/} excluding the Bank of Tanzania.

Table 3.5: Profits and Losses by Parastatals, 1989

Sector	Number of enterprises making		Profits	Tah million
	profits	losses		Value of Losses
Finance	14	3	7,420.9	89.8
Industry	49	61	2,999.0	13,020.4
Transport	15	9	2,152.4	7,735.8
Energy & Minerals	3	5	1,380.4	721.7
Agriculture	32	41	1,059.3	7,084.0
Marketing	8	24	389.9	3,662.9
Other	62	46	813.0	590.9
Total	175	189	16,214.9	32,905.5

Source: Tanzania Audit Corporation, 1989 Annual Report

3.16 Two central problems have been identified for the public enterprise sector: that the sector is too large relative to the limited resources and managerial capacity available in Tanzania and that it has been operating in a protected environment without sufficient competitive pressures,^{2/} thus allowing inefficiencies to be ingrained in the system. In the past, much of that inefficiency was hidden by subsidies and protection. To some extent this has begun to change with the improvement to the general policy framework: through exchange rate adjustment, trade liberalization, deconfinement, price decontrol and some limitation on direct subsidies. Appropriate institutional and managerial arrangements for public enterprises should place considerable pressure on the enterprises to improve both efficiency and performance or to shut down operations altogether. In the Tanzanian context, however, these are not yet in place, as evidenced by the government's willingness to continue financial support and the negligible number of enterprises which have actually been allowed or forced to close.

3.17 Parastatals continue to draw heavily on the government budget (Table 3.6).^{3/} Direct support from the budget includes grants and subventions (generally to non-commercial parastatals) and subsidies and transfers (generally to commercial and financial parastatals). Transfers to parastatals have risen from 6 percent of total expenditures in 1980/81 to 8.8 percent in 1989/90. Explicit budgetary subsidies to public commercial enterprises were abolished beginning in 1984/85, although even in that year transfers (mostly payments under previous restructuring and continuing grants to non-commercial parastatals) represented 6.2 percent of total budgetary expenditures. By the next year, however, and continuing throughout the remainder of the decade, coverage of new overdrafts by crop authorities (payment to NBC by the

^{2/} As exemplified by import licensing, discriminatory foreign exchange and credit allocation systems, willingness to tolerate arrears, etc.

^{3/} From a background paper prepared for this report: "Issues Concerning Budgetary Subsidies to Parastatals and Budgetary Constraints on Social Sector Spending in Tanzania", Fidelis P. Mtatifikolo, UDSM, 1989.

government to cover arrears of marketing boards) and parastatal restructuring/rehabilitation (transfers to TIB and direct government investment expenditures) grew substantially. During the period parastatal dividends paid to the budget were negligible (never exceeding 7 percent of total subsidies).

Table 3.6: Direct Subsidies to the Parastatal Sector
(million Tsh)

	1980/81	1982/83	1984/85	1985/86	1988/89 est.	1989/90 prog.	Average	
							80/1-85/6	86/7-89/90
Grants and Subventions	350	845	889	1886	5137	8170		
Subsidies and Transfers	512	1334	734	715	2663	3900		
Gross Total	862	2179	1623	2601	7800	12070		
Net Total (see note below)	612	1929	973	1951	7400	9670		
Gross as % of total expenditures	6.0	11.8	6.2	8.0	7.6	8.8	8.5	8.2
Net as % of total expenditures	4.3	10.5	3.7	6.0	7.3	7.0	6.8	7.0
Memo:								
Parastatal income tax paid	1185	1690	2959	8066	8349			
Parastatal dividends (excl BOT)	48	92	161	350	863			
Net transfer to govt. (incl inc tax)		-341	159	519	616	-2858	-5024 (sum 81/2-89/90)	
Net transfer to govt. (excl inc tax)		-1526	-1531	-2440	-7450	-11207	-37089 (sum 81/2-89/90)	

Note: 1980/81 restructuring: NMC overdraft of Tsh 2,000 million converted to 8 year loan.

1984/85 restructuring: Crop authorities's arrears of Tsh 2,525 million to be repaid over 6-8 years.

1988/89 restructuring: Crop authorities's arrears of Tsh 13,642 million to be repaid over 10 years at 8 percent interest.

Note: Net total refers to gross subsidies to parastatals less required payments under NBC restructurings.

3.18 In addition to direct grants and subsidies, the central government in recent years has engaged in lending short-term finance to public enterprises – for bridging finance, covering the value of import duties and for purchase of imports and capital investment. These, effectively, have represented substantial continuing subsidies to the parastatal sector. During 1987/88, for example, the government made eight such loans totalling Tsh 140.9 million (about US\$ 1.7 million), equivalent to 1 percent of total development expenditure and net lending in that year. Interest rates were generally 10 percent per annum, though some were free of interest, at a time when inflation was running approximately 30 percent and comparable lending rates at NBC and CRDB ranged between 18 percent and 31 percent. Furthermore, 28 percent of these loans were in arrears by the end of the year, while 67 percent of total bridging financing granted since 1984/5 was in arrears by end 1987/88. By 1990/91 lending of this type had grown enormously. During the first six months of 1990/91 the Treasury lent Tsh 1,521 million (about US\$ 7.5 million) to six public enterprises – an amount equal to over 9 percent of total development expenditures and net lending actually undertaken during the entire previous year. Most of these transactions have taken place at 14-15 percent interest, about half of the prevailing interest rate at the banking institutions.

3.19 In recent years the government has also granted credit on favorable (and even grant) terms to public enterprises which are beneficiaries of bilateral import support programs – by allocating foreign exchange to public enterprises without requiring payment of counterpart shillings or pursuing payments at a later date. Reviews by Sweden and the Netherlands of their bilateral aid programs have indicated that counterpart funds for between 15 and 40 percent of the Treasury-allocated import support granted each year have not been paid by the recipients of the foreign exchange (the public enterprises). Estimating, conservatively, that 20 percent non-payment applies to all import support, and given enterprise-specific import support programs of about US\$ 100 million annually, through just this mechanism the central government has thus been providing a large effective subsidy to parastatals equal in 1990/91 to at least 3 percent of total government revenues. These subsidies, as foregone revenue, are not reflected explicitly in the budget or determined based on transparent budgetary processes. Furthermore, they represent substantial losses of foreign exchange as it would be reasonable to assume that the import would not have taken place without the subsidy.

E. The Central Budget and Spending through the Financial Sector: A Consolidation

3.20 The direct contribution of the government's budget deficit to money supply growth and to inflation has steadily declined in recent years (Table 3.7). As seen previously (section C above), domestic financing requirements for the budget deficit have fallen substantially since the ERP began (Table 3.4) – to 7.6 percent of government expenditure, down from an average 23 percent during the early 1980s. Despite this apparent improved performance in the narrowly-defined fiscal budget, money supply (M2) growth accelerated steadily from 17.5 percent in 1982/3 to 42 percent by 1989/90.

Table 3.7: Central Government Deficit and its Contribution to Monetary Growth: 1982/83-87/88

	Money Growth	Overall Government Deficit	Borrowing from		Impact on Inflation*
	Tsh bil. (%)	(cash basis)	Banks (% monetized)	Contribution to M2 (%)	
1982/83	3.8 (17.5)	4.0	56.9	105.3	0.59
1983/84	4.3 (19.4)	4.5	69.5	104.5	0.59
1984/85	5.5 (21.0)	3.1	45.6	56.0	0.31
1985/86	7.2 (22.5)	5.2	62.9	72.9	0.41
1986/87	9.0 (23.0)	1.7	9.6	19.1	0.11
1987/88	18.5 (38.3)	4.5	18.2	24.1	0.13
1988/89	28.5 (43.3)	5.4	16.0	19.0	0.11
1989/90	36.1 (41.9)	0.7	3.1	2.1	0.01

Sources: Hyuha and Ndulu (1990) Bank of Tanzania, Economic and Operations Reports (various issues). URT, Economic Survey (various issues). Table 3.1 above.

- * The impact on inflation is obtained by multiplying the coefficient of money supply growth on inflation, from regression estimate (Ndulu and Hyuha), by the contribution of fiscal deficit to growth of money supply.

3.21 Hyuha and Ndulu's background paper for this report (1990) provides substantial evidence of a close relationship between money supply growth and inflation. Their regression estimates suggest a large and statistically significant monetary growth effect on inflation. The elasticity of the price level with respect to money supply was estimated to be 0.88 over the period, and highly significant statistically. These estimates suggest that, on the average over the period, a 40 percent money supply growth would have translated itself into 35 percent increase in prices over the year, holding constant other parameters.^{9/} But while a clear link exists between monetary growth and inflation, is the absence of a clear connection between the fiscal deficit and inflation in recent years (Table 3.7) an indicator of a delinking of monetary and fiscal forces in the Tanzanian economy? As shown below this is not the case: once allowance is made for the nature of the Tanzanian financial system, there is a virtual one-to-one correspondence between a more broadly defined budget and monetary growth and inflation. Essentially, a broadly-defined budget includes those public sector expenditures which have been shifted to the financial sector -- but which are still controlled by the government (i.e., akin to a "soft" budget).

3.22 Expenditures by the Financial Sector. Lending in Tanzania's banking system, which is publicly owned, has largely been determined by government priorities and administrative allocation -- not by market criteria. As a result, the commercial banks have largely lent to the public sector. As of end-December 1988, the top 20 enterprises (including industrial and commercial concerns, marketing boards and cooperative unions) receiving credit from the National Bank of Commerce represented 78 percent of NBC's total portfolio of all loans over Tsh 10 million. Of that share, 99 percent comprised credit to 19 parastatals (including the cooperative unions which have received directed credit allocations) while 1 percent went to 1 private enterprise. Similarly, the top 50 enterprises receiving credit represented 89 percent of NBC's portfolio. Forty-one public enterprises received 97 percent of that credit granted while nine private concerns received credit equalling 3 percent of the total outstanding.

^{9/} In addition, GDP growth and a reduction in import prices were also found to affect the level of inflation (downward).

Table 3.8: Public/Private Access to Credit

	<u>Public</u>		<u>Private</u>		Share of total NBC Portfolio
	# of firms	value share	# of firms	value share	
I. Access to credit					
A. Total NBC Portfolio					
Top 20 borrowers	19	99%	1	1%	78%
Top 40 borrowers	34	97%	6	3%	87%
Top 50 borrowers	41	97%	9	3%	89%
B. NBC Industrial and Commercial Portfolio					
Top 20 borrowers	13	82%	7	18%	16%
Top 40 borrowers	20	74%	20	26%	19%
Total	85	70%	81	30%	25%
II. Contribution to Industrial Gross Output and Value Added (1983-1986)					
	Industrial				
	Gross Output	Value Added			
Public Enterprises	63%	58%			
Private Enterprises	37%	42%			

Sources: Credit data from Coopers & Lybrand Report. Data as of December 31, 1988.
National Accounts from Bureau of Statistics

3.23 Credit to industrial and commercial enterprises comprises 25 percent of the total portfolio of NBC. Of that borrowing 70 percent has been directed to public industrial and commercial enterprises and 30 percent to the private sector (Table 3.8, Part I.A.). Biases in credit allocation are immediately obvious by contrasting this with value added by the industrial sector. Fifty-eight percent of total industrial sector value added is generated by parastatals and 42 percent by private enterprises.

3.24 Within the public sector, lending is determined by need rather than by viability. Further, loans have been largely made to cover the operating deficits of public agencies rather than being earmarked for asset formation. For example, around two-thirds of all bank lending outstanding at the end of 1987 was to cover the operating deficits of the crop marketing parastatals. During 1988 the government officially took over 40 percent of these liabilities, yet by the end of the year the indebtedness of the crop marketing parastatals to the banking system was higher than at the end of 1987.^{10/}

^{10/} Bank of Tanzania (1988), Table 14, and unpublished information from the Bank of Tanzania.

3.25 Thus while the commercial banks take in deposits from private agents, they have not used those deposits to finance lending to productive economic agents in the public or private sectors. In other words, the banking sector has not performed significant intra-private agent financial intermediation function. There is no pyramid of credit and hence no banking multiplier. The banking system is therefore more appropriately thought of as an agency which has been selling government debt (deposits) and which channels government funds to meet certain items of recurrent public expenditure.

3.26 Just as Tanzania's commercial banking system must be analyzed in a different fashion, the central bank has also not operated in a conventional manner. The chief function of the Bank of Tanzania has been to lend to the commercial banks to finance that part of their expenditure function which is not covered by their debt sales. Between the end of 1983 and the end of 1988, net lending by the central bank to the commercial banks was Tsh 35.5 billion whereas lending by the commercial banks to the government and parastatals was Tsh 50.9 billion.^{11/} Hence, most of the subsidies to public enterprises channelled through commercial bank "lending" appear to have been financed by the central bank.

3.27 Thus in Tanzania, while the financial sector may have the nomenclature of those found in market economies, its functions can be radically different. Tanzania's system is better seen as an additional instrument by which the public sector has financed its expenditure, both by debt sales (through private deposits) and money creation (printing) from the central bank. Given this background, to analyze the overall inflationary pressures present in Tanzania due to public sector deficits, it is important to consolidate the government's accounts with the financial system. Once this consolidation takes place, there is close correspondence between the public sector deficit, broadly defined, and the increase in the money supply. In turn, this increase appears to be closely related to the observed rate of inflation.

3.28 Consolidation. The adjustment of the government accounts through their consolidation with those of the banking system makes an enormous difference to the residual monetary financing item. Table 3.9 consolidates fiscal and financial accounts by adjusting the accounts in three ways. First, net commercial bank "lending" to the government and other public entities to finance recurrent expenditure is treated as part of the expenditure. Of this lending, the main components can be readily identified, namely lending to the government itself and to the agricultural marketing boards. These loans, which account for 68 percent of all lending to the public sector during the period, clearly financed recurrent expenditure. Some of the remaining loans to the public sector are for asset acquisition and therefore should not be treated as a disguised item of expenditure. Since we lack sufficient information on how much of the lending to industrial parastatals falls into this category, the analysis which follows makes the conservative assumption that all remaining lending was for asset acquisition.

3.29 Second, commercial bank payments of interest on time and savings deposits should be regarded as domestic debt service payments and thus should also be treated as part of expenditure. Third, these two adjustments double count one component of expenditure, namely bank lending to public agencies to meet their debt servicing, for this is merely an internal book-

^{11/} Bank of Tanzania (1988), Tables 11 and 12.

keeping transaction within the public sector. It is therefore necessary to add back to government revenue the debt service payments of public agencies. Residual monetary financing is then the difference between adjusted expenditure and revenue, inclusive of non-bank financing (almost entirely foreign).

Table 3.9: The Budget, Banking Financing and the Money Supply
(In current Tsh billion)

	1983/4	1984/5	1985/6	1986/7	1987/8	Cumulative Total
1. Budgetary Expenditures	23.9	26.7	33.2	55.5	76.9	216.2
2. Commercial Bank Lending and Interest Payments	1.5	2.6	0.2	15.5	28.6	48.4
3. <u>Adjusted Expenditure</u> (1+2)	25.4	29.3	33.4	71.0	105.5	264.6
4. Budgetary Revenues and other Items	16.1	19.7	24.0	42.7	55.8	158.3
5. Interest Payments to Public Entities	0.1	0.3	0.6	-0.2	2.5	3.3
6. Non-Bank Deficit Financing	3.4	3.8	4.2	11.5	20.2	43.1
7. <u>Adjusted Revenues</u> (4+5+6)	19.6	23.8	28.8	54.0	78.3	204.7
8. Financing Gap (Residual Monetary Financing (3-7))	5.8	5.5	4.6	17.0	27.0	59.9
9. Actual Increase in Money Supply	1.1	8.8	11.4	16.1	23.4	60.8
10. Memo: Conventional Budget Deficit Residual Financing	n.a.	n.a.	n.a.	n.a.	n.a.	14.8

n.a.: Not Available.

3.30 These three adjustments dramatically alter the estimate of residual monetary financing: summing over the fiscal years 1983/84 to 1987/88, residual monetary financing totalled Tsh 59.9 billion (rather than Tsh 14.8 billion looking solely at the more conventional public deficit). Equally important, the trend overtime indicates a widening gap between the conventionally defined (narrow) monetary financing and the adjusted monetary financing: in 1987/88, the last year when complete data were available, the adjustment implies residual monetary financing of Tsh 27 billion, instead of the conventionally derived figure of Tsh 0.9 billion. In other words, less than 4 percent of the residual monetary financing resulting from public expenditures can be captured by analyzing the government budget -- i.e., without consolidation of the public expenditures of the banking sector.

3.31 Monetary financing of a budget deficit leads either to a depletion of the foreign exchange reserves or to an increase in the money supply. The government of Tanzania has been in no position to buy back its currency with foreign exchange reserves since by 1983 its reserves were largely depleted. Hence, there should be a fairly close correspondence between monetary financing and the increase in outside money. As shown in Table 3.9 this is indeed the case. Over the five years the increase in the money supply was Tsh 60.8 billion compared with the Tsh 59.9 billion residual monetary financing item.

3.32 Money supply and inflation. If the velocity of circulation is constant, predicted inflation should equal the rate of money supply growth minus GDP growth. In Tanzania, a constant velocity assumption is tenable as long as the rate of actual inflation, per capita income and the extent of shortages of consumer goods is fairly constant. Such was the case during the period 1985-88 (Table 3.10).^{12/} The exception to the constancy of velocity is 1984, when the relaxation of price controls and own-funded imports substantially removed what had been acute shortages of consumer goods. The return to market clearing enables agents to reduce cash balances to normal levels and during this process of adjustment the velocity of circulation rises. Indeed, the implied velocity of circulation shown in Table 3.10 for 1984 is extremely high, since the constant velocity prediction of inflation is far below actual inflation. In other words, during the adjustment period when the once-and-for-all increase in the velocity of circulation was at work, prices would be expected to rise substantially more rapidly than the money supply -- which is what happened during that year.

Table 3.10: Money Supply and Inflation

	1984	1985	1986	1987	1988	Average 1985-88
Money Supply ^{1/}	3.7	29.0	29.2	32.0	36.7	31.7
GDP Growth	3.4	2.6	3.1	4.0	4.5	3.6
Predicted Inflation ^{2/}	0.3	26.5	26.2	28.0	32.2	28.1
Actual Inflation	36.1	33.3	32.4	29.9	28.2	30.5
Ratio Predicted/Actual Inflation	0.01	0.80	0.81	0.94	1.14	0.92

^{1/} Currency outside banks plus banks deposits.

^{2/} Percentage increase in Money Supply minus GDP growth rate. Velocity of circulation assumed to remain constant.

^{12/} The year to year correspondence is less close, reflecting errors introduced by the conversion from calendar to fiscal year for some items, minor fluctuations in reserves and the incompleteness of the consolidation of the banking system into the government accounts.

3.33 After 1984, there was a close correspondence between the growth of the money supply and the constant velocity prediction of inflation.^{13/} Hence, if real growth in the economy is regarded as independent of monetary policy, changes in the money supply in excess of real GDP growth should be associated with equal changes in the price level.^{14/} While it is clear that non-monetary factors appear also to have played a role in explaining inflation during the 1970s and 1980s in Tanzania, the importance of monetary factors in the post-1984 era is suggested. In turn, monetary forces are the direct outcome of (consolidated) fiscal performance, much of which utilizes the financial sector as a "soft" budget conduit for fiscal expenditures.

F. The Financial Sector: A Sector in Crisis

3.34 Nearly all of Tanzania's financial institutions are public sector institutions, and thus government's dominance of the financial system has until now been virtually complete.^{15/} As discussed above, credit, for the most part, has been directed on the basis of national priorities without regard to creditworthiness, and banks have become quasi-fiscal agents, channelling public expenditures through extra-budgetary conduits. In such a system, the assessment of financial risks against rewards has been largely lost, and this has affected the speed of economic recovery in recent years and continues to impair growth prospects.

3.35 The lack of separation between fiscal and financial activities, combined with the overall pricing distortions and economic decline in the early 1980s, and inadequate regulatory framework and managerial skills, have led to: (a) significant misallocation of credit, and a banking system clientele (consisting mainly of uncreditworthy large state-owned institutions) that is, for the most part, bankrupt and chronically in arrears; (b) the inability of the system to mobilize adequate domestic resources; (c) an ineffective monetary policy, which has resulted in largely unchecked money supply growth; (d) the loss of accountability; and (e) the lack of competition.

13/ It should be noted that a precise analysis between the money supply and prices cannot be done in Tanzania because of the absence of a series for GDP at market prices, the only price series being for urban consumer which is dominated by food.

14/ This begs the question as to the direction of causality. Potentially, either inflation or the budget deficit could be exogenous. Inflationary expectations could drive up the price level, which in turn might increase the budget deficit (if revenues are less fully indexed than expenditures). The rising deficit might sufficiently increase the money supply to accommodate the increase in money demand. Alternatively, the budget deficit might be exogenous with changes in the money supply generating a changed price level. In Tanzania despite quite rapid inflation there is no indexation in the labor market as wage revisions are infrequent. Hence, government expenditure is not heavily influenced by inertial inflation. It therefore seems more plausible to regard the budget deficit as determining inflation rather than the other way around.

15/ The only exceptions are the Diamond Jubilee Trust Company, which is privately owned and managed (it accounts for less than 1 percent of assets of the banking system), and the Tanganyika Development Finance Ltd, which is 40 percent owned by government and accounts for only a small percent of assets in the banking system.

3.36 These problems are now most visibly manifested in the condition of the banks, which are largely insolvent. The full extent of the losses is still in the process of being determined. At this stage the total cost of recapitalization of the main government banks could be Tsh 70 billion or more. Basic financial services provided by the banking system are also grossly inadequate, and new credit (other than directed credit mainly for financing operating deficits of state-owned enterprises) and venture capital are scarce, resulting in inadequate financing of working capital and asset formation for productive activities (see Chapters 4 and 5 on agriculture and industry, respectively).

3.37 Faced with this crisis in the financial sector, the government set up a Presidential Commission of Enquiry with a view to developing a blueprint for financial sector reform. The Commission undertook considerable diagnostic work, and its report was released in July 1990. The report clearly recognizes that Tanzania's financial system is facing a crisis. It attributes the failure of the system to carry out its role of financial intermediation to government intervention. It also recognizes that "government operations have had a major impact on money creation and inflation through: (a) government's excessive demands on the banking system to finance its budgetary deficits; (b) capital transfers by government to finance loss-making parastatals; and (c) government pressures on the banks to fund unviable parastatals, marketing boards and cooperatives."

3.38 Based on the recommendations of the Presidential Commission, the government of Tanzania has embarked on a wide-reaching reform of the financial sector. New banking legislation was passed in the April 1991 session of Parliament which will help establish the framework for a healthy and competitive banking system. Under the guidelines of this Banking and Financial Institutions Act, the banking sector is now open to private banks, both domestic and foreign. In addition, the legislation supports a policy environment that provides for a clear separation of fiscal from financial operations, with freedom for all financial institutions to henceforth act on the basis of commercial principles alone. If the reform of the financial sector proceeds as proposed in this legislation, it should contribute to accelerated economic growth through improved banking services, greater efficiency in resource allocation and increased effectiveness in domestic resource mobilization.

3.39 The key components of the next steps of the financial reform process include:

(a) **Control of money supply growth:** Money supply in Tanzania, as shown above, has been essentially driven by the credit demands of inefficient and unprofitable public sector institutions. Adhering to credit targets requires that banks and their main customers be restructured and run on a commercial basis. Equally important, it requires a strengthening of the BOT, enabling it to act as an independent authority controlling monetary targets and effectively supervising the banking system. This process is already underway. Monetary and credit control will be tightened through refinancing ceilings and through maintaining an appropriate policy for the discount window so that the BOT can be flexible enough to meet the temporary liquidity needs of the banks, but can also effectively discourage banks from using it as a regular source of funds as in the past.

(b) **Interest rate policy :** The government intends to follow a more market-oriented interest rate policy with the aim of ensuring sufficient flexibility to attract private banks to begin

operations in Tanzania, while encouraging the mobilization of domestic savings. In the first instance, the policy will focus on eliminating differentials based on ownership; unifying rates across institutions; reducing subsidies to government-determined preferential borrowers; and allowing banks to operate with positive real interest rates and reasonable financial spreads. Interest rate policy will be reviewed on a quarterly basis to assess its appropriateness, taking into account the progress in restructuring both the financial and real sectors, developments in inflation, and targets for domestic liquidity expansion. The objective is to move towards further interest rate liberalization once the fundamental changes in credit allocation processes have taken place and there is significant competition in banking services.

(c) Prudential regulations and banking supervision : The new banking law combines standardized banking legislation, as is in place in many African countries, with a modern approach to prudential bank supervision. The latter is intended to allow the BOT to supervise financial institutions in an up-to-date manner. Prudential regulations that clarify and implement key sections of the Law need to be enacted fairly quickly. Banking supervision needs to be strengthened by giving the BOT adequate information-gathering and enforcement powers and substantially increasing the quantity and the quality of the staff of the BOT supervision department. Work has already been initiated in this area. This would involve, inter alia, elevating the status of the supervision department within the BOT, developing procedures for on- and off-site supervision, and putting into place reporting procedures.

(d) Restructuring of financial institutions: All major financial institutions (NBC, CRDB, TDFL and TIB) are technically insolvent; their capital base is eroded; and they are carrying large non-performing portfolios. As a first step towards banking restructuring, the loan portfolios of these institutions need to be classified and evaluated. A portion of the non-performing assets will then have to be transferred out of the banks and replaced with government obligations. Additional public resources will be required for the recapitalization of those institutions that are retained in the public sector so that they can start operations again with a sound financial position. The budgetary implications of banking restructuring are very serious since a very tight fiscal stance will have to be maintained in the medium-term for reasons of macro stability. However, the budget will have to bear significant costs of restructuring and recapitalizing the public financial institutions. These costs need to be kept in mind when key policy decisions are being made on the future of these bankrupt institutions.

(e) Restructuring of major clients of the financial sector: This will be essential to ensure the sustainability of the financial sector reform and will largely involve restructuring many cooperative unions and the major industrial/commercial/marketing parastatals to stem the drain of their requirements on available credit. The expenditures available for restructuring would have to be consistent with fiscal and monetary stability objectives -- i.e., clear limits would prevail, suggesting the importance of seeking private sources of financing through joint ventures and privatization of enterprises, government decisions on liquidations and efforts to improve radically parastatal performance (see Chapter 5). Decisions to maintain some unviable public sector enterprises and cooperative unions would have to be made on a very selective basis. Financing would be provided only to those entities of critical importance to the economy and provided that financing is provided on a temporary basis and is linked to implementation of restructuring plans. Financing for these uncreditworthy enterprises would have to be borne by the budget.

(f) **Financial deepening:** This will be important for the medium to longer run, once the basis for a restructured banking system has been established and, importantly, the appropriate legislative, regulatory and prudential frameworks are established. These longer term developments could involve, inter alia, development of money, bond and equity markets.

G. Public Sector Management Reform

3.40 While financial sector reform is presently high on the agenda for policy and institutional reform in Tanzania, clearly Tanzania's developmental objectives of growth, macro stability and social progress cannot be realized without attention directed to other issues of public sector management reform as well. A productive economy – and one in which the social costs of a decade of economic decline can be alleviated – requires a supportive public sector environment which delivers required services effectively. From this perspective substantial improvement is needed in Tanzania.

3.41 The productivity of Tanzania's public sector deteriorated during the years of economic decline, and there is little evidence of improvement over the past few years of economic reform. As detailed in the Public Expenditure Review and above, the fundamental problem has been inefficient allocation of public sector resources. Productivity decline in the public sector has been associated, inter alia, with an inadequate structure of compensation. As a result, morale and discipline continue to suffer, and many civil servants have had to devote considerable resources to non-public sector activities such as private ventures, low priority seminar and other travel, rent-seeking, etc., rather than to the work of delivering government services. In addition, public sector managers have understood that outside income-earning activities are necessary just to survive and thus have not felt compelled to demand greater discipline within the civil service. Given this, absenteeism is high, and civil service productivity is low.

3.42 Manifestations of poor management, inefficient resource allocation and the strain on public sector resources are documented in this report, the Public Expenditure Review, other World Bank sector work and studies by others. The problems created can be seen in the neglected maintenance of the country's infrastructure, the low volume and quality of social services, low and still falling public investment, deficient operating funds throughout the government, poor resource mobilization efforts and the high level of parastatal recourse to the banking system and the budget.

**Table 3.11: Public Sector Reform Program
Elements of a Strategy**

-
- I. Medium-term financial framework / budget restructuring**
- develop planning/budgeting framework for rolling three to five year period
 - determine employment level government can afford over long run at appropriate (higher) pay levels
 - working from a top-down approach, restructure/reallocate sectoral expenditure shares along identified priorities -- i.e., increase budgetary allocations to social services and infrastructure
 - working from a bottom-up approach, undertake ministry-by-ministry reviews to determine appropriate roles for government vis-à-vis resource availabilities, which functions currently carried out could be dropped (e.g., the price commission), which could be privatized (e.g., messenger, cleaning services)
 - rationalize central, regional and local government responsibilities and strengthen local government capabilities
 - develop alternative delivery systems for public services (e.g., community schools, private sector provision of services, etc.)
 - raise level of public investment expenditure (initially rehabilitation, then new investment) -- particularly targeted at social services and infrastructure
 - integrate recurrent and development budget preparation processes
 - rationalize/reduce number of investment programs and projects
 - develop better recurrent and development expenditure information/monitoring system
- II. Civil Service Reform**
- establish and maintain reliable database and information system on civil service employment (including reliable count of employees)
 - establish effective control mechanisms over additions to payroll
 - strengthen job performance appraisal and management of civil service
 - improve systems to ensure that employees are paid on time (e.g., so that teachers can teach instead of seek their monthly salaries)
 - annually, over period of years, increase real pay of civil servants to appropriate levels (by factor of 3 to 5), possibly beginning by targeting increases at tax collection authorities, teachers, health workers; more fully monetize benefits over period of years retrench government employment (affecting all sectors): to reduce overstaffing and to effect cost savings; develop strategy and sequencing of efforts based on early retirement, voluntary departures, more compulsory schemes
 - establish compensation/retraining programs for retrenched
- III. Public enterprise reform - systemic issues**
- classify all public enterprises as viable, non-viable, or potentially viable
 - liquidate, close non-viable enterprises
 - eliminate budgetary subsidies, including subsidized lending and preferential access to foreign exchange under bilateral import support programs
 - adopt public enterprise reform policy dealing with, inter alia, strategy for restructuring (joint ventures/ privatization), relative roles of government and PEs, autonomy
 - implement monitoring system for PEs
- IV. Resource mobilization - tax/revenue reform**
- widen tax base through integrated tax policy and administration reform encompassing measures of indirect, direct and other taxation by central and local governments
 - rationalize/lower indirect and direct tax rates with objective of reducing/compressing/unifying rates for ease of administration and efficiency gains
 - move urban local governments to being self-financing through tax, cost recovery and other measures
 - establish other cost recovery/cost sharing measures affecting central and local government services
-

3.43 The World Bank's analysis in the PER and in this report has concluded that a fundamental restructuring of the Tanzania government's public sector management is required. In particular, it has been recommended that the government adopt a public expenditure strategy based on (i) continuation of the macro and sectoral policy reform effort; (ii) greater resource mobilization efforts -- widening the tax base to bring in all segments of the economy and greater

emphasis on cost recovery; (iii) restructuring of parastatals to reduce their burden on the public sector; (iv) strengthening of local government finances, management and manpower; (v) civil service reform through compensation reform and retrenchment and measures to build capacity in the public sector; (vi) measures to improve planning and management of public expenditure and aid coordination; and (vii) restructuring of the recurrent and development budgets to more appropriately reflect priorities. The analysis of these issues was contained in the PER, but not repeated to a great extent here. An outline of possible actions consistent with this strategy is reflected in Table 3.11.

H. Financial framework for public sector restructuring.

3.44 A central requirement of PSM reform in Tanzania is the development of a realistic medium-term financial framework which, operating under a hard budget constraint, would relate planned resource use with its availability -- thus showing the distinct limits to government resources, the need for greater resource mobilization efforts, the need to prioritize among expenditure possibilities and the linkages between actions by government and outcomes in terms of the budget. Indeed the government has begun preparation of such an accounting framework by revising and extending the budgetary projections model developed for the analysis of the PER.^{16/}

3.45 That framework has been used here for illustrative purposes -- to distinguish between three scenarios: (i) minimal restructuring, consistent with the pace of institutional reform to date; (ii) gradualistic restructuring over the 1990-95 period, and (iii) more accelerated and comprehensive restructuring, with most critical measures implemented early in the 1990-95 period (see Table 3.12 for the financial outcomes of these scenarios). Specifically, for each scenario the following key assumptions apply:

Scenario 1: minimal restructuring: (i) real salary increases by a factor of 1.25 and staff reduction of 10 percent; (ii) some level of public enterprises subsidization from the budget; (iii) recurrent and development expenditures as a share of GDP remain relatively constant, with only minor changes in their structure (only change being a slight increase in maintenance). Since both tax and civil service reform are very incremental, and real salaries improve only slightly under this scenario, tax collection efficiency declines, further eroding the domestic revenue base. Slow progress on policy and institutional reform front is reflected in slower commitments and disbursements of aid flows: balance of payments support from aid declines by 15 percent over the period, reducing the foreign financing of the deficit. Restructuring of the parastatal, cooperative and financial sectors is presumed to proceed at a very slow pace, resulting in: (i) retrenchment and restructuring of only a small share of inefficient parastatals by 1995, (ii) no clear separation between the budget and the financial sector, and (iii) no major transformation of the existing cooperative system.

^{16/} see the Public Expenditure Review, Volume III, Annex V for a full description of the model, its underlying assumptions and relationships.

Scenario 2: Gradual restructuring: moderate-to-major restructuring over the 1990-95 period: (i) real salary increases by a factor of 3 and civil service retrenchment of 30 percent; (ii) gradual budgetary restructuring: larger increase in maintenance expenditure than under scenario 1, some shift toward education, health and agriculture (research and extension); and development expenditure increased to 7 percent of (a larger) GDP; (iii) improved tax collection efficiency by 10 percent, due to salary restructuring, penalty enforcement and tax reform; (iv) level of BOP counterpart aid flows is maintained essentially constant in nominal US dollars terms; (v) partial, yet significant restructuring of the parastatal and cooperative sector, involving streamlining, liquidation or privatization of the majority of assets by 1995, while viable parastatals and cooperatives would operate on commercial principles. This would result in a decline in overall budgetary subsidies by 25 percent (in contractual and contingent liabilities) and greatly reduced net public expenditures through the financial sector.

Scenario 3: Major Restructuring. Over the 1990-94 period, major restructuring of the budget, the key parastatals, and the cooperative and financial sector: (i) real salaries increase by a factor of 5 (restoring them to the level of the mid-1970s), and civil service retrenchment of 30 percent (as in scenario 2); (ii) larger-scale budgetary restructuring by 1994, resulting in greater reallocation from towards social sectors and infrastructure and overall increase in development expenditures to 8 percent of GDP; (iii) tax collection efficiency gain by 25 percent due to salary increases and tax reform efforts; (iv) small increase in foreign aid counterpart financing in real terms; and (v) major restructuring of the parastatal, financial and cooperative sectors, resulting in contractual and contingent liabilities declining by over 50 percent and absence of public expenditures through the financial sector.

**Table 3.12: Budget Simulations
(as percent of GDP)**

	1989/90	by 1994/95		
		Scenario 1	Scenario 2	Scenario 3
Total Revenue	20.5	18.3	23.5	27.3
Recurrent Expenditure	21.2	24.3	24.6	25.8
Development Expenditure	3.5	6.0	7.0	8.0
Total Expenditure	25.8	30.3	31.6	33.8
Budget Deficit	-5.3	-12.0	-8.1	-6.5
Net Financing	5.3	12.0	8.1	6.5
Net Foreign Financing	4.3	4.0	7.0	9.0
Net Domestic Financing	1.0	8.0	0.9	2.5
Net Public Expenditures through Financial Sector	4.0 1/	4.5	1.0	0.0
Memo:				
Inflation Rate	26.0	35.5	15.0	10.0

1/ Estimate based on 1988 figures and average 1985-88 arrears.

3.46 The accounting framework illustrates that the first scenario is essentially unsustainable. The lack of civil service reform and budgetary restructuring result in the continuing decline in the public sector productivity. Efficiency of domestic revenue collections and actual collections decline, and the budget deficit, narrowing defined, rises to 12.0 percent of GDP, of which aid counterpart funds would only cover one-third -- or less, if donor aid retrenchment would be greater than assumed. Domestic borrowing would cover the other two-thirds of the deficit, crowding out private sector credit. Since little or no budgetary restructuring takes place, the government cannot emphasize infrastructure maintenance or social services; education and health shares of the budget decline (see Table 3.13 on sectoral restructuring below).

3.47 In contrast, the second scenario could be consistent with relative, though fragile, financial stability; however, external shocks or small policy or institutional reform deviations could render the scenario unsustainable. The outcome suggests that civil service reform improves somewhat the incentives for effective delivery of public services. Revenue collection efficiency increases, and development expenditures can increase slightly as well. Budgetary restructuring takes place to a significant degree so that shares for education, health and works can increase. But public enterprises still claim some budgetary resources, slowing down the budgetary restructuring to social services and infrastructure and the deficit decline, which would still be about 8 percent of GDP, to be largely financed by aid.

3.48 The outcome of the third scenario suggests that it would be both more stable and sustainable. Tax and civil service reform provide greater revenue collection effectiveness, and budgetary restructuring allow much greater emphasis on social sectors and infrastructure. Parastatals claim an even smaller share of budgetary and extra-budgetary public resources as alternative sources of investment resources are sought (e.g., foreign investment), though restructuring requirements would impinge on the budget and would be spread out over time. Support from the international community for the major restructuring program results in some increased aid in real terms from the high current levels, more than covering the fiscal deficit, permitting repayments by government to the banking system and increasing access of financing to the private sector.

Table 3.13: Restructuring of the Budget
(recurrent budget as a percent of total supply)

	1989/90	1994/95		
		Scenario 1	Scenario 2	Scenario 3
Finance	22.0	21.1	13.3	7.7
Local Government	13.8	14.7	20.7	23.5
o/w: Education	9.4	9.8	13.8	15.8
Health	3.2	3.4	5.1	5.8
Defense	9.7	10.3	8.7	8.9
Home Affairs	10.0	10.3	10.1	10.8
Education	9.2	8.3	9.7	10.8
Health	4.8	3.4	5.6	7.6
Foreign Affairs	3.1	3.4	1.5	1.2
Communications & Works	3.4	6.9	8.3	8.0
Agriculture	3.3	3.4	5.5	6.2
National Service	2.3	2.5	2.3	2.3
Prime Minister	0.7	1.5	1.8	1.9
Other	11.3	9.3	8.3	8.1
Regions	6.4	5.4	4.2	3.0
o/w: Health	2.3	2.0	1.8	1.2
Total Supply and Regions	100.0	100.0	100.0	100.0
Priority Sectors (incl allocations from central, regional and local government)				
Education	18.8	18.1	23.5	26.6
Health	10.3	8.8	12.5	14.6

3.49 The benefit of the modelling framework and the scenarios above is not so much for precision as a predictive exercise,^{17/} but rather to illustrate some of the key inter-linkages and tradeoffs which government officials will have to consider as decisions are made with respect to

17/ The model contains exogenous assumptions regarding, for example, the link between tax and civil service reform and the widening of revenue collections. As the government revises and extends the medium-term financial framework more specificity and precision may also come about.

public sector management reform. Thus using the framework makes more obvious the budgetary implications of: (i) reforming civil service pay – it becomes more feasible as parastatal subsidies are eliminated, grants to urban local governments (which have a tax base and could become self-financing) are reduced, and the tax base and cost recovery widen; (ii) widening the tax base – it requires both civil service (raising salaries and incentives) and tax policy and administration reform; and (iii) raising budgetary shares for priority sectors – this will occur as a natural result of pay reform (since, for example, the social sectors employ more employees than other sectors) - - thus real reallocation of budgetary shares can only take place as the result of conscious decisions on the part of budgetary authorities to shift expenditures from other sectors (e.g., reduce parastatal subsidies, shifts from other sectors). Overall, the framework illustrates the continuing necessity of foreign financing, hence donor assistance, for the government budget and suggests the pace of reform needed to ensure that resources continue. Table 3.14 depicts further the key indicators and outcomes of the budgetary scenarios.

Table 3.14
Key indicators and outputs of the budgetary simulations

Indicator	Scenario 1	Scenario 2	Scenario 3
I. Expenditure			
Civil Service Reform			
Retrenchment	none	30 percent	30 percent
Pay increases	none	by factor of 3	by factor of 5
Benefits monetized	no	some	yes
Budget restructuring	none	slower - allowing some reallocation to priority sectors	faster - allowing greater budgetary reallocation to priority sectors
Parastatal Restructuring	subsidies continued	Moderate pace of reform	reform
Financial Sector Restructuring			
Financial Sector Restructuring	Protracted: continued fiscal expenditure through the financial sector	Gradual/moderate pace	Faster pace of reform: restructuring completed by 1993/94, incl. competition from private Banking
Development expenditure	some growth	some real growth	faster real growth
II. Revenue			
Tariff, sales tax and income tax reform	small	gradual	faster
Domestic revenue collections	declines in real terms	gradual efficiency gain	faster efficiency gain
III. Financing			
Aid levels	real declines	aid flows maintained at essentially present levels	some real increases
Domestic financing	continued requirement for domestic bank financing and crowding out of private sector	alight requirement for domestic financing	net transfer to banking system - allowing greater credit to private sector
IV. Sustainability			
Sustainability	No	more fragile	more sustainable

I. Conclusions

3.50 This chapter focussed on the financial performance of the public sector during the 1980s. A contrasting picture of Tanzania's economic performance has emerged from the analysis. While an assessment of the performance of the real economy (at the aggregate, sectoral and micro-level) suggests that a sharp break and turnaround had taken place from the mid-1980s onward, the financial performance of the public sector does not appear to have experienced any major improvement during the decade -- if anything, the fundamental shift of public sector expenditures to the financial sector has been deleterious to the banking sector and to the economy as a whole, and the government expenditure program, more narrowly defined, continues to need restructuring.

3.51 In the short-to-medium term, weak financial and public expenditure performance will cause continued macroeconomic instability which would tend to impair the sustainability of the recovery and the prospects for future growth. This chapter has briefly outlined the broad direction of the financial sector and public sector management reforms that are required to achieve macro stability and a more appropriate balance of expenditures. As such it should provide a starting point for the government and for donors in the development of support for these policy reform and institution-building programs.

3.52 Over the longer term, the structural and institutional weaknesses of agricultural marketing and industrial sector parastatals must also be addressed. The following two chapters lay out an agenda for actions required in those areas. Also, a successful reversal of the deteriorating trends in social sector achievements of the past decade or more requires restructuring of public sector expenditures -- in addition to the continued improvement in the enabling environment for private sector activities. Some actions shall cause some short-term negative impact (e.g., civil service and parastatal labor force retrenchment), though these should be ameliorated through complementary measures which can be developed; the existence of short-term costs are not reasons to avoid carrying out the actions. From this standpoint as well, public sector restructuring is important so that targeted interventions can be sustainable and effective -- i.e., donor-financed project interventions cannot effectively deliver improved social sector services to the Tanzanian population without such fundamental shifts (for instance, without regard to public sector compensation). The key will be to bias further interventions in ways to benefit social progress through education, health services, poverty alleviation, and issues of special concern regarding women in development.^{18/} Some of these issues are addressed in Chapter 6 which is devoted to social welfare issues.

18/

see World Bank report "Tanzania - Women and Development", October 30, 1990 (report 9108-TA).

CHAPTER 4

The Agricultural Sector: Performance and Linkages

A. Introduction

4.1 In the first decade following independence agricultural production in Tanzania expanded rapidly, aided by well-functioning extension services, input delivery and marketing systems and favorable world market prices and weather. However, in the late 1970s and early 1980s, the policy environment deteriorated. The exchange rate became increasingly overvalued, and government exerted even greater control over agricultural prices and markets and nationalized most estates and agro-processing firms. It also introduced villagization, which disrupted traditional production patterns.^{1/} Agricultural services (extension and research) and physical infrastructure (roads, railways and ports) deteriorated as government found it increasingly difficult to maintain service levels in face of declines in public sector salaries and productivity. Consequently, agricultural growth only averaged 1 percent per annum between 1978 and 1985. Export crop production was particularly hard hit, falling on average by 8 percent each year between 1976 and 1985, more than halving agricultural export revenues from a peak of US\$426 million in 1977 to US\$184 million in 1985. Since then revenues have averaged about US\$225 million per annum. Meanwhile, domestic food crop production over the period to 1985 barely kept pace with population growth, requiring increased reliance on imported grains.^{2/}

4.2 Policy measures implemented since 1984 as part of the government's economic recovery efforts have helped stimulate recovery in agricultural production, particularly for food crops. This has virtually eliminated the need for grain imports and even allowed limited exports of maize. This chapter outlines the changes in the policy environment affecting agriculture and analyzes the impact and key inter-linkages of these policy changes on the peasant farmer. A key objective of the recovery program has been to stimulate agricultural output by increasing producer incentives through improved agricultural terms of trade. The chapter analyzes changes in the terms of trade and the incentive structure facing farmers. It argues that changes in the terms of trade did little to improve producer prices, due largely to continuing inefficiencies in the marketing of agricultural goods. The failure to improve the incentive structure farmers face blunted the increase in farmers income, though as the chapter indicates, the easing of long-standing shortages of consumer goods did provide a powerful, albeit one-time, increment in output.

4.3 In addition, the chapter examines several of the major smallholder production systems to help identify the policy, institutional and infrastructural constraints affecting different

1/ Villagization was meant to move the rural population into centrally located villages where essential services (health, education and water) could be more easily provided. However, farmers were often moved long distances from their customary plots and required to cultivate "village plots" on a continuous basis, contributing to declining yields.

2/ Tanzania's food self-sufficiency ratio, defined as total production of food grains divided by total consumption of grain, declined from 97 percent in 1978 to 90 percent in 1985 and net cereal imports reached 402,000 metric tons in 1985 compared to 76,000 metric tons in 1978.

farming groups. It argues that efforts to introduce improved technologies have often stumbled because of failures to consider differences in resource endowments or yield potential. The analysis also shows that the work on improving producer incentives, which has begun under the ERP, is far from over. Beyond improved incentives, other constraints arising from poor policies, inefficient institutions and deteriorating infrastructure must be addressed if agricultural growth is to be sustained. The chapter concludes with a discussion of the agenda of key issues that must be addressed to ensure continued gains in agricultural productivity the 1990s and beyond.

B. Agricultural Policy Reforms under the Economic Recovery Program

4.4 Policy measures initiated during ERP have resulted in a gradual improvement in the environment facing the Tanzanian agricultural producer. At the macro-economic level, exchange rate adjustments since 1984/85 have reversed the real appreciation of the shilling that began in the late 1970s. As a consequence, production incentives have improved for agricultural export, particularly non-traditional crops. The implementation of the own-funds imports scheme in 1984 coupled with the subsequent relaxation of official imports and the gradual elimination of price controls on most goods further contributed to the improving economic environment facing the farmer. The policy of confining wholesale trade of certain imports and domestic items to government parastatals was also dismantled. These measures to liberalize trade helped to fill long-empty retail shops in rural areas with a wide-range of consumer goods. The return of these goods has provided a powerful incentive to peasants to expand agricultural production.

4.5 Policy reform in agricultural marketing has also occurred. Beginning two years before the ERP was launched, a series of reforms were introduced, first for grain marketing and later for export crops. These reforms initiated a gradual transition from a government-controlled, single channel system consisting of primary cooperative societies at the farm level, cooperative unions at the regional level and crop-specific marketing boards at the apex to a multi-channel marketing system consisting of both government and private marketing agents. The reforms were intended to improve the operations of the marketing system which since independence had become increasingly inefficient resulting in low prices and delayed payment to producers, untimely delivery of inputs and poor quality exports due to processing and shipping bottlenecks.

4.6 The first grain marketing reforms were undertaken in 1984 when restrictions were removed on the movement of grain across regional boundaries by individuals in lots of less than 500kg. By March 1987 all weight restrictions on inter-regional movement of grain had been eliminated, and private traders effectively began to compete with the National Milling Corporation (NMC), the government's marketing parastatal for grains. Starting in the 1988/89 marketing season, regional cooperative unions and primary societies were allowed to sell directly to private traders though market outlets for farmers were still confined to the primary societies. In the following marketing season farmers were allowed to sell directly to traders, effectively removing the last obstacle to a fully liberalized grain trade. Further, due to NMC's large debt arrears to the banking system, its access to crop financing was cut-off, effectively eliminating it from the market ^{2/}.

2/

NMC's accumulated debt in early 1991 stood at Tsh 24 billion.

4.7 With the liberalization of the grain trade, official pricing policy was also revamped. Previously, under the single channel monopoly, prices were established by government for each stage of the marketing chain (i.e., for sales by farmers to the primary societies, by the primary societies to the unions, by the unions to NMC and by NMC to the consumer). When limited competition was officially allowed in 1987, the official prices became minimum prices to be paid to producers by the cooperative societies. Prices at the other stages of the marketing chain could be freely negotiated and the official consumer price was eliminated. In the 1990/91 marketing season the official minimum producer price was replaced by a system of indicative prices that serve as a guide to farmers in negotiating sales. Actual prices paid to farmers now depend on market conditions prevailing at the time of the sale. Direct government intervention is limited to the operations of the Strategic Grain Reserve, a 150,000 ton government maize reserve used for emergency food distribution and buffer stock operations.

4.8 The response of the private sector to the dismantling of the grain trade restrictions has been encouraging. The share of grain sales handled by the open market in Dar es Salaam is estimated to have increased from six percent in 1980 to over 52 percent in 1987/88^{4/}. In volume terms, open market sales grew seven-fold between 1980/81 and 1987/88. Since then NMC's growing financial difficulties have reduced its sales from a high of 229,000 tons in 1987/88 to 114,000 tons in 1989/90 and virtually nothing in 1990/91 with a corresponding increase in the share of open market sales. The growth in open market sales has been accompanied by an increasing number of market participants in grain assembly, wholesaling and retailing. In Dar es Salaam wholesale markets, a new class of indigenous traders has emerged that provides short-term financing for crop purchasing, and who, in addition to trading on their own account, act as brokers and provide buying and selling services to others for a fee. The number of these traders grew from 15 in the early 1980s to nearly 100 by the end of the decade. Similarly the number of traders active in rural markets has proliferated. Traders are active even in the more remote regions, questioning the notion that private trade would not operate due to the distance and costs involved^{5/}. Of course, some problems have accompanied the reforms in grain trade. For instance the rapid withdrawal of NMC from the market has caused difficulties in marketing for the state farms, which had previously relied solely on NMC as a marketing outlet.

4.9 For export crops, in contrast to grain crops, the single-channel monopoly initially remained untouched. In terms of prices paid to farmers, processing and transport delays, and financial management, the system for export crops performed as badly as the earlier monopoly for grain. The operation of the system discouraged cost effective marketing and heavily taxed the producers of traditional export crops in the form of low producer prices relative to export prices. This taxation, which at times was as high as 60 percent, was absorbed by inefficient transport and processing as well as by the marketing boards and cooperatives in the form of higher margins. Despite the higher margins the boards and cooperatives have consistently lost money and failed to repay outstanding bank overdrafts. Service to the farmers has also been poor. Farmers often must make repeat visits to primary society buying centers to sell their crops,

4/ Henry Gordon: An Overview of Basic Data on Grain Marketing in Tanzania, 1974/75 to the Present, unpublished paper for the World Bank, November 1989.

5/ Evidence from Gordon's research suggests that much of the openly traded grain comes from private traders buying in Ruvuma.

and payments are frequently delayed. ^{6/} Timely delivery of inputs of the right kind is rare, and distribution of inputs on credit results in a high level of default as credit recovery mechanisms function poorly.

4.10 In response to the continued inefficiency of the system and in order to deepen the reform measures begun in the marketing of domestic food crops, the government is implementing several reforms in export marketing during the 1990/91 marketing season. The basic thrust of the reforms is to move away from single channel marketing to a multi-channel system that offers alternative outlets to the producer and reduces the role of government. The reforms are intended to improve efficiency, lower marketing costs and improve production incentives for producers of the major traditional export crops (cotton, coffee and cashewnut). They are also aimed at easing the macroeconomic burden imposed by the current system, particularly with respect to credit expansion, inflation and export performance.

4.11 Beginning in July 1990, the government marketing boards for cotton, cashew nuts, and coffee stopped buying and selling of these crops. Instead they began to provide basic marketing services such as administering export auctions or tender procedures, providing market intelligence, and acting as marketing agents on a fee basis. The marketing boards currently are being restructured in keeping with their reduced functions. Restructuring of the coffee marketing board is nearly complete. Fourteen out of 16 regional buying centers have been closed, all departments reorganized and new terms of reference drawn-up for all remaining staff. Overall staffing levels have been reduced from 949 to 119.

4.12 The monopoly of the cooperatives on the purchase of export crops from farmers has also been broken. Primary societies, other farmers associations, private estates and, for cashewnuts, licensed private traders are now being allowed to sell their commodities directly through the auction or tender systems, thereby receiving the prevailing international market price. For coffee, this system allows individual estates and primary societies to market coffee under their own label and profit directly from any quality premia that their coffee might earn. Cotton marketing is to be liberalized for the marketing season beginning in July 1991. Private individuals will be allowed to establish and operate cotton ginneries either solely or in joint partnership with the cooperatives. The private ginneries will be able to buy seed cotton directly from farmers or primary societies, gin it and sell it through tender system.

4.13 Input distribution has also been liberalized. Trade in agrochemicals has been fully deconfined since 1987 and a number of parastatals, farmers associations and private chemical firms are competing with cooperatives in supply and distribution. Agrochemicals can be imported under the OGL by private firms but access to the banking system for financing of cash cover is difficult to secure because of the banking crisis. Fertilizer is imported by the Tanzania Fertilizer Company and distributed through a growing system of private stockists that in the 1990/91 season are estimated to have handled nearly half of total supplies. Fertilizer can be imported by private firms under the OGL but so far there is no mechanism for paying the subsidies to the potential suppliers, which has precluded private importation.

^{6/}

In some instances cotton farmers have been forced to wait up to two years for payment.

C. The Impact of ERP on Production and Agricultural Terms of Trade

4.14 This section reviews agricultural performance during the ERP and seeks to explain the peasant farmer's supply response to the policy reforms. Since the beginning of the ERP, there has been an acceleration of agricultural growth, with overall growth rates of 3.5 percent in 1986, 4.4 percent in 1987 and approximately 5 percent in each year through 1990. The volume of peasant crop sales also increased substantially, reversing the trend of the pre-ERP period. Between 1977 and 1985, the volume of official sales of export crops declined by about 5 percent per annum whereas between 1983/84 and 1987/88 it expanded annually by 4 percent before falling back in 1988/89 and 1989/90 by 3.7 percent and 7.7 percent, respectively, due largely to continuing bottlenecks in cotton marketing. The recent growth in the volume of food sales has been far more dramatic, particularly through non-official channels. Overall, food sales increased by about 100 percent between 1983/84 and 1987/88 (Table 4.1). Production growth continued as well through 1989/90 with maize production in that year standing 4.5 percent above the 1987/88 level.

**Table 4.1: Indices of Crop Sales and Corresponding Prices
1982/83 - 1987/88**

	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88
Maize Sales	100	87	103	149	173	180
Maize Prices (Real) 1/	100	150	122	86	76	84
Rice Sales	100	92	120	195	118	191
Rice Prices (Real)	100	143	304	148	111	98
Export Crop Sales 2/	100	101	102	90	119	121
Export Producer Prices (Real)	100	101	95	107	106	111
All crops sales	100	94	105	125	139	151
All crops prices	100	125	114	100	93	101

Notes: (1) Price indices based on weighted average of open market and official prices.

(2) All traditional exports produced by small-scale farmers (coffee, cotton, cashew, tea, tobacco, pyrethrum, cardamon).

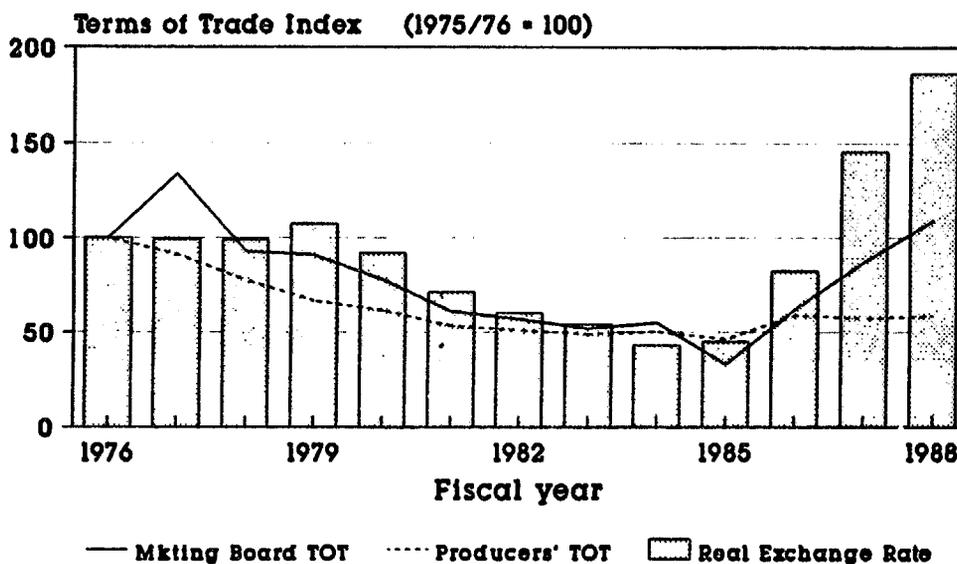
Sources: Henry Gordon, 1989, op.cit., data from Marketing Development Bureau, and Bank of Tanzania.

4.15 Agricultural Terms of Trade. It was anticipated that the exchange rate devaluations under the ERP would stimulate increased production of export crops through the more favorable terms of trade (TOT) for the agricultural sector. In looking at what actually happened to the terms of trade since 1985, a distinction must be drawn between crops marketed through official and private channels and between the terms of trade (TOT) accruing to the official marketing agencies and the TOT facing producers.

4.16 Terms of Trade for Export Crops. The appreciating real exchange rate between 1976 and 1984 resulted in a decline of the TOT for both marketing boards and producers of about

50 percent causing a deterioration in the incentive structure facing export producers (Graph 4.1)^{2/}. With the real devaluation beginning in 1985, the TOT received by the marketing boards underwent a dramatic reversal, increasing by more than 110 percent between 1984 and 1988. But the changes in the incentives structure facing farmers followed a quite different path after 1984. As Graph 4.1 shows, the producer TOT, which had followed closely the marketing board TOT and the real exchange rate prior to 1985, jumped 28 percent in that year but failed to improve any further in subsequent years. Thus, while the decade-long decline in incentives facing producers had been halted, the farmers' gains were negligible compared to those accruing to the sector in general. The marketing boards and cooperative unions, who saw their marketing margins more than double between 1983 and 1987, absorbed nearly all the benefits of the improved terms of trade. The farmers' share of final export value dropped substantially since the ERP began because government producer prices were not fully adjusted to reflect exchange rate movements. The producers' share of the export price fell from over 80 percent in 1986 to 35 percent during 1989 before moving back to 50 percent in 1990 (Graph 4.2).

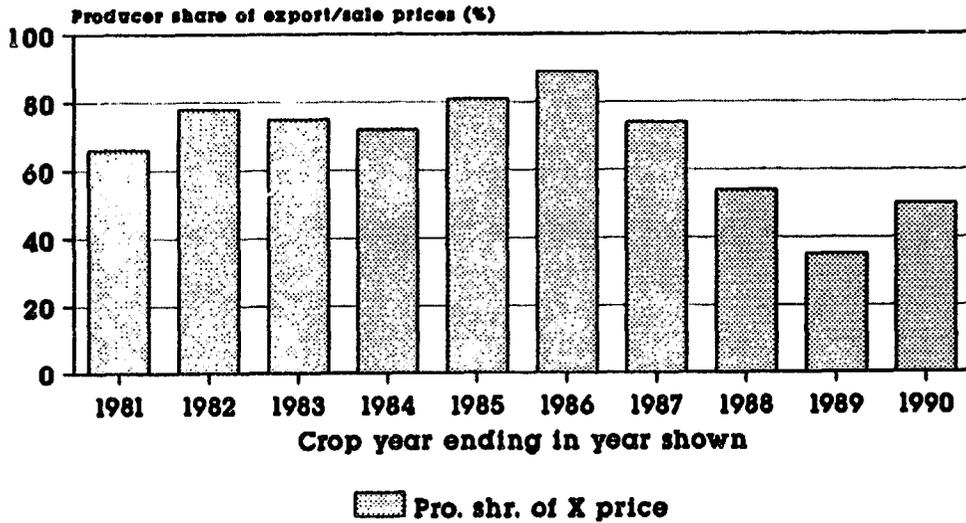
Graph 4.1
Export Crop Terms of Trade
for Marketing Boards and Producers



Fiscal year data ending in year shown

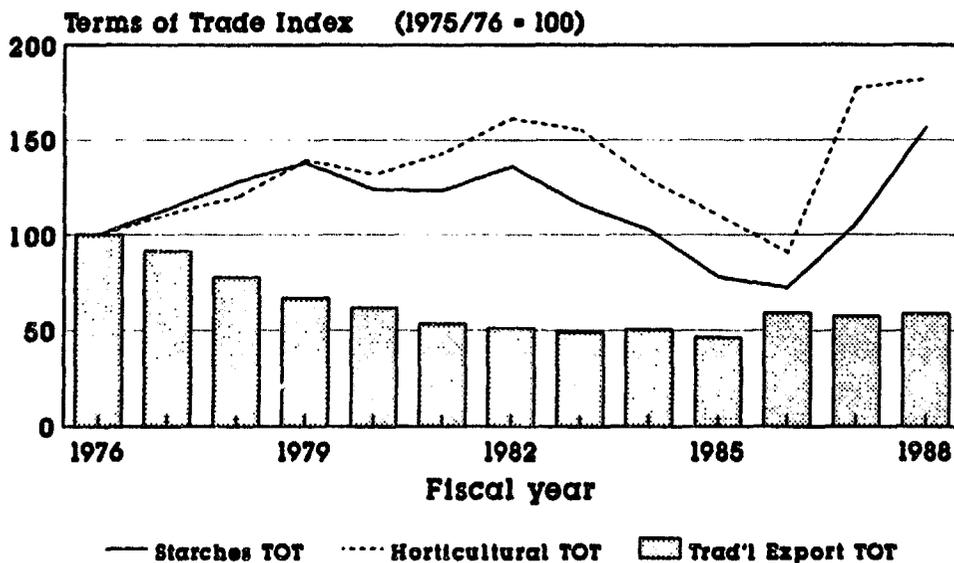
^{2/} The agricultural price index used to calculate the marketing board TOT for export crops is the index of world market prices. The resulting ratio provides a measure of the changes in terms of trade for export crops that are realized by the marketing boards. The appropriate index to measure changes in producer TOT is the index of producer prices received from the monopoly marketing boards and cooperative unions.

Graph 4.2
**Major Export Crops
 Producers' Share of Export Prices**



Wghtd avg of coffee, cotton, cashew
 using official exchange rate
 Source: MDB & Government statistics

Graph 4.3
**Non-Traditional Crops
 Producers' Terms of Trade**



Fiscal year data ending in year shown

4.17 Terms of Trade for Openly Traded Crops. The changes in the incentive structure facing producers of openly traded crops shows a much different pattern than for traditional export crops. Horticultural crops and starches are marketed totally independently of official marketing channels. During the early 1980s, prior to the ERP, the terms of trade for these crops deteriorated as the appreciation of the shilling increased the implicit rate of taxation across the entire agricultural sector (Graph 4.3). The decline in the terms of trade for starches and horticultural crops between 1976 and 1985 was 28 and 9 percent, respectively. But, in contrast to the producer TOT for traditional export crops, the producer TOT for both starches and horticultural products responded positively to the real appreciation of the exchange rate during of the ERP. The producer TOT for both crops doubled between 1986 and 1988, dramatically improving the incentive structure facing producers of these crops .

4.18 The comparison of the trends in TOT between officially marketed and openly traded crops yields two important conclusions. First, for all crops, the overvaluation of the shilling prior to 1986 had a significant negative impact on agricultural terms of trade. This decline served as a heavy implicit tax and helps explain the poor agricultural growth performance in the late 1970s and early 1980s. Second, while the reforms under ERP reversed the decline in terms of trade, the incentives facing producers of traditional export crops did not improve significantly because most of the gains were appropriated by the official marketing agencies.

4.19 Producer Response During the Recovery. Since the incentive structure for producers of export crops did not improve appreciably during the ERP, what stimulated the expansion in production recorded since between 1984/85 and 1987/88? Relatively good weather during the 1985 - 89 period certainly helps to explain the recovery. But the coincidence of good weather with the start of the economic recovery is not the only factor affecting production, just as bad weather cannot explain the ten years of decline preceding the recovery.

4.20 To find the cause of the post-reform recovery, it is necessary to understand the pre-reform decline in production. In the pre-reform period, the relationship between agricultural prices and crop supply was fundamentally altered by the extreme shortage of consumer goods in rural areas. When consumer goods are adequate, the sales of crops is based on the expectation that the resulting income can be spent on desired purchases. However, in rural Tanzania in the late 1970s and early 1980s households were repeatedly unable to make desired purchases due to the shortages of consumer goods. With relatively little to buy, the need for cash income diminished and households sold fewer crops. Hence, as the shortage of goods became increasingly acute in the early 1980s, crop sales were determined more by the availability of goods than by a conventional price relationship. In face of the shortages, the normal relationship between crop prices and supply appears to have been reversed. Whereas under normal market-clearing conditions, raising crop prices (relative to goods prices) will increase crop supplies, in the condition of shortages the opposite occurred. Faced with a limit in the amounts of cash income that could be spent on rationed goods, higher crop prices would tend to be offset by lower sales. Consistent with this explanation of farmer supply response, the supply of export crops per capita fell by 30 percent between 1977 and 1984. Moreover, econometric tests during the period 1978-84 in 17 regions found that the volume of crop sales were positively and significantly related to the supply of consumer goods in rural areas. ^{8/}

8/

see Bevan, et al, 1989.

4.21 The positive relationship between the availability of goods and marketed agricultural output was maintained into the ERP years. As the shortages eased, and goods began trickling back into the rural economy in response to the own-funded imports scheme and elimination of price controls, peasants increased production to gain access to cash for long-delayed purchases. They increased sales to finance current expenditures despite the fact that the real price for their crops fell on average by twenty percent over the period. Further, rural price inflation coupled with the desire for increased cash holdings, appears to have provided added impetus for crop sales.^{9/} As Table 4.1 shows, the strongest response in crop sales was in food crops, suggesting that steps to liberalize the grain trade provided better marketing opportunities to farmers than the traditional export crops remaining under government control.

4.22 The preceding analysis suggests that the pricing structure facing farmers did not improve significantly during the reform period. Nonetheless, there was a supply response to increased availability of consumer goods as farmers began increasing output and sales to get cash to meet long pent-up demand for these goods. But the nature of such a response is essentially short-run. As markets return to equilibrium, as indeed they have in rural Tanzania, more conventional price relationships will prevail. This return to equilibrium makes the removal of remaining constraints on agricultural pricing and marketing particularly important. Pricing signals and incentives need to be effectively translated into improved producer terms of trade for output responses to occur in a setting where scarcity of consumer goods no longer prevails.

D. Basic Farming Patterns

4.23 Smallholder farmers in Tanzania employ a wide variety of production systems and differ dramatically in the crops they grow, production constraints they face, their access to resources and the type of farming practices they use. This section provides a few examples of the many farming systems found in Tanzania to demonstrate the diversity and complexity of smallholder agriculture. A good understanding of this diversity in farming systems and the types of constraints farmers face is important in the design of improved farming practices and the development of agricultural and livestock support services. Yet little detailed information exists on the different production systems making it difficult to adapt technological innovations and government services to the particular needs of different farming communities.

4.24 Tanzania can be divided into five basic agro-climatic zones.^{10/} Of the five zones, two including the arid and semi-arid lands encompassing some 35 percent of Tanzania's land area are for the most part unsuitable for increased agriculture production due to unreliable rainfall. The remaining zones range from the coastal regions to the highlands in the north and

9/ The level of desired cash balances went through three distinct phases. In the pre-reform period of shortages, farmers maintained large cash balances in the off chance that a supply of goods might actually reach their village. When the shortage of consumer goods began to ease, in the early phase of the recovery, farmers had less need for cash balances, and they spent their reserves, resulting in a decline of cash savings by about 15 percent per annum between 1983-85. But by 1986 inflation had picked-up in rural areas, and peasant cash holdings as a percent of income began increasing again (see Volume II, paper by Collier and Gunning).

10/ As many as 9 zones with 21 different sub zones have been identified but the three zones presented here fairly describe various farming systems, cropping patterns and resource endowments found in Tanzania.

south of the country. The discussion below describes the typical farming systems in these three zones.

4.25 Coastal Zone. The coastal zone encompasses much of Tanga, Coast, Dar, Lindi, and Mtwara regions. The zone has a medium density of population and receives rainfall in the range of 500 - 1,000 mm per annum. Smallholder production predominates with the exception of sisal estates located mostly in Tanga. Major smallholder crops include rice, maize, legumes, cassava, cashewnuts, coconut, oilseeds, tropical fruits and sugar. The cashew production system is one of several production systems common in the southern part of the coastal zone. It serves well to illustrate the impact on smallholders of the long-term decline in Tanzania's agricultural sector. Cashewnut farmers typically have holdings ranging from 1.5 to 3.0 hectares and use simple farm tools and virtually no improved inputs. Cultivation requirements for established cashew groves involve simple brush clearing with most labor expended on collection, drying and sorting nuts.

4.26 Cashewnut has traditionally been the major cash crop of the Mtwara area but production has steadily declined over the years. Recent export levels have been around 16,000 tons or only about 10 to 20 percent of peak levels achieved in the 1970s. The decline in cashew production can be traced to the process of villagization which moved farmers a long distance from their trees. The distances involved, coupled with low prices and poor marketing services by the marketing board and cooperatives, led farmers to neglect their trees, cut back on new plantings, and abandon efforts to collect and market nuts. In addition, a virulent powdery mildew has contributed to declining production. Sales of cassava, sorghum, groundnuts and oilseeds, traditionally grown for home consumption, have replaced cashew as the major source of cash income.

4.27 A number of steps are now being taken to revive the cashew industry. The application of sulphur powder to reduce the impact of powdery mildew has been recently introduced. The use of sulphur powder is part of a comprehensive program to rehabilitate cashew production through an aggressive research program to develop improved methods of disease control including disease resistant planting materials. As noted above, marketing reforms are also being introduced to increase the price to producers and provide them with alternative marketing channels. The prices paid through official marketing channels have been increased substantially, and private traders are now permitted to participate in both input distribution and the purchase of nuts.

4.28 The initial reaction to the program activities now being implemented is encouraging – with marketed volumes increasing in 1990/91 marketing season by about 50 percent to nearly 24,000 tons, finally reversing the long slide in export sales. The success of the marketing and research initiatives are crucial to the future revival of cashew production. Without improved disease control, adequate input delivery systems and market outlets, cashew production could collapse completely and the cashewnut farmer would revert to near subsistence cultivation, relying on periodic sales of food crops for cash to meet essential expenditures. But Mtwara's isolation from major trade routes limits the market outlets for staple foods. Compounding the farmers problems is erratic rainfall that in some years contributes to localized food shortages. Evidence from nutritional studies in Mtwara suggests that it has among the lowest levels of per capita food availability and highest levels of malnutrition in all of Tanzania.

4.29 **The Plateaux.** The plateaux areas cover much of western and southern Tanzania encompassing parts of Tabora, Rukwa, Mbeya, Shinyanga, Mwanza and Mara regions. These areas, which cover about 35 percent of Tanzania's land area, are not densely populated and generally have good soils. Rainfall ranges from 900 to 1300 mm per annum, and overall there is good scope for increased crop production. Most production is by smallholders cultivating mainly rain-fed cotton, rice, maize, cassava, pulses, tobacco, and groundnuts.

4.30 One of the common production system in the plateaux area is the small scale cotton system. The typical cotton farmer grows cotton and rice for cash and maize, sorghum, millet, cassava and legumes for food. Farm sizes vary across the cotton growing areas of Tanzania. In the more densely populated areas around Mwanza, farms are small -- often between 1.5 to 2.0 hectares. Due to limits on farm size, standards of soil preparation, planting, and weeding are high. The major constraint affecting yields is soil fertility as fields are under constant cultivation with no fallow. In the less populated lower plains, where clay soils predominate, larger farms are common and cultivation is more extensive. Farm size is determined by the number of oxen available for plowing and the length of the planting season.^{11/} Seed is broadcast and plowed into the soil making plant population erratic. Weeding is also limited due to the larger farm sizes. In both areas land preparation is largely done by ox plow, but oxen are rarely used in other farming activities. Most labor is supplied by women and the rest of the family and is supplemented by reciprocal work groups and casual labor. Use of improved inputs is limited. The cotton growing areas account for less than 10 percent of Tanzania's total fertilizer consumption due largely to the poor yield response to fertilizer applications.^{12/} Limited quantities of pesticides are used depending on availability and prices.^{13/}

4.31 Cropping patterns are determined by a strategy that seeks to meet basic food requirements coupled with the production of rice and cotton for the market. Area devoted to the mix of food crops for own consumption remains pretty constant over time. But the amount of area devoted to rice and cotton is determined on the basis of weather, pricing and marketing factors. The impact of these factors can be seen in the cotton production figures for the past few years. In 1986 producer prices for cotton were increased substantially. At the same time, the marketing of domestic food crops, including rice, was substantially liberalized. Farmers initially responded to the jump in cotton prices by reversing the long decline in production in the 1986/87 crop year and maintained production levels at about 400,000 bales in the next two years. But cotton trading was not liberalized, and inefficiencies in the single channel marketing system, in cotton ginning and in transportation led to delayed purchase of the cotton crop from farmers. In the meantime, the liberalized rice market began offering a viable alternative to cotton largely because private traders paid cash on delivery. The better marketing outlets for rice, coupled with

11/ Clay soils are too hard to plough before the onset of the rains but quickly become too sticky to work after the rains begin.

12/ In FAO fertilizer trials on cotton conducted in 1978, only one out of 30 trials gave a value-cost ratio of 2:1. In another trial in 1983-84, a mean increase of one kg of seed cotton per hectare was recorded for recommended applications of 30kg N and 15kg of P. Not surprisingly most farmers fail to follow recommended application rates.

13/ The recommendations for pesticide application also appear not to be economical with actual application rates much below the recommended technological package.

delayed rains in the 1988/89 crop year, precipitated a large shift out of cotton into rice, which helps explain the 30 percent drop in cotton production and the doubling of rice production in the last two years. In the 1990/91 season, increased producer prices seem to have revived some interest in planting cotton. However, the limited marketing reforms for cotton to date still leave the cooperatives in a monopoly position in the cotton sub-sector. Any response by farmers to the higher prices may be tempered by the continued inefficiencies and delays inherent in this system.

4.32 The Highlands. The highlands are for the most part located in southern, western and northern Tanzania and encompass some 18 percent of total land area. They traverse parts of Mbeya, Rukwa, Ruvuma, Iringa, Kilimanjaro, Arusha, Kagera and Kigoma regions. The highlands are heavily populated and intensely cultivated, except for the highlands in Rukwa.¹⁴ Rainfall is plentiful and generally reliable ranging from 880mm to over 2000mm per annum. Cultivation is mainly undertaken by smallholders, except for tea which is cultivated mostly on estates. With the exception of the southwestern highlands, the scope for expanding area under cultivation is limited due to population pressure.

4.33 One of the production systems common to the northern highland areas involves very intensive inter-cropping of bananas, coffee, vegetables, and maize. The Kilimanjaro coffee farmer is typical of this system. Arabica coffee has been grown on the slopes of Mt. Kilimanjaro since before the turn of the century. It is grown on small plots on the well-watered middle slopes of the mountain and is inter-cropped with bananas, which is the principal food crop. In addition, the farmer usually has one or two plots at lower elevations where maize, beans, potatoes and some rice are produced. Because of population pressure, plots on the middle slopes are often small (less than 0.5 ha) and total farm size does not exceed 1.5 to 2.0 ha. The land pressure faced by small holders is exacerbated by the high proportion of lands on the lower slopes held by parastatal farming enterprises.

4.34 In recent years farm income has been supplemented by keeping one or two dairy cows on the middle slopes. Fodder for the cows is produced on the distant lower slopes and carried up the mountain to the farm household. Cultivation of the middle slopes plots is by hoe. Input use is limited to chemicals to control disease, particularly coffee berry disease. Chemical fertilizer is rarely used on the banana/coffee plot as soil fertility is maintained by mulching with banana waste, elephant grass, and farmyard manure. Yields average about 236 kgs per hectare.

4.35 Coffee production systems in the southern highlands are considerably different than in the north. Land is relatively more abundant in the south so coffee is usually grown on larger plots in pure stand. Yields average about 293 kgs per hectare. The area planted to coffee in the south underwent a large expansion in the 1970s. Total coffee area is estimated to have expanded from 90,000 hectares to over 220,000 hectares today.

4.36 Despite the large expansion in area planted to coffee, production has essentially stagnated at about 50,000 tons per annum over the past 20 years due to a dramatic decline in

14/ Population densities average about 92 persons per square kilometer in the northern highlands, reaching as high as 200 persons per square kilometer in Moshi District.

yields. Moreover, coffee quality has deteriorated.^{15/} Both yields and quality of coffee are largely determined by soil fertility, pruning and weeding, competition from other crops, and disease and pest control. All of these factors are influenced by the prices paid to farmers and the promptness of those payments. Over the years, the single channel marketing system has kept producer prices low relative to world market prices, has failed to pay on time, and has not offered quality premiums. Poor and inefficient processing of coffee parchment or dry cherries, shipping delays, and a cumbersome coffee classification and auction system have contributed to poor prices.^{16/} In face of uncertain returns and lack of incentives to maintain quality, many farmers have failed to maintain their coffee stands and have allowed shading by bananas, low applications of manure and pesticides, weed competition and poor pruning to affect coffee quality and yields. Moreover, the input supply system has repeatedly failed to provide timely supplies of the right types of chemicals and the practice of taking blanket deductions for inputs from the price paid to farmers discouraged efficient use. The marketing reforms introduced beginning in October 1990, including removal of the blanket deductions for inputs, have been designed specifically to improve marketing services and restore incentives for production of quality coffees. If successful, these efforts should restore growth in coffee production and increase export earnings as quality improves.

4.37 Another important highland production system is the maize farming system found in the southern highlands. The maize farmers in this area have produced in recent years between 40 and 50 percent of national maize production. Much of this production comes from smallholder farms with relatively large land holdings. For instance, average maize farm size in Ruvuma region is in excess of 3 hectares and many smallholders farm between 4 to 5 hectares. The typical highland maize farmer grows maize both for home consumption and sale and in addition cultivates beans, cassava, groundnuts, and vegetables. Most farmers grow maize in pure stand and fields are most often prepared using oxen plow or tractors. Use of improved inputs is widespread. In Ruvuma over 90 percent and in Rukwa between 60 to 70 percent of maize farmers apply fertilizer, and up to 50 percent of farmers use pesticides. Overall the highlands regions account for up to 70 percent of total fertilizer consumption in Tanzania, up from 40 percent in the mid 1970s, and by African standards fertilizer applications per hectare are high. For instance, it has been estimated that fertilizer use in Iringa and Mbeya was about 124 and 114 kg per ha respectively during the period 1986 to 1988.

4.38 The high levels of production and fertilizer use in the southern highlands is the result of deliberate government policy to stimulate maize production in this area through heavily subsidized fertilizer prices. For example, the level of subsidy in the 1990/91 season was nearly 80 percent. With the subsidy, value-cost ratios (VCRs) for fertilizer use on local maize varieties are between 1.5 and 2.6, while for fertilizer use on hybrid seed varieties the VCR ranges between 1.3 to 3.3. Removal of the subsidy would have a dramatic effect. VCRs for fertilizer use would drop to between 0.76 and 1.41 if full world market prices were charged for fertilizer and

^{15/} In 1968/69, 15 percent of the crop were graded in the top five of 17 quality classes, but in 1986/86, only a little more than 2 percent were in the same five classes.

^{16/} Coffee presented at the auction is bulked together and is not distinguished by producer trademark so that premiums for quality are not passed back to the producer. The performances of the coffee auction may have also been affected by a pre-export financing facility that since 1987/88 has diverted coffee from the auction to finance oil imports.

farmers received the government price for maize.^{17/} VCR's at this level would not be attractive for even the best farmers using improved inputs and management techniques.

4.39 On top of the fertilizer subsidy, farmers in the southern highlands have received a considerable transport subsidy. Historically, the National Milling Corporation (NMC) was responsible for official maize purchases, and it operated a panterritorial pricing structure. In the 1989/90 marketing season NMC paid 11 Tsh per kilo for maize nationwide. At this price many farmers in the Southern Highlands preferred to market their maize to NMC. In fact up to 46% of all maize marketed in Rukwa region has historically gone through official channels, compared to about 25% nationally. The reason for the high proportion of official maize marketing is the high level of implicit subsidy for transport that arises from the panterritorial pricing structure. A recent study by the Ministry of Agriculture suggests that the implicit subsidy for grain procured in Rukwa was in the range of 40 to 50 percent. Throughout much of the last marketing season the private sector was paying about half NMC's price in order to cover transport costs. At this price, the VCR of fertilizer use becomes even more unattractive and it is unlikely that without the official price support and fertilizer subsidies, fertilizer use and production levels would be maintained at present levels. An expected outcome of this change would be a shift in cultivation to other crops as well as development of alternative marketing channels, particularly trade with neighboring countries.

4.40 **Farming Systems – Implications.** The principal theme arising from the discussion above is that of appropriate technological packages for different farming systems. The discussion suggests that overly standardized technological packages are often promoted in areas where they are of little relevance for local conditions. The lesson that emerges is that even for the same crop, different packages are often required in different agroclimatic zones, and sometimes even within the same zones, to account for different soil types or resource endowments of the farming population.

4.41 Examples from the discussion of maize and cotton systems illustrate the importance of accounting for the farming systems approach. For maize, the technological packages promoted in the southern highlands, which include improved seed and fertilizer, are labor intensive, involving significant incremental labor for weed control and harvesting. These packages are most appropriate in a land-constrained environment where ample labor exists and increasing the intensity of production is the only means available to increase production. Land is still relatively abundant in this area suggesting that the use of less labor-intensive packages, such as increased oxen-based cultivation, could have as effectively increased production as the subsidized seed/fertilizer package. The context of the cotton-based system provides another example of the need to tailor packages to the resource mix. In the low lying areas, where land remains abundant, efforts to promote a package involving intensive fertilizer/pesticide use have failed in face of limited labor resources and erratic rainfall patterns. Yields can vary dramatically over short distances due to variable rainfall, and farmers intensively cultivating a small plot risk total crop failure. So farmers reduce this risk and cut labor costs by farming a larger area with minimal field preparation, and little weeding and no fertilizer or pesticide. Yields per hectare are not particularly high but total crop failures are rare.

4.42 The maize and cotton systems also provide examples of what appears to be blanket recommendation of technologies without consideration of the potential yield response. Most farmers applying recommended fertilizer and seed packages to maize in the southern highlands are achieving maize yield responses and VCR's at barely acceptable levels. Similarly, cotton packages in the plateaux continue to emphasize fertilizer use despite evidence of extremely low yield results.

4.43 The preceding discussion is not intended to be exhaustive, nor indeed can it be given the lack of information available on the farming systems. But it does point to the importance of gaining a much better understanding of the different production systems in Tanzania for the development of appropriate policies and packages. Government, in setting its agenda of medium and long term policy issues, has identified the need to gain a better understanding of production systems and has commissioned a study to draw together existing information and conduct field surveys to better understand the various farming system. This work will serve as a precursor to an in-depth review of sectoral policies and programs to help ensure that the complexities of agriculture in Tanzania are better reflected and the needs of farmers are better served.

E. An Agenda for the Agricultural Sector in the 1990s and Beyond

4.44 The preceding section illustrated the pervasiveness of the decline in agriculture that has occurred in the late 1970s and early 1980s. Cotton, cashew and coffee producers have all faced growing production and marketing difficulties as a result of a poor policy environment and deteriorating or inappropriate agricultural services. Use of improved technology and inputs has grown little over the years. Cultivation, with minor exceptions, is still largely based on the hoe, and the increases in production that have occurred have largely resulted from expanded area under cultivation and not increased yields. The deterioration in marketing and transport services has contributed to stagnation in export crop production and in some instances led to farmers to alter production strategies. Government has begun to address the problems facing farmers by its efforts to improve the incentive structure through its marketing reforms. But further reforms are required to extend marketing reforms to farmers of crops which still face inefficient and high cost marketing outlets. Moreover, while addressing the marketing incentive system is a necessary condition to restore growth, it alone is not sufficient. Other policies in areas such as food security, livestock, and land tenure, are important determinants of growth. Also, poorly performing agricultural services (extension, credit and research) and a deteriorating physical infrastructure also constrain growth and will need to be addressed if the recent growth in agricultural output is to be sustained.

4.45 This section seeks to identify remaining constraints and issues that face the agricultural sector and outlines an agenda of future policy, institutional and infrastructural reforms that are required for agricultural growth. The section looks first at the remaining marketing and pricing policies that need to be addressed. It then examines the food security issues before turning to livestock and land policies. On institutional issues the section considers efforts underway and required to improve the development and adoption of improved technological packages for smallholder through strengthened agricultural research, extension and financial systems. For infrastructure, the section considers, in particular, the impact of a deteriorated transport network.

4.46 Agricultural Marketing. Section III of the chapter suggests that the positive supply response experienced since 1983/84 is a one-time phenomena associated with a return to a market clearing situation in the rural economy that cannot be expected to sustain growth in the 1990s. The devaluation and trade liberalization succeeded in returning the farm sector to an equilibrium position and as a result shortages of consumer goods no longer exist in rural areas. Thus, future output responses to producer price increase can be expected to be positive and significant. Future growth in agricultural production will require further improvements in crop marketing systems and pricing.

4.47 For grains, the private trade has moved quickly in response to liberalization to assume responsibility for much of the grain trade. However, functioning of the private market can be improved further. The trading network that has developed so far is essentially a "point to point" system with supplies moving from major surplus areas to major urban areas. With such a system other areas, particularly those with only occasional surpluses or deficits, are often not well integrated into existing marketing channels. When they face temporary disruptions in supplies, prices may need to rise well above costs of transport and handling before traders will respond.

4.48 For a marketing system to become better integrated so that price signals are effectively transmitted and appropriate market responses are forthcoming, better market information systems are needed. The government market price collection and dissemination system has made a good start in this regard with daily radio announcements and weekly market reports in the newspaper. The possibility of establishing open grain auctions in major wholesale markets also needs to be examined. Such auction would provide more transparency in the price formation process and would provide a good gauge on the availability of supplies. Moreover, the availability of trade finance can be a barrier to traders moving into new markets, and the development of crop financing mechanisms for private traders could contribute to better market integration.

4.49 Export marketing reforms introduced beginning in the 1990/91 marketing season (including restructuring the marketing boards; allowing private traders to market cashewnut, and primary societies and estates to sell coffee on the auction; and the expected liberalization of cotton trade) all promise to bring marked improvement in the marketing of traditional export crops. The challenge facing government in the first instance is to ensure that these reforms are effectively implemented. This requires timely restructuring of the marketing boards and clear signals and explanation of all the reform measures to traders, producers, the cooperative unions and regional authorities. Equally important are measures to create an environment conducive to active private sector participation in the marketing of inputs, establishment and operation of ginning companies and the marketing of cashew nuts. For inputs, the roles of the private sector and public institutions in the importation and distribution of inputs need to be clearly articulated and based on commercial criteria. Banking sector reform should soon relieve the constraints on arrears by the private sector for financing the importation of inputs. But a mechanism is required for payment of the fertilizer subsidy to private importers to encourage greater competition. For cotton, the planned construction of several donor-financed gins in the western cotton growing area provides government with a unique opportunity to encourage private participation in the ownership and management of the new gins. For cashewnut, simple criteria and procedures for registering traders need to be developed and disseminated.

4.50 In addition to the reforms currently under implementation, further reform measures need to be given careful consideration to solidify the move to a fully functioning multi-channel marketing system. For coffee the costs and benefits of allowing farmers to sell their coffee directly to private traders needs to be examined. The possibilities also need to be explored for extending the liberalization measures adopted for coffee, cotton and cashew nuts to other traditional export crops such as tobacco and pyrethrum.

4.51 Cooperative Policy. Cooperatives were reintroduced by government in 1982 after having been abolished in 1975 during villagization^{18/}. Unlike the farmer-led expansion of cooperatives beginning in the 1930s, the 1982 resurrection of cooperatives was mandated as part of government and party policy and implemented with strong government intervention. According to the 1982 Cooperative Act, cooperatives were intended to play social roles, such as building socialism and self reliance in rural areas, that were often in conflict with the immediate interests of producers in maximizing their returns from farming. At the village level, candidates for cooperative society management positions were screened by the party before being placed on the ballot, and the society members often had little choice in who was managing their societies. Consequently, management tended to give more weight to the political demands of the party and government than to the economic interests of the members.

4.52 Due in large part to the conflicting objectives of management and members, the operations of the cooperative unions and primary societies have been characterized by widespread financial mismanagement. The problem has been exacerbated by the rapid expansion of primary societies since 1982 which has overextended already weak managerial and financial control functions. The result has been a dramatic deterioration in the finances of the cooperative system. At the end of 1989, cooperative system overdrafts in arrears to the banking system were estimated to be as high as Tsh 25 billion, of which about 45 percent were over one year old. This figure compares with annual crop and input financing requirements of about Tsh 15 billion. Several recent assessments suggest that about 20 of the 27 cooperative unions are technically bankrupt and unable to qualify for crop and input financing under normal commercial criteria.

4.53 In response to the growing crisis, government in 1990 made cooperative reform a top priority and a new cooperative policy was adopted. The revised policy is intended to ensure that management is democratically elected by members with no undue influence by government or the party and that the management is solely accountable to the members. The responsibility of the government will also be limited to defining a legal and regulatory environment and providing training and support. In line with the new policy, a new cooperative act was passed by parliament in April 1991. The major changes incorporated into the new act are: (i) provisions for the voluntary membership in democratically-controlled societies and unions with management that is solely accountable to its members; (ii) a de-emphasis of social and political objectives; (iii) a reduction in the power of the Registrar of Cooperatives in the establishment and management of cooperatives; (iv) explicit recognition of economic viability as the principle

^{18/} The Cooperative Ordinance was promulgated in 1932 and the first agricultural primary cooperatives were formed by smallholder coffee growers to handle crop marketing and input supplies. The cooperative movement continued to spread at the initiative of growers so that by independence in 1961 there were 18 unions with about 700 affiliated primary societies and a membership of more than 500,000.

criteria for establishing and operating societies; and (v) allowances for single crop unions to operate in more than one region.

4.54 These policy and legislative changes, once implemented, should provide a more favorable environment for the development of a more democratic 'bottom-up' farmer-controlled cooperative system, replacing the top-down bureaucratic and politically motivated system that had prevailed. Cooperatives would function as free associations of farmers to pursue objectives as defined by members and not imposed from above. Donor dialogue with government, including decisions by some to end assistance to the cooperative movement until reform was undertaken, has been instrumental in influencing the new policy direction. Further donor support and dialogue will be required to ensure that the policy and legislative changes discussed are enacted as envisaged.

4.55 Now that the policy and legal framework is in place, the formidable task of realigning the cooperative system and restructuring individual societies and unions is now getting underway. Criteria for judging economic viability are now being developed and will be used to screen existing primary societies. Those societies not satisfying the viability criteria will be disbanded. For the remaining societies, government intends to launch a major exercise to explain the changes in the act to institutional members and to encourage them to participate actively in society decisions on management and affiliation with unions. It is likely that the transition to a new farmer controlled cooperative system will be gradual as farmers begin to appreciate and then exercise the power to manage their own societies.

4.56 A financial restructuring program also needs to be developed and implemented in the context financial sector restructuring. The banks would need to assess on a case-by-case basis which unions they deem viable for future lending, which unions are potentially viable with restructuring and those that are unviable. The unviable unions would be cut off from future lending and liquidated. The potentially viable unions would be candidates for restructuring. Management structures would need to be reorganized and the number of primary societies rationalized. Improved accounting and stock control systems would also need to be developed and an assessment undertaken of union functions to rationalize operations by dropping non-core and uneconomic activities. Transitional financing arrangements would most likely be needed by the potentially viable cooperatives while the restructuring exercise is underway.

4.57 **Pricing Policy.** The proposed changes in marketing policy outlined above should result in a stronger and more competitive multi-channel system for exports. However, changes in market structure will also require changes in pricing policy for exports. For export crops official prices are still enforced. These prices are intended to provide producer incentives, but as indicated earlier they have failed to reflect international market prices, and rather than serving as an incentive for production, they have levied an implicit tax on producers. As export crop marketing is liberalized further, there will be a need to develop pricing policies for export crops that allow farmers to benefit fully from the competition expected to emerge from the development of alternative marketing channels. Indicative prices similar to those introduced for grains that provide guidance to farmers for price negotiations, along with good market price information, should be sufficient in a multi-channel marketing system to ensure that farmers receive competitive prices.

4.58 World market prices for Tanzania's traditional export crops have declined in real terms for much of the 1980s, and projections suggest that while the decline may halt during the 1990s there is little prospect of prices increasing. For government, the limited prospects for traditional crops require that an environment conducive for crop diversification by the private sector is fostered. Measures being taken to promote private investment (Chapter 5) and improve the private sector's access to credit and equity financing through financial sector reform (Chapter 3) are crucial. Improvements in marketing systems and transportation infrastructure and in government agricultural support services (research and extension) are required to ensure that technological packages are developed and adapted to local conditions. Efforts also are needed to strengthen and develop trade within the region as an alternative to traditional market outlets. Donors and the international community at large can also play an important role in fostering a more diversified agriculture by looking to their own trade policies that restricts access by Tanzania and other developing countries to new markets. What is not needed are government stabilization schemes that attempt to buffer farmers from the vagaries of world market prices. Such schemes are generally expensive to operate and tend to tax farmers when prices are high but fail to protect them when prices drop.

4.59 Food Security Policy. The government's marketing and pricing policy for maize has been partly driven by national food security objectives which are focussed mainly on ensuring national food self-sufficiency. A strategy was developed in the late 1970s that emphasized maize production in the southern highlands through fertilizer subsidies, and panterritorial maize prices that provided a substantial transport subsidy to producers. The decision to promote maize production in the southern highlands was based on its abundance of land and suitable soils and the belief that rainfall patterns were more stable in the southern highlands than elsewhere. Therefore, increasing production from this area would lead to less year-to-year fluctuation in domestic maize supplies.

4.60 The policy of emphasizing maize production in the southern highlands was successful in raising maize production in that area and contributed to achieving national self-sufficiency in maize. But whether it contributed to a more stability in year to year food production than would have occurred with policy measures which were less regionally focused or crop specific is open to question. In fact, concentrating production incentives on a single crop in a single area misses the scope for risk reduction that stems from regional and crop diversification, and also increases the potential for greater instability in production. This point is illustrated in Table 4.2 which shows coefficients of variation for maize production in the major maize producing regions over the period 1974/75 to 1988/89.^{19/} The areas comprising the southern highlands do indeed have the lowest year-to-year variation in production, ranging from 13 to 25 percent, though it is interesting to note that maize production in Rukwa and Ruvuma is no more stable than in Arusha, Mwanza or Tabora regions (all between 19 to 26 percent). But the coefficient for all of Tanzania is only 10 percent due to the fact that production decreases in some areas are often offset by increases in other areas. Calculations of year-to-year variance in total food crop production also yielded a smaller variance than for maize (seven percent), again due to compensating changes in production levels. Quite possibly then, emphasis on a wider variety of food crops over all producing areas of Tanzania would have been a more effective

^{19/}

The coefficient of variation measures year-to-year fluctuations in regional production. The higher the coefficient is, the higher the degree of year-to-year instability in production.

means of reducing instability in food production than the maize production program in the southern highlands.

**Table 4.2: Regional Instability of Maize Production in Tanzania
(1974/75 - 1988/89)**

	Region	Coefficient of Variation
<u>Group 1:</u>	Iringa	12.6
	Mbeya	15.1
<u>Group 2:</u>	Rukwa	19.3
	Ruvuma	24.8
	Kilimanjaro	24.9
	Mwanza	25.1
	Tabora	25.3
	Arusha	26.5
<u>Group 3:</u>	Morogoro	29.8
	Singida	30.9
	Dodoma	39.3
	Shinyanga	51.6
<u>Tanzania</u>		10.0
<u>Tanzania (All Cereals)</u>		7.0

Source: MDB, Early Warning Unit, Ministry of Agriculture

Note: The coefficients of variation have been calculated at the regional production average.

4.61 The maize production strategy for the southern highlands has also proved to be impossible to sustain, particularly with respect to cost of the panterritorial pricing policy that was borne largely by NMC. NMC losses increased as government began to relax the restrictions on the private trade of food grain in the mid 1980s, impairing NMC's ability to cross-subsidize its losses on purchases in remote markets with profits from imports and transactions in closer-in markets. As national surpluses began to replace the occasional shortfall and NMC's losses mounted, government responded to the growing losses by cutting off NMC's access to crop financing in 1991, effectively ending its support of pan-territorial maize prices. Government also began to reduce fertilizer subsidies, nearly tripling fertilizer prices for the 1991/92 season which reduced subsidy rates from about 80 to 55 percent.

4.62 A risk reduction strategy that emphasizes improved stability of the food supply by improved productivity for a variety of food crops in all producing areas would require strengthening agricultural services to develop and disseminate improved technological packages that are well adapted to local conditions. Also required are improvements in transport

infrastructure and market information systems so that all producing areas are well integrated into the marketing system and responsive to changing market signals.

4.63 The Role of Women. While efforts to achieve stable and adequate food supplies at the national level are important, they are not enough to ensure adequate food supplies and nutrition at the household level. Despite achieving national food self sufficiency, 28 percent of Tanzania's population suffers from protein energy malnutrition and the figure is over 50 percent for children under five (see Chapter 6). Chronic malnutrition can be traced to low farm productivity, inadequate household incomes, poor health, and insufficient time for meal preparation. Women with primary responsibility for household food production and care of children are key actors in determining the nutritional status of the household, and children in particular. Women are responsible for cultivation of food crops, while the men are responsible for livestock and cash crops. Women must prepare the land, plant, weed and harvest all food crops in addition to their other household chores including food processing and preparation; care for children, the sick, and elderly; fetching water and firewood; washing clothes; and keeping the house clean. They are also often required to help their husband with his livestock and cash crops.

4.64 The multiple demands on rural women's time help explain both low farm productivity and the poor nutritional status of children. Essentially, the typical woman farmer does not have sufficient time to do an adequate job of either farming or child care. For food production, low yields arising from inadequate field preparation, late planting, and insufficient weeding result in inadequate household food supplies. For child care, time constraints limit women's ability to prepare a sufficient number of meals in the day. Children also often suffer from diseases that impair their ability to absorb sufficient nutrients to assure adequate nutritional intake. Moreover, women's ability to fulfill the multiple roles required of them is also often hampered by pregnancies, frequent illnesses and malnutrition. In sum, a typical small farmer in Tanzania works 12 hour days at hard physical labor, is pregnant or breast feeding, and has three or four other children to feed and care for. She also has little time to supplement household income with off-farm activities.

4.65 Efforts to improve household food security must focus on two key areas: first, women's productivity needs to be improved both in the production of food and her other household chores. For agriculture this requires improved technologies that increase output and the productivity of labor, for example through better land preparation and weed control techniques. But perhaps the biggest impact on a woman's ability to feed and care for her family would come from improving her productivity in off farm activities. For example, intervention aimed at improving access to fuelwood such as village woodlots or introducing more fuel-efficient stoves can save time in wood gathering and food preparation. Improved village water supplies, introduction of small grain mills and development of village day care facilities would also all serve to improve women's productivity. These labor-saving interventions would free women's time for farming and for pursuing other opportunities to earn additional income such as food preparation and trading.

4.66 Second, interventions aimed at improving the health of women and children will have direct impact on household productivity and nutritional status. For women, health education and direct interventions to control anemia (up to 80 per cent of pregnant or lactating women are anemic), improve ante-natal care and provide family planning services would have direct impact

on productivity. For children, nutritional screening and growth monitoring to identify cases of severe malnutrition allow for interventions such as supplemental food to be targeted at the most vulnerable household. Also, efforts to control malaria, and diarrhea-related diseases in children will improve their nutritional status.

4.67 The linkages between improved on-farm and off-farm productivity and between health and the household's productivity suggests that a multi-sectoral approach is required. Interventions in agriculture must be coupled with steps to improve women's productivity in household chores, and with health and nutrition programs. For such a comprehensive approach to be successful it must be community-based and involve the potential beneficiaries in the identification of the problem, design of interventions and implementation. One such program, the joint (WHO/UNICEF) nutrition support program started in Iringa in 1983, shows some promise of improving nutritional status of children. It is based on the premise that children's health is closely linked with their mother's health and work demands. Thus elements of the program, besides nutritional interventions, emphasize child care, technological packages, and income-generating activities to alleviate the time constraints facing women and increase their income (see Chapter 6).

4.68 Livestock Policy. A government priority for the 1990s is improving the productivity of the livestock sector, which currently contributes about 10 percent to GDP. With approximately 13 million cattle and 10 million sheep and goats, Tanzania has the fourth largest ruminant population in Africa. But because of low productivity, per capita consumption of animal protein is limited compared with international standards. Higher productivity would not only increase consumption levels but would contribute to household food security as both pastoralists and farmers manage their livestock to provide protection against sudden loss of income or food shortages. Improved productivity would also increase the availability of manure for fertilizer, hides and skins, and draft power, all of which are under exploited.

4.69 Another government priority is improved rangeland management to help protect against land degradation. Most livestock is kept by pastoralists in the semi-arid rangelands of the north-western and central highlands. Cattle numbers have increased steadily, and the population now exceeds the carrying capacity of the range land that is not infested with Tsetse fly. As a result, overgrazing is wide-spread, and considerable erosion is occurring.

4.70 Efforts to improve productivity and livestock management will need to address a number of constraints. Productivity is constrained by poor nutrition, high disease rates and the low yield potential of indigenous stock. Improved rangeland management will need to address constraints imposed by water shortages in many grazing areas, the loss of traditional grazing areas to crop production, and limited access to new areas because of tsetse fly. Communal land ownership of grazing land also makes it difficult to introduce improved management practices.

4.71 Past efforts to develop the livestock sector has for the most part concentrated on large-scale parastatal production and marketing institutions. These institutions proved to be high-cost and inefficient and have been in a state of steady decline since the mid-1970s. Government is now in the process of restructuring its parastatal ranching company, and it is seeking joint venture partners for its investments in tanneries. More recently government and donors have focussed with some success on the development of small-holder dairy through feeding programs and the provision improved cross breeds. Disease control is another area of concentration,

particularly efforts to control rinderpest. But overall the government-run veterinary service is weak.

4.72 Government recently completed preparation of a livestock development plan that sets very ambitious targets for the sector. The plan recognizes the weaknesses of past approaches to livestock development and calls for a more balanced mix of public and private sector participation in the provision of livestock services. Government, in seeking to achieve its targets, must evolve its role away from direct involvement in the implementation of production oriented projects and towards provision of basic services and an enabling environment for private sector development of the sector. Perhaps the quickest gains in productivity will come from efforts to improve the functioning of the private marketing system through investments in basic market infrastructure and information systems. The promising start in smallholder dairy development needs to be sustained, with greater emphasis on the commercial production of improved cross-breeds. Better animal health requires improvements in the veterinary services, again with the private sector playing a larger role in the provision of basic animal care services. Efforts to stop overgrazing also need to begin. New grazing areas will need to be opened through control of tsetse fly and water development. Control of grazing in existing areas will also need to be improved and will require the participation of the local populations in the development and implementation incentive systems that encourage better range management.

4.73 Land Policy. Land allocation and insecurity of land tenure will become increasingly critical issues in the 1990s as population continues to grow. Despite the fact that less than 20 percent of arable land is currently under cultivation, the increasing demand for farm land arising from population growth is causing growing pressure on forests and grazing areas. Much of the conversion of land is done without the land use planning or soil conservation measures necessary to ensure proper land use. Of primary concern is the uncontrolled clearing of forest lands that according to the recent Tropical Forest Action Plan is proceeding at a rate of 300,000 to 400,000 hectares per year. Likewise, as discussed above, contraction in area available for grazing is leading to severe land deforestation and to insecurity of land tenure. Under the existing land ordinance, all land belongs to the republic and is under the control of the president. The traditional power of the chief to make land allocation decisions was abolished and vested in various local authorities (village, divisions, wards and district authorities). These authorities have not always proven to be competent in making allocation decisions and settling disputes. Also the existing regulations are confusing and often contradictory, making enforcement difficult and giving rise to numerous land disputes.

4.74 In response to concerns about land allocation and insecurity of tenure, government has started a program of demarcation and registration of village titles with plans to move eventually to individual titles. This process was started in 1985 and has moved slowly, covering to date less than 20 percent of all villages. The program is also hampered by lack of clarity about the meaning of village boundary demarcation. In some areas, boundaries are demarcated to include public lands; in other areas, these are excluded. Moreover, the exercise is proceeding without the benefit of an official national land use policy and in face of overlapping jurisdiction among institutions with authority to allocate land. Also, there has not been an analysis of the costs and benefits of the proposed move to individual title.

4.75 In order to understand land tenure systems in Tanzania and their impact on such issues as agricultural productivity, land use and the conservation of natural resources, an agenda

of research and policy studies is required. Critical issues to be addressed include: (i) the status of public lands, (ii) current land use patterns, (iii) the efficacy of the current program of village demarcation; (iv) the mechanisms for settlement of land disputes; and (v) the impact of current policy and legislation on land use, security of title and productivity. Also national land use policy needs to be developed and legislation revised to ensure that land allocation and titling procedures lead to a transparent and equitable mechanism for securing access to land and settling disputes. In addition, strengthening of institutions dealing with land issues at the central and district level will be required to eliminate overlapping jurisdiction over land and ensure effective implementation of land policies. Donors will have an important role in supporting the government to undertake the necessary analysis, develop an effective policy, and strengthen the institutions that will implement the policy.

4.76 **Technological and Institutional Issues**. Successful development and dissemination of more productive farm technologies for small-holder agriculture is among the most important medium- to long-term challenges facing the government. Meeting this challenge requires well-functioning agricultural research and extension services. Agricultural research like most other government services, declined dramatically beginning in the mid 1970s. Due to budgetary constraints, Tanzania spends about half of what neighboring countries spend on research and less than 20 percent of what is deemed sufficient by international standards. Moreover, the research establishment has suffered from frequent organizational changes that have proved disruptive and have failed to improve performance. The result is that little effective research is undertaken at the 55 research institutes, centers, stations and substations. Numerous donor-supported training programs have resulted in a substantial cadre of highly trained staff. But low salaries and inadequate funding to support research activities have demoralized the staff and rendered them unable to exercise and maintain their skills.

4.77 To address these constraints government has started a program to rehabilitate the research service. The program's objective is to provide the scientific and technical basis for improved smallholder productivity with an emphasis on low-input technology developed through effective links between policy makers, extension services and farmers so that farm problems are correctly identified and low cost technological packages are developed. To achieve these objectives, government is developing a national research strategy that aims at rehabilitating the agricultural research system in Tanzania by matching national research needs to resources available through careful consideration of research priorities. Criteria have been established to develop the priorities that include: contribution to food security; potential for increased foreign exchange earnings; the importance of the research for small holder farming; and the availability of research from other sources such as the international centers. ^{20/}

^{20/}

Using these criteria, government is developing a three-tier research priority system which will guide future resource allocation. The first priority group for crops includes coffee, cotton, tea and rice, which will be given top priority in the allocation of funds, staff and facilities over the next five years. In addition, agro-forestry, ruminant meat production, animal health and soil and water management will be given priority. Second-tier crops and programs which will receive limited support include maize, cassava beans, legumes, oilseeds, vegetables and cashew. Support for third tier programs will be scaled back until additional resources are found with the exception of existing donor supported programs which are under implementation. Among the programs in the third tier are wheat, barley, sorghum, millet, coconuts, sisal and sugarcane.

4.78 The challenge facing government is to develop a responsive and flexible research service that can develop new farm technology and adapt it to local conditions. Research in some instances will need to focus on developing new techniques and materials. Current research on controlling powdery mildew in cashewnut is an example of this approach. Fungicides to control powdery mildew are in use throughout the world, but they are typically applied using large amounts of water. Lack of access to water in the cashew growing areas precludes the use of this technique and research is currently looking to alternative application techniques. Breeding programs are also focussed on developing varieties that are resistant to the fungus. In other instances, research will need to focus on adapting existing technological packages to local conditions. For fertilizer packages, understanding of local soil conditions can provide information on types of fertilizer to use, application rates and potential yield response.

4.79 Both development of new packages and adaptation of existing packages will require that research be conducted in the agro-climatic zones for which the packages are intended. Moreover, further research to adapt results emerging from research centers to local conditions would best be accomplished in trials on actual farmers' fields to simulate actual farming conditions. The absence of such research helps explain the lack of farmer response to extension messages for cotton in the Mwanza area as described in the farming systems discussion.

4.80 Given the limited resources available to government for research, there is a potential role for privately-supported research efforts, particularly for crops grown on estates. This is already happening in the case of the Tanzania tea industry which is supporting research on the water and nitrogen requirements of tea, and to evaluate how different clones respond to drought and controlled irrigation. Prior to independence, private industry supported research in coffee, sisal, and tobacco. These activities were eventually nationalized, and output declined as government was unable to sustain adequate support. Efforts are now required by government to involve the private sector once again in the financing of commodity research for these crops.

4.81 Extension, like research, has in the past suffered from a number of problems including: (i) ineffective management and supervision due to poor leadership and fragmentation of the structure into two uncoordinated services (crops and livestock); (ii) insufficient facilities and funding; (iii) poor linkages with other services such as research; and (iv) low staff morale due to poor training, out of date skills and inadequate compensation. As a result of the fragmented structure of extension, policy guidance on extension activities was ineffective, activities were uncoordinated, and planning non-existent. And at the farm level the extension service provided messages of limited relevance, and failed to provide a mechanism for feedback from farmers to researchers and policy makers.

4.82 In 1989 the government began to put into place a donor assisted program to reorient and rehabilitate the extension service. The program's objectives are to establish a cost-effective multi-disciplinary extension system with consistent direction, technical support and stable funding. To achieve these objectives the program involves: (a) a gradual merging of crops and livestock extension services into a multi-disciplinary system; (b) strengthening of extension management and organization; and (c) improved human resources, physical infrastructure and logistical support. The program employs a modified form of the training and visit system of extension management which involves village extension agents meeting with groups of farmers in contact farmers' field on a regular and systematic basis. The agents are also trained on the messages to

be extended during regularly-scheduled training sessions which also serve as a mechanism to provide feedback on extension messages and farm problems.

4.83 The program has been gradually implemented so it now covers nine of the twenty regions in the country and will be expanded to include twelve regions by the end of the first phase. Moreover, the program has been supported by the development of extension policy guidelines that, among other things, require that all donor-assisted programs in other regions incorporating extension services be in accordance with the new system.

4.84 **Extension - Research Linkage.** Under the government's new research and extension programs considerable emphasis is being placed on establishing strong linkages between extension and research. Senior extension officers are being appointed as research-extension liaison officers to coordinate the linkage. The officer would be responsible for: (i) ensuring extension participation in the formulation of research activities so that farmers' problems are accurately reflected; (ii) working with the farming systems research teams in conducting field trials on possible solutions and evaluating results and (iii) coordinating other activities to facilitate stronger linkages such as visits by researchers to farmers fields, training of extension staff by researchers, evaluation of the feasibility and economic viability of recommendations, and feedback to the research community on problems encountered in the field.

4.85 The future success of the extension program will depend on the ability to cover the costs of the system. Continued donor support for both development as well as recurrent costs will be required for some time. Several approaches are possible to take some of the burden of extension out of the public sector. At the village level, as the extension system becomes better established, local communities could be encouraged to provide support to extension in the form of housing, salary contributions or other support. Also, NGOs such as Global 2000 are already active in extension activities and, if effectively harnessed within the extension framework, can contribute significantly to the operation of the system at the farm level. As private input delivery channels develop, the private sector should also be encouraged to play an increasing role in extension activities as part of their marketing function.

4.86 As improved technological packages become available, better rural financial services will be required to finance input requirements and capital improvements. Increasing the effectiveness of financial services available to the agricultural sector is important for increasing uptake of new technology and increasing agricultural production and incomes. Most production credit for smallholders is provided by the Cooperative and Rural Development Bank through the cooperative system. The system is fraught with inefficiency. Repayment rates are low even by African standards, contributing significantly to the poor financial position of CRDB. Interest rates, although nominally positive in real terms, do not adequately reflect the risks and costs of seasonal credit. Other financial services including medium term credit and savings opportunities are limited, and little of the resources mobilized in the rural areas through the available formal savings mechanisms stay in the sector.

4.87 Little is known about the financing requirements of the smallholder sector, and the role that the informal sector plays in meeting these requirements. Studies are currently underway to assess the demand for financial services and determine how this demand might best be met. There is also a pilot credit scheme being implemented by CRDB that is testing alternative mechanisms for credit delivery to smallholders. These initiatives are expected to lead to a

program of improved rural financial services within the context of a broader financial sector restructuring. Any effort to improve rural finance should build on community-based approaches to utilize savings and on existing informal credit mechanisms provided by local business, traders, and money lenders.

4.88 Infrastructural Constraints. The extremely poor condition of existing road and rail systems raises marketing costs and dampens the impact of macroeconomic and marketing reform at the farm level. The pattern of settlement and agricultural production gives transport an important strategic role in the development of the agricultural sector. Tanzania's large size with its population widely disbursed around the geographic periphery requires an extensive and well functioning transport network. Most smallholder farmers live in widely scattered villages while major market centers for crops, as well as the distribution points for agricultural inputs, are located in distant urban centers. Because of transport's strategic role, a priority of government is on rehabilitating the transportation network to facilitate reliable movement between farm communities and urban centers of agricultural commodities, consumer goods and farm inputs.

4.89 The deterioration in Tanzania's transportation infrastructure over the last fifteen years has been dramatic. The road network in particular has suffered. The total road network, of which about two-thirds are impassable or unmaintainable, is about 55,500 km, consisting of 10,200 km of trunk roads (3,600 paved), 13,000 km of regional roads that basically link regional and district centers, and about 32,300 km of district roads which provide the inter-village road network.^{21/} In comparison with neighboring countries, the Tanzanian road network is among the least developed in terms of density per land area, and that which does exist is one of the worst in terms of road conditions (see Table 4.3). The state of the road network imposes a significant penalty on agricultural production through higher vehicle operating costs, delayed evacuation, and damage to crops. Losses to the economy from higher vehicle costs alone are in the range of US\$150 million per annum, equivalent to about one third of total export earnings.^{22/} The deterioration in the road network resulted primarily from inadequate resources for maintenance, inefficient road administration, and inadequate technical capacity. Operation of the rail network has deteriorated for similar reasons. As a result of poor operational performance, the rail network has been unable to meet the demand for long-distance transport of export crops and critical agricultural inputs. This situation has forced the stockpiling of export crops, in particular cotton, and the diversion to road transport of many bulky items better suited for rail transport. In all, the estimated loss to the economy from poor rail operations is estimated at US\$40 million per annum.

^{21/} In addition there are about 30,000 km of roads which are under the control of agricultural parastatals, the National Parks, or are unclassified roads under the control of village councils.

^{22/} Integrated Roads Project, Staff Appraisal Report, May, 1990, p. 3.

**Table 4.3: Trunk Road Conditions: Cross Country Comparison
(in percent)**

	<u>Paved Roads</u>		<u>Unpaved Roads</u>	
	<u>Good</u>	<u>Poor/Fair</u>	<u>Good</u>	<u>Poor/Fair</u>
Tanzania	24	76	10	90
Zambia	40	60	30	70
Kenya	32	68	66	34
Malawi	50	50	30	70
Zimbabwe	70	30	50	50

Source: World Bank, SAR, Integrated Roads Project, Report No. 8367-TA, 1990.

4.90 The extent of the damage to the road and rail network from years of neglect and abuse requires a massive investment in rehabilitation and repair. The government has embarked on an ambitious road and rail rehabilitation program based on a detailed national transportation plan. In addition to extensive rehabilitation of the trunk and rural roads, the roads program emphasizes institutional strengthening to build maintenance capacity, development of private sector capacity for contract maintenance work, reorientation of budgetary allocations to increase the budget share for roads, and improved resource mobilization to enhance capacity to finance road maintenance activities. The road rehabilitation effort is expected to cost about US\$1.2 billion between now and the turn of the century and aims to bring 70 percent of the trunk roads and 50 percent of the regional road networks, including all essential rural roads, to good condition. Fifteen donors have responded to the financing needs of the roads program. A railways rehabilitation program is also under way that will include organizational restructuring, institutional strengthening, policy reform and investment in rolling stock and roadbed rehabilitation. Several donors are active in rail rehabilitation and a new program is being developed to improve rail management and operation as well as rehabilitate rolling stock and road bed.

4.91 **Expected Impact of Removing Constraints.** Removing the remaining institutional and infrastructural constraints facing the agricultural sector, combined with continued macro-economic adjustments, could help spur substantial gains in agricultural productivity and output. In particular, export crop production can be expected to benefit from measures to improve marketing and increase the share of export proceeds accruing to the producer. Cotton production would likely respond the quickest to improved prices and marketing arrangements. Cotton production has proven to be very price-responsive in recent years, and production levels of up to 500,000 bales of seed cotton can be accommodated with the planned expansion in ginning capacity. Cashewnut production also shows signs of recovering from its long decline, with farmers responding well to higher prices and new control measures for the powdery mildew. These measures, coupled with the introduction of private marketing channels, should stimulate a sustained recovery in production levels. The improvements in coffee marketing being introduced this marketing season should set the stage for increased production as farmers begin to realize gains from improved quality. Finally, though not covered explicitly by marketing

reforms under ERP, there has been a resurgence in sisal planting in response to improved world market prices and privatization of some sisal estates that promises to restore much of the lost production levels. Overall, the changes in agricultural marketing and improvements in the transportation network described above could sustain growth in output at rates of five to seven percent per annum to the turn of the century. During this period, Tanzania could recapture the market shares it lost during the 1970s and improve export earnings through the production of higher quality exports.

F. Conclusion

4.92 . This chapter has reviewed the impact of the reform period on the agricultural sector in Tanzania. By distinguishing between agro-climatic zones and farming systems, the combined impact of the structure of incentives, institutions and infrastructure is more readily observed and analyzed. The gains in agricultural performance achieved since the beginning of reform to a large extent represent a one-time response to trade liberalization. Thus there remains a continuing need for Tanzania to improve the economic environment facing the agricultural producer. As the chapter points out, exchange rate movements and realignment of other incentives have been beneficial as an incentive to greater agricultural production, but a large part of the potential benefits, which should have accrued to Tanzania's producers, have instead been taxed away by Tanzania's monopolistic agricultural marketing institutions – both the marketing boards and the cooperative unions. Thus the immediate priority is to achieve further progress toward agricultural marketing liberalization. In fact, the opening up of multiple marketing channels has already been achieved in foodgrains, inputs and non-traditional commodities, thus providing a model for marketing changes needed for the traditional export crops. Some movement toward multi-channel marketing in these crops has been undertaken in the past year, yet more is needed. In the short-run significant cooperative reform is also key as these institutions will remain important means for assisting producers. While successful implementation of marketing reforms is a necessary condition for future agricultural growth it is by no means sufficient. Land, food security and livestock policy are all important elements of the future agricultural strategy. Also, as the chapter stresses, the development, and adaptation of new technology through current efforts to strengthen the research and extension services are absolutely essential for the productivity increases required to fuel future growth. Furthermore, agricultural production and marketing remain significantly constrained by the poor state of Tanzania's infrastructure, and continued, heightened improvements are needed.

4.93 Another lesson emerging from the chapter is the importance of understanding inter-linkages between the various constraints affecting agriculture and between the different measures that are required to address the constraints. Some are obvious, such as the necessary links between research extension, and input supply, or the need for well-functioning transport and market information systems to support the market liberalization efforts. Others are more subtle, such as the linkage between the time constraints facing women, the health status of the household and food security. Better understanding the constraints facing the smallholder and designing appropriate interventions are among the major challenges facing the government. Meeting the challenge will require much greater participation of farmers and the community in identifying problems and designing interventions.

4.94 Further agricultural reform is imperative as well to ensure that Tanzania can achieve macro stability. The agricultural marketing institutions and the inefficient marketing system

remain among the chief causes of Tanzania's inability to gain control of its monetary aggregates. Greater agricultural dynamism also is central to Tanzania's desire to achieve a viable balance of payments position -- as greater exports are essential to pay for increasing import requirements - - and to achieve overall income growth. Government can best foster this dynamism by creating an environment that is conducive and supportive of private investment in agriculture and not through direct involvement in productive activities. Through the creation of a stronger income base and consumer demand in rural areas and for development of efficient, agro-based industries, this dynamism is critical as well for laying a basis for a healthy industrialization process in Tanzania.

CHAPTER 5

Industry and Small-Scale Enterprise Development

A. Introduction

5.1 At the time of independence, Tanzania had only a rudimentary industrial sector. After the Basic Industrialization Strategy was adopted industrial capacity grew rapidly. The rapid expansion of import intensive industrial investments was not matched by the economy's ability to earn foreign exchange. By the early 1980s, as the exchange rate became increasingly overvalued, the administrative allocation of dwindling foreign exchange resources resulted in substantial capacity underutilization. Restrictive import licensing and other quantitative restrictions isolated domestic industry from external competition, while price controls, regulatory policies, and the confinement of goods posed barriers to domestic competition. Consequently, manufacturing production fell by an average of 15 percent per annum during this period, resulting in a decline in the share of manufacturing in GDP from 13 percent in 1979 to only 7 percent in 1985. Economic efficiency in many industrial sub-sectors was low, including large scale manufacturing which was concentrated in the parastatal sector. While specific programs to promote small scale enterprises were in place, the overall trade, pricing and resource allocation regime did not significantly benefit the small scale sector.^{1/}

5.2 The major trade and industrial policy reforms undertaken since the mid-1980s, coupled with the increased availability of external resources, have provided a markedly changed environment for both the large and small scale industry. This chapter assesses the impact of the reforms implemented during the Economic Recovery Program (ERP) on the industrial sector. It also recommends the additional policy measures that are needed to reform large scale industry and promote the small scale sector.

B. Industry and Trade Reforms during the ERP

5.3 **Policy Measures that were Adopted.** The economic reform program initiated under the ERP has resulted in an improvement in the trade and industrial policy environment, mainly through the large exchange rate adjustment, the policy of own-funded imports, ready access to foreign exchange through the creation and expansion of the Open Generalized Licensing (OGL) facility, tariff and sales tax reform, the provision of export incentives and internal trade liberalization.

5.4 Prior to the start of the Economic Recovery Program, the exchange rate had become substantially overvalued. In mid-1986, as part of the ERP, the government implemented a substantial real devaluation of the shilling from Tsh 16.5 per US dollar to Tsh 51.7 per dollar. The exchange rate was continuously adjusted thereafter until early 1988 when the adjustment of the nominal exchange rate slowed considerably, resulting in significant appreciation of the real

1/ See Report No.6357-TA of the World Bank, "Tanzania: An Agenda for Industrial Recovery" for an analysis of the impact of Government policies on the industrial sector through 1985.

exchange rate. However, further real depreciation was achieved through sizeable discreet devaluations in November 1988 and December 1989. The rate was essentially held constant in real terms throughout 1990.

5.5 The policy of allowing own-funded imports that began in 1984, whereby the importer is authorized to use foreign exchange from unofficial sources to import a wide range of commodities, now accounts for an estimated one-third of total imports.^{2/} The range of commodities allowed under the scheme has been broadened significantly to include most intermediate goods and a number of capital goods, spare parts and building materials, as well as some consumer goods. The opening and significant expansion of the own-funded imports scheme over the past six years has represented a de facto sanctioning by the government of a sizeable trade liberalized window, and has helped to dismantle the elaborate system of quantitative restrictions (QRs). The own-funds import policy exposed the industrial sector virtually overnight to a trade regime in which levels of protection had fallen dramatically. Average levels of effective protection for industry declined from about 500 percent in early 1984 to about 150 percent in 1985, and some firms became effectively disprotected. Therefore, the own-funds scheme initiated a significant increase in external competition for the industrial sector.

5.6 From 1979 until early 1988, all official foreign exchange had been administratively allocated, effectively implying that variable QRs applied to all imports funded from official sources. Starting in February 1988, the government began to make a portion of overall foreign exchange available on a non-administrative and automatic basis for selected high priority overall import categories, through an Open General License (OGL) System. The foreign exchange for the OGL has been provided by the World Bank and other donors. The opening of this OGL facility represented an important trade liberalization step for imports financed by official sources of foreign exchange. The OGL facility has been gradually expanded and is now governed by a negative list and provides access to official foreign exchange to all importers for intermediate, capital and some consumer goods. Imports through the OGL accounted for about 10 percent of total imports during 1990. With OGL imports running at almost US\$20-25 million per month this percentage will increase substantially during 1991.

5.7 Until the mid-1980s the role of Tanzania's tariff structure in determining the pattern and efficiency of resource allocation had been overshadowed by the prominence of quantitative restrictions and centralized allocation of foreign exchange. From the late 1970s to the mid-1980s, therefore, output and input prices were hardly influenced by the structure tariffs. Instead, prices were determined by the monopoly power given to the local producer through restrictions on competing imports, the structure of 'cost-plus' price controls, the nature of the confinement in the internal trade of commodities and the overvalued exchange rate.

5.8 However, the introduction of own-funded import scheme enhanced the role of tariffs in influencing prices and providing protection to local industries. Nevertheless, in practice the role of the tariff regime has only gradually been increasing partly due to the gradual alignment in the official exchange rate, but more importantly, due to pervasive undervaluation of imports and customs and outright evasion. Nonetheless, since 1988, with the opening of the OGL

2/

Prior to the introduction of the OGL, own fund imports accounted for over 40% of the total imports.

facility, preshipment inspection of most imports (except for own-funds imports) and with the attainment of a more realistic exchange rate, the role of the tariff schedule has become more pronounced.

5.9 Until 1988, Tanzania's tariff structure was relatively complex, including 18 different rates ranging between 15 and 200 percent. The lower rates applied mostly to intermediate and capital goods, while the 60 to 150 percent tariff rates applied mostly to consumer items. In June 1988, the government simplified the tariff structure by lowering of the maximum tariff, compressing tariff rates, and reducing tariff exemptions. The simplified tariff structure resulted in six positive rates being retained and in the elimination of specific duties. The maximum tariff rate was lowered to 100 percent, while most consumer goods attracted duty rates of 40 to 60 percent. Basic need items were subjected to lower duty rates. The Finance Bill of 1990/91 introduced further reforms of the tariff structure by reducing the number of tariff rates to four ad valorem rates: 20, 30, 40 and 60 percent. Also, a number of inputs were given zero duty rates. Nevertheless, these latest changes have actually increased slightly the average customs duty and the dispersion of tariffs (approximately 30 percent).

5.10 There have also been a number of sales tax reforms during the ERP. Until recently there were 18 different tax rates, ranging from 10 to 300 percent, and there were numerous zero rated goods. In 1989 the government started reducing the number of rate categories. In addition, sales tax rates were separated into sales tax and excise tax rates to counter the perception of a high sales tax structure. The 1990/91 budget reduced the number of sales tax categories to four: 0, 20, 30 and 40 percent, though there still are excise duties in place that make the sum of excise and sales taxes at least equal to the old high sales tax rates. It should also be noted that imports are also subject to sales tax according to a schedule equivalent to that for domestic sales taxes.

5.11 During the ERP, the government introduced a number of measures to promote exports. The major exchange rate adjustments that were adopted were powerful incentives for export promotion. Complementary to the adjustments in the exchange rate, in 1987 the government introduced a number of measures to consolidate the export retention schemes and to reduce the dispersion of rates by aligning retention rates for a large number of non-traditional exports to 50 percent and 10 percent for traditional exports. In 1989 the government generally reduced the maximum export retention share to 35 percent, though with continuing exceptions for the seed capital fund, and eliminated export retention for traditional exports. However, the 1990 national investment act reintroduced the higher retention rate of 50 percent, increasing the dispersion and thus the potential misallocation of resources – since different exporters face different effective exchange rates.

5.12 Until mid-1988, there was no export duty drawback system in place, with the result that there was no compensation for the existing anti-export bias against exporters who had to pay duty on their imported inputs. However, due to the widespread duty exemptions that were granted and evasion, the absence of a duty drawback system had only a limited detrimental effect on exports. But as tariff reforms were implemented and exemptions programmed to be reduced, the implementation of an export duty drawback scheme was required in order to reduce the disincentives to exports caused by import duties. Consequently, a duty drawback scheme was initiated in the context of the 1988/89 budget.

5.13 The government also adopted a number of measures to liberalize internal trade, most importantly price decontrol and deconfinement. Since the mid-1980s, the government has decontrolled most prices. Whereas 400 categories of goods were subject to control in the early 1980s, price control coverage was down to ten categories in 1989. Even though the remaining controlled items comprise about 15 percent of the CPI weights, the distortions arising from the remaining price controls are likely to be small due to two factors. First, since 1987 the methodology for calculating those controlled prices utilizes international prices as a key reference point. Second, the policy of own-funded imports has resulted in increased competition, generating pressures on prices to reflect international prices.

5.14 Under Tanzania's policy of confinement, wholesale trade for some domestic and imported commodities was restricted to particular parastatal organizations. Under this system of state trading monopolies, industries were required to sell certain goods through national and regional trading companies and to purchase many of their import requirements and some domestic inputs through designated parastatal trading firms. Over fifty broad categories of goods were subject to internal confinement, comprising mainly consumer goods, building materials and agricultural implements. All imported goods were deemed confined, unless specifically exempted. From 1986 to 1989, some de facto movement away from monopoly confinement to more diversified confinement took place, the result of the granting of numerous exemptions. In 1989, the government approved legislative measures to end confinement for virtually all firms and products. As of 1990/91 there were only 10 manufactured items still under price controls and confined,^{3/} in addition to services which remain controlled, and an additional 6 items confined but not price controlled.^{4/} As of mid-1991 price controls and confinement will officially only apply to petroleum products and fertilizer, though the effect of these regulations are minimal as both items are freely importable through own funds and the OGL.

C. Impact of the Reforms

5.15 A repeat formal sector industrial survey (FIS) was conducted by the World Bank in late 1989, covering the same sample as the 1985 survey,^{5/} to help assess the impact of the reforms on the growth of output and the structure of the industrial sector since the mid-1980s. The original and repeated surveys covered production of particular products of 48 firms, or over 10 percent of the formal industrial sector, and as such can be seen to give some indication of the situation throughout the sector. However, one weakness of the trace survey is that it cannot capture diversification of production by these firms or new entrants to the sector. Nonetheless, both the evidence from the FIS and the national accounts suggest that overall industrial performance has improved during the ERP era. Both sets of data indicate that the significant decline in manufacturing GDP that began in the late 1970s has been reversed. Whereas

3/ Farm implements, electric cables, cement, sugar, galvanized corrugated iron sheets, tires and tubes, petroleum products, fertilizers, reinforced steel and beer.

4/ Gunny bags, bicycles and spares, khanga, kitenge, uniform materials, pipes and pipe fittings.

5/ The 1985 survey provided the data on which the World Bank Report, "Tanzania: An Agenda for Industrial Recovery", was based. It surveyed 118 private and parastatal manufacturing activities in 48 firms covering all subsectors, collecting information on the firms' performance during 1984.

manufacturing GDP declined by about 7 percent per annum between 1979-1986, it grew by about 5 percent per annum between 1986-89. The manufacturing share of GDP rose from 7 percent in 1985 to 9 percent in 1989. Capacity utilization increased from 25 percent in 1985 to 35 percent in 1989 and manufactured exports rose from US\$ 33 million in 1984 to US\$ 87 million in 1989.

5.16 Data from the FIS were used to examine the impact of the reforms on the pattern of the industrial recovery and on resource allocation and use within the industrial sector. To complement that data a small survey, covering a subset of the companies included in the larger survey, was conducted on investment patterns, present and planned, as an indicator of changes in Tanzania's industrial structure. From the analysis of data from both surveys it is apparent that a significant restructuring in production has begun to take place. The survey also suggests that even though production of inefficient firms has contracted, these firms continue operating because they continue to enjoy preferential access to credit and foreign exchange. These insights emerge from exploring the relationships between production and: (i) firm efficiency, (ii) ownership and size, and (iii) export orientation.

5.17 The survey evidence indicates that firms which were found to operate relatively efficiently in 1984 (a domestic resource cost -- DRC -- ratio of less than 2 was used for this measure) increased output significantly during 1985-90. Even as the structure of effective protection was being radically changed between 1985-90, their output on average increased by 28 percent (Table 1). Conversely, inefficient firms (DRC greater than 2) contracted their production by an aggregate 22 percent over the period. Among the inefficient firms, the most inefficient -- those with negative value added in 1984 (i.e. infinite DRC) -- experienced the largest contractions in production (28 percent). Therefore, the relationship between the degree of efficiency and production performance in the post-1984 era appears to signal a break from the past. Before 1985, the protective trade and industrial policy regime resulted in a pattern of output which was unrelated to economic efficiency, and many large, inefficient and import-intensive firms came into being and grew as a result of the administratively allocated and subsidized foreign exchange (and other inputs), while smaller firms folded. ^{6/}

5.18 However, in spite of this apparent break from the past, it is still evident that inefficient enterprises have managed to survive in the much more competitive environment created by the ERP; no inefficient enterprise surveyed in the original survey has closed down. One possible explanation is that their efficiency has improved dramatically over the period, or that these firms were never as inefficient as the original measurement suggested in 1984. This explanation is unlikely, however, in light of the evidence of the continuing high imported input content for the inefficient firms: the foreign exchange cost for these firms alone is estimated to represent almost 70 percent of the value of their production. The evidence for the firms which were operating at negative value added in 1984 is even more striking: between 1985-88 the value of foreign exchange used appears to have exceeded their value of production, indicating that production continued to result in negative value added. A more plausible alternative explanation explored below is that subsidies and/or some form of protection precluded the restructuring of inefficient firms and the exit of unviable activities.

6/

See World Bank Report No. 6357-TA, "Tanzania: An agenda for Industrial Recovery", 1987.

Table 5.1: Formal Industry - Efficiency, Production, and Foreign Exchange and Credit Use

Firms' Efficiency g/ in 1984	Cumulative Production Value Increase (1985-90)	Foreign Exchange Used as Share of Production Value (Average 1985-88)	Outstanding Credit as Share of Production (end-1988)
Relatively Efficient g/ (DRC < 2):	+28 percent	22 percent	12 percent
Inefficient Firm (DRC > 2) of which:	-22 percent	69 percent	41 percent
Negative value added g/:	-28 percent	103 percent	N.A.

g/ Classification of firms efficiency based on the analysis of the 1985 survey of 118 activities reporting on their performance in 1984 and hypothetical performance for higher levels of capacity utilization. A DRC of less than 2 is used as relative efficiency cutoff to allow for a 100 percent margin of error (choice of a depression year, infant industry considerations, etc.). An 'absolutely inefficient' firm is defined as one that had negative value added in 1984.

Source: FIS

5.19 Output trends also appear to be related to firm ownership during the period. While over two-thirds of private firms increased production, only half of public enterprises managed to do so, with the remainder experiencing a decline (Table 5.2). The size of the firm also appears to matter, although the pattern is less significant. Most larger firms contracted, while smaller and medium sized (about 10-100 workers) expanded (Table 5.2). Finally, consistent with the exchange rate and trade reform process during the period, exporting firms typically fared better than non-exporters and were more efficient users of foreign exchange. (Table 5.3).

Table 5.2: Industrial Output, Firms's Size and Ownership, 1985-90

	Share of Firms Expanding	Share of Firms Contracting
Public Enterprise	.52	.48
Private Enterprise	.69	.31
Larger Firm	.48	.52
Smaller Firm	.60	.40

Source: FIS

Table 5.3: Export Orientation, Production, and Foreign Exchange Use

	Production Increase (Total 1985-90)	Foreign Exchange Used as Share of Production (Average 1985-88)
Exporter	14 percent	22 percent
Non-Exporter	3 percent	47 percent

Source: FIS

5.20 The evidence suggests, therefore, that a measure of industrial restructuring is underway, and that the direction of the restructuring in output is consistent with the revamped incentives provided by the exchange rate, trade and industrial policy reforms. Enterprises which are economically efficient, medium scale, privately owned and export-oriented have tended to expand output significantly, while firms that were economically inefficient in 1984, including large-sized parastatals, have contracted.

5.21 Resource Allocation and Use. One important issue raised by these results is whether this output restructuring implies that resource allocation in industry has improved significantly. This need not necessarily be the case since the inefficient firm, while contracting output, could utilize resources with increasing efficiency. Similarly, the efficient firms could be expanding output with declining efficiency. Since the repeat survey of 1989 did not reassess the overall efficiency of the firms, it cannot be determined conclusively whether resource allocation has improved significantly or not. It is clear, however, that major inefficiencies in production and substantial misallocation of resources could remain as firms that were found to operate at negative value added in 1984 which comprised one-third of the sample, continued to exist today.

5.22 These results have a number of implications. First, the availability of additional foreign exchange *per se* does not necessarily lead to improved industrial sector performance and higher value added. As long as foreign exchange continue is channeled to inefficient enterprises, such foreign exchange would not be associated with gains in manufacturing value added. Second, although the previously efficient firms appear to continue to produce efficiently, judging by their low import content and ability to expand output in a more competitive environment, firms found to be very inefficient in 1984 are still producing and at high levels of inefficiency. This, in turn, suggests that some type of protection or subsidy is keeping these enterprises operating as in the past, and protecting them from facing the choice of restructuring or closure.

5.23 How do the inefficient enterprises continue to be protected under the present trade and industrial policy regime? The main instruments of protection for inefficient enterprises, following the *de facto* removal of most internal and external trade-related protection during the ERP, are at present provided by the financial sector and the Treasury. The financial sector has continued to lend to ailing firms, particularly parastatals, many of which are in serious arrears (See Chapter 3). Out of 100 industrial parastatals, the audited financial statements of 61 of them showed net operating losses before tax in 1988. Total accumulated losses for all the parastatal industrial holding companies at the end of 1988 was more than Tsh 3 billion; their total outstanding debt was Tsh 74 billion, greater than the value of net fixed assets of Tsh 54 billion (on a revalued basis) at the end of 1988. The financing of investment of industrial parastatals

has been largely through external debt, while recurrent operating losses have been financed through the commercial banks, and to a lesser extent, by Treasury.

5.24 The financial system has played an increasingly important role in overall resource allocation as the exchange rate alignment proceeded. The higher price of foreign exchange, coupled with the trade liberalization measures, implied a significant decline in the rationing of foreign exchange and made the administrative allocation of credit the binding constraint. Firms with access to financial resources have been able to purchase significant amounts of imports through the OGL. To the extent that credit provided by the banking system does not follow strict creditworthiness criteria and is not repaid, the result is a substantial misallocation of foreign exchange and imported inputs.

5.25 The findings from the FIS sample on credit utilization, while indirect and not definitive, are supportive of the credit misallocation hypothesis. End-1988 outstanding credit as a share of production was 3.5 times higher among inefficient firms, compared to the efficient firms (Table 5.1). Furthermore, the lending of the formal financial sector has been biased in favor of the parastatal sector, when compared with the private sector. The public manufacturing sector, which produces roughly 50 percent of formal sector industrial value added (and a significantly smaller share of total manufacturing output if the very small and informal sector is included) draws about 70 percent of the total loans to the industrial sector.

5.26 There are a number of other ways in which inefficient firms have received financial support (Chapter 3). Many parastatals in difficulty have had access to loans from the Treasury, which has become a de facto banking institution – though without any credit analysis capability. At the end of June 1989 debt obligations of the parastatal industrial holding companies to the Treasury were about Tsh 55 billion. Most of these loans are either free of interest or charge well below market rates of interest. More significant, however, is the fact that two-thirds of these loans outstanding were in arrears at that time. The Treasury also de facto provides credit because the counterpart shilling payments for foreign exchange provided through import support programs of donors are often not paid by the importer. The Treasury, through the budget, has continued to provide subventions and grants to parastatals equivalent to 6-8 percent of overall expenditures. In addition, Treasury often provides financially distressed parastatals with relief from customs duties, sales taxes and corporate taxes. Donor import support programs which target specific enterprises have also supported some inefficient manufacturing firms.

5.27 Industrial parastatals, on the whole, have therefore not been forced to undertake a major restructuring, in spite of the pervasive inefficient nature of a large segment of the sector. Inefficient enterprises have contracted output on the average, but inefficient resource use continues. The formal private sector also includes inefficient firms that have continued operating inefficiently, also due at least in part to protection from the Treasury or the financial sector. Overall, however, inefficient private firms have benefitted from access to subsidized credit to a much lesser degree and appear to have been exposed to much larger pressures to restructure through the market.

5.28 Investment in Industry. Another critical indicator of the degree and direction of change in the manufacturing sector in recent years is the pattern of investment. Although recent official data on industrial investment is virtually non-existent, mini-studies to investigate the

patterns of public and private investment were undertaken for this report's preparation. While these have not covered the entire sector, the results of the studies could provide an indication of the general situation. The research combined a survey of recent and planned investment of 28 medium-size and large firms in the formal sector, equally divided into public and private sector firms, with an in-depth investigation into the Public Investment Program.

5.29 Analysis of these data suggests a number of patterns. First, a decline in industrial investment has taken place. Overall investment declines over the past decade are consistent with the fall in government's and donors' industrial sector investment expenditures (see Chapter 3 on the declines in development budget expenditures). In addition, the National Accounts data indicate a decline in capital formation over the 1986-89 period. Similarly the investment survey suggests that investment levels were substantially higher in the manufacturing sector during 1983-85 than the 1986-89 period. The survey data indicate that the decline in total investment during this period was primarily due to a marked fall in investment by private firms (public investment levels already having fallen). Nevertheless, one-quarter of the sampled firms significantly increased their investments during 1986-89. With the exception of one of these firms, they all had efficient operations in the 1985 survey, suggesting that one effect of the ERP has been to alter the structure of investments in favor of more efficient operations.

5.30 Expectations about the firm's investments over the next few years vary by the type of enterprise. All but four of the private firms in the sample expect to invest significantly (i.e., greater than 25 percent) more over the next three to five years. One of the factors driving these investment plans appears to be the increasing export orientation of the private firms in the sample. About half of those private firms that are planning to significantly increase investment are already exporting. They also plan to raise the export share of their total sales. Moreover, half of those private firms with plans to significantly increase investment, but which do not already export, expect to start exporting over the next three to five years. By comparison, most of the parastatals surveyed project no new investment in the next three-five years. Almost none of those parastatals that do not plan to invest are currently exporting nor do they expect to start exporting. They also have experienced very sluggish growth of domestic sales. The perception of a limited domestic market is an important factor in the lack of investment plans among those import substituting industries that have lost market share to imports in the aftermath of the post-1985 import liberalization.

5.31 Other important constraints to investment are the price of, and access to, credit and foreign exchange. Given the scarcity of term finance in the banking system, the surveyed firms expected access to credit to be a key constraint to investment, both for the parastatal and private sectors. However, respondents ranked access to credit behind devaluation and access to foreign exchange. The explanation seems to lie in the ways in which firms tend to finance investment. None of the reporting firms have used bank credit to finance their investments since 1983. Nearly all foreign financing has come from donor support, foreign equity, allocations of foreign exchange for the Bank of Tanzania or own funds. All local currency financing has come from retained earnings.^{2/}

^{2/} As seen in the next section of this chapter, this finding is marked contrast to the situation for small scale industries where the shortage of credit appears to be the principal obstacle to expansion.

5.32 Aside from the constraints to present and future investments mentioned above, many firms that were surveyed pointed to the high level of corporate and indirect taxes as major concerns. Textile manufacturers in particular complained bitterly about the structure of customs duties which they feel has adversely affected their ability to compete with imports. A few firms also pointed to restrictions relating to hiring expatriate technical staff and repatriation of profits as constraints. At least two firms also pointed to the difficulties in obtaining the necessary government approvals (e.g., a business license) as an obstacle to investing in new areas.

D. Technological Capability in Tanzania's Industry^{8/}

5.33 The sources of the problems in much of Tanzania's industry cannot be solely traced to trade, financial and pricing policies alone. Dynamic factors, namely the inadequate technological and human resource development base have been equally important. In any country, the dynamic process of acquiring technological capabilities through learning, adaptation and improvements, is crucial to the efficient use and to productivity gains over time of given manufacturing technology.^{9/}

5.34 Although some restructuring and streamlining has taken place, industry today appears to still be over-extended in relation to the country's technological, skilled labor and managerial capabilities. The capabilities constraint had three different causes: (i) Tanzania embarked on industrial activities which demanded more advanced skills and know-how than it possessed, i.e. some 'inappropriate technological choices'; (ii) Tanzania's industrialization resulted in more activities, regardless of the level of technological capabilities they require, than its human resource base could handle, i.e. 'overextended' industry; and (iii) the country has not yet developed new skills and capabilities to meet growing industrial demands, i.e. 'inadequate capability growth'. The relatively short history of industrialization in Tanzania, with the lack of a supportive base of technically qualified manpower and with a policy framework not conducive to adequate technological development resulted in serious weaknesses in project preparation and execution, and in process, product and industrial engineering. These two aspects, which take time to address, are associated with remaining inefficiencies in the performance of the sector today.

5.35 There have been substantial shortcomings in project preparation and execution capabilities. The highly protected environment and the thrust of the Basic Industrialization Strategy resulted in many uneconomic investment choices which may now prove difficult or impossible to restructure. In addition, actual project design was often undertaken by foreign consultants or equipment suppliers unfamiliar with local conditions and lacking long-term

8/ This section draws from the Industrial Sector Report, op.cit.

9/ The phenomenal export success of the newly industrializing countries' has been largely based on their own efforts to master new technologies and raise their productivity. In fact, the very same technologies when used by other countries with similar factor endowments, were much less successful where the technological capability to operate them efficiently and upgrade them over time was lacking, or where the growth of technological capability was frustrated by misdirected government interventions. The recent growth in such skill-intensive exports as micro-electronics, ships, aircraft or automobiles from a number of developing countries testifies to the role of their own dynamic learning in successful industrialization.

commitment to the success of the project. The problem was magnified by the limited local capability to assess the project design, equipment specification, appropriateness of product technology, and the need for infrastructural support. Weakness in project execution also resulted in delayed completion of investments. Some foreign technology suppliers did not transfer fully the know how to operate their plant which domestic skills could not fully fill. In addition, some suppliers failed to train the local operating staff properly even when they retained technical and managerial control. By contrast, some firms in Tanzania started with only a minimal capability to set up their project, and sought the most appropriate equipment and technology. For example, a radiator manufacturer and a firm which reconditions vehicles procured equipment and know how from several countries according to their specific requirements and from inexpensive suppliers.

5.36 The substantial deficiencies in the launching of new projects in Tanzania have been less apparent since the ERP was launched, given its emphasis on utilizing existing capacity more effectively. However, large technological capability gaps still prevail today in ongoing manufacturing firms. One of the important technological gaps in Tanzania is the lack of preventive maintenance. Although anecdotal evidence suggests that some improvement has taken place since the mid 1980s, it is still the case that in many firms equipment is run until it breaks down. In addition, quality control is weak in many sectors, largely due to the shortage of technical personnel and appropriate management. For example, pharmaceutical firms operate without enough qualified pharmacists. Many firms have not had a quality control manager for years; often the positions of production engineer, production manager and maintenance engineer are also vacant for long periods of time. More generally, as was found in the Industrial Sector Report, there are no distinctive sub-sectoral patterns of technological capability in Tanzanian manufacturing. Traditional industries (textiles, footwear) are not necessarily technologically more competent in Tanzania than modern sectors (cement, chemicals). Underdeveloped engineering capabilities exist throughout the sector.

5.37 The performance of many industrial firms in Tanzania is also seriously hampered by infrastructural bottlenecks. Inadequate provision of power, water and transport is associated with frequent production stoppages and high unit costs for a substantial number of enterprises. In power, frequent interruptions in the supply of electricity is a recurrent problem affecting most of the sector. In the textile sector, for instance, the problem has been particularly acute in a number of plants which have experienced losses of about ten percent of production. In addition, some enterprises lack access to power altogether, resulting in severe production losses and even in production shutdowns for several months. Water shortages, often due to lack of power, hamper some industries, such as textiles and tanneries. Furthermore, transportation difficulties resulting from the lack of appropriate port facilities outside Dar es Salaam, the scarcity of trucks and railway wagons, equipment breakdowns and inadequate road infrastructure, lead to frequent shortages and delays in deliveries of inputs. These transport problems have hampered normal operations of many factories, as in the cases of cotton delivery to textile mills. Because of the low value of cement per weight unit, transportation costs seriously affect the performance of this sub-sector: inadequate port facilities, different gauges used by the railway system and poor road conditions increase overall costs of cement. Aside from the inadequacy of infrastructural investments and maintenance in the past, the infrastructural bottlenecks have often been brought about by inadequate plant size selection.

E. Impact of the Reforms on Small Scale Enterprises

5.38 The development of small scale industry has been affected by many of the same obstacles and has also been confronted with its own special problems. Over the past twenty or so years the environment for small scale private enterprise has been less than hospitable. Through much of the 1970s and early 1980s, the government's attitude towards the private sector in general was hostile or ambiguous at best. Nevertheless, for historical reasons, Tanzania still has a cadre of experienced private entrepreneurs primarily of Indian origin. On the other hand, indigenous entrepreneurship is at a much earlier stage of development. In the wake of the economic crisis of the early 1980s and the onset of the ERP micro-entrepreneurial activities have mushroomed throughout Tanzania. According to a recent data from the Bureau of Statistics, the number of small scale firms established in Dar es Salaam between 1986 and 1990 was about 2500--was three times the total number of similar firms that were established in the almost twenty year period from 1967 to 1985 and are still in business.

5.39 Unfortunately, very little data is available on the small scale enterprises. Therefore, as background to the preparation of this report an entrepreneurship survey was carried out in 1989 to evaluate the obstacles to development of the small scale sector. The survey was carried out in three subsectors -- furniture making, the construction industry and horticulture -- that are potentially efficient and pose limited barriers to entry for small scale operators in Tanzania. Even though not all of these subsectors are part of the industrial sector, and not all small-scale subsectors were covered, the results suggest some of the problems throughout small scale industry. In addition, those findings are consistent with findings of similar studies in other countries and should thus give the government greater confidence in the conclusions and policy ramifications set forth. While a complete analysis of the survey results are contained in Annex 5A, this section summarizes the main findings from the survey.

5.40 The available aggregate data and the results of the entrepreneurial survey all point towards the conclusion that there exists in Tanzania an abundant supply of indigenous entrepreneurs with the initiative and commitment to sustain a development strategy which gives a central role to efficient private enterprises. These indigenous entrepreneurs appear to be a highly diverse group when viewed from the perspective of education and prior employment experience. Further, a substantial fraction of the entrepreneurs of all backgrounds appear committed to increasing substantially the size of their enterprises, and -- most clearly in the furniture and horticulture sectors -- the opportunities for growth of these enterprises are abundant. Whether this potential can be realized largely depends on the character of the environment for entrepreneurship in Tanzania.

5.41 The environment for small scale entrepreneurship poses a number of obstacles to its growth and development. Among those obstacles are regulatory policies which are quite restrictive in Tanzania. The most significant regulatory obstacles to small scale industry are problems associated with the licensing of enterprises to operate, the assessment and collection of taxes, and gaining access to industrial sites. The system of enterprise licensing is comprehensive in Tanzania. Licenses are required for all enterprises regardless of size. The fees involved and compliance with licensing requirements often entail significant costs because of the side payments extracted by officials. The system of tax assessment and collection also is associated with side payments and frequent harassment of entrepreneurs. Scarcity of industrial sites, inadequate

zoning laws and uncertainty of land tenure status for firms that are already operating inhibits the entry of new enterprises and the expansion of existing firms. Therefore, overall costs of the prevailing regulatory environment -- the official fees and payments, side payments and time spent navigating the bureaucratic morass -- are substantial. The relative burden of these costs is significantly greater for the smaller, indigenous entrepreneur. Larger, often non-indigenous, firms are able to manage these costs much better. Therefore, Tanzania's regulatory environment has the paradoxical and unintended consequence of strengthening the competitive position of large enterprises in relation to indigenous small firms whose entry and expansion are inhibited.

5.42 Although the regulatory environment is exceedingly restrictive, costly and inhibiting, regulatory obstacles do not now appear to be the dominant binding constraint on the small scale sector. Other weaknesses in the external environment -- especially limited access of firms to finance -- represent the greatest obstacle to the development of indigenous entrepreneurship. Lack of access to finance was identified as the most severe constraint on expansion of an overwhelming majority of firms surveyed. As is the pattern worldwide, small scale firms in Tanzania rely heavily on the savings of the proprietor, retained earnings and support from family members or partners to finance their ventures. Unlike small scale firms elsewhere, their counterparts in Tanzania generally do not have access to trade credits or informal financial markets. Financing from the formal financial system has also been problematic. Only about one third of the indigenous firms interviewed obtained finance from formal financial institutions, and they are largely of medium size. Less than 10 percent of the sample had ever received support from the Small Industries Development Organization.

5.43 Very few firms had good relationships with the formal financial institutions. Many firms found the requirements of applying for a loan very difficult. Even those firms with the necessary collateral, feasibility studies and financial statements in hand reported that the processing of loan applications takes an average of six months, and may still require side payments as a precondition for processing. Consequently, even firms with a track record of success and with significant potential for growth are often discouraged by the banks. The banks have not assisted such firms in graduating from being small scale enterprises and generally are not responsive to the needs of small firms. Overall, Tanzania's banks do not view their lending to indigenous SMEs in developmental terms, with a goal of identifying and supporting enterprises that have real potential to succeed commercially, and a mutual interest on the part of both the bank and the enterprise in a venture's success. Rather, as many indigenous enterprises see it, the banks perceive them to be unwelcome supplicants, to be dealt with only so long as stringent conditions are met and, even then, only so long as the enterprise respects without question the omniscient authority of the lending agency.

5.44 The survey results pointed to a number other obstacles faced by small firms. Infrastructure constraints -- telephone service, electricity and water -- emerged repeatedly in interviews. Access to equipment, spare parts and materials also was identified as an issue although its importance has declined since the time firms started their operations and the time of the survey, suggesting the importance of the liberalization program (particularly own-funded imports, OGL and deconfinement) in increasing the availability of inputs. While a lack of technical and marketing skills received a low ranking, it may become more of a constraint in the future as firms endeavor to move into new, more demanding markets, including exports, in the future. Whether they will be able to overcome these obstacles will depend crucially on the

quality of (private and public) technical and marketing support services to which they now have little access.

F. Agenda for Reform of the Industrial Sector

5.45 The trade and industrial policy reforms that have been implemented during the Economic Recovery Program have helped to revive both large and small scale firms in the industrial sector. The policy framework has initiated not only a recovery of output, capacity utilization and investment, but also some move toward some restructuring of industrial sector, in which the more efficient firms are expanding and some of the more inefficient enterprises are contracting and not planning to invest. A significant segment of the industrial sector has moved ahead in spite of the continuing difficulties in the overall business environment and persistent infrastructural constraints in Tanzania. This strongly suggests that there is substantial potential for further recovery and growth in the industrial sector provided these issues are addressed.

5.46 The following section attempts to outline the main elements of the agenda of further industry-wide policy and institutional reforms that are required for industrial sector development and suggests those measures needed for reform of the industrial parastatals, development of the private sector in general, and promotion of small scale industry in particular. It also suggests new directions for the roles of the government and donor community in supporting the next phase of industrial development in Tanzania.

5.47 **Further Industry-wide Policy Reforms.** While recent reforms of trade and industrial policies have done much to encourage exports and greater efficiency in import substituting industries, there are a number of areas where further policy reforms are needed. On the trade side, achieving and maintaining a more competitive exchange rate and expanding access to imports on a market determined basis will obviously continue to be of critical importance. In this regard, the government should move over the next three years to a unified import system under which all goods are imported under a single facility, the OGL. With the exception of tied procurement under agreements with donors, all imports funded through the Bank of Tanzania should be administered under the OGL. The government and donors should also work together to make the necessary changes so that import support from donors is provided through the OGL rather than by tied procurement or arrangements tying the support to particular enterprises. The own funds scheme should continue to function as an unrestricted import window funded from sources other than the Bank of Tanzania. In addition, the negative list governing the OGL should be progressively shortened so that it is finally limited to a very short list of items prohibited for health and security reasons, while increasingly relying on other policy instruments, e.g. taxes, to encourage domestic industries and discourage luxury consumption. That same list should also govern imports under the own funds scheme.

5.48 In order to support this further liberalization of the import regime and improve the medium-term viability of the balance of payments, the government would have to achieve and maintain a foreign exchange regime which would determine the exchange rate on the basis of balance of payments viability within the context of liberalized imports, equilibrating supply of funds and demand for imports under the OGL, export profitability, and other fundamentals. The government could also gain indications of a market-determined exchange rate from an appropriately discounted (for capital flows) parallel exchange rate. One option being considered

would be to establish foreign exchange bureaus which would be allowed to purchase foreign exchange freely, at a rate determined by them. Foreign exchange purchased through these facilities could be used, *inter alia*, for own funds imports or for service imports, which are not presently liberalized. One source of the bureaus' foreign exchange could be exporters' receipts from the export retention scheme, which would have to become freely available for such purposes. It is also important to eliminate all exceptions to a uniform export retention rate. Therefore, the seed capital revolving scheme, which provides foreign exchange financing for exporters, should be merged with the general export retention facility.

5.49 Also in the area of imports, there is a need for further rationalization and coordination of the structure of tariffs and sales taxes to provide lower and more uniform levels of effective protection to industry.^{10/} Another important issue relating to imports concerns customs administration. First, there is the need to reduce container turnaround time. This is because the demurrage charges by shipping companies are high. In addition, awkward customs procedures have acted as a barrier to imports, as time spent in the port (which ranges from a few weeks up to two months according to importers) adds additional inventory and working capital charges that must be borne by importers. Second, customs procedures need to be strengthened to address the problem of disprotection of local industry (e.g., textiles) from non- and under-declaration of imported goods, including possible pre-shipment inspection of own-fund imports, more thorough inspection at port of entry, compensation reform and incentive schemes for customs officers and improved procedures for licensing clearing agents. In the longer term, exchange rate reform and elimination of exemptions would allow across-the-board reductions of taxes and tariffs which would eliminate incentives for many of the anomalies now facing Tanzania.

5.50 Export procedures also need to be improved. Despite recent improvements, there are still a number of bureaucratic barriers that act as a deterrent to exports, including the various documentation, permits and licenses required to export. Export licensing requirements, save on an exceptional basis (i.e., for a very short list of goods), should be abolished. TANPRO's efforts to establish a "one-stop" center for export documentation and approval need to be supported by government and donors. The Export and Import Control Ordinances and the Customs Management Act should be streamlined to help simplify customs procedures for exports as well as imports. Also, donor support is needed for the training of customs officials and the development of an effective operational manual for Customs procedures. On the organizational side, exporters should no longer be confined to go through the Central Freight Bureau in applying for space on a vessel since exporters could negotiate (perhaps more successfully) directly. The Seed Capital Revolving Fund also needs to be streamlined so as to, as was originally intended, provide pre-shipment export credit only to new exporters. Established exporters should not qualify for the fund.

5.51 These trade reforms need to be complemented by reforms of regulatory policies to promote greater domestic competition, including the entry of new firms and the exit of unviable

10/

While there is some scope for further, revenue neutral tariff reform that could achieve these objectives, the need for additional revenue is an important macroeconomic consideration to be taken into account in setting tariffs and sales taxes. The Tax Commission is analyzing tariffs and sales taxes in this kind of broader context.

ones. As noted earlier, there is limited domestic rivalry among industrial firms in many subsectors because of the dominance of a few producers, many of which are parastatals—e.g., for sugar, beer, cigarettes, corrugated iron sheets and cement. New firms should be encouraged and licensed to enter these subsectors. At the same time, the orderly exit of unviable companies must be facilitated by better implementation of the Companies Ordinance. While the procedures set out in the Ordinance for winding up companies appear to be adequate in theory, actual implementation is very slow due to delays in the court system and the lack of lawyers familiar with the practice of company law. While these shortcomings will take some time to overcome, Tanzania needs to develop a bankruptcy protection law, where a company can seek protection from its creditors while it implements a court-supervised restructuring.

5.52 Parastatal Restructuring. On the whole, except through changes to the overall macro framework, industrial parastatals in Tanzania have not undergone a major restructuring despite their economic and financial problems. Government policies that postpone industrial restructuring should be tackled as a top priority. In particular, the government should put an end to Treasury's guarantees of commercial bank loans to ailing parastatals and hidden subsidies, including tax breaks, forgiveness of counterpart funds and the provision of bridging finance, which keep unviable firms operating. In complementary fashion, the proposed financial sector reforms, particularly the elimination of directed credit, are also needed to stem the flow of bank credit to non-viable firms. By hardening the soft budget constraint that the parastatals have enjoyed, closures of some parastatals would be inevitable. This underscores the need to strengthen bankruptcy and liquidation procedures.

5.53 At the same time, attention should be focused on direct measures to restructure the parastatals. In this context the government should quickly proceed with its plans to classify the entire parastatal sector into potential divestments, retentions and liquidations. Those that are noncommercial in nature would be reclassified as government departments that would be financed through the government budget. For those parastatals that are fundamentally commercial entities, those which are judged to be strategic (e.g., public utilities and defense-related industries) and therefore would be more likely to remain as parastatals for the time being, should be given the autonomy needed to be run efficiently and forced to operate within a competitive and commercial environment.

5.54 Improving the autonomy of the parastatals would entail reducing the layers of management over the parastatals, which today inhibit the ability of managers to carry out their responsibilities. As a first step, the parastatal holding companies should be abolished since they add little value to the operations of member companies though add significant costs in terms of management fees and interference in company management. Second, interference by parent ministries in the management of parastatals should be removed. The boards of directors of the parastatals should be empowered to set the strategic direction for the company and review the company's performance accordingly. The boards should be properly constituted with competent professional managers, including some from the private sector. The boards of directors in turn would not be involved in day-to-day management of the company. This would be left to the general manager who must be given the autonomy to select his management team and permitted to run the company in a manner that is consistent with the strategy agreed upon with the board, in particular relating to pricing and employment policies (including setting wages, determining retention, etc.).

5.55 To improve the incentive framework for those enterprises that are to remain as parastatals, the government should use performance contracts, initially for the larger enterprises, that clearly lay out the expectations regarding performance that the government has for the parastatals as well as the degree of independence and government support the parastatal would receive in return. In addition, productivity-based incentive schemes for managers and workers alike are needed to encourage greater commercial orientation and efficiency of the parastatals.^{11/} Commensurate with the need to improve the autonomy and commercial orientation of the parastatals is the need to improve the accountability of the parastatals. The government should also tighten its enforcement of financial regulations to ensure that financial audits of the parastatals are carried out and timely.^{12/}

5.56 For most commercial parastatals, which are clearly not strategic, the government should invite the private sector, local and foreign, to participate in those companies either on a joint venture basis or as wholly private companies with the degree of private sector participation being determined pragmatically through negotiations between the government and investors, based on resource requirements of the enterprise rather than on pre-determined rules. Private sector participation would bring sorely needed financial and managerial resources to improve the performance of the public sector enterprises; another benefit could be access to outside know-how and capital in order to become more efficient and competitive.

5.57 At the same time, the government should ensure that all subsector policy issues that might discourage private investors from taking equity positions in these parastatals would be satisfactorily addressed. However, government policy should not be made too favorable in an effort to encourage private sector participation. The government should steadfastly resist pressure from private investors for preferential treatment, including guaranteed monopoly status, bans of competing imports, high tariff protection, duty exemptions or preferential access to credit as conditions of participating in parastatals; replacing inefficient public enterprises by uncompetitive private companies would be counter-productive and could create a political backlash to privatization. Private investors interested in participating in joint ventures or in completely taking over parastatal enterprises must know that they will have to face the rigors of competition from other domestic producers and imports, and in export markets as well.

5.58 The choice of parastatals for privatization depends on the government's underlying objectives for the program. In some countries, privatization has been part of a more general effort to deregulate and liberalize the economy and to establish widespread participation in ownership of the parastatals. In these circumstances, the scope of the privatization program has been very broad in terms of subsectors from the outset, and the government has made a general announcement of its intention to privatize a broad array of industries. To date Tanzania's approach has been more cautious. The subsector-based approach has been to seek additional

^{11/} Starting in 1991, TANESCO will use a productivity-based incentive scheme for its managers and workers that is expected to improve the company's performance.

^{12/} At the end of 1989, 94 out of 365 parastatals in all sectors were more than one year in arrears in producing audited financial statements. In addition to lack of enforcement of financial regulations, this reflects a general lack of internal auditors and the need for greater emphasis by government and donor support on accountancy training.

equity investment and a dilution of state ownership of parastatals, rather than liquidation of existing assets. In this context, privatization has been aimed at improving the financial position and technical renovation/expansion of selective parastatals. This approach is currently being taken for the parastatals in the shoe and leather industry in Tanzania and will be followed shortly in the textile and edible oils subsectors. The current efforts underway in these three subsectors should be expanded to other subsectors in industry.

5.59 In the future, given that virtually all parastatal enterprises will most likely require new investment to replace and expand capacity, and given that government does not have the resources for this investment, Tanzania's restructuring and privatization effort will also need to take on aspects of a more general program to relieve government of the financial and administrative burden of the parastatals. Thus the subsector approach should be supported by parastatal-wide reforms aimed at: (a) hardening the budget constraint that all enterprises face so that the parastatals have to manage without government subventions; (b) improving the autonomy and accountability of the parastatals; (c) increasing the commercial orientation of the parastatals through the use of performance contracts, management contracts and productivity-based incentive schemes, and (d) increasing competitive pressure on the parastatals to become more efficient and dynamic through further reforms in trade and industrial policies.

5.60 Whether under the present case-by-case approach or in the context of a parastatal-wide program, it is important that the choice of parastatals for joint venture not be too ad hoc. There are a number of criteria that could be used in deciding which enterprises to privatize. One important factor, of course, is whether or not the parastatal is financially viable. While the privatization potential of a PE is not solely determined by its profitability, it is a critical determinant of how easy or difficult the partial sale of its assets will be. Certainly at this early stage of privatization in Tanzania, it is important that the first divestiture attempts are successful. Therefore, the initial choice of companies to privatize should mostly comprise companies with strong potential to be viable. Some chronically poor performers that are also economically inefficient may also need to be included to relieve pressure on the budget and financial system, but government must recognize that, ultimately, many such firms may have to be liquidated. In this context, current discussions on the choice of next subsectors for developing restructuring plans -- a principal element of which would be inviting private sector participation -- have focused on including those which contain economically viable product groups with high domestic value-added. Since access to new technology may best be had through investment relationships, parastatals in the technology-intensive textiles and metals and engineering subsectors should be considered for early privatization.

5.61 Among those companies which do not attract private participation, those which are unviable should be liquidated. In some instances it may be possible for the liquidation itself to be targeted toward development of indigenous small-scale enterprises. For example, shoe manufacturing assets and equipment which are programmed for liquidation could be sold to individuals who were trained on that machinery but can no longer be gainfully employed in the enterprise to be closed. Hence government should not view liquidation of assets as a total loss to the economy.

5.62 On the other hand, those enterprises which do not attract immediate private participation but are judged to be viable over the long term could be restructured to achieve

financial and economic viability -- though the resources for undertaking this are, at best, minimal. The necessary restructuring could require asset disposal and downsizing given the chronic under-utilization of assets held by parastatals and the lack of public funds for technical renovation. Such a process would require giving greater authority to the parastatals over the use and disposal of assets. In some cases, there may also be some scope for mergers, consolidation and asset amalgamation among ailing parastatals to achieve viability. After undergoing such restructuring these companies may become more attractive to private investors.

5.63 Private Sector Development and Promotion of Small Scale Industry. While parastatal restructuring must play an important part in Tanzania's industrial strategy, this must be complemented with private sector development. In fact, the private sector must be given a greater role in industrial development in Tanzania. While continued reforms in the policy environment and the divestiture of parastatals will help the private sector take on a greater role, additional measures are needed. These would include, but not be limited to, improvements in the private sector's access to credit and equity financing, which is expected to develop with the proposed financial sector reforms (see Chapter 3) and the reduction in credit demands placed on the banking system by loss-making parastatals.

5.64 There also is a need to improve the implementation of the new Investment Promotion Policy. This can be expected to encourage the development of the private sector, provided the new Investment Center is able to facilitate new investment by identifying opportunities for investors and by cutting through the bureaucratic obstacles that have hampered private investment in the past. One potential concern is that the tax holidays that are allowed in the Investment Code: (a) may be too generous and result in too much foregone and sorely needed government revenue and therefore be unsustainable long term; and (b) could confer unfair competitive advantage on new projects sanctioned by the center vis-à-vis existing firms. International experience suggests that tax holidays are generally not an effective incentive for investment, but rather that low and uniform tax rates and a stable tax regime offer a more conducive investment environment for the longer term. The industrial reservation clauses of the Code should also be interpreted flexibly to permit entry of new firms into areas that hitherto have essentially been monopolized by the public sector.

5.65 The promotion of small scale industry in particular requires special attention to the issues discussed in Section IV. Improved access of small firms to credit is one important objective of the proposed financial sector reforms (see Chapter 3). The regulatory system also needs to be improved. For example, there is a good case for gradually abolishing the restrictive licensing practices, retaining the requirement for licensing initially only for larger enterprises involving investments of say US\$5-10 million. Investments below this level should not require licensing. Reforms of tax administration procedures as being examined by the Tax Commission should also include measures to help eliminate harassment of small scale firms by tax collectors. Finally, to encourage entrepreneurship in small scale industry the Leadership Code should be amended to legitimize private business involvement for civil servants.

G. Institutional Issues

5.66 Implementing the kind of reform agenda described in the previous section calls for different roles of the government and the donor community. The government's role must evolve

from one of investment planning and implementation of projects, to providing a suitable environment for private sector development, promoting competition, regulating monopolies, providing the necessary infrastructure and delivering efficient services to industry, and managing well those enterprises that remain in the public sector. In several areas, this may require technical assistance and training that should be supported by the donor community. The government also needs to develop ways to engage the private sector in a dialogue on industrial sector issues so that it continues to be aware of policy and institutional measures that are needed for development of the private sector. In addition, it has to be able to tap outside resources to help ensure that the divestiture program is successful. For example, its bargaining positions vis-à-vis private investors must be well prepared by having sound company valuations as a basis for negotiations. Similarly, assistance may be required to help evaluate bids for private participation in parastatals and in negotiating deals. For such services the government must be prepared to draw on specialized firms and the banks. It also must come up with mechanisms to handle the immediately visible social costs of restructuring since unemployment may be an immediate consequence. Therefore, government needs to go into a divestiture program with a menu of severance packages for redundant employees, retraining and redeployment programs and lines of credit for laid-off workers to enter the informal sector, along with mechanisms for financing such programs, e.g., through the proceeds of earlier divestiture and donor support.

5.67 The role of the donor community also needs to be reviewed in light of the requirements of the next phase of Tanzania's industrial development. Whereas in the past most donor assistance in industry has gone in the form of direct project assistance to specific government-owned enterprises, donor assistance will now need to focus much more assisting the government in the areas outlined above. In addition, the process of parastatal restructuring will require further studies and technical assistance. Beyond this the role of the donors in providing general funds for recurrent inputs and investment goods where market mechanisms play the allocative role (such as balance of payment support through the OGL, and not through administrative mechanisms) will remain critical. Donor support for the OGL is rapidly proving to be one of the most efficient forms of donor assistance to Tanzania, both in terms of the programs, projects and enterprises that benefit from the resources and in terms of the low costs to both the government and the donors in administering the program. Wherever possible, donors should channel their assistance in the form of support for the OGL. Donors should move away from this form of assistance only when it can be demonstrated that through specific project assistance they are able to provide benefits that go beyond the purely financial. However, those specialized donor institutions that have many years of experience in dealing directly with the private sector (e.g., IFC, CDC, DEG, and FMO) should be encouraged to rapidly expand their activities in Tanzania in response to the new policy environment. These institutions and interested NGOs also have an important role to play in the development of small scale firms.

5.68 Another critical role for the government will be to promote industrial technology development. A necessary precondition is the provision and maintenance of an enabling policy environment, one characterized by domestic competition and external openness.^{12/} Further,

^{13/} The evidence of countries in East Asia and Latin America that have developed technological capability is that policies discussed earlier in this chapter that promote competition, both domestically and in export markets, provide the essential driving force for firms to improve product quality and technology. In fact,

institutional support is also required. In Tanzania the major focus of efforts to enhance industrial technology has been on improving the supply of some technological services to industry (e.g. product testing and research and development) and the supply of technical personnel in the industrial sector. However, Tanzania's R&D and testing agencies suffer from low budget allocations and are under-equipped. While such institutes will continue to require government and donor support, they must be encouraged to become more self-reliant and private sector-oriented by seeking to generate fees for the services they provide. This would also give them an incentive to become customer-oriented. For example, they could generate fees by providing needed services such as information about available and best practice technologies, and the dissemination of product standards of major export markets and product certification services to help Tanzania's manufactured products meet the rigorous quality standards in export markets.

5.69 In the critical area of manpower development, the government has begun to pay greater attention to the gaps which exist in the tertiary education. While there are a number of vocational and technical training institutes which specialize in imparting skills that are important to the development of industry (e.g. the High Precision Technology Center), the number of training slots needs to be expanded as well as its quality, and it needs to be made more relevant to the needs of industry. Similarly, the level of industrial engineering training needs to be upgraded. Finally, measures to promote foreign direct investment have been shown in many developing countries to have a positive effect on improving the technological level of industry while also promoting exports and overall industrial competitiveness.

lessons from developing country experience suggest that (over and above the static allocative gains from a more liberalized trade regime), government policies promoting openness and domestic competition are found to induce dynamic productivity gains over long periods of time. Firms are induced to learn, adapt and adopt new technologies; the openness to external markets exposes domestic products to new ideas, designs and techniques – which they will undertake to try and implement in a competitive environment.

Chapter 6

Accelerating Social Progress

A. Introduction

6.1 The role of social services is central to Tanzania's development strategy. Over the years since independence, there have been a number of impressive achievements in terms of social progress. However, the long-term impact remains elusive. Overall health outcomes, for example, are still not satisfactory -- infant mortality rates remain high, total fertility and population growth rates continue at high levels,^{1/} malnutrition still exists, and there are still major problems in health care delivery. In the case of education, primary enrollment ratios, which had grown admirably in earlier years, have declined; literacy rates have begun to decline; and there are severe skills problems at higher levels. In addition to dealing with these and other continuing challenges, Tanzania is now also facing new challenges in the social sectors -- as evidenced by the health care and social implications of AIDS and other diseases.

6.2 Restoring momentum and accelerating social progress in Tanzania will not only depend on economic growth but will further require a two pronged strategy within the social sectors: namely (i) the expansion of a pluralist, participatory environment for social service delivery; and (ii) the implementation of comprehensive public sector management reforms.

6.3 The basis for this prescription lies in the lessons of the past two decades -- this chapter describes this experience and subsequently lays out the elements of the strategy which is required.

B. Achievements and Problems Prior to ERP

6.4 The Arusha Declaration of 1967 was the start of a fundamental change in government strategy and policies not only for agriculture and industry but also for the social sectors. In the face of the growth of an urban elite, widening urban-rural income differentials and the relative neglect of basic rural services, the government, in the context of the Arusha Declaration and subsequent policy statements (e.g., Education for Self-reliance, 1967) and party conferences (especially the TANU National Conference, 1971 and the TANU Executive Conference, 1974) defined an ambitious new strategy based on basic needs. This strategy included the achievement of universal primary education by 1989 (the date was subsequently advanced to end 1977); the eradication of adult illiteracy by 1976; the achievement of population-per-health facility ratios of 50,000 for rural health centers and 6,500 for rural dispensaries by 1980; and provision of adequate and safe water within easy reach of everyone by 1991.

6.5 The means for implementing this new strategy also involved a radical departure from previous practices. Political involvement went far beyond defining overall goals, down to

^{1/} Preliminary results for the 1988 population census show that the overall population growth rate has fallen to 2.8% per annum, but until the full results are available, it is not possible to analyze the determinants of this change.

actual detailed implementation of the strategy. The party promoted mass mobilization and government civil servants were obliged to respond to party directives. Many private schools were nationalized and private medical practices were banned. District and urban councils were abolished and regional administrations were given some of the responsibilities from the central government and all of the council responsibilities; these administrations followed central government budgeting and accounting practices and were not expected to raise revenue on their own behalf. Still, total government expenditures on the social sectors, supported by donors, grew rapidly during the late 1960s and the first half of the 1970s.

TABLE 6.1: Selected Social Sector Indicators: Tanzania and Other Low Income Countries +

	TANZANIA			CHINA AND INDIA			OTHER LOW INCOME COUNTRIES		
	1965	1980	1987	1965	1980	1987	1965	1980	1987
Daily Caloric Supply	1832	2051	2192 a	2001	2270	2463 a	1976	2050	2226 a
Primary Educational Enrollment (%) c	32	104	66	83	100	117	49	70	76
Secondary Education Enrollment (%)	2	4	4	25	32	41	9	19	26
Life Expectancy at birth	43	52	53	51	61	63	44	50	54
Infant Mortality Rate (per thousand of live births)	138	101	104	114	92	59	149	124	98
Population per nurse	2100	2980	8130 b	4420	3322	1710 b	10170	8953	3250b
Population per physician	21700	17560	26200	2930	2626	1640	28080	15486	13910

+ Low income countries according to World Development Report Classification, comprising a total of 48 countries with an income of US\$ 545 or less in 1988.

a For 1986

b For 1984

c As a percentage of population in its age group. Total fertility rate represents the number of children that would be born to a woman if she were to live to the end of her child bearing years.

Source: World Development Report, 1991.

6.6 By the end of the 1970s the strategy had substantially achieved many of its major goals and most social indicators had improved both in absolute terms and relative to other low income countries (see Table 6.1). In education standard I enrollments, increased from 248,000 in 1974 to 665,000 in 1976; by 1982 98 percent of the 7-13 age group were reportedly in school; enrollments in literacy classes reached 5.2 million in 1975 or 90 percent of the estimated number of illiterates; the rate of effective literacy increased from 13 percent in 1967 to 59 percent in 1975; and by the end of the 1970s over 90 percent of the population were living within 10

kilometers of a health facility. The result of all of this was that major changes had become evident in the life of typical Tanzanians. There was a high likelihood that the prototype farmer was literate, that her children were enrolled in school, that health care was accessible and within walking distance, and that she and her children attended MCH clinics. Her urban worker counterpart was enjoying better services, but the differential had been narrowed considerably.

6.7 However, although quantitative targets were being met to some degree, the system came under increasing strain during the 1970s and early 1980s, and qualitative weaknesses and elements of imbalance began to be exposed. Children in rural areas were in school, but the standard of accommodation was very low, many of the teachers were poorly trained and only 10 percent of textbook requirements were available in the classroom. Meanwhile secondary enrollments remained extremely low and a lack of good secondary school graduates resulted in facilities at teacher training, technical colleges and the University of Dar es Salaam being severely under-utilized. In the health sector, the development of an extensive network of facilities greatly improved the availability of health care, but system performance suffered because of a lack of training and poor motivation of doctors and health workers, shortages of supplies, breakdown of transportation and inadequate management of a dispersed rural health system. In urban areas the health situation was worse. The quality of hospital care declined dramatically and clinics became increasingly crowded -- some dispensaries in Dar es Salaam, for example, were attempting to cater for over 300,000 people.

6.8 Although achievement of the quantitative targets had been dependent to a very large extent on mass mobilization it was also apparent that the process had not involved local communities in assessment of problems, analysis of causes and implementation of solutions. As a result communities did not feel they "owned" the strategy or resulting programs and projects. Social service providers, who should be entrepreneurs in their respective professions, had also become increasingly proscribed. Public sector teachers, and even less so health workers, had little input in the running of schools and health centers (e.g., curriculum, staff management, etc).

6.9 Most serious of all, however, was the fact that the massive expansion during the previous period proved to be financially and administratively unsustainable, particularly in the context of a general economic deterioration and very constrained government resources and institutional/managerial capacity. There were insufficient funds to buy basic supplies for schools and hospitals and insufficient funds to adequately remunerate teachers and health personnel. In addition, policies such as granting specific parastatals monopoly rights to the production and distribution of education and health supplies (a policy characterized as "confinement") combined with management weakness throughout the system meant that even the funds that were available were frequently inefficiently used -- textbooks, for example, piled up in storage while 30 or more pupils in a class would "share" a single text.

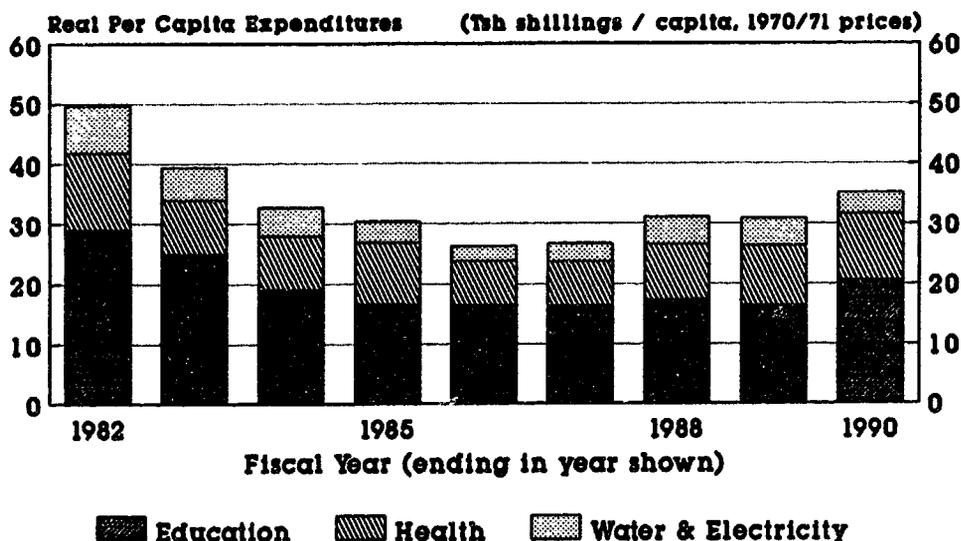
C. Progress and Constraints under ERP

6.10 Beginning in 1983/84 and continuing through the ERP and into the ESAP, the government has introduced major policy and institutional reforms aimed at reversing the economic decline and putting the economy back on a sustained growth path. Significant changes affecting the social sectors were introduced beginning in 1983 with the reestablishment of district and urban councils. In the context of severe resource constraints and increasing demand

generated by population growth, reestablishment of local authorities was designed to provide opportunities for raising revenue locally. Equally important it aimed at achieving a greater degree of community participation in the provision of services, thereby reducing their budgetary cost.

6.11 After declining precipitously during the second half of the 1970s and early 1980s the government (central and local) was able to stabilize real per capita expenditures on the social sectors during the mid 1980s and more recently to increase them (see Graph 6.1). The government has also begun to increase the level of cost recovery for social services - parental "contributions" of Tsh 200 per child per year have been introduced at primary schools for example and fees at government secondary schools have been increased. With the initiation of the ESAP in 1989, the government fully incorporated social concerns into the recovery program.

Graph 6.1
Expenditures on Social Services
1981/82 - 1990/91



Source: Planning Commission
Data includes expenditures through
Ministry of Local Government

6.12 The government has also been giving much greater encouragement to non-government organizations to support the social sectors. In education, most of the nongovernment resources are being provided by community groups and have been dedicated, to expanding the secondary schooling system to accommodate the rising demand from primary school graduates. During the last five years, more than 50 new secondary schools have been established independently of the central government secondary system. Indeed, 200 of the 334 secondary schools are now run by NGOs. District associations, parents, private sources and local NGOs have contributed to the costs of establishing and running new schools, often utilizing district-level trust schemes. There is also an expanding non-government involvement in health. In major urban centers, health care is provided by some companies to their employees and their families. Private practices are flourishing because of the relative scarcity of primary level government

health facilities. In rural areas voluntary agencies (primarily churches) are running many of the health facilities and charging fees to defray at least part of their costs. This is in addition to the traditional sector, including traditional healers, midwives and traditional birth attendants. Traditional birth attendants attend about 40 percent of deliveries in rural areas and 20 percent in urban centers.

6.13 The changes introduced so far have helped to stem the deterioration in social services that became apparent in the early 1980s, but, given the substantial lags in getting results from social sector developments, it will be some time before the full impact from these changes is apparent on social sector outcomes. In the meantime social indicators continue to show a mixed picture (see Table 6.2). In education the effects of the crisis that began in the late 1970s were, until recently, reflected in declining primary school enrollment ratios, and learning achievements overall remain very low. For the last 10 years many of the pupils completing standard 7 have been barely literate and numerate, and certainly not adequately prepared for secondary education or for life and work in rural areas. The quantity and quality of technical, vocational and higher education also remains very inadequate.

Table 6.2: Social Indicators, 1975-90

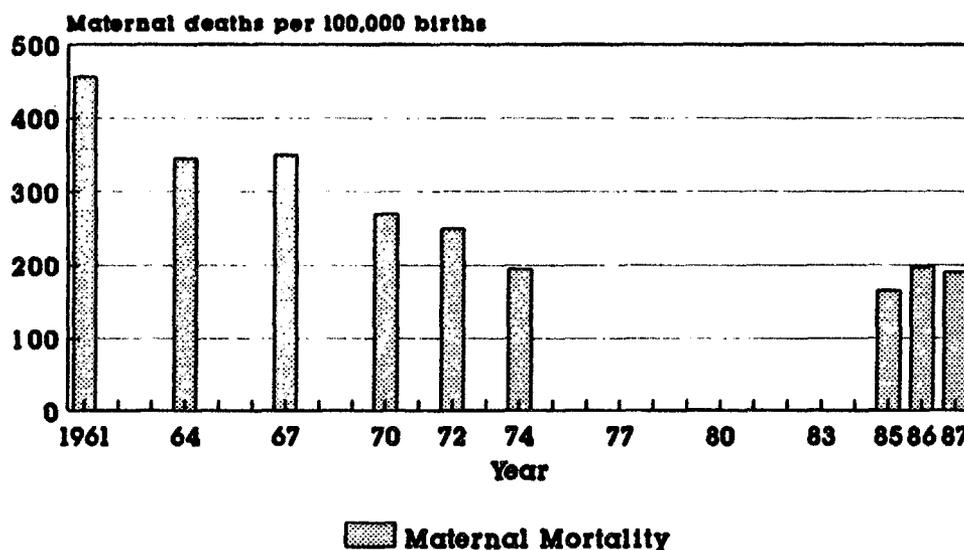
	1975	1980	1982	1985	1986	1987	1988	1989	1990
Enrollment ratio, primary									
Total	53	93	90	85	81	78	76	80	n.a.
Female	44	86	85	85	81	78	76	80	n.a.
Enrollment ratio, secondary									
Total	n.a.	n.a.	n.a.	3	3	4	4	5	n.a.
Female	n.a.	n.a.	n.a.	2	2	3	3	4	n.a.
Illiterate pop as % of pop									
15+	0	1	1	1	1	5	n.a.	n.a.	n.a.
% under 5 immunized against									
measles	n.a.	n.a.	50	66	97	88	106	79	80
diphtheria	n.a.	n.a.	50	67	74	81	95	77	79

Source: For education data, Ministry of Education and Culture; for illiteracy data, World Bank Social Indicators; for immunization data, Information System Summary for WHO Africa Region, Expanded Program on Immunization, January 1990 for 1982-87, and Tanzania Expanded Program for Immunization for 1988-90.

6.14 In the health sector, it will not be possible to say anything definitive about trends in indicators such as infant mortality until the full results of the 1988 census are available. Some health indicators have continued to improve over time, in part at least because of the introduction of special programs such as the essential drugs program and the expanded program of immunization. On the other hand, information from health monitoring stations show that cases of malaria have increased substantially in recent years and there have also been increases in diarrhoea, pneumonia and upper respiratory infection. Maternal mortality rates may also have

increased in recent years (see Graph 6.2) as a consequence of deteriorating conditions of hospitals and breakdowns in the referral system (few referring facilities have working transportation).

Graph 6.2
Maternal Mortality in Tanzania
1961 - 1987



Source: Women & Children in Tanzania.
UNICEF, 1990 (estimated from graph).
Data unavailable for years not shown

6.15 Improved water supplies have been built to serve some 50-70 percent of the population in urban areas, and about 45 percent in rural areas; however, in both cases, problems of inadequate maintenance and rehabilitation reduce the number actually served to about 25 percent. Most urban centers also have sewer mains based sanitation systems (serving perhaps 10-15 percent of the population), supplemented by septic tanks, cess pits or pit latrines. About 80 percent of the rural households have latrines, three-quarters of which are considered suitable by the Ministry of Health. Generally speaking, however, expansion of both water and sanitation services is barely keeping pace with population growth and the quality of those services continues to decline.

6.16 Nutrition levels appear to have stayed about level during the 1980s after improving most of the 1970s. High levels of chronic malnutrition persist throughout the country, especially among infants and children under five years of age (see Table 6.3). The high levels of chronic malnutrition most commonly takes the form of protein energy malnutrition (PEM) which affects 28 percent of the total population and over 50 percent of children under five. Pregnant and lactating women are most vulnerable to anemia and iodine deficiencies.

6.17 There are a number of factors that may explain why the deterioration in social service provision in the late 1970s and the first half of the 1980s did not have a more severe impact on outcomes. First is the overall recovery in the economy and particularly the improvement in food availability in both urban and rural areas. Second is the strength of

Tanzania's underlying basic needs strategy and the still heavy emphasis on rural services which has facilitated the successful introduction of the immunization and essential drugs programs. Third is the perseverance of donors in supporting key interventions in the social sectors. Nevertheless, it does appear that further institutional reforms are required – both in the strategy for delivering the required services and in the public sector itself – in order to ensure major improvements in social sector outcomes and the reduction of poverty.

Table 6.3

**The Prevalence of Major Nutritional Problems in Tanzania According
To Population Groups (1987)
Type of deficiency and percent affected**

	PEM	ANEMIA	IDD	VIT. DEF.
Children under 5	52.0	45.0	13.0	30.0
Pregnant/Lactating women	13.0	80.0	52.0	0.7
School children & adults	20.0	20.0	40.0	0.1
All age groups	28.0	32.0	25.0	6.1

Note: Protein Energy Malnutrition (PEM); Anemia Deficiency; Iodine deficiencies (IDD); and vitamin deficiencies (VIT.DEF.)

Source: Kavisho F.P. (1987): The Food and Nutritional Situation in Tanzania 1987. TFNC Report No. 1215

D. Strategy for the future

6.18 Although the social indicators for Tanzania are still relatively better than the economic indicators (see Table 6.4), the government has recognized both the urgency of social sector rehabilitation and the fact that this will require both institutional and policy reforms. In the context of the preparation of the second phase of the economic recovery program, both the state of the social sectors and the strategies and policies needed for recovery were critically reviewed and actions proposed in the social area were incorporated as an integral part of the overall recovery program. The Priority Social Action Program now needs to be developed into detailed implementation strategies for each of the sub-sectors. Critical to these strategies will be: (a) programs and policies that recognize the links between sectors and the need for interdisciplinary approaches to addressing social problems; (b) policy initiatives towards pluralist delivery systems; (c) changes in the role of the government and public sector restructuring comprising institutional and expenditure reforms (including salary reform); and (d) financial reforms (fiscal decentralization, cost-sharing).

Table 6.4
International Comparison of Economic and Social Indicators: Country Ranking ^{a/}

	Human Development Index (Composite)	Life Expectancy at birth 1990	Adult Literacy Rate 1985	Real GDP Per Capita 1985-88
Sierra Leone	1	1	1	39
Mozambique	15	15	15	43
Malawi	23	17	28	8
Nigeria	32	27	29	40
TANZANIA	34	37	47	7^b
India	38	51	32	27
Ghana	40	44	49	32
Kenya	48	53	59	38
Indonesia	63	57	69	58
China	79	97	67	77

^{a/} Ordinal ascending ranking position among all industrialized and developing countries, 1 being the lowest and 160 the highest (Japan).

^{b/} The 1990 World Development Report shows an even lower ranking. The UNDP estimates for GDP are based on purchasing power parity dollars.

Source: UNDP Human Development Report, 1991

6.19 Intersectoral Linkages. International experience shows clearly that strategies to improve people's social conditions must recognize the links between different sectors and the need to develop interdisciplinary approaches to resolving social problems. It is critical to recognize that social welfare improvements in general, and health, nutrition and education in particular cannot stem from improvements in the delivery of social sectors alone. Often improvements in social indicators can be attained effectively through policies and results in other sectors, agriculture being a prime example.

6.20 The reduction of population growth through the lowering of fertility will have the benefit of reducing the growth of dependents and prime consumers of government-financed social services while leaving the growth of the labor force little affected for the next two or three decades. Strengthened family planning programs will also have major benefits for maternal and child health, as well as for AIDS prevention with increased use of condoms. However, a successful program to reduce fertility will depend very much on improvements in the quality of both family planning and health services and on the strengthening in education programs for children and parents as well as on the overall recovery in the economy and improvements in people's living standards.

6.21 In health, the major problems in Tanzania are infectious diseases (especially malaria, acute respiratory and diarrheal infections, measles, sexually transmitted diseases including AIDS, and tuberculosis); pregnancy-related conditions; and malnutrition. Successful strategies to deal with these problems must recognize, *inter alia*, that preventive health is multisectoral, and must respond to the particular needs of the local community, including all the issues that have a particular bearing on its well-being (e.g., nutrition practices and family food security, water supply and sanitation, child-care arrangements, the distribution of labor between men and women, etc.).

6.22 With regard to nutrition, young children's diets fall short of their requirements in two interrelated ways: (i) the daily number of meals is insufficient (4-5 snacks are needed, given the amount of food a young child's stomach can absorb at one meal); and (ii) the caloric density of the staple gruels and stiff porridges is too low, relative to their bulk, for a child to eat enough to take in sufficient calories. The low number of meals is partly due to inadequate specific knowledge in the population; but it is more due to the heavy workload of mothers. The low caloric density is partly due to lack of awareness, partly to the lack of adequate supplies of high density foods (itself due primarily to low incomes). In this context programs to alleviate nutritional deficiencies will have to recognize the broad range of interventions that will be needed and their interlinkages. One successful example of such an approach in Tanzania is the UNICEF-sponsored Iringa Nutrition Project^{2/} which involves the explicit implementation of activities simultaneously in a number of subsectors -- women's nutritional education, on-farm agricultural production improvements, improved nutrition surveillance of infants and children, improved village sanitation and preventative health and others.

6.23 Improvements in water supply and sanitation in both rural and urban areas are critical to health/education outcomes. Malaria and diarrhoeal diseases for example are closely associated with problems of water, hygiene and sanitation. Water supply is also critical to improve women's lives -- to free time and energy for child care, family production activities, and income earning activities, all of which generally depend critically on the participation of women. A daily trek of 2 to 3 hours for water is costly not only in terms of time but also in terms of calorie consumption which is estimated to average about 600 calories or one-third to one-quarter of a woman's average daily calorie intake.

6.24 In what has been called "the seamless web of interrelations" among social services,^{3/} education plays the central role. Education substantially raises farm productivity; it gives workers a wider range of self-employment options; and it is closely associated with reductions in child mortality, reductions in fertility and improvements in health. In many of these areas, female education is particularly important. There is little doubt therefore that Tanzania should continue with its strong emphasis on the provision of basic education. Improvements in the effectiveness of current programs will however be greatly dependent on the effectiveness of other social interventions including reductions in population growth (which will ease

2/ Similar projects are now being supported by UNICEF and other donors in other parts of the country.

3/ World Bank, World Development Report, 1980.

administrative and financial constraints) and improvements in health and nutrition. Just as the education of parents has a positive effect on child nutrition, better nutrition improves the child's capacity to learn.

6.25 In developing effective social sector programs the links to sectors outside social services must not be forgotten. Improvements in transport infrastructure, for example, are critical to input delivery and operation of the medical referral system.

6.26 **Pluralist Delivery Systems.** Both the urgency and the complexity of the task of improving social conditions suggest strongly that there needs to be a fundamental policy initiative to achieve the broadest possible participation in this effort within Tanzania. This means more recognition of the important role that NGOs and the private sector can make. Of course, both have continued to contribute in education and health throughout the past twenty years. But a new strategy must encourage participation of NGOs and the private sector not just in areas which the government has not emphasized (such as urban secondary education). There must also be a recognition of the extent and type of services already sought out by the Tanzania population (traditional medicine, private clinics or additional special services) and support to these to better serve national objectives.

6.27 The health services infrastructure already includes services provided by voluntary agencies such as churches and charities, industrial health services provided by certain industries and companies, and private services offered by traditional healers and birth attendants, private doctors (including, in their spare time, government physicians) in addition to the extensive network of government services at central, regional, district and village levels. But the government now needs to give more effective support and encouragement to non-government organizations. The ban on private medical practice by individuals is no longer being followed and should be formally removed, at the same time as the salaries of doctors in government service are substantially increased and efforts are made to ensure that concessions to government doctors (to engage in private practice outside of normal hours) are not abused. The Ministry of Health also needs to assess how it can better support voluntary agencies in such areas as training of church hospital staff, upgrading and posting of church health workers, secondment of government health workers to church hospitals or projects, procurement of medical supplies (mainly equipment) for church hospitals and allocation of government grants. Voluntary agency hospitals could also be encouraged to assist in the implementation of primary health care strategies in their catchment areas, including supervising rural health centers and dispensaries.

6.28 In education, almost all primary schools are government-run, but more than half of the secondary schools are run by NGOs, including district education trust funds and parents associations. An illustrative success case in this recent community self-help educational movement is the Kanyigo Development Association (KADEA) in Bukoba rural district in Kagera region.^{4/} KADEA began as a mass community association whose largely professional leadership articulated the grassroots demands of the Kanyigo community, with a population of 18,000. Their needs were made very clear: in 1982, only one child out of a total of about 600 was

^{4/} This section is drawn from the background paper for this report entitled: "Self-help Secondary Schools: a case study of the KADEA initiative", by J.C.J. Galabawa and A.G.M. Ishumi, April 1990.

qualified to enter secondary school. They decided to organize themselves and solely depend on community members for financial and human resources, management capacity and preparation of educational projects. This was originally supported by professional advice and contributions from the many ethnic members currently working outside the ward in other regions and towns. By 1984, a legally constituted voluntary development association was formed by Kanyigo workers and peasant farmers, with headquarters in Kanyigo ward and with a branch in Dar es Salaam, linking most workers, professionals and businessmen of Kanyigo ethnic origin in the capital and other towns.

6.29 The establishment of the school, renovation of the borrowed premises, recruitment of the headmaster and teachers, and preparation of teaching materials proceeded efficiently and expeditiously. The Kanyigo secondary school formally opened as originally scheduled, in January 1985. In fact, the only slight delays encountered along the way related to government 'red tape'. But it was clear to them that all such 'red tape' paled in comparison with the official and political hostility towards such non-government efforts in the 1970s. Without the major transformation in the environment for private educational initiatives that has taken place during the 1980s, Kanyigo's school could not have become reality.

6.30 From early 1985 to late 1989 the school expanded significantly. Having initially enrolled 120 students with 5 teachers, by 1989 it had 520 students with 17 teachers. It is financed by its members, in large measure through a direct deduction amounting to 3 Tsh from each kilogram of coffee sold by farmers. The school curriculum is agricultural-based, complementing the ordinary academic subjects. A technical workshop for carpentry and masonry is being established. By 1990 the completed infrastructure of the school includes sixteen classrooms, two laboratories, ten teacher houses, a water tank, kitchen, student hostels, a library, a general store and a canteen. The academic results already compare very favorably with private and public secondary schools in and outside the region.

6.31 The government has recently decided to encourage community self-help initiatives in establishing new secondary schools by setting up and supporting the initial operations of an independent National Education Trust Fund. This fund will provide grant-in-aid to NGOs to assist in the completion of new schools, purchase of materials and equipment, and training of teachers. At the same time the Ministry of Education has established a division responsible for supervising and overseeing the compliance of non-government secondary schools with official standards for curriculum content and syllabus, teacher qualifications, student/teacher ratios, school timetables, and physical facilities (building norms, equipment, furniture). Consideration now needs to be given to whether similar encouragement should be given to the establishment and operation of non-government primary schools. The government and its donor partners in education should encourage NGOs to operate in the more remote and poorer regions where NGOs have not to date been very active.

6.32 Community Participation. An essential component of pluralist delivery systems must be active community participation in the design and delivery of social programs, be they NGO, private sector, or government. This will involve building on Tanzania's techniques of mobilization that have been developed and proven effective at village level, but ensuring that the process involves villagers in assessment of problems, analysis of causes, and action to respond.

6.33 All social sectors can benefit from the experience of the Iringa Nutrition Project, whose objective is sustainable improvements in nutrition and health, through community-based action.^{5/} The core elements of the approach are advocacy, information, training and the establishment of village-based monitoring systems. A six month preparation stage entails training of regional and district development staff, social mobilization to identify interested villages, election of village health committees with a prescribed minimum number of female members, selection of both a male and a female village health worker, and preparation of a village register. Program activities at the village level are begun with an information film and a "campaign" day during which children are weighed and, if necessary, immunized. Subsequently, each village has a "health day" once a month or once a quarter to permit systematic weighing and monitoring of children and the provision of basic health services and information. After this first phase of the program has been introduced, other activities take place. The precise form of these activities depends on the villagers' perception of problems, analysis of causes and determination of appropriate actions. They have included informal day care for children of mothers working in the fields, child feeding posts, vegetable gardens, small livestock raising, introduction of grain mills and other labor-saving devices such as more fuel-efficient stoves and training of village health workers.

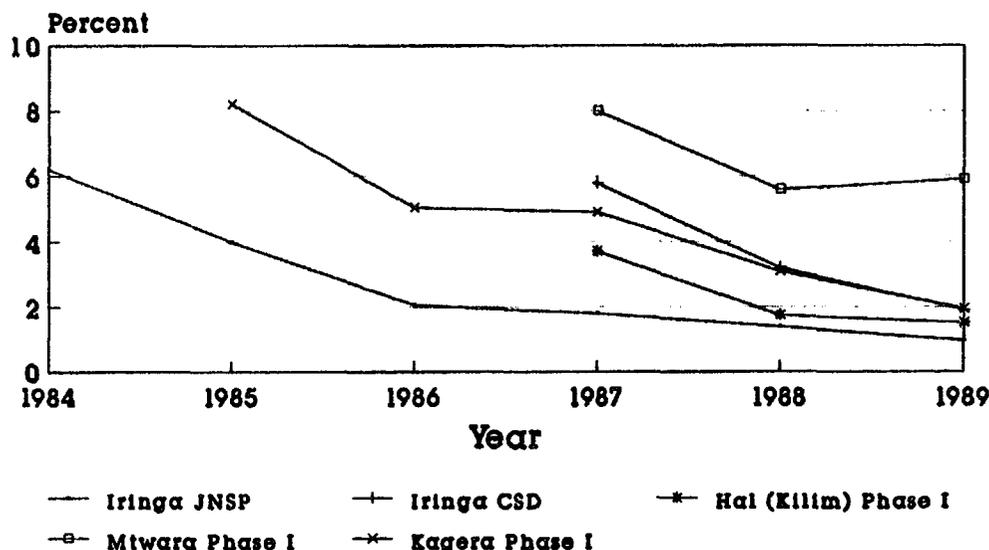
6.34 This approach to community participation has helped mobilize the time of parents and members of village health committees as well as community contributions for compensation of village health workers and child feeding post attendants, food for the feeding posts, etc. With these contributions and with outside financing equivalent of about \$3 per child (for drugs, transportation etc.)^{6/} it has been possible to reduce significantly the rate of severe malnutrition in Iringa and in other parts of the country (see Graph 6.3). The general approach of developing relevant information systems for communities to identify, analyze, and implement solutions to key local problems now needs to be extended to other social issues and could become a regular feature of enhanced community control over resources and community responsibility for performance.

6.35 Decentralization. Even with a larger role for NGOs and the private sector and with more active community participation in the design and delivery of social services, the government's role remains critical in both the development of overall strategies and policies and in the implementation of programs and projects. In order to discharge its responsibilities more efficiently the government needs to review carefully how its organization could better serve its objectives particularly with respect to the roles of central and local governments in the delivery of social services. Both efficiency and equity considerations seem to argue for a strong central government role in policy setting, monitoring and technical supervision, and ensuring equity in service provision, while local governments bear responsibility for program and project implementation.

^{5/} For more details on the Iringa Nutrition Program see "Women and Children in Tanzania: A Situation Analysis" produced by the Government of the United Republic of Tanzania and UNICEF, November 1990.

^{6/} This is equivalent to \$15 million per year for all children in Tanzania.

Graph 6.3
Severe Malnutrition in Children
under Five in CSD Programs



Source: Women & Children in Tanzania,
UNICEF, 1990.

6.36 Following the reforms of 1983, this is now the basic structure, but a clearer definition of responsibilities (and on the basis of this definition an appropriate allocation of human and financial resources) is still required. Under the new structure, district councils are at the forefront of social service delivery; but they are facing increasing difficulties in meeting their obligations. The government is now in the process of a major review of the responsibilities and performance of local governments. This review should lead to an action program for reform and further progress. Such a program will need to address the issue of the scope of services performed by the councils and whether some activities cannot be left to communities or the private sector, thereby increasing the resources available for priority activities in social and physical infrastructure. Measures to rationalize the organization and improve the managerial and administrative capacity of councils will also need to be introduced. These would include a determination of optimal staffing levels and of the minimum expenditures on salaries, supplies and other inputs necessary to secure efficient service delivery. Districts will also need to focus on the major inequities in provision of social sector workers and social services that currently prevail within districts. Finally the scope for local revenue enhancement and the system of central government grants will need to be reviewed and improvements introduced.

6.37 The ministries themselves are responsible for formulating and monitoring implementation of national policies and for the training of the necessary personnel, as well as being directly responsible for such centrally managed activities as secondary and tertiary education, regional and national hospitals, urban water supplies, etc. But the ministries need to be restructured to adequately carry out such responsibilities. In the case of education, for example, the government has recognized that improvements in quantity and quality are required at all levels of the system. To facilitate this the government has established a new Ministry of Higher Education Science and Technology to oversee technical vocational and higher education

while the Ministry of Education and Culture retains responsibility for primary and secondary education. Among the important priorities for the new ministry will be the need to restructure the universities including rationalization of courses and perhaps even departments; increased cost recovery; a higher proportion of non-residential students; more realistic student-staff ratios; reduction of non-teaching staff, etc. The ministry will also need to address the severe skills problems that are already confronting the economy through measures to expand and improve technical and vocational education.

6.38 Beyond reorganizing responsibilities among technical ministries there is also an urgent need for restructuring within ministries. The planning sections, for example, need to be strengthened and the scope of their work broadened to include not just review of capital development projects but research on and monitoring of sectoral developments and development of policies and programs to deal with emerging issues. The sections of the ministries dealing with monitoring and supervision of national policies (e.g., the education inspectorate) also need to be strengthened and provided with additional resources. At the same time the government needs to look at the potential for streamlining other activities and responsibilities of the ministries involved in social services. For example it may be more efficient to decentralize some of the activities still under central government control such as provision of urban water supplies. There also appears to be considerable potential for rationalizing allocation of responsibilities and staff between the ministry headquarters in Dar es Salaam and regional offices and for reducing numbers in certain areas – it is hard, for example, to imagine that the 93 drivers employed by the Ministry of Education at its head office are all gainfully employed. Finally the respective roles of the technical ministries, the Ministry of Community Development, Women Affairs and Children, and the Ministry of Regional Administration and Local Government need to be clarified.

6.39 **Training and Motivation.** Teachers and health care workers constitute the major segment of the civil service – approximately 50 percent. They need to be well trained and motivated. Compensation increases are essential to improve productivity and to provide minimum acceptable standards of living for social service providers in the public sector. Reforms in salaries and incentives need to be considered in the context of general public sector management reform. But in view of the fact that civil service wage reform will be a long-term process it may well be appropriate to begin salary reform with workers in the social sectors.

6.40 In the case of education ^{7/} a major reason for the present low quality of the education system is the low standard of the teachers due to low salaries and poor training as well as difficult working conditions. In the case of secondary teachers, salaries will need to be increased very substantially (probably by a factor of at least 4) if the profession is to attract and retain able and motivated diploma and degree teachers. In the case of primary teachers the evidence seems to point to a different conclusion. A recent survey shows that an overwhelming majority (90 percent) are satisfied or very satisfied with their job; about seven out of ten believe that teaching is equal to or better than other jobs; an equivalent share say that their salary motivates them in their work; 41 percent would advise the younger generation that teaching pays

^{7/} The following is a brief summary of a forthcoming report on teachers being prepared jointly by officials of the Tanzania government, the World Bank, SIDA and ODA.

a good salary; and 92 percent intend to stay in the profession. These are not the responses of a demoralized teaching force, and may be explained by the fact that many of the primary school teachers were crash trained at the end of the 1970s and realistically have no other prospects of a salaried and formal sector job. Overall, primary school teachers appear to be much more concerned with their inability to have an effective impact on their pupils learning achievements (because of inadequate supplies of books, poor management etc.) than with the absolute level of their salaries. Some salary adjustments will certainly be needed for primary school teachers to ensure that they are sufficient to support a household and keep pace with inflation. But major adjustments should be linked to level of training and should therefore be phased in with an overall improvement in teacher qualifications. In the short run at least, the average salary differential between primary and secondary teachers would be greatly increased. Major adjustments in the salaries of health personnel will also be required.

6.41 Ultimately the objective of increasing salaries is to enhance the quality of education and health by attracting and retaining talented individuals into the profession and encouraging high levels of effort. Wage increases alone, however, are unlikely to improve significantly the attractiveness of public service in the social sectors or the quality of service delivery. Improvements in the physical environment and in the availability of supplies will be essential; in addition the training system needs to play a development role much more efficiently so that (i) pre-service training ensures that all new entrants are adequately trained; (ii) in-service training takes place in regular, short-duration courses and other activities for all health and education personnel, but especially for those who had earlier received inadequate training; and (iii) in-service, upgrading training is available for a relatively small number of staff able to attempt further qualifications. The government also needs to review the current promotion system and consider: (i) improving its fairness by clearly articulating the qualification profiles required for vacant posts and inviting applications; (ii) instituting mechanisms whereby incompetent staff are dismissed or placed in a position more suitable to their capabilities; and (iii) establishing a more direct link between professional development efforts and promotional opportunities.

6.42 **Production and Distribution of Inputs.** The revitalization of the social sectors requires major reforms in the still highly centralized and monopolistic systems for producing and distributing inputs for the social sectors, particularly educational and medical supplies. The modifications need to be based on the following general principles. First, market oriented production and distributions systems should be promoted. The government should as far as possible avoid direct involvement in actual production and distribution. Production and distribution should be deconfined and where parastatals exist, they should be judged on their commercial abilities and participate in tenders on the same conditions as other enterprises. Second, local councils, schools, hospitals and households themselves should be the buyers of these inputs, not the central government, and any subsidies or subventions for purchase of inputs should be channelled to the consumer level.

6.43 In the case of textbook production and distribution this means the introduction of major reforms to the current very inefficient system. To this end an inter-ministerial task

force recently completed work on guidelines for a comprehensive restructuring of the system.^{8/} Under the guidelines, which are currently being considered by government, drafting of curricula and syllabi would remain the responsibility of central government. The Institute of Curriculum Development (ICD) would concentrate on drafting curriculum and syllabi and the Ministry of Education and Culture would be responsible for reviewing and approving the drafts. Production of manuscripts based on the approved curriculum would become the responsibility of publishers and authors and ICD's direct role in manuscript preparation would be phased out. Eventually several competing titles for the same subject could emerge, at which point the choice of which book to order would lie with the schools. Considering the fact that the printing market is functioning reasonably well, there is no need for government intervention. The guidelines envisage that publishers would negotiate printing contracts with printers in accordance with internationally-established procedures. Printers should obtain their supplies through normal commercial channels (including OGL for direct imports). Where more than one title is being produced prices should be competitively determined, but in cases of only one title per subject the consumer price level would still have to be decided in special negotiations. The guidelines would make publishers responsible for the distribution of textbooks. Several distribution channels are envisaged using both government and private entities. For instance they could go directly from the publisher through the Ministry of Regional Administration to the district councils and the schools. Or they could go to private wholesalers who could sell directly to the district councils, the schools or individual customers. Key to the system is that the schools themselves would have the option to choose the distribution system that best suits their needs.

6.44 In the case of pharmaceuticals and health supplies, serious reforms are also needed. The government has recently adopted a revised drug policy and is presently preparing implementation guidelines and requests for financing of pharmaceuticals based on this revised policy. The issues that need to be resolved are: (a) the role of the domestic pharmaceutical industry; (b) the institutional and financial set-up of the Central Medical Stores (CMS), the central agency responsible for procurement and distribution of pharmaceuticals; (c) the role of the private sector in distribution; and (d) integration of the Essential Drugs Program into the mainstream drug supply system. Presently the domestic industry is suffering from under-utilized capacity and poor management leading to costs several times higher than the cost of similar products procured internationally. As part of the general increase in competition in the economy the government must decide how to increase efficiency in the pharmaceutical industry through increased competitive pressure or possibly de-nationalization of the industry.

6.45 The CMS is presently a department under the Ministry of Health. Its management structure and reporting hierarchy within the Ministry has changed several times in just the last year. The government has recently taken measures to clarify this situation. The issue remaining is how much independence CMS should have, how much subvention (if any) is needed for its operation, and how sufficient cost recovery could be ensured to avoid bringing the CMS close to bankruptcy as happened in the past. The government is presently developing a

^{8/} The task force is chaired by the Planning Commission with members from the Ministries of Regional Administration and Local Government; Education and Culture; and Community Development, Women Affairs and Children. It was convened to prepare guidelines on the basis of recommendations of a SIDA mission that in November 1989 undertook a comprehensive review of schoolbook production and distribution.

master plan for CMS, with DANIDA support, which will contain recommendations in these areas.

6.46 The private sector plays a only limited role in supply of health supplies at the present time. The government is reviewing how to increase private involvement while assuring the availability of low-cost medicines and supplies. The Essential Drugs Program delivers drugs to dispensaries across most regions of Tanzania. The Program is run totally outside the CMS system by UNICEF. In a long run solution to the supply problems in health, such a system is not sustainable, and implementation plans must address how a new and improved supply system could include the pharmaceuticals presently supplied under the Essential Drugs Program. Finally also this sector, like many others, suffers from inefficiencies in the procurement system for public sector purchases.

6.47 Rehabilitation and Maintenance of Facilities. Throughout Tanzania and in both urban and rural areas, the physical state of social infrastructure is appalling. Substantial resources will have to be devoted to rehabilitation. Just as important, however, is the need to put in place maintenance systems which will ensure that, once rehabilitated, social facilities remain in an adequate state of repair. Crucial to successful maintenance systems will be the involvement of local communities and the effectiveness of local governments (including recognition that maintenance is an essential budget item).

6.48 One of the factors contributing to poor learning in schools is the poor physical environment, in particular the dilapidated state of most primary school facilities. About 70 percent of the 10,400 existing primary schools are estimated to require some form of major repair and/or replacement. Given the magnitude of the need and resource limitations, the government has recognized that the motivation of local communities and the mobilization of non-government resources to rehabilitate and maintain school facilities is essential and is now putting in place a strategy to achieve this. This strategy involves: (i) formulation of cost-effective norms for primary school construction and maintenance; (ii) formation of school maintenance and rehabilitation teams at the district level which will help organize and supervise community-level teams and construction brigades; and (iii) provision of building materials to complement the labor resources to be provided by the communities themselves.

6.49 In health, maintenance of facilities has also been lacking, and there is some doubt as to the rationality of the sizes and standards of facilities. Presently the primary health care referral system consists of dispensaries at village level, health centers, offering some inpatient care and district hospitals. The health centers are often being bypassed in the referral chain, resulting in very low utilization rates of staff, facilities and supplies at this level. It would be more efficient to improve the standard of dispensaries and have dispensary staff refer patients directly to the district hospital. The government is presently implementing a revised primary health care strategy with a strong district focus. This strategy is focusing on providing infrastructure and staff based on needs and service delivery targets not pre-set standards. With respect to maintenance, the government is beginning to address the serious situation, relying to a large extent on self-help activities supported with resources from the Ministry of Regional Administration and Local Government. Such activities are being supported by donor agencies. The rehabilitation is based on detailed health plans for each district, specifying what services and staff will be expected at each facility.

6.50 **Financial Management.** With respect to financial reforms, it is very important that the government find ways and means of expanding expenditures on the social sectors; but higher government expenditures on their own are not the answer. The efficiency and equity of government resource utilization also needs to be increased along with additional resources for the sector to be mobilized from internal and external sources.

6.51 In education it is clear that the existing resources only cover a small fraction of the sector's needs – teachers salaries are too low especially at higher skill levels and expenditures on textbooks, teachers books and consumable items cover only a very small proportion of the targeted acceptable level of provision. The government has begun to increase the share of education in the total government budget and some further increase can be expected. But whatever the future course of the overall budget, more efficient use of resources will have to be made. In this regard it will be important for the government to continue its policy of encouraging more efficiency through a reduction of unit costs in the secondary and tertiary sub-sectors, as well as increased cost recovery. There is undoubtedly room for cost savings through reduction of non-teaching staff, especially at central and regional levels. Combined with this should be a rationalization of the teacher training colleges and programs. Any additional salary resources should be concentrated mainly on secondary and tertiary rather than primary teachers as it is these groups who are presently most dissatisfied with their existing conditions of service. In this way, there will be scope for more efficient utilization of resources, including the provision of additional funds for such items as learning materials and school supervision. In addition, however the central and local government's own funds will need to be augmented increasingly by increased school fees, greater community contributions, and additional (or different) external support to the sector.

6.52 With regard to school fees, at the primary level emphasis needs to be placed on encouraging parents to pay the existing levels of fees -- currently actual collections are only a third of what they ought to be. In order to encourage maximum responsiveness from the parents, systems should be set up either to keep the revenue at the school level for use there, or to ensure that the revenue raised at each school is spent by the local authority at the respective school. If collection rates can be increased to 60 percent this would equate with an increase in cost recovery from the current 2 percent to 4 percent of present recurrent expenditures. In the case of secondary schools, revenues from fees have risen substantially in recent years due both to an increase in fees and to the determination of education officials and head-teachers at the schools that the fees should actually be collected. There is, however, scope for further increasing fee levels. An immediate doubling in fees to Tsh 5,000 per annum, for example, would increase cost recovery from 4 percent to 8 percent while still leaving fees at government schools substantially below those at many non-government schools. In the medium term, the objective would be to create a link between costs incurred and fees charged and to introduce a system of regular revision of fees as necessary. With short term targets of 4 percent and 8 percent cost recovery respectively at the primary and secondary levels, it would be reasonable also to argue for at least 10 percent cost recovery at the tertiary level. In view of the difficulty of moving to this, however, it is suggested instead that the government move to a graduated system of student support. The net result of such measures would be to make it easier for the government to reverse the trend in recent years towards a diminished share of the recurrent budget allocated to primary education.

6.53 With an increased emphasis on cost recovery and an enhanced role for local communities in the provision of education there is a danger that inequities in the system could increase. The government is already moving in the direction of providing additional resources to those areas of the country considered to be particularly badly resourced, but care needs to be taken to ensure that the efforts of the communities themselves are not undermined. This could be accomplished by augmenting provision of resources according to an "objective" assessment of available resources and conditions with a policy of matching grants -- e.g., grants linked to labor contributions for the construction of teacher houses or funds provided on a matching basis to buy additional learning materials and books, etc. The government could also lay down minimum standards that it would support, e.g. paying the salaries of one teacher per 50 pupils, with parents and communities being allowed and encouraged to hire additional teachers themselves.

6.54 In the health sector, too, an increase in the level and efficiency of government expenditures will need to be accompanied by measures to increase cost recovery and encourage greater community contributions.^{9/} Many people are already paying for health services as all traditional healers and most NGOs charge for services rendered. A small study in Singida^{10/} region showed that even where services were supposedly free about one third of respondents did pay for most services. Willingness to pay was high as long as cost sharing is associated with (perceived) improvements in quality of services. The preferred payment method was that used by NGOs and traditional healers where payments are made after service delivery. The study also shows the need to target cost recovery carefully. Such targeting needs to be done at a local level where there is sufficient knowledge of beneficiaries' ability to pay. When health workers were surveyed about how to charge for services and how to target, the answer was "just like the NGOs".

6.55 In the immediate term, charges for outpatient care based on drug items (e.g., 10 shillings per item) and for deliveries could be introduced and charges for special wards could be increased. In the medium term, and after primary care facilities have been improved, charges should be introduced for persons who seek outpatient care at hospitals without being referred or being an emergency case. Experiments should also be made in districts which have an active community participation with selling health insurance cards at village level. Cards could be sold through village health committees and would entitle families to a fixed number of free treatments from the health services each year. In the longer term preparations should also be made for introducing health insurance for all regular employees of private employers and parastatals, with contributions calculated as a proportion of earnings and shared between employer and employee. The Tanzania Occupational Health Service is already providing what is in effect a voluntary health insurance scheme with contributions paid by employers. This service could be used to experiment with different ways of providing services with the aim of combining quality and cost-containment with consumer satisfaction.

9/ The following is a brief summary of the recommendations of a report on health sector financing prepared by Brian Abel-Smith and Pankaj Rawal under assignment from ODA.

10/ Dr. Kavishre: "Access to 'Free' Health Services in Tanzania".

E. Role of External Assistance

6.56 The discussion above and in the rest of this report indicate that major improvements in the quantity and quality of social services are absolutely critical to the sustainable development of the Tanzania economy in the 1990s and beyond and to any strategy of poverty reduction. Given the deterioration in social service provision and the government's limited financial and institutional capacity, donor assistance is definitely required. However, consideration needs to be given to the type of assistance that would be useful. Large-scale, capital-intensive, engineering-based infrastructural projects are obvious vehicles for aid in that they require foreign expertise and participation in implementation, whatever the source of funding. But successful development in the social services depends more on local small-scale initiatives, and is best implemented focusing on simple infrastructure construction and rehabilitation using locally available human and physical resources.

6.57 As pointed out, social sector performance is very much constrained by the same kinds of policy weaknesses that have constrained other sectors. Liberalization of the systems for producing and distributing textbooks and drugs is thus just as crucial to the revitalization of the education and health systems as liberalization of the marketing system for inputs and outputs is for agriculture. However, in contrast to the agriculture sector or transport, for example, where the government is well advanced in the development and initial implementation of sector strategies, in-depth implementation strategies have not yet been developed in the social sectors, and donor assistance has not been adequately coordinated. The government, with the assistance which would be forthcoming from donors, thus needs to develop implementation strategies for the social sectors.

6.58 Beyond helping the government to design sectoral strategies and implement policy and institutional reform, there is also a role for the donors in direct funding of rehabilitation and development programs. However, for donors to effectively undertake such a role, there needs to be a major change in the approach to project preparation – away from a process in which projects are identified and designed by the donors, which concentrates on the hardware of the project, and which relies heavily on expatriate experts and are inflexible in implementation. What is needed is a process in which institutional issues are as explicit as considerations of the harder engineering aspects, potential beneficiaries of the project are much more involved in its design and implementation and greater provision is made for flexibility during the course of implementation. Such a change in role may best be accomplished by donors providing more flexible support for the social sectors in the context of agreed strategies and programs and delegating greater responsibility for specific project design and implementation to local communities, NGOs, and beneficiaries themselves.

CHAPTER 7

Sustainable Growth in the 1990s and Beyond: Scenarios and Conclusions

A. A Strategic Agenda for the 1990s

7.1 A dramatic change has taken place in the Tanzanian economy since the mid-1980s. The cumulative outcome of Tanzania's gradual reform process has resulted in an economy that now largely relies on market signals for pricing and allocative decisions. Steady implementation of measures in the trade, pricing and exchange rate regimes have resulted in the dismantling of much of the centralized system of controls and administrative allocation that prevailed until 1984. This transformation in the structure of incentives has been a key factor in the turn-around in economic performance over the past five years. Since 1986 per capita income and consumption growth has been positive, and the availability of basic consumer goods and inputs has increased dramatically. For the first time in almost a decade, the standards of living for most segments of the Tanzanian population have been improving.

7.2 Altering the incentive structure faced by economic agents has required politically-difficult decisions and time-consuming consensus-building within Tanzania. Yet reforming incentives were considered necessary to achieve recovery as it had become clear that marginalist measures with the aim of improving the functioning of the past regime of controls had not succeeded previously and would not succeed in the future.

7.3 However, it is also evident in Tanzania that reforming pricing and trade incentives, while enough to generate significant supply response during the first stages of the reform program, would not be sufficient to thrust the Tanzanian economy onto a sustained and equitable growth path. Redressing the deteriorated physical and social infrastructure base, and improving institutional performance, are also absolutely critical for Tanzania's objectives for the economy to be achieved. To date the government has recognized the importance of implementing public investment and institutional reforms, as reflected in the ESAP and elsewhere. Appropriate investments and institutions are not merely a needed complement to an adequate set of market incentives: in Tanzania, resolution of institutional and infrastructure weaknesses are key to attaining macroeconomic stability and sustaining the system of market-based incentives which is being put in place. Implementation has begun in certain areas, such as in infrastructure (the integrated road project), the financial sector and agricultural marketing. In other areas initial steps have been taken, such as in the social sectors and in public sector management, though much more remains to be done.

7.4 The focus of strategy for Tanzania considered in this report has thus been to create an efficient, well-functioning and growing economy. Only with such an economy -- coupled with other policy and program interventions -- will Tanzania be able to realize its critical objective of social progress -- equitable growth with poverty reduction. Given the limited availability of resources for Tanzania's public sector for the foreseeable future, and the public sector's limited capacity, it is evident that the country's strategy for economic development and social progress over the coming years, and the strategy for donor involvement in the implementation of that strategy, must have as central components a redefinition of the role of the government in the economy and the realization of the potential dynamism of Tanzania's private sector.

B. The Scope and Pace of Reform

7.5 A central conclusion of this report is that Tanzania needs to deepen its reform effort -- and to implement the reform measures at a pace consistent with further improving supply response -- if it is to gain greater efficiency in resource allocation and achieve its longer-term objectives for the economy and for social progress. There are several reasons why this will be important. First, recent growth performance has greatly been the outcome of one-time gains due to the increased availability of goods. Now that the liberalization in many sectors has substantially taken place, fewer additional welfare gains and less supply response can be expected from this source alone. Second, even those gains that have been achieved to date could be lost if macroeconomic balance were not achieved, if public infrastructure (e.g., transport, social services) were not improved or if even greater efficiency of investment and import use were not realized. There would also be clear limits to the replicability of continued increases in aid levels for Tanzania as aid even at present levels is contingent on continued progress on economic reform.

7.6 Third, many gains during the ERP have been due to substantial increases in capacity utilization. In the future, particularly industrial operations will face effective capacity constraints, requiring not only continued recurrent inputs but also efficient investment. As the public sector does not have the resources to undertake the required investment economy-wide, what will be needed are changes in the economic environment which are conducive to significant private sector investment, both from domestic and foreign sources. A restructured public sector and budgetary framework would also be necessary to facilitate the implementation of those key public investments which can and must be made to complement and encourage private sector development, e.g., physical infrastructure.

7.7 Finally, an additional important objective for Tanzania's reform strategy is to support the process of unifying the country's parallel and official economies. Unification is important to reduce inefficiencies associated with rent-seeking, induce greater resources to flow through the official economy, encourage more efficient investment and other resource allocation within the country and increase the government's ability to manage the Tanzanian economy through indirect measures. An incentive-led unification of these markets, which is the only means of successfully achieving that goal, shall require an integrated approach including continued flexibility of exchange rate action to reflect an appropriate premium between the parallel and official markets, monetary and fiscal policies supportive of exchange rate realignment, and other complementary policies, particularly trade, regulatory and financial sector reform. The response of economic agents will unavoidably be gradual as gaining credibility will take time, but government can influence the pace of "behavioral" unification by hastening "policy" unification -- the required policy and institutional reform.

7.8 Overall, therefore, it is evident that deepening reform -- in the public, parastatal and financial sectors, in infrastructure and in the social sectors -- will be crucial for sustainable development of the Tanzanian economy. It will also be important where possible to hasten the implementation of further reform to ensure a continued positive supply response to the reform program. This, of course, does not mean rushing implementation without adequate preparation and capacity. Policy reform will require appropriate sequencing, and institutional reform, capacity building and priority public investment, which are equally critical, will unavoidably take

time. What this does mean, however, is that the benefits of adjustment – including achieving objectives of poverty reduction and other social progress – cannot be fully realized or sustained without undertaking reforms on a comprehensive basis without unnecessary delay. This is made easier by the fact that government, in many cases, has already decided on the reforms required and in many instances has taken appropriate steps to initiate them. What is now needed is to follow through with implementation which has already been planned and to undertake new programs as well.

C. Constraint-Relieving versus Capacity-Intensive Reform Measures

7.9 Many of the economic constraints now facing Tanzania are essentially institutional in nature – for example, restructuring existing financial institutions, improving planning of public expenditures, reforming the civil service, restructuring parastatals, restructuring cooperatives and other marketing institutions, rehabilitating agricultural services, and improving delivery of public health and education services. Undertaking many of these institutional reforms will likely be time-intensive, but more significantly may also place exceptional demands on the capacities of government to develop and implement the programs as well as on the donor community to assist this process. Undertaking the most important of these reforms needs to be begun in the near-term but completion of the reforms and results – supply response, for example – can only be expected over a longer period.

7.10 Equally clear is that there also remains a large number of actions which government could undertake which would be both constraint-relieving and relatively less capacity-intensive - - which would reduce the administrative burdens on government machinery and promote greater productivity throughout the economy. In many cases these represent further "policy" reform as opposed to "institutional" reform -- of the type that Tanzania has successfully implemented over the initial years of the ERP and ESAP: for example, the efforts taken to date on external and domestic trade liberalization, exchange rate devaluation and price decontrol. In the future, priority constraint-relieving actions on the agenda include such actions as completing liberalization (deconfinement) of agricultural export crop marketing; eliminating parastatal subsidies; closing non-viable public enterprises; allowing the entry of domestic and foreign private sector banks; rationalizing the tax and tariff system; deconfining remaining goods, including medical and educational supplies; encouraging private sector and NGO participation in service delivery systems; and the achievement and maintenance of an appropriate exchange rate policy. As these are necessary conditions for further supply response it will be important for government to take these "constraint-relieving" actions in the immediate term -- at the same time it begins to address the higher priority "capacity-intensive" actions.

7.11 Matrix 1 (at the end of the Executive Summary) summarizes the recommendations of this report and sets forth for discussion a strategic agenda for Tanzania over the coming years. It is illustrative of the three types of actions to be taken: (i) the constraint-relieving measures which should be undertaken in the near-term, (ii) capacity-intensive measures which should be the areas of emphasis over the near-term for the government's limited and implementation capacities, and (iii) capacity-intensive measures which should receive the attention of government over the more medium- and long-term. The extent and speed to which the Tanzania government, with the assistance of donors, addresses categories (i) and (ii) and initiates actions included in category (iii) would be an important indicator of intensification of Tanzania's further reform

efforts. As the government has already begun to address a number of the actions specified and has decided to implement a number of others, the final column of the matrix sets out in summary form the status of government's initiatives in this regard.

D. Longer-term Viability: Projections and Prospects

7.12 Given Tanzania's economic potential and the evident supply response capacity of Tanzania's economic agents, achieving sustainable economic growth and social progress is certainly a realistic long-run objective. However, progress toward these goals -- and whether they are achieved at all -- depends on the comprehensiveness and pace at which those actions are effected by government.

7.13 To illustrate the possible differential impact of alternative assumptions regarding Tanzania's restructuring efforts, a simple model was used to examine two alternative projection scenarios. These projections reflect implementation of: (i) less comprehensive reform at a gradualistic pace and (ii) more comprehensive restructuring actions at an accelerated pace.^{1/} For example, the two scenarios reflect different speeds and comprehensiveness of implementing the measures set forth on Matrix 1 (end of Executive Summary), which deals specifically with:

- (a) financial sector reform -- policy measures to improve resource mobilization and allocation, eliminate quasi-fiscal expenditures, improve macro stability, open the financial sector to new banks and to strengthen existing financial institutions;
- (b) public sector restructuring -- budgetary restructuring, civil service reform, and tax policy and administration reform to improve public sector resource allocation and improve the productivity of the public sector;
- (c) implementation of infrastructure rehabilitation and investment programs -- putting in place the required roads, railways, ports, power, telecommunications and other physical and service infrastructure;
- (d) further trade liberalization and exchange management reform -- achieving and maintaining an appropriate exchange rate and exchange system, harmonizing the various foreign exchange windows and unifying the official and parallel markets;

^{1/} The projection framework for the alternative paths of reform and restructuring (the World Bank's Revised Minimum Standard Model) utilizes a consistency accounting framework. As such, it requires the incorporation of policy parameters as exogenous to the modelling framework. Thus, the specific point estimates ought to be used with caution. However, internal consistency features of the model itself, whereby many iterative steps are required -- to ensure that projections regarding GDP, imports, investment, export, consumption and foreign and domestic financing are consistent with each other -- delimits the range of variability (and thus error) of the exogenous parameters. Furthermore, care has been exercised to ensure that the exogenous assumptions regarding response to policy and institutional change do not err on the "pessimistic" side. In other words, the likelihood is that these projections err on the side of being too optimistic. At any rate, these scenarios should be used as a flexible tool to explore strategic options, point out key tradeoffs, likely directions and orders of magnitude of the critical variables and are thus amenable to change, sensitivity analysis and further elaboration.

- (e) completion of domestic trade liberalization -- to open alternative channels for production and trade and promote private sector development;
- (f) additional agricultural liberalization -- multi-channel marketing arrangements for all crops, restructuring of the cooperatives -- and addressing longer-term productivity issues;
- (g) parastatal and industrial reform -- to promote greater and more efficient production and macro stability; and
- (h) social sector reform -- to encourage more effective delivery systems for priority social services.

7.14 The assumptions regarding terms of trade (slight deterioration during the 1990s) and weather conditions ("average") are the same in both scenarios. The outcomes of the scenarios are summarized in quantitative terms (see Table 7.1). The more detailed quantitative projection results are presented on Tables A.7.1 and A.7.2.

Table 7.1: Projection Scenarios - Comparison of Key Indicators
(in percent per annum)

	Gradual Reform Scenario			Accelerated Reform Scenario		
	1991-1995	1996-2000	2001-2010	1991-1995	1996-2000	2001-2010
GDP Growth	4.0	4.0	4.0	5.0	5.2	5.2
GDY/Capita Growth	0.9	0.5	1.0	2.2	1.8	2.6
Consumption/Capita Growth	0.2	0.2	0.5	0.6	1.1	1.6
Export Growth	8.6	8.1	6.6	11.6	11.4	8.6
Exports/GDP (current terms)	18.7	21.4	27.2	19.6	25.0	34.5
Import Growth	4.1	4.6	4.2	3.6	5.0	5.1
Imports/GDP (current terms)	58.1	59.9	62.0	54.5	53.4	53.6
Current Account/GDP	-34.5	-36.0	-32.6	-29.1	-24.4	-14.5

7.15 The scenario of gradualist/less comprehensive reform reflects a reform effort which is not broadened to include all of the financial, public and parastatal reform actions and does not fully encompass the various constraint-relieving and near-term priority capacity-intensive measures identified in this report (see Matrix 1). It is based on fairly optimistic assumptions of production and export growth rates and, as such, appears generally to be consistent with continuing economic recovery at least for the coming few years. The assumed 4 percent per annum GDP growth (which mirrors the growth performance since the initiation of the ERP) would be translated into positive consumption per capita growth averaging about 0.7 percent per annum over the coming years.

7.16 However, a fundamental question regarding this scenario concerns its fragility. For example, agricultural growth in this scenario is estimated to stay at about 3.7 percent per annum (compared to about 5 percent over the past few years). But as agricultural supply response cannot continue to rely on increased availability of goods, rather it requires improved incentives and support systems, maintaining agricultural output even at this level would become problematic

unless further and more comprehensive liberalization of agriculture marketing takes place over the near term and longer-term productivity issues are addressed through, inter alia, public sector management reform and sectoral-specific interventions. In addition, as the economy's capacity utilization is assumed to improve further, the importance of additional, efficient investment for growth as a complement to trade liberalization will become crucial, requiring the appropriate incentive framework as well.

7.17 Under this scenario, the balance of payments situation would remain very fragile for the next 20 years. Import utilization, given slower exchange rate movement and continued parastatal subsidies, would remain at its present level of inefficiency. Under the somewhat optimistic export growth rate of 7-8 percent, (assuming partial incorporation of unofficial exports into the official economy in the earlier period), coupled with import growth of about 4 percent p.a., the current account deficit would continue to grow in US dollar terms throughout the projection period, and as a share of GDP the deficit would only barely fall over the coming 10 years.

7.18 While concessional assistance and debt rescheduling at present real levels would finance the growing current account deficit until 1995, the external situation would turn unviable thereafter (with a gap of over US\$400 million by 2000). As increased donor financing and commercial lending would be difficult to locate -- since aid even at present levels is contingent on continued substantial progress on economic reform -- this could require reducing the import bill. This suggests that the assumed 4 percent GDP growth rate would most likely not be sustainable after that time. Sustainability could, in fact, be threatened earlier if adverse terms of trade shocks were to occur. In short, this scenario of gradualistic/less comprehensive reform, while consistent with continued recovery in output and limited gains in consumption per capita over the near term, would most likely be unsustainable in the longer term given the fragility of the resulting balance of payments situation.

7.19 A scenario comprising more accelerated and more comprehensive economic restructuring would be more likely to permit Tanzania to achieve a sustainable growth path over the coming years. By implementing the identified restructuring measures -- encompassing a greater number of the constraint-relieving and near-term priority capacity-intensive measures as well as initiating the medium-term capacity-intensive measures -- it would be possible to achieve greater macro stability and an improved environment for economic growth. For instance, agricultural output growth and relatively better export performance could result from a more appropriate incentive structure, and coupled with more efficient import utilization and investment could lead to GDP growth rates of slightly over 5 percent. At this rate per capita income would stand at about US\$260 by the year 2010, i.e., almost 40 percent above the current levels in real terms.

7.20 The balance of payments situation under this scenario, while remaining difficult for the foreseeable future, would have a higher likelihood of being financed. The current account deficit would still increase in current dollar terms well into the next decade, but its increase would be more gradual and would decline steadily as a share of GDP (from 34 percent in 1991 to just over 20 percent in 2000). By 1998, the current account deficit would be US\$400 million lower than under gradualist scenario. Given modest assumptions regarding additional investments and aid under an accelerated program of restructuring, the deficit should prove financeable --

although the balance of payments would still remain tight for many years to come, generate limited room of maneuver, and continue to require substantial aid in the form of balance of payments support.

7.21 Importantly, the scenario of more accelerated and comprehensive reform would be much more likely to be consistent with Tanzania's critical objectives of reducing poverty and achieving social progress. As demonstrated in Chapter 3, public sector and budgetary restructuring would permit greater resources allocations to improve social sector delivery, to address critical health threats and to achieve other social objectives.

7.22 Adjustment costs and risks. Clearly, any program of adjustment and structural transformation, while likely to benefit most people, will also result in some losers. By not yet tackling the institutional issues where adjustment costs would tend to arise, to date Tanzania has avoided some further adjustment costs -- though at the cost of continued macro instability and lower supply response. In the future, the transformation of the economy resulting from public sector, financial, parastatal and agricultural reform will in turn precipitate transitional costs which will have to be addressed (e.g., civil service retrenchment and labor reductions from parastatals). While adjustment costs will most likely be greater under the scenario of more accelerated reform, a key question as well is under which scenario would the ability to address the problem of vulnerable groups be greater? It seems apparent that in addition to greater growth prospects, the institutional and budgetary framework providing the greatest ability to deliver targeted social programs and offer compensatory packages would be expected more under the scenario where a much greater number of constraint-relieving and priority capacity-intensive measures had been taken than under a more gradualist reform pace.

7.23 Given different perceptions of winners and losers in the reform process, there may also be political risks to reform. To some extent, though, Tanzania appears ready to take these risks on. For instance, already the government has directed that uncreditworthy cooperatives shall not receive further credit from the financial system until they become creditworthy and announced the objectives of cooperatives standing or falling on their own and future membership to be based on voluntary association. When implemented this not only implies the need for full liberalization of marketing to multiple private channels. In addition, this will require restructuring of cooperatives and, significantly, removal of party and government controls and their imposition of non-economic goals for the cooperatives. In addition, the government has announced that private foreign and domestic banks will be allowed to set up operations in Tanzania -- a substantial change from past policy. It will be important that the government continues its private sector development strategy in a way that provides neutral incentives across sectors and ethnic groups. In this respect it is important to note the substantial evidence that African Tanzanians respond significantly to the environment of incentives, regulations, support systems and infrastructure. Undertaking the reforms suggested and adopting a strategy of active private sector promotion and development is essential to achieve the levels of investment and growth required over the coming years.

E. The Role of External Assistance

7.24 The strategy outlined in this report involves a major change in economic management and in the role of the government from that which prevailed in the 1970s and early

1980s. Donors potentially could play a major role in assisting the government with the substantial changes still required.

7.25 **Resources.** Without question Tanzania will continue to require substantial financial assistance from donors. The projections above assumed that aid levels would, at a minimum, remain constant in real terms (approximately US\$ 880 million per annum from bilateral and multilateral donors, plus additional debt rescheduling) and would also continue with approximately the same mix of import support and project assistance (approximately a 50/50 split). Even with these aid levels, Tanzania's balance of payments situation will remain exceptionally difficult. Maintaining, and even slightly increasing, that real level and mix will be important in the coming years as a means of supporting Tanzania's policy reform and restructuring program.

7.26 **Donor coordination.** To be effective, and recognizing that donors share with government some responsibility for past mistakes, changes from past practice in donor coordination should continue to take place on the part of both the government and donors. Foremost, it will be important that the dialogue between government and donors (including (i) assistance with research and studies, (ii) advice and discussion, and (iii) negotiated policy conditions) further move away from confrontation and negotiation toward collaboration and coordination so that the resulting assistance programs are consistent with understandings reached on priorities. Not that there is yet comprehensive coverage or that all efforts have been successful, but in recent years there has been progress toward implementing this collaborative approach. In the case of economic analysis, for example this report, there has been an increasing effort to plan and implement the work by drawing on teams of donors, government officials and non-government experts. This approach recognizes the increasing body of Tanzanian expertise and contributes to capacity-building and improving the empirical basis and relevance of policy studies. Joint efforts also have a greater chance of internalization of the reasoning and conclusions of policy analysis and on coming to a greater mutual understanding of priorities.

7.27 As policy dialogue between government and donors gradually expands to cover sectoral as well as macroeconomic issues, there will be even more need to improve current arrangements for donor consultation and coordination. One possible approach (elements of which are already in place) would involve:

- a. using consultative group meetings not only to discuss the policy framework paper and external financing requirements for the coming year, but also to discuss government proposals on priority issues for further review -- and the results of those reviews;
- b. the government could then agree with the donors on collaborative work programs involving inputs from the government, multilateral and bilateral donors and other local and foreign experts; on the donor side a "lead agency" might be proposed by the government and be appointed to be responsible for coordinating donor work on a particular issue, in consultation and collaboration with a "lead ministry" in Tanzania which the government would also identify;

- c. In allocating tasks there would be a need to take account of comparative advantage within the donor community and to rationalize and concentrate donor assistance; those donors requested and agreeing to take a "lead role" would need to be very active in assisting the government, including strengthening local capacities, while others would have to consider relying more on the government and the lead donor agency or agencies to guide decisions on involvement and financing; they would also need to exercise restraint in fielding missions and taking up policy issues not on the agenda.

7.28 Further, donors need to review the most efficient mechanisms for making their financing available. Such review would likely conclude that provision of general funds for recurrent inputs and investments -- where market mechanisms play the allocative role (such as balance of payments support through the OGL or other non-administrative, non-tied systems) -- is the most efficient means for donors to support Tanzania's economic development -- both in terms of the imports supported and the assistance to government. Given the flexibility accorded government with these funds and the potential usefulness of contributing time-slices of government programs, consideration could be given to continuing this form of assistance even as, over the medium to longer-term, Tanzania's balance of payments requirements begin to decline.

7.29 It is important that the government and the donors also consider the agreed policy and expenditure framework that would be necessary to ensure maximum effectiveness of counterpart funds and indeed of all government revenues. Clearly further improvements in the quality of the public expenditure program and budget implementation and monitoring procedures are critical elements in the next phase of the reform program. With such improvements the need for detailed control and earmarking of counterpart funds (which in any case provides only illusory comfort that the budget is being improved) will be further reduced. To the extent that some donor agencies are subject to strict legal requirements on use of counterpart funds and may find it difficult to relax earmarking requirements completely, donors should endeavor to harmonize procedures, including possibly consolidating counterpart funds generated into one account which would be released into general budget resources on the basis of an evaluation of the overall policy environment and public expenditure program.^{2/}

7.30 In the near term, it will also be important for donors to shift import support assistance which is currently tied to specific public enterprises to support for the OGL -- where, if the enterprise is viable and creditworthy, the same foreign exchange could be accessed. As documented in this report and by a number of bilateral aid program reviews, while import support tied to particular enterprises may have been a suitable response to Tanzania's needs during the first years of the reform effort when an appropriate macro framework was not in place, continuation of this type of support is no longer warranted given the existence of a non-administrative foreign exchange access system -- the OGL. In fact, given that a substantial proportion of counterpart funds (as high as 40 percent) due on this type of administrative import support may not be paid by the recipient enterprise, the effective exchange rate for this import

^{2/} This recommendation reflects the outcome of recent discussions at a meeting of SPA (Special Program of Assistance to Low-Income Debt-Distressed Sub-Saharan African Countries) donors.

support can be substantially overvalued. Thus the continued existence of enterprise-specific support can actually contribute to macro instability and continued import inefficiencies and potentially deprive efficient importers of needed foreign exchange. During the transition toward greater support for the OGL, at a minimum the import programs should support the government's plan to shift the burden of granting credit for counterpart fund payment to the restructured financial sector institutions where decisions would be made on commercial criteria only. To the extent the budget does continue to provide such support, it should be done transparently, as part of a restructuring program for the enterprise and in line with agreed interim financing arrangements.

7.31 Conventional project assistance will undoubtedly also remain a major component of external assistance. To better assure effectiveness donors will need ensure that the appropriate overall policy framework -- which experience in Tanzania has shown to be essential if aid is to be effective -- exists. In addition, donors will need to review very carefully the preparation of traditional investment projects. Conventional large-scale capital-intensive, engineering-based infrastructure projects are natural vehicles for aid in that they require foreign expertise. In the future, the preparation of such projects needs to take greater account of the need to build capacity of the executing institution to supervise implementation and eventual operation and maintenance of the infrastructure. In other cases, such as in social services where local, small-scale labor-intensive projects may be appropriate, a more radical approach of more general and flexible programs would most likely be necessary. In all sectors, donors need to work with the government to assess best practices for capacity-building and the implications for future technical assistance. In the case of both project and technical assistance, a greater effort also needs to be made to assess the full costs of such assistance and reflect it in the government budget.

7.32 With such changes in approach, the effectiveness of donor assistance in accelerating economic growth and reducing poverty could be increased significantly with benefits therefore to all sections of the Tanzanian community. Over time, it may be possible to reduce not only the government's administrative burden of managing external assistance (in regard to missions, meetings, documentation, etc.) but overhead costs of donors as well.

F. Conclusions

7.33 The creation of an efficient, well-functioning economy will allow Tanzania to pursue more vigorously its objectives for equity and social progress. However, as set forth in this report this will not be possible without redefining the role of the public sector in Tanzania. Given the resource environment the government faces, it needs to focus more of its attentions on the establishment of an enabling environment of appropriate policies and efficient infrastructure and services and on building capacities -- investing in the people of Tanzania -- to attain a greater degree of self-reliance. This strategy also requires a greater reliance by Tanzanians on other than the public sector -- on community participation and on private sector development.

7.34 In the near term Tanzania's economic situation will remain difficult. To attain macroeconomic stability and to spread the benefits of the reform process more widely, Tanzania's reform process will have to be deepened and, wherever possible, the pace of decision-making and implementation hastened by both the government and the donors. With such a program to support, donors would be in a position to continue to assist Tanzania through the coming years.

Table A.7.1

Gradualist Reform Scenario

TANZANIA
KEY MACROECONOMIC INDICATORS

	1991	1993	1995	2000	2010	1991-95	1996-2000	2001-2010
GDY Growth rate	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
GDY Growth rate	4.2	3.9	3.8	3.8	4.1	3.9	3.8	4.0
GDY/Capita Growth rate	1.2	0.9	0.8	0.8	1.1	0.9	0.8	1.0
Consumption/Capita Growth rate	3.6	0.2	0.2	0.2	0.6	0.9	0.2	0.5
Debt Service/XO 1/	60.3	73.0	59.5	26.2	11.7	65.3	34.6	17.0
Debt Service/GDP 1/	14.8	17.7	15.5	6.4	5.0	16.2	10.4	6.4
Gross Investment/GDP	21.4	21.7	22.2	23.6	24.0	21.7	23.1	24.0
Domestic Saving/GDP	-5.1	-3.9	-2.4	-0.6	5.4	-3.8	-1.3	2.9
National Savings/GDP	-0.1	-1.1	-1.1	-2.6	4.4	-0.9	-1.2	1.5
Public Investment/GDP	6.7	6.9	7.2	7.9	7.9	6.9	7.6	7.9
Private Investment/GDP	14.7	14.8	15.0	15.7	16.1	14.8	15.5	16.1
Ratio of pub/pvt Investment	45.6	46.6	48.1	50.3	49.0	46.9	48.6	49.1
Govt. Revenues/GDP	21.3	22.4	23.5	23.5	23.5	22.4	23.5	23.5
Govt. Expenditures/GDP	28.2	29.6	29.8	29.8	29.8	29.1	29.8	29.8
Deficit(-) or surplus(+)/GDP	-6.9	-6.8	-6.3	-6.3	-6.3	-6.7	-6.3	-6.3
Export Growth rate	11.0	6.8	8.1	7.5	5.8	8.6	8.1	6.6
Exports/GDP (in current terms)	17.2	18.5	20.2	22.2	31.1	18.7	21.4	27.2
Import Growth rate	3.8	4.5	4.5	4.5	4.1	4.1	4.6	4.2
Imports/GDP (in current terms)	57.6	58.2	58.7	60.6	62.9	58.1	59.9	62.0
Current Account (in US\$ m.)	-965.3	-1172.0	-1352.0	-2081.0	-3155.0	-1163.9	-1733.2	-2642.6
Current Account/GDP	-33.6	-34.6	-34.9	-37.9	-28.4	-34.5	-36.0	-32.6
GDY (current US\$ m)	2875.8	3362.8	4150.5	5496.0	11099.0	3368.9	4799.6	8254.5
Gross Reserves(months of imports)	1.0	0.3	0.7	1.6	2.7	0.5	1.2	2.4
Agriculture Growth rate	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Industry Growth rate	5.2	4.2	4.2	4.2	4.3	4.4	4.2	4.2
Services Growth rate	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5

1/ The last service ratios show scheduled payments before debt relief and in relation to exports of goods.

Table A.7.2

Accelerated Reform Scenario

TANZANIA
KEY MACROECONOMIC INDICATORS

	1991	1993	1995	2000	2010	1991-95	1996-2000	2001-2010
ODP Growth rate	4.7	5.2	5.2	5.2	5.2	5.0	5.2	5.2
ODY Growth rate	4.9	5.1	4.9	4.9	5.3	5.0	4.6	5.2
ODY/Capita Growth rate	2.1	2.3	2.1	2.3	2.7	2.2	1.8	2.6
Consumption/Capita Growth rate	0.8	0.2	0.8	1.1	1.9	0.6	1.1	1.6
Debt Service/XQ 1/	56.6	55.6	50.6	19.4	7.4	59.2	27.5	11.5
Debt Service/GDP 1/	14.7	17.2	14.8	7.6	4.0	15.7	9.6	5.5
Gross Investment/GDP	19.5	20.3	20.8	21.0	21.1	20.2	21.0	21.0
Domestic Saving/GDP	-5.6	-1.9	1.5	5.8	16.1	-2.0	4.1	11.9
National Savings/GDP	-0.5	0.8	2.7	3.9	15.3	0.9	4.2	10.6
Public Investment/GDP	7.0	7.7	8.0	8.0	8.0	7.6	8.0	8.0
Private Investment/GDP	12.5	12.6	12.8	13.0	13.1	12.6	13.0	13.0
Ratio of pub/pvt Investment	55.9	61.0	62.6	61.5	61.2	60.1	61.7	61.8
Govt. Revenues/GDP	21.3	24.3	27.3	27.3	27.3	24.3	27.3	27.3
Govt. Expenditures/GDP	27.4	29.4	31.4	31.4	31.4	29.4	31.4	31.4
Deficit(-) or surplus(+)/GDP	-6.1	-5.1	-4.1	-4.1	-4.1	-5.1	-4.1	-4.1
Export Growth rate	12.2	11.8	11.8	11.0	7.3	11.6	11.4	8.6
Exports/GDP (in current terms)	17.3	19.8	22.1	26.9	39.9	19.6	25.0	34.5
Import Growth rate	1.3	4.1	4.4	5.0	5.2	3.6	5.0	5.1
Imports/GDP (in current terms)	56.0	54.5	53.4	53.4	53.9	54.5	53.4	53.6
Current Account (in US\$ m.)	-912.0	-1008.0	-1079.0	-1464.0	-1097.0	-1000.1	-1269.1	-1316.7
Current Account/GDP	-31.5	-29.2	-28.6	-24.0	-8.0	-29.1	-24.4	-14.5
ODP (current US\$ m)	2894.0	3453.2	4062.4	6099.5	13763.0	3466.6	5218.5	9804.7
Gross Reserves(months of imports)	0.9	0.3	0.4	1.6	2.7	0.5	1.1	2.4
Agriculture Growth rate	4.4	4.9	4.9	4.9	4.9	4.8	4.9	4.9
Industry Growth rate	5.9	5.4	5.4	5.4	5.5	5.5	5.4	5.4
Services Growth rate	5.2	5.7	5.7	5.7	5.7	5.6	5.7	5.7

1/ The debt service ratios show scheduled payments before debt relief and in relation to exports of goods.

