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STABILIZATION AND ADJUSTMENT
POLICIES AND PROGRAMMES

COUNTRY STUDY

17

TANZANIA

BENNO NDULU

WORLD INSTITUTE FOR DEVELOPMENT ECONOMICS RESEARCH OF THE UNITED NATIONS UNIVERSITY

STABILIZATION AND ADJUSTMENT POLICIES AND PROGRAMMES

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COUNTRY STUDY: **TANZANIA**

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WORLD INSTITUTE FOR DEVELOPMENT ECONOMICS RESEARCH
Lal Jayawardena, Director

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PREFACE BY THE DIRECTOR

This monograph is part of a series being published by WIDER on the experience of developing countries with stabilization and adjustment programmes in the 1970s and 1980s. Each study analyzes the package of policies implemented by a specific country; its relations with the IMF and World Bank; the effects of the policies on production, employment, the balance of payments and social welfare; and what other policies might have been followed instead.

The intention of the series is to assist developing countries to devise adjustment policies that would, while accomplishing desirable adjustment and growth objectives, simultaneously remain politically viable in the particular country settings studied.

For this purpose it was thought desirable to explore policy alternatives to the adjustment programmes being implemented. Built into the design of the series, therefore - and constituting indeed its special feature - is the requirement that each study include a 'counterfactual' exercise to illustrate the effects of alternative policies. Utilizing econometric models adapted or specifically developed for each country, the probable effects of alternative policy packages are estimated; the object was to see how far the balance-of-payments adjustment and growth goals of a particular programme might have been achieved at a possibly lower social cost with a different policy mix.

Each country study is written by an independent scholar and expert in the relevant country. First drafts of the studies in this series were discussed at the WIDER conference on stabilization and adjustment policies in developing countries which was held 19-22 August, 1986 in Helsinki.Each study has been reviewed by WIDER's research advisers for the project, Professors Gerry Helleiner and Lance Taylor, and revised substantively by the author as necessary; subsequent editing has been conducted under the overall supervision of Mr Robert Pringle, Senior Fellow, who serves also as editorial adviser on WIDER publications.

A companion volume by Professor Taylor summarizing the experience of the countries surveyed will draw broader implications for the theory and practice of stabilization and adjustment policies; this volume will be published by Oxford University Press. The individual country studies in this series will subsequently be grouped into separate volumes, also for eventual publication by Oxford University Press.

Lal Jayawardena
Director
March 1987

EXECUTIVE SUMMARY

Tanzania has not yet successfully had an IMF standby arrangement that ran its course, although several programmes have been implemented at various points in time. These programmes combined demand restraint and structural adjustment with the help of external resources. While demand restraint measures were actively pursued, structural adjustment measures were inadequate. This was caused partly by shortfalls in external resources to support the programmes and partly by uncertainty surrounding the effects of stabilization measures on growth. Although the prolonged debate with the IMF on stabilization finally culminating in 1986 agreement on a $82 million standby loan has delayed required action, it has also helped generate greater maturity in the internal policy dialogue and created the feeling that a programme of recovery should be essentially Tanzanian - with external resources seen as supportive rather than as a substitute for Tanzania's own effort.

The recent reforms, of 1984-86, are having some positive impact and the economy is estimated to have grown by 3.3 per cent in 1986: a similar rate is estimated for 1987. But it is far too early to be sure that this tentative recovery will be sustained.

In the view of the author, Dr. Benno Ndulu, an internal consensus on the major causes of the crisis and a generally agreed-upon programme for recovery are the most important conditions for sustained stabilization and adjustment efforts. Action based on conviction can never effectively be substituted by imposed action. Tanzania has learnt much from its previous efforts, unsuccessful though they were. The current gradual recovery and the reforms that have been put in place give some grounds for believing that the lessons have not been forgotten. Tanzania's prospects look better than they have been for several years.

I THE CRISIS

Tanzania experienced economic stagnation in the decade to 1985 and this reached crisis proportions in the last seven years of this period. After recording a reasonable average real GDP annual growth rate of 5.0 per cent during the first decade after independence in 1961 (2.3 per cent in _per capita_ terms), a combination of a slow-down in economic growth and rising population growth rates resulted in a decline of _per capita_ GDP growth to an average of 0.2 per cent between 1976 and 1978 and an average real decline of -2.5 per cent per annum between 1979 and 1984 (Table 1).

The crisis manifested itself in extensive and persistent macroeconomic imbalances, both internal and external. The internal disequilibrium showed itself mainly in a growing savings-investment gap. As can be seen in Table 2, the shortfall of savings in the monetized economy grew from an annual average of 9.9 per cent of monetary GDP between 1970 and 1977 to an average of 19.3 per cent during 1978-81. The public-sector accounted for 66.3 per cent of this increased gap. The private-sector became a net borrower during 1978-81, after having previously consistently been a net lender. The extent of dependence on deficit financing for domestic investment thus drastically increased after 1978. Unprecedented rates of inflation, averaging 29 per cent per annum, chronic balance-of-payments problems with cumulative import payment arrears reaching 200 per cent of export earnings by 1985, and a runaway budget deficit became prevalent. The crisis punctured the social development achieved during the first one and a half decades of independence (1961-1978) and threatened to cause a further deterioration of the social and economic infrastructure.

The slow-down of output growth together with the high inflation rate brought about a reduction of real incomes of both rural and urban dwellers and a decline in the quantity and quality of social services the country has strived so hard to provide. ILO (1985) estimates that between 1979 and 1984 rural incomes declined by 13.5 per cent and non-agricultural wage incomes fell by 65 per cent in real terms. Expansion of education, health and water facilities stopped, despite increasing needs, as development expenditure was drastically cut. Increase in recurrent expenditure to keep current capacity under operation averaged 5-8 per cent annually (ibid, p. 40), compared to the inflation rate of 30 per cent. This implies a sharp real decline in recurrent support for the maintenance of facilities and provision of services.

In a nutshell, the economic crisis was visible in the sharp decline in living standards, in a deterioration of the nation's physical and social infrastructure in recurring dislocations in oil supplies transportation and in the critical shortage of inputs into productive and service sectors (Msuya, 1986).

II OPERATIONAL FEATURES OF THE TANZANIAN ECONOMY AND THE INSTITUTIONAL SETUP

Rashid (1984) has neatly characterized the operation of the Tanzanian economy in a policy simulation model of the macroeconomy. Subsequent studies on the same subject, e.g. Lipumba (1984, 1985) have adopted the same approach with minor modifications. Supply or production sectors in these models determine the level of economic activity. Supply in turn is foreign exchange constrained, given its critical dependence directly or indirectly on both intermediate and capital goods imports in the production process. Non-agricultural sectors are basically dependent on imports for production. The agricultural sector, the main contributor to output (currently 43 per cent of real GDP) plays the dominant role in the determination of the level of economic activity, being the main generator of foreign exchange. Thus the central position of the agricultural sector in the Tanzanian economy stems not only from its high contribution to income and employment but more critically from its position as a generator of foreign exchange directly through exports and indirectly through food imports savings. The policy influence on the determination of output and its composition are thus mainly through policy instruments that affect agricultural production in general and export crops in particular, as well as through foreign exchange allocation policies.

The other main feature of the above model is the close relationship between the fiscal deficit, balance of payments and money supply process. The underdeveloped nature of the financial and capital market limits finance of government deficits to monetary expansion. There is almost a one-to-one correspondence between the fiscal deficit and expansion of money supply. Although during 1967-73 the monetary base was backed predominantly by foreign assets holdings, changes in net foreign assets (NFA) accounting for over 70 per cent to annual changes of monetary base (Kimei, 1986, p. 190), the situation changed dramatically in the subsequent period, especially after 1978. Between 1978 and 1981 for example, NFA contributed negatively to the expansion of the monetary base (by some 53 per cent), while net claims on government grew rapidly to become a major source of monetary base expansion, contributing over 90 per cent (Kimei, 1986, p. 112). This drastic change was a result partly of the poor balance of payments out-turn but also of high domestic credit demand pressure, especially from the public sector. The 1978 Bank of Tanzania Act ammendment lifted the 1965 government lending limit of 25 per cent of recurrent revenue to enable the expansion of the budget deficit to be accommodated. Monetary policy instruments, such as open market operations, are unimportant for macroeconomic management (Rashid, op. cit., p. 60). In addition, the immaturity of financing market limits the extent to which reserve movements can be sterilized.

The last major feature of the model is the linkage between real and monetary sectors of the economy. Given government control of interest rate the IS-LM analysis is deemed inappropriate and instead the link is established via the price level. In the domestic markets for goods and services, we can distinguish three main mechanisms for price formation. The food market is by and large flex-price. Prices for tradeables are policy oriented via exchange rate fixation and setting of producer prices for export crops. There is partial insulation of these prices from world market prices via administrative controls. The prices of domestic manufactures and services are basically mark-up pricing oriented at least at wholesale level and officially at retail level. However, as will be discussed later, due to shortages and the erosion of enforcement, prices of these at retail level have become more flexible.

The inflationary process itself is fundamentally structural in nature although monetary accommodation to structural pressures and external shocks has played a significant role in its exarcebation and sustenance, especially after 1978. Key among the structural causes are the inelastic nature of food supplies relative to the growing demand, an import capacity that has lagged behind targetted growth rate requirements and a weak economic structure that has hampered a flexible response to external shocks. The leading role of food prices in the inflationary process is evident in their 78.4 per cent contribution of the increase of the NCPI during 1973-78. Although the high weight (64.2 per cent) of food items in the NCPI provides a partial explanation of this leading role, the increase of food prices relative to non-food items at an annual average rate of 7.3 per cent is another explanation (see Table 3). Import capacity constraint showed itself more during the post 1978 period. During this period the relative price of food to import-dependent non-food items declined at an average rate of 0.9 per cent as non-food items, especially clothing and footwear, fuel light and water assumed a leading role in the marginal rate of increase of NCPI.

Monetary accommodation to these pressures included, among other things, government subsidies to food consumers designed to avoid wage-price spirals which had to be absorbed through the expanding government budget deficit, largely financed via monetary expansion. An even more significant cause of monetary expansion was the maintenance of high investment rates to effect long-term structural transformation in the face of declining savings and productivity of investment due to falling capacity utilization. In view of the lack of external resources to fill the resource gap, the government, especially in its development budget, resorted to financing through borrowing from the banking system. The resultant monetary expansion in excess of real output growth exarcebated the underlying structural inflation. Thus price levels are determined partly through cost push factors stemming from structural constraints and partly through excess demand through excess money supply growth.

Institutionally, the ruling party (CCM) and the government in Tanzania play a central role in the determination of the pace, the level and the path of the socio-economic development. This is effected through the long-term development strategy implemented via government medium term (five-year period) plans and annual budgets. In this process, the government is itself a major participant in resource mobilization through its fiscal instruments and direct participation in investment as indicated by the high share of public-sector investment in the total, averaging 54 per cent over the last 10 years (URT, National Accounts, Table 4). The dominance of the public-sector in the provision of both social and economic infrastructure to support the development process is especially noteworthy. Indirectly the government influences non-governmental resource mobilization and allocation via its control of prices of key resources and commodities as well as through institutional rationing of financial resources. Through its financial monopolist institutions, the government fixes interest rates and exchange rates and has direct control over sectoral and institutional allocations of investible funds, working capital and foreign exchange in line with its objectives and targets. External resources are also channelled via governmental institutions. The government sets the minimum wage and is the price leader generally for labour resources. Through direct intervention and price control the government has in part exercised de jure control over internal and external trade. It implements these controls partially via 'policing' of the official distribution system with penalties for violation and partly via supply management and/or subsidies to both consumers and producers.

However, this dominant role of the government takes place in a social environment which involves several interest groups, each keen to protect its own interests in the process of development. Apart from the government which partially plays the role of arbitrator among the other groups, the other major interest groups include the urban wage/salary earners, the commercial entrepreneurs and rural peasantry. Although the rural peasantry is not, by and large, formally organized as a pressure group, the party and the government have to take account of their interests. While over the first two decades of independence (1961-80) the government emphasized urban-centred modernization to promote economic diversification, as evidenced by the concentration of resource allocation in non-agricultural sectors (see the previous four five-year plans) and the extraction of investible surpluses from the rural sector, it also placed commendable emphasis on providing social services to the bulk of its citizens (80 per cent rural). This is evidenced by the rapid eradication of illiteracy (from a literacy rate of 20 percent at independence to 80 per cent in 1980) and increased life expectancy, from 37 years at independence to 51 years in 1982 (ILO, 1985, p. 39). On the income distribution side, however, until the mid-1970s, the government through its producer pricing policy and urban consumer subsidy policies had effectively supported income gains to urban wage earners relative to the rural peasantry. Throughout this period, private commercial entrepreneurs were demobilized via government control of their activities and its own direct participation in production and trade.

However, the late 1970s and the 1980s saw a remarkable shift in the relative positions of these groups, setting up the current social environment. Low producer prices to agriculturalists brought two types of reaction on the part of the rural peasantry. On the one hand, production growth slowed down, with production of export crops declining in real terms; on the other, the structure of agricultural production shifted in favour of food crops (Ellis, 1982), which could fetch higher prices on the growing parallel market as controls became difficult to enforce. The combined effort of raising nominal producer prices and maintaining consumer subsidies to urban dwellers became increasingly difficult to shoulder via the government budget. Increased parallel market channels made subsidies ineffective. The result was the 1984 decision to remove food subsidies. On the other hand reduced import capacity combined with the fixed overvalued exchange rate led to illegal exports and imports, inducing a rapid growth of the parallel market for non-food consumer imports and a flourishing black market in foreign exchange. These developments caused significant changes in the relative positions of the principal interest groups.

The agricultural producers gained relatively vis-a-vis urban wage earners via higher parallel market prices for food and protection of their own real consumption levels through subsistence production. Relatively, a smaller decline in per capita incomes was suffered by agricultural producers compared to wage earners (ILO, 1985). The absolute decline in real per capita incomes is mostly explained by the continued decline in real producer prices for export crops for which, by and large, no domestic markets exist. The urban wage earners suffered the steepest fall in real incomes as evidenced by the 65 per cent decline in non-agricultural wage incomes, for the period 1979-80 - 1983-84 (ILO, 1985). The government was able to depress real wages partly due to the weakness of labour organizations which are subsumed into the partly governmental system. However, urban wage earners also made adjustments to this situation, as shown by the growth of urban subsistence activities and reduction in effective paid work-time put in by employees. It is virtually impossible to live on the current official minimum wage. Urban wage earners resort of necessity to sideline subsistence activities and 'veiled' redistribution from public-sector resources into private pockets.

Those who gained most from the economic retrenchment are the commercial entrepreneurs, mostly traders. These earned high incomes from scarcity premiums on the rapid growth of parallel markets and the erosion of the enforcement of government control. Even after the removal of food subsidies in 1984 a large gap persisted between official prices for grains and parallel market prices in food deficit regions. Consumer imports under the current 'trade liberalization' scheme, where an allowed list of import items financed privately are sold at prices markets can bear, at prices up to five times their c.i.f. values at official exchange rates. Based on import licenses issued by the central bank, such imports on average constituted 57 per cent of total consumer imports during the first 18 months of the post-liberalization period, July 1984 - December 1985 (Table 4). Though prices later came down somewhat from their previous black market levels, these items still earned high scarcity premium.

The situation is similar in domestic import substitutes. Although official prices are enforced at wholesale levels, at retail level prices closely track their imported counterpart. The scarcity premiums earned by retailers typically range from 60 per cent to over 300 per cent depending on the scarcity of the items. (The above figures are based on an ongoing study on 'Inflation and economic recovery in Tanzania' undertaken by myself and colleagues which involved among other things an extensive survey on price levels for items entering the consumer price index.)

The various operational features of the Tanzanian economy and the institutional setup described above form a background against which our subsequent analysis of the economic crisis and the response to it is undertaken.

Subsequent to the above introduction, the paper first characterizes the onset of the crisis and tries to provide an explanation of its major causes. It then goes on to assess the constraints on stabilization and adjustment programmes in view of the characteristic features of the economy, the depth of the crisis, resource availability, political factors and the likely efficacy of standard stabilization policy instruments. The next section describes the stabilization and adjustment programmes adopted by the government in an attempt to reverse the crisis. An evaluation of the results of programme implementation and lessons from this experience for future programmes is undertaken.[1] The last section of the paper offers a brief survey of current strategy and prospects.

III THE ONSET AND MAIN CAUSES OF THE CRISIS 1979-80

Following the 1976-78 commodity boom Tanzania was subjected to several overlapping shocks. Barter terms of trade dropped by 31 per cent from their peak of 1977 over the following three years (Table 5). Commodity prices slumped; coffee prices, the largest export commodity in Tanzania fell by 36 per cent between 1977 and 1978; and import prices soared, especially the price of oil, the single largest import item, which increased by 80 per cent over the same period (World Bank, 1981). Income terms of trade fell even more steeply dropping by 46 per cent between 1978 and 1980 (Table 5). The resultant loss in purchasing power will probably be permanent (World Bank, 1981, p. 19). Bella Balassa estimates an income loss of 14.3 per cent for Tanzania between 1977 and 1978 alone as a result of the terms of trade deterioration (Balassa, 1981, p. 17b).

The Idi Amin war of 1978-79 was another major shock, unfortunately coinciding with the external shock above. The war not only made heavy claims on foreign exchange earnings and reserves, estimated to cost four billion shs., equivalent to one year's total export earnings, but also disrupted production as resources, manpower and equipment were diverted to war.

However, there was a long lag before policy reacted adequately to these shocks. Internally, a strong inertia in spending persisted. Government spending increased by 47.5 per cent between 1978 and 1980 relative to a 27.6 per cent increase in revenue (Table 6). Government development expenditure increased by 53.4 per cent over the same period. Recurrent deficit rose quickly from a net surplus position in 1977-78 to a deficit of shs. 1471.7 million in 1979-80. The ratio of the overall budget deficit to GNP rose from 10.6 per cent in 1977-78 to 20.4 per cent in 1979-80. The proportion of the fiscal deficit financed through bank borrowing increased from 8 per cent in 1977-78 to 50 per cent in 1979-80 (Table 6). At the level of the economy as a whole, the investment-saving gap increased from shs. 2881m. in 1978 to shs. 3549m. in 1980. This was financed through borrowing and grants. This happened despite a general decline in investment productivity due to capacity utilization constraints (Ndulu, 1984). 'Capital habit'[2] continued despite resource gaps and productivity decline (Wheeler, 1984). A 53 per cent growth in the money supply over the same period contributed to the 'overheating' of the economy and a jump in the inflation rate to 30.3 per cent in 1980 from 11.6 per cent in 1977.

The import surplus, which had increased ten-fold between 1977 and 1978, partly as a result of decline in exports and partly due to 1978 import liberalization, rose by a further 26.3 per cent between 1978 and 1980 in nominal terms. The overall balance moved into large deficit. Cumulative import payment arrears reached 39.5 per cent of export earnings in 1980 compared to 13.0 per cent in 1978. This deterioration in the balance of payments situation reflected a 9 per cent decline in export prices (between 1977 and 1979), a 26 per cent decline in export volume (between 1977 and 1980) and a 55 per cent increase in import prices. Real imports declined over the period. The decline in export volume was partly explained by the 29 per cent decline in real producer prices of agricultural exports (Table 7) between 1977 and 1980 and a further 24 per cent relative producer price shift against export crops over the same period.

Thus a combination of external shocks and ineffective countercyclical management characterized the onset of the economic crisis in Tanzania. The government attempted to keep up demand in the face of the supply shock. David Wheeler (ibid, p. 18) estimates a 3.6 per cent annual growth opportunity cost for Tanzania as a result of inappropriate policy response during this early part of the crisis. Granted that this might be an overestimate due to a failure to take into account the effects of import strangulation on output, it is generally accepted that an appropriate policy response to the shocks, especially on the demand management side, would have reduced inflationary pressure.

The underlying causes of the crisis and its continuation over the following seven years fall into several groups: first, short-term inappropriate countercyclical management policy in response to shocks; second, medium-term structural misadaptation and third, longer-term structural weaknesses of the economy.

As pointed out above, at the onset of the crisis, lack of effective countercyclical management exarcebated the effect of the shocks. Demand overexpansion relative to the slowing down of output growth led to domestic 'overheating' fuelling the underlying cost-based inflation. Government expenditure growth of 380 per cent between 1976-77 and 1984-85 far exceeded revenue growth of 165 per cent over the same period (Table 6). The proportion of the fiscal deficit financed through bank borrowing grew steeply from 8 per cent in 1977-78 to 60 per cent in 1982-83, and then declined slightly to 54 per cent in 1984-85 (Table 6). The rapid expansion of the money supply, averaging an annual growth rate of 24 per cent in the post 1978 period was caused mainly by increased government borrowing from the central bank. Government borrowing averaged 65 per cent of total domestic credit over the period 1981-84 (Bank of Tanzania, 1986).

Empirical studies relating the growth of the fiscal deficit, money supply growth and inflation in Tanzania strongly support this contention. Ali Kilindo (1981) using the model of Aghvelli and Khan (1978) found a statistically significant elasticity of .96 for money supply with respect to the government deficit. Changes in international reserves, central bank claims on the private sector and balancing items contributed 4 per cent to variation in the money supply. Kilindo (1981d), Hyuha and Osoro (1982), Lipumba, (1985) and Rashid (1984) all found money supply growth to be statistically a significant determinant of inflation in Tanzania. Rashid (1984), Lipumba (1985) and Rwegasira (1976b) included money supply, wages and import price index in their equations. Both demand overexpansion and cost-push factors turn out to be significant explainers of inflation in Tanzania.

Structural misadaptation is a fundamental cause of Tanzania's economic stagnation. Persistent balance-of-payments disequilibrium, though exacerbated during the post 1978 period, had already started from 1970 onward. The pre 1970 period had been characterized generally by maintenance of external sector equilibrium and absence of significant resource gaps (Ndulu, 1984). Imports were by and large paid for by export earnings and the current account balance was such that there was no need for exceptional finance to achieve overall balance. The unsatisfactory export performance is the main cause in the deterioration of the balance of trade (Rashid, 1984, p. 26). It should be noted that the volume of exports declined during the 1970-71 - 1977-78 even when the commodity terms of trade improved (Table 5). The steep increase in food imports to make up for shortfalls was another cause.

The basic problem in the decline of export volume is a combination of an incentive structure and institutional setup that has over time discouraged peasants and farmers to increase production in general and export crops in particular. Real producer prices for agricultural products as a group declined by 31 per cent between 1971-72 and 1984-85 levels (Table 7). In the case of export crops, real producer prices declined even more steeply, by 37.5 per cent over the same period. Both absolute levels of real producer prices of export crops and their levels relative to food crops declined.[3] This decline was a result of a relatively moderate increase in nominal prices in the face of rapidly increasing rates of inflation, especially in the late 1970s and 1980s. In view of the non-adjustment of exchange rates to reflect the relative inflation rate, increasing prices to producers while maintaining f.o.b. prices at fixed exchange rate and high consumer food subsidies entailed absorbing rapidly growing losses of crop parastatals into expanding budget deficits. Given the inflationary pressures of a rapidly growing budget deficit, this approach of increasing producer prices was ineffective and not sustainable. Thus, although some limited efforts to raise nominal prices were made, the budget constraint limitation resulted in real producer price declines. A related problem was the increasing share of f.o.b. prices going to finance growing marketing cost of inefficient parastatals. Over the period 1969-1978 the producer share of export price for all major export crops declined; from 70 to 55 per cent for cashew, from 70 to 45 per cent for coffee (Ellis, 1982, p. 279). It is necessary to point out that increase in export price through exchange rate adjustment constitutes only a necessary condition for real producer prices increases. An additional condition is that the increase be passed through to producers.

The rapid appreciation of Tanzania's shilling on the other hand reduced the competitiveness of non-agricultural exports. This constrained diversification of the export basket. The trends and the extent of appreciation of the Tanzanian shilling can be seen in Table 8.

There is ample evidence as to the positive supply responses to real producer prices. Frank Ellis, using time series data for official purchases and prices of food and cash crops, has shown that the composition of marketed production changed in favour of food and against export crops between 1975 and 1979 as relative prices changed in favour of food (Ellis, 1982, opt. cit.). G.D. Gwayer (1971), Kighoma Malima (1970), Ndulu (1979), Lundhal and Ndulu (1985), Christopher Gerard and Tery Roe (1983) and Odegaard (1985) using Nerlove's supply response model found significant positive supply responses with respect to both real producer prices and relative prices for sisal, cotton, maize and paddy. Estimated adjustment speed for annual crops in these studies showed more or less immediate responses, other things remaining the same. For the agricultural sector as a whole supply many be inelastic once on the production possibility frontier due to structural constraints but not when within it in view of current production levels being far below historical peaks.

For ten years up to the mid 1980s, the investment structure was strongly biased against agriculture and emphasized the expansion of industrial capacity even when established industries were being underutilized. Over the period 1978-84 manufacturing sector's share in gross fixed capital formation averaged 25.8 per cent compared to 8.1 per cent for agriculture (National Accounts, 1985, Table 16). As a result the agricultural sector was starved of expansionary resources and the necessary supportive services such as transportation, extension services and marketing capacity. The gross underutilization of industrial capacity led to a steep decline in investment productivity (Ndulu, 1984, Ndulu and Hyuha, 1984, Ravi Gulhati and Gautam, 1983) with its high opportunity cost of resource use.

Institutionally, the overexpansion of the public sector relative to its technical and managerial capacity led to gross misuse of resources as a large number of public enterprises got into deep financial losses and became a budgetary burden. Excessive intervention in markets by the government led to the rapid growth of parallel markets with the inefficiencies that go with their operations. Overcentralization of economic management stifled initiative, reduced social accountability and caused seemingly endless delays in the decision making processes.

These are among the fundamental structural weaknesses of the economy that reduce its ability to respond to shocks and act as bottlenecks to growth. The Tanzanian economy is characterized by "weak openness". It relies heavily on primary exports that are highly vulnerable to external shocks. Though some efforts to diversify the export basket and set up a self-sustained economic structure have been made, this weakness remains. The agricultural sector which provides livelihood to more than 85 per cent of the population still relies on antiquated technology. Improvement in production techniques and crop husbandry is a critical necessity for setting up a basis for sustained growth in the long run and medium term flexibility in response to shocks.

IV STABILIZATION AND ADJUSTMENT CONSTRAINTS

The depth and prolonged nature of the economic stagnation of 1979-84 is unique in Tanzania's economic history. The 1973-74 oil shock combined with drought, though severe, was short-lived. Its management was fairly smooth, import restrictions were short-lived and output restoration rather quick especially with the help of the commodity boom of 1976-77. External balance was quickly restored and inflation rate brought under control with its level in 1976 being below that of Tanzania's major trading partners on average. (Green, Rwegasira and Van Arkadie, 1981). A combination of sustained overlapping shocks and delay in major countercyclical action due to the optimism of the economic management to ride through the shocks akin to the 1973-74 crisis made the current required efforts for recovery difficult.

Sustained macroeconomic disequilibria, structural rigidities and weaknesses and political constraints on short-term demand restraint measures have all played significant roles in both the delay and ineffectiveness of past stabilization and adjustment efforts. Import strangulation between 1978 and 1984 (real imports dropping by 60 per cent) and poor prospects of rapid export expansion made forced short-term adjustment without a massive external resource cushion painful. This would have resulted in further current output losses due to increased underutilization of the partially import dependent productive capacity (Green, 1985). Furthermore it would have led to increased damage of the limited, painfully accumulated existing capital stock (Helleiner, 1986, p. 10). Indeed all adjustment efforts undertaken so far in Tanzania have put a rather high weight on the availability of external resources. Implicit in this consideration was the desire to have a non-contractionary adjustment process. It is partially due to this concern that whenever external resources were not forthcoming the government tried to bridge the gap through running a budgetary deficit with its inflation fuelling consequences. Output continued to decline or grow very modestly given that expansion was basically import dependent which could not be supported in view of the dwindling export earnings, external resources for current production support and the general decline of the purchasing power of foreign exchange earnings.

Despite substantial inflows of external resources to Tanzania between 1978 and 1981, increasing from $424.1 million to $701.8 million (World Bank, 1986) economic stagnation set in. Most of these resources were tied to specific capacity expansion projects and not for current import support for utilization of existing capacity. As Helleiner (1986, p. 11) argues, increased supplies of 'free' foreign exchange in situations of foreign exchange constraint can in fact yield extraordinarily high returns. For the manufacturing sector in Tanzania, for example, output elasticity with respect to intermediate imports was estimated at 33 per cent (Ndulu, 1985). A simulation with fungible foreign exchange resources (between capital expansion and intermediate input use) following the simple rule of 'first claim for current capacity maintenance and utilization and the residual for expansion' suggests that manufacturing sector growth rate could have averaged 5.2 per cent per annum between 1973 and 1981 as opposed to the actual rate of 0.7 per cent over the same period with the same resources. (ibid, p. 27).

Faced with a deficit that is not self-correcting and with limited access to fungible external resources, the correction of deficits where output is not growing certainly involves sacrifices in domestic absorption (Graham Bird 1983, p. 479). This is an important cost to be concerned about especially given policy makers objectives of raising output, protecting employment and inducing structural adaptation. This is especially the case where the underlying causes of deficit are themselves structural rather than financial (ibid, p. 479).

A major concern among policy makers in Tanzania in the consideration of adjustment and stabilization policies has been on the uncertainty of the efficacy of the standard policy instruments. Short-term demand restraint measures are called for in view of the overexpansion of demand in the face of falling output and supplies. Measures to reduce the budget deficit and thus reduce 'overheating' of the economy, as will be seen below, have been dominant so far in the actual stabilization efforts. However, given the underlying structural causes of the disequilibria, significant domestic supply restructuring for the restoration of external balance with growth is fundamental. This requires medium term measures to increase the production and reduce the consumption of tradeables (Helleiner, ibid, p. 16). Thus a main issue of concern is what policy instruments could efficiently achieve this.

A subject of major debate in Tanzania for the past several years is the efficacy of currency depreciation as a tool of balance of payments adjustment. On the basis of the foregoing discussion it is obvious that the issue is not on the side of import restraint so much as on the expansionary effects of this instrument and distributional effects of its induced cost inflation. It is the supply aspect of depreciation that is in many ways critical given the central importance of export growth and relatively little latitude for further import cuts.[4] Fiscal simulation of currency depreciation or the use of multiple rates, though frequently tried in the Tanzanian case, are generally agreed to be inferior alternatives (Bhagwati and Desai, 1970, Bhagwati, 1968, Killick, 1978, Laker, 1981) given the difficulties of effectively administering them.[5] The use of the budget deficit as an instrument to increase prices to producers of export crops (through budgetary absorption of marketing parastatal losses while maintaining an overvalued currency) has become non-supportable in view of the high rates of inflation. This is the background to the 31 per cent devaluation in 1984 to shift the burden of increases in producer prices away from the budget. Now the question is how rapidly the shilling should continue to depreciate.

Theoretical treatment of currency devaluation generally concludes that it stimulates economic activity. Graham Bird's (1983) review of theory and evidence on this issue supports this conclusion. However, Taylor and Krugman (1978) warn of the possibility of contractionary effects of devaluation through the creation of an excess of saving over planned investment ex ante and reductions in real output and imports ex post. They urge that devaluation should be accompanied by measures to increase demand (p. 455). Expenditure-switching combined with expenditure-reducing policy without measures to expand output may be contractionary. It is precisely this caution that has permeated the minds of policy makers in Tanzania and has generated a cautious attitude to the use of devaluation combined with a determination to maintain domestic growth.

Equally important has been the worry on the income distribution effects of devaluation. Tanzania is committed to the provision of basic needs to its entire population and achievement of equity. This is an issue that has not been in much dispute even among international agencies that have been engaged in policy dialogue with the country (Helleiner, 1985, p. 29). Redistribution effects from producers of non-tradeables to those of tradeables are well known. However, given unofficial adjustments that various interest groups have made to protect themselves in response to the crises, the current income distribution pattern is hard to discern. The prevalence of parallel markets for both products and factors of production and the growth of urban subsistence activity makes available data on distribution unreliable.[6] A definite impact of devaluation has been to reduce rental incomes of traders who earned the premium between official prices of both resources and products and those that are market clearing. The erosion of the government's capacity to enforce official prices and the expansion of the officially-sanctioned range of commodities which can be sold at market clearing prices after 1984 provided the basis of the situation described above.[7]

Raising nominal interest rates above the inflation rate is another standard policy instrument usually included in stabilization packages. The aim of this policy is to encourage financial savings and efficient utilization of credit. Empirical evidence of the responsiveness of financial savings to interest rates has at best been uncertain in developing countries. (Khan and Knight, 1985, p. 14, Chandravarkar, 1971, Hyuha, 1980, Giavannini, 1985). In the case of Tanzania emprical studies show that expansion of the financial infrastructure in terms both of geographical coverage and the range of financial instruments have proved to be a more effective means to increase financial savings (Hyuha, 1983, Maje, 1981). A more critical constraint on a sharp increase in the interest rate is its likely contractionary effect. The cost of working capital would increase substantially during the critical period of recovery. A severe restriction of credit would thus work against output growth. In addition high interest rates can also be contractionary if they discourage investment by more than they encourage financial savings. In the long run it may be sensible to maintain positive interest rates, but this should be achieved via anti-inflationary policies (Shaw, 1973) rather than through interest rate liberalization as McKinnon (1973) urges.

Trade liberalization is another item in the standard policy package, advocated on grounds of allocative efficiency. A key component of liberalization policy is a complete "freeing" of imports through the abolition of administrative controls in foreign exchange allocation system and protective tariff structure. It is true that generally long-lasting trade restrictions are inefficient in the resources allocation sense. By contributing to an overvalued exchange rate such restrictions discriminate against agriculture in general and exports in particular. In Tanzania's case, the tariff structure has in the past protected inefficient import substitution industries. The cumulative losses and decline in resource productivity in this sector in the early 1980s raised the prospect of permanent infancy for some industries. The continued supply of higher cost commodities (relative to unrestricted alternative supplies) implied continued de facto subsidies from consuming sectors (S. Lewis, 1986, p. 486). There was a need for a full appraisal of the tariff structure to remove unnecessary protection and to rely increasingly on better management and improved skills for increasing productivity and competitiveness.

However, a complete 'freeing' of imports starting from a severely distorted system poses major problems for recovery, notably the crowding out of intermediate and capital imports by consumer goods. Major sectoral allocation of foreign exchange to support targetted sectoral growth is necessary. Otherwise imports required to allow existing productive capacity to be more fully utilized will just not be available.

The process of formulating and indeed implementing stabilization and adjustment policies involves a careful balancing of the different, and usually conflicting, interests of various groups active in the political system. Unless the political system is completely closed, the disposition of economic management will reflect an interaction of the various interests through the political machinery (Sandbrook, 1982, p. 77, Ndulu, 1986, p. 82). In the absence of a more open political system where organized interest groups can thrash out their differences in an open democratic process the state's management of policy necessarily entails much more involvement in resource allocation. It is necessary to understand the actual social and political forces at work in a country if policies are to stand any chance of being implemented.

The political-economic environment in Tanzania is dominated by national interest groups, partly articulated through the ruling party, state machinery and the bureaucracy. Apart from a general consensus among these interests as far as the longer-term targets of growth and inward-looking structural transformation are concerned, distributional issues, as affected by policies, constitute the main areas of potential conflict. Political constraints on stabilization and adjustment policies are dominated by these issues. In the absence of a sudden increase in political resources, a careful balance of the incidence of adjustment burdens among different groups is needed (Joan Nelson, 1984.)

It is important to note at this juncture that the _actual_ distributional constraints on adjustment are significantly different from those implied by the _officially-declared status quo_. The period of economic deterioration has been characterized by significant departures of perceived _de facto_ from _de jure_ resource allocation pattern and benefits. Via parallel markets and corruption, effective distributional adjustment processes have actually been taking place, albeit in a disorganized fashion (Ndulu, 1986, p. 84). The state control of the economy has been weakened and this has tended to water down the effect of whatever distributional policies were officially adopted. Official control of pricing and _de jure_ subsidies of basic consumer goods and services have been undermined. This situation has reduced the political constraints on change from the official _status quo_ since such a change may in effect just legalize what is actually taking place. Thus, politically it is easier to remove food subsidies when consumers in fact pay much higher prices on parallel markets, and to introduce cost-sharing schemes to improve the quantity and quality of basic services when 'free' services are deteriorating for lack of funds. All groups have reacted informally; producers have switched to parallel markets to evade control and urban wage earners work shorter hours at their place of employment and use the rest for urban subsistence activities. The political calculus of the effects of stabilization and adjustment programmes have thus become hard to assess in the absence of formal analysis of the changes in the relative positions of various groups during the period of economic retrenchment. The professed (official) distribution of resources and power among various interest groups has been altered and a more malleable situation obtains, making the official status quo fuzzy as unofficial adjustments are being made by different groups in reaction to changing situations.

V RESPONSES TO THE ECONOMIC CRISIS 1979-85

The first official response to the onset of the crisis was the 1979 (calendar year) financial programme which was supported by a first credit tranche purchase from the Fund and loan from the Trust Fund (IMF, 1980, EBS/80/192). The programme was geared towards alleviating both internal and external imbalances. The main targets included limiting the overall balance of payments targets to 20 million SDR (which had reached SDR 232 million in 1978), sustaining real growth at about 5 per cent per annum and holding down inflation rate of between ten and 20 per cent. This was to be achieved through a combination of reduction in domestic absorbtion (via demand management) and structural adjustment that was geared towards increased, relative emphasis on the external sector.

To reduce internal imbalance the budgetary deficit was to be reduced partly through increased revenues and grants and partly through reduction in government expenditure. During the first half of 1979, all personnel vacancies were frozen, non-salary expenditure reduced and implementation of locally financed development projects halted (IMF, ibid). Domestic credit expansion was to be slowed down to reduce 'overheating'. Table 9 and 9b compare the targets of the programme with the actual performance.

With regard to the external imbalance the programme relied on a combination of a shift in resources to the external sector and increased restrictions on imports (via reduction in the value of import licences issues and curtailing the system of open general licences for several commodities). Devaluation by 10 per cent of the Tshs. against the SDR and increases in producers prices for export crops ranging from 25 per cent for cotton and to 6 per cent for cashewnuts was effected. Table 6c gives the targets and actual performance of the external sector under the programme.

The actual performance relative to the programme targets was generally poor. Real GDP at factor cost grew only by 0.8 per cent between 1979 and 1980 (revised figures, National Accounts, 1984) compared to the programme target of 5 per cent. Prices (CPI) increased by 12.2 per cent between the first and fourth quarters of 1979, within the target but exceeding the 1978 rate of increase of 10 per cent. The budget deficit expanded, exceeding the target by 25 per cent. Domestic credit during the calendar year 1979 expanded by 39 per cent compared to the programme target of 19 per cent. Government borrowing from the banking system increased by 79 per cent relative to the targetted increase of 30 per cent. These increases placed added pressures on the price level and the balance of payments.

On the side of the external sector, the current account deficit was reduced by 16.2 per cent compared to 1978 and the overall balance of payment improved remarkably from a deficit of SDR 232m. in 1978 to SDR 46 million in 1979. However relative to the target this was still an underperformance (see Table 9c). In fact during 1979 payment arrears increased by 65m. SDR. The improvement in the balance of payments situation was due to an 8 per cent increase in export earnings (mostly from non-traditional exports), a reduction in imports (which fell by 6 per cent in value terms compared to 1978 level) and larger than expected net capital inflows (medium and long-term loans). The continued war with Idi Amin and the rise in oil prices were major drains of foreign exchange - the rise in oil prices accounted for additional payments of 75-80 million SDR and 65 million SDR respectively (IMF, ibid, p. 12). The import squeeze thus was effectively made more severe by these additional payments. The import volume index dropped by 24 per cent (UNCTAD, 1984) and was reflected in a severe output squeeze as the availability of raw materials and spare parts was reduced and capacity underutilization increased. This situation was made worse by the relative shift of import structure against intermediate imports; the ratio of intermediate imports to capital imports declined from 1.005 in 1978 to 0.89 in 1979 (Economic Survey 1984, p. 25).

There were two other stabilization efforts between 1980 and 1982. The first one was the 1980 IMF standby agreement which had to be abandoned after the first quarter following failure to meet credit ceilings. The second was the National Economic Survival Programme adopted in 1981 which focussed on crisis management of the external sector imbalance via exhortation. Neither of these two programmes ran its course and hence we will not analyse them extensively here. Suffice to say that their important components were later included in the 1982/83 - 1985/86 Structural Adjustment Programme.

This was a comprehensive adjustment programme covering a three-year period, 1982/83 - 1984/85. The programme was adopted as an independent effort to deal with key imbalances related to the economic crisis. The three-year programme was designed to restore balance in the government and external sector accounts, contain inflation and restore output to pre-crisis levels while maintaining social services and the expansion of economic infrastructure. It was envisaged that following the restoration of balance, economic restructuring necessary to reduce longer-term structural weaknesses of the economy would be undertaken in a more stable economic environment.

The main macro-economic objectives and policy instruments of the three-year programme included:

(a) Restoration of output by utilizing foreign exchange inflow and shifting of resources from capital to recurrent use and rehabilitation. Realization of this objective hinged heavily on external inflow necessary for increasing import capacity to levels that could support increased capacity utilization and rehabilitation of the required supportive economic infrastructure. There was also an expectation change in the composition of external resources, shifting relatively to import and local cost support rather than capital formation for capacity expansion.

(b) Reduction of the budgetary deficit to reduce domestic 'overheating' generated by excess demand. Realization of this objective was to be achieved through a combination of increased revenues and reduced growth of both recurrent and development expenditures. To increase revenues, collection capacity and effort was to be expanded and tax base was expected to increase through improvement in production (a. above) and bringing into the tax-web non-salary incomes using presumptive tax assessment and collection. Reduction in recurrent expenditure growth was to be effected through reduction in defence spending to peace time levels, limitation of accommodation of crop authorities losses by appropriate pricing measures to minimize losses from trade. Significant savings were also to be achieved via reduction of over-employment in the public sector. On the side of development expenditure, government was to reduce the level of investment by shelving some projects, especially those with minimum short and medium-term impacts on the balance of payments.

(c) Reduction of money supply growth linked to the reduction in the government deficit. This was to be achieved mainly through restricting government borrowing from the banking system.

(d) Restoration of external balance through expansion of exports so that on completion of the programme import requirements could be met without recourse to exceptional financing. It was envisaged that all import payment arrears would be paid off by the time of programme completion. To achieve this, supply of inputs and incentive goods would be increased for short-term boosting of agricultural exports. Agricultural marketing system was to be improved to the same effect. Non-traditional exports were to be promoted via appropriate incentives and input provision.

In order to achieve the above objectives, negotiations with the IMF/IBRD were undertaken to seek programme funding and with bilateral donors to seek required flexibility to shift resources to import and local cost support, but these did not result in agreements until 1986 (see below, Section VI).

The specific macroeconomic targets and actual performance are given in Tables 10a to 10d and discussed later below. One observes a rather heavy emphasis on resource support for programme implementation. There is relatively little in the programme pertaining to the economic environment for effective utilization of these resources to achieve the objectives. Notably, there is a conspicuous absence of active use of pricing system to correct for resource misallocation and reduction in the costly parallel markets for both resources and output. There is also an absence in the programme of the provision for institutional rigidities which by and large continued preempting the required flexibility in dealing with changing economic situations. The key areas of institutional rigidities not dealt with by the programme include those that hinder both internal and external trade and excessive centralization and control of resource allocation and economic management. The impacts of these rigidities on lack of accountability, stifled local initiatives, delays in critical decision making and bottlenecks in trade and production are well known.

Actual adjustment efforts and their effects can be analysed following the main objectives given above.

1. Output restoration

The level of real GDP, which had shown zero growth from 1979-83, rose by about three per cent in 1984 and 2.3 per cent in 1985. However, this still left it below its 1978 peak - and per capita income continued to decline until 1986-87.

The achievement of this objective hinged heavily on an injection of external resources. Relative to the programme targets there was an actual shortfall of inflows of 65 per cent taking the whole period of the programme (see Table 9d). The export earnings performance relative to programme targets fell short by 33 per cent over the same period. As a result, the level of imports was only 64 per cent of that anticipated. This shortfall in imports impaired output growth, especially of high import-dependent sectors such as manufacturing and economic infrastructure with the consequent negative impacts on agricultural growth stemming from reduced supply of incentive goods, inputs and infrastructural services. Relative to the average ratio of imports to GDP in 1970-75, the import cut back during the post 1979 period was 52 per cent (ILO, 1985, p. 5). This import squeeze translated itself partly into direct falls in output in material production, due to import shortfall-induced underutilization of existing capacity. In terms of the structure of imports over the same period, capital imports relative to intermediate imports increased, contrary to the programme expectations. The heaviest cut back in imports prior to July 1984 was in consumer imports. Coupled with steep decline of domestic manufactures, this reduced significantly the supply of incentive goods for boosting agricultural production.

During this period there was a general lack of active use of the pricing system. Real producer prices continued to decline for both export and food crops with the reversal taking place in July 1984 subsequent to removal of food subsidies and exchange rate adjustment (see Table 7). This decline was a result of continued high rates of inflation and relatively moderate nominal price increases to producers. As explained previously price increases were limited by budgetary deficit pressures. Achievement of 5 per cent real price increase annually as targetted in SAP would have involved more than 30 per cent annual increase in nominal prices which would create unsurmountable pressure on the budget. It should be noted that the above was taking place despite higher effective prices for foodstuffs and foreign exchange in their respective parallel markets.

The continued deterioration of the economic infrastructure during this period was another major factor behind the failure to restore output. This was linked to the lack of imports and of local funds for the rehabilitation and adequate maintenance of infrastructure.

2. Reduction of fiscal imbalance

The general performance in this area relative to the programme targets was successful. As can be seen in Table 6a the overall fiscal balance performance exceeded SAP targets over the three-year period. This was achieved through strong overperformance in revenue growth stemming from a strengthened collection system and increased tax rates, counterbalanced by moderate underperformance on the expenditure side. However, on the recurrent expenditure side one observes increasing underperformance after 1982-83 as expenditure overruns grew in the next two years. It should be noted, however, that in real terms total expenditures declined over the three-year period given that the average annual growth rate was significantly below the inflation rate. The average annual growth rate of total expenditure in compound terms over the three-year period was 14 per cent relative to average annual rate of inflation of 30 per cent.

With respect to the financing of the fiscal deficit, however, performance was much poorer. Financing through bank borrowing exceeded the target by 32 per cent over the whole period (Table 10a). However, the proportion of fiscal deficit financed through this avenue declined progressively from 60 per cent in 1982-83 to 37 per cent in 1984-85 (the targeted proportions decline were from 38 per cent to 30 per cent for the same period). This poorer performance was accounted for mostly by non-realization of external loans and grants.

3. Monetary expansion

Money supply performance was again poor. With the exception of 1982-83, in all subsequent years the rate of growth of money supply (broad definition) considerably exceeded SAP targets (see Table 10b). The actual performance was 19.1 per cent and 21.1 per cent against the targets of 13.8 and 13.0 for 1983-84 and 1984-85 respectively. High rates of growth of money supply were generated solely by rapid expansion of domestic credit, in view of the fact that the change in net foreign assets was negative throughout the period under consideration. The domestic credit expansion rate averaged 19.3 per cent annually between 1982 and 1984 and shot up to 21.8 per cent during 1984-85 (see Table 10b). Government borrowing from the banking system accounted for most of the domestic credit expansion between 1982 and 1984.

4. External balance

Performance in this area was disastrous. From 1982-83 to 1984-85 exports in terms of dollars declined (see Table 10c); actual exports for the period were only 66 per cent of SAP targets. This was combined with a shortfall in external resource inflows, which reached only 65 per cent of the target. As a result actual import capacity was only 36 per cent of projected levels. Instead of the projected elimination of import arrears over the programme period, there was an actual build up of arrears all through the period of more than $650 million The overall external balance worsened by nearly 80 per cent between 1982 and 1985.

The post-1984 July period adjustment efforts, however, need a special treatment. At that time, major measures were taken to reduce price distortions, bottlenecks in trade, and to increase incentives to agricultural production via increased real producer prices and the supply of incentive goods. The overvaluation of the shilling was reduced through a devaluation of 35 per cent in shilling terms. Food subsidies and inputs subsidies were removed and built into producer prices which increased in real terms by 3 per cent and 10 per cent for export and food crops respectively. The bulk of new imports under the liberalization scheme was allowed to be sold at market clearing prices; bottlenecks both for external trade (especially on import side) and domestic trade (food and imported goods) were reduced; a big effort was made to reduce the accommodation of the operating losses of parastatals in the budgetary system and to improve business confidence. Although there was some backsliding in the 1985-86 budget, these reforms laid the basis for gradual recovery and paved the way for the eventual agreement with the World Bank and IMF.

The main features that would have to be incorporated in the recovery programme were by now clear. The programme would have to emphasize stabilization with growth in order to minimize short-term adjustment costs stemming from demand restraint and protect the achievements in the sphere of social development. Although longer run development objectives remain important, the recovery programme would need to focus on a short to medium-term horizon of about five to seven years. Such a recovery programme would combine expenditure switching measures, demand restraint and measures to increase output in the short run in order to avoid stagflation. Essential for effectiveness of these efforts would be the rationalization of the macroeconomic environment and administrative structures to make the economy more responsive and efficient without at the same time undermining the basic social and economic objectives of social equity and self-reliance (Msuya, 1986, p. 8).

The major objectives of the recovery programme would need to include the following:

(a) Restoring output to pre-crisis level (pre 1978) in various productive sectors; for this, the rehabilitation of economic infrastructure, especially transportation, is critical.

(b) Redressing the external imbalance through corrective exchange rate action and prevention of subsequent appreciation and balance of payments support.

(c) Redressing the fiscal imbalance to reduce the budget deficit and set up a non-inflationary basis for the expansion of government expenditure by linking it to revenue growth.

(d) Cutting the inflation rate through a combination of demand restraint and expansion of supply in order to generate price stability and reduce the erosion of real incomes.

(e) Enhancing the effectiveness of resource utilization through rationalization of institutional structures to increase accountability, checks and balances and sound economic management. Bottlenecks to initiative and mobilization of additional local resources could be reduced through the democratic involvement of all Tanzanians in the process of recovery.

(f) Rehabilitating and subsequently maintaining basic social services to ensure continued well-being of Tanzanians and raise the quantity and quality of human capital for future growth - all of which are necessary for achieving social equity, which is a key objective of Tanzania's development philosophy.

Thus it was obvious that the programme for recovery would need to focus on the medium-term outlook, emphasizing rehabilitation and utilization of current productive capacity while at the same time undertaking structural adaptation. This should not be construed as deemphasizing long-term development strategy. Fundamental structural weaknesses have to be tackled in the long run in order to reduce the economy's vulnerability. Further integration of the national economy to enhance flexibility to response to shocks, raising the technological capability of the agricultural sector and the quantity and quality of human capital, remain key long-term development goals. However, in order to continue with the implementation of the long-term development strategies it was clear by 1985 that the first priority is to ensure a stable economic environment. Without seriously addressing these critical medium-term problems, the long-term development goals would remain wishful-thinking.

VI THE CURRENT STRATEGY AND PROSPECTS

By mid 1987 Tanzania appeared to be sustaining its gradual recovery from its deep and persistent economic difficulties. As we have seen, this prolonged decline was attributable both to severe external shocks and to the inadequacy of the policy response to them. These brought about acute 'import strangulation', throttling economic growth and setting back the entire process of economic development. Starting in 1984-85, the recovery reflected partly the absence of such severe shocks and partly economic policy reforms, which in turn paved the way for the mobilization of external financial support.

Harvests were good both in 1985 and 1986, after the drought years of 1979-84; oil prices were declining on balance (while remaining volatile); and in 1986 coffee prices staged a short-lived recovery, providing a fillip to export earnings. The economic policy reforms discussed in earlier sections of this paper, many of which were implemented well before the 1986 IMF agreement, were maintained: these included cuts in consumption and recurrent government spending, as well as in government borrowing and money supply growth. Also, in the year to March 1987 the shilling was devalued by 400 per cent against the pound (Sh 20 to Sh 100) and almost 300 per cent against the dollar (to Sh 60). Finally, external resources were successfully mobilized following the IMF agreement and Paris Club rescheduling with government creditors. Thus several of the principal requirements for sustained recovery that have been identified in this paper were in place and the economy began to respond positively: GDP at constant prices rose by an estimated 3.5 per cent in 1986 and a further rise of 4-5 per cent was expected for 1987.

However, it is well to remember that even in absolute terms the pre-crisis level of output was regained only in the course of 1986; and that per capita income, which fell an estimated 25-30 per cent in 1978-85, only began to recover in 1986.[8]

The external situation, though encouraging by comparison with past disasters, remains fragile. The exchange rate policy is based on a 'crawling peg', with the shilling tied to a weighted average basket of currencies: each month the price of foreign exchange is raised by the estimated excess of Tanzania's inflation (of about 30 per cent a month) over world inflation plus one per cent to avoid the re-emergence of over-valuation and continue a real devaluation. External assistance in 1986 is estimated at about $500 million, and in 1986 virtually all the principal and arrears on government were rescheduled (deferred for five years, with five years to pay).

It is reported that negotiations in mid 1987 - following the precedent set in early 1987 Mozambique and Zaire reschedulings - deferred payments on the covered loans for 1987-89 (and perhaps longer) for up to 10 years (to the late 1990s) with ten years to repay.[9]

On trade account, exports rose from $286 million in 1985 to $348 million in 1986 and imports from $999 million to to $1,017 million: but exports were boosted by the rise in the coffee price, which has since collapsed, and imports held down by the fall in the oil price.[10] An estimated one-quarter of 1986 imports were financed privately (without forex licenses) under a scheme allowing such imports with no questions asked about the source of the foreign exchange. The remaining gap was financed by donor countries. It is essential that regular export earnings increase further, that further external assistance is secured to finance the necessary imports required to continue the rehabilitation of the economy and that the critical medium-term problems identified in this paper are addressed. Clearly, there is a long way to go before this process is fully accomplished.

FOOTNOTES

1. This section of the paper draws heavily from the 1985 paper by Ndulu and Lipumba presented at an economic policy workshop in Dar es Salaam titled "Adjustment processes and efforts towards economic recovery in Tanzania 1980-1985".

2. 'Capital habit' here means inertia in capital spending irrespective of cyclical domestic resource gaps. Such inertia in capital accumulation has been basically supported through deficit financing both domestic and external.

3. The ratio or returns per manday of work in export crops (say cotton) to food crops (say maize) has fallen from one in 1971-72 to 60 per cent by 1983-84 to 40 per cent in 1984-85 at the official prices (ILO, 1985, p. 59).

4. Taylor (1986, p. 26) argues that since intermediate imports are limited by quota and price responsiveness of capital goods imports is likely to be weak, exchange depreciation can only improve the current account on the side of exports.

5. Various strategies other than direct currency depreciation to promote exports and reduce imports have been tried in Tanzania. These have basically revolved around export subsidies (Export Rebate Scheme) to cover losses accrued by exporters in Tshs. due to lack of competitiveness in the world markets and import quotas. The more recent Exports Retention scheme, where exporters are allowed to retain 50 per cent of earnings to support their activities addresses itself more to foreign exchange allocation mechanism to support further export production.

6. ILO, (1985, p. 58) contends that throughout the recession period total rural incomes and urban incomes recorded in the national income accounts have increased in step causing no maldistribution to account for. But as Helleiner (1985, p. 24) argues, lack of crucial data on GDP, the rate of price inflation which take into account the operations of informal sectors and parallel markets makes it difficult to work out the details of distribution of the effects of shock, restraint and adjustment efforts in Tanzania.

7. In 1984, the number of price-controlled locally produced items was only 26 per cent of the number in 1978 and in the case of imported items it was only 6 per cent of that in 1978. (Doriye, 1986, p. 2).

8. _Africa Contemporary Record_ 85/86, p. B 460. This estimate adjusts for the 1978-85 terms of trade loss, falling real _per capita_ resource transfers after 1980 and war costs over 1978-80.

9. A.C.R. 86/87.

10. Budget Speech and related articles in African Economic Digest, June 19-25 and 26. July.

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TABLE 1: MAJOR ECONOMIC PERFORMANCE INDICATORS

	1976	1977	1978	1979	1980	1981	1982	1983	1984
Real GDP Growth rate (%)		2.8	2.9	1.2	0.8	-1.1	1.3	-0.4	2.5
Per capita GDP Growth rate (%)		-0.5	-0.4	-2.1	-2.5	-4.4	-2.0	-3.7	-0.8
Inflation rate (%)	6.9	11.6	13.2	13.0	30.2	25.6	28.9	27.1	36.0
Balance of Trade Deficit (Shs. million)	1242	1697	5127	4589	6142	4747	6472	5905	76240

Source: URT, Economic Survey, 1984.

TABLE 2: SAVING-INVESTMENT GAP AND IT'S COMPOSITION: 1966-81

Monetary savings as % of monetary GDP (Annual average)

	1964-65	1966-69	1970-73	1974-77	1978-1981
Private Sector	6.6	5.7	7.0	8.6	6.4
Public Sector	1.6	3.0	2.9	1.3	1.8
Total	8.2	8.7	9.9	9.9	8.2

Net Investment as % monetary GDP

Private sector	4.7	4.7	2.9	7.3	12.9
Public sector	2.3	5.6	15.9	13.4	14.6
Total	7.0	10.3	18.8	20.7	27.5

Net lending of (as % of monetary GDP)

Private sector	1.9	1.0	4.1	1.3	-6.5
Public sector	-0.7	-2.6	-13.0	-12.1	-12.8
Total	1.2	-1.6	-8.9	-10.8	-19.3

Source: Kimei, C.S., Tanzania's Financial Experience in the Post-War Period, Uppsala Universitet, 1986, p. 42, table 2.7

TABLE 3: CHARACTERIZATION OF INFLATION IN TANZANIA AND ITS COMPONENT SOURCES (1977=100 AND 1977 WEIGHTS)

	Ovarall	Food	Drinks and Tobacco	Rents	Fuel, Light and water	Cloth-thing and Foot-wear	Furni-ture and Utensils	House-hold Opera-tions	Perso-nal care and Health	Recrea-tion and Entertain-ment	Transpo-rtation
1. 1973-78 (%) Average change p.a.[1]	16.48	18.5	14.1	-16.9	15.78	14.3	18.96	9.2	4.5	13.06	10.16
Weighted contribu-tion[2] share by group (%)	100	78.4	2.3	5.5	7.9	9.4	1.7	2.0	0.4	0.6	2.8
2. 1978-84 Average change p.a. (%)	26.8	26.3	32.2	28.6	30.9	25.2	30.6	29.2	30.6	22.1	20.8
Weighted contribu-tion share by group (%)	100	63.1	3.0	5.2	8.8	9.3	1.6	3.7	1.5	0.4	3.2
3. 1970-84 Average change p.a. (%)	19.0	19.6	20.3	4.6	19.7	17.8	21.3	16.8	15.3	16.5	17.3
Weighted contribu-tion share by group (%)	100	68.1	2.8	1.2	8.1	9.5	1.6	3.1	1.1	0.6	3.8

1. Change in the price index
2. Centribution of each group to the overall change in the index.

Source: Computed based on NCPI data from the Bureau of statistics and published in Economic Survey various issues adjusted for base year.

TABLE 4: SHARE OF PRIVATELY FINANCED IMPORTS OUT OF TOTAL (%)

CATEGORY	Jan-June 1984 (Pre-Liberalization)	July 1984-Dec. 1985 (Post-Liberalization)
Intermediate Goods	8.5	9.7
Machinery and Equipment	18.8	41.0
Spares and Accessories	11.5	26.0
Building Materials	11.4	29.4
Consumer Goods	20.6	57.5
Miscellaneous	3.7	46.6
Total	13.9	30.0

Source: Computed based on Import licences issued data from Bank of Tanzania.

TABLE 5: EXTERNAL BALANCE AND TRADE INDICATORS

	1976	1977	1978	1979	1980	1981	1982	1983	1984
Exports (f.o.b.) Shs. Million	4108	4464	3670	4435	4776	4373	3767	4567	5125
Imports (c.i.f.)	5346	6161	8798	9071	10261	9120	10239	10478	12749
Current Account Balance Shs. Million	-80	-352	-3352	-2884	-4273	-2280	-5004	-4381	-5757
Overall Balance Shs. Million	156	992	-2447	-410	-1354	-15.2	-1360·0	-1547.2	-2511.0
Barter terms of trade (1975 = 100)	107	128	110	95	89	79	79	81·7	84·4
Income terms of trade (1975 = 100)	129	132	104	91	71	78	62		
Volume of exports (1975 = 100)	82	88	122	93	83	77	65		
Export|GDP) (%)	18.2	17.2	12.7	13.7	12.4	9.7	6.9	7.5	7.5
Imports|GDP (%)	23.7	23.7	30.4	27.9	26.5	20.2	18.7	17.3	18.5

Source: URT, Economic Survey, 1979-1984
UNCTAD: 1983 Handbook of International Trade and Development Statistics (New York, 1983) and 1984 supplement.

TABLE 6: FISCAL BALANCE AND BANK BORROWING (1977|78-1984|85) (Shs. Million)

	1976|77	1977|78	1978|79	1979|80	1980|81	1981|82	1982|83*	1983|84**	1983|84
Recurrent Revenue	6129	6082.1	6812.0	7757.3	8872	10960	13645	15466.6	15028.1
Recurrent expenditure	4702	5563.3	8229	9229	10136	13214	14871,5	18182.0	18119.7
Recurrent budget deficit	(1426.5)	(518.8)	1483	1471.7	1264	2254.1	1226.5	2715.4	3091.6
Development expenditure			4740.9	5184.0	4795.4	5185.4	4404	5047.0	6560.5
Overall Deficit			6223.9	6655.7	6023	7439.5	5630.5	7762.4	9652.1
Bank Borrowing			3056.7	2804	2916	3278	4206	4699	5200

* Provisional actual

** Provisional

** Estimates

Source: URT, Economic Survey, 1980-1984

TABLE 7: INDICES OF REAL PRODUCER PRICES 1976|77-1984|85 (1983|84=100)

	1976|77	1977|78	1978|79	1979|80	1980|81	1981|82	1982|83	1983|84	1984|85
All domestic food staples	152	161	146	133	107	110	99	100	110
All export Products	184	151	131	131	109	107	97	100	103
All Agricultural Products	178	152	134	132	109	108	97	100	107

Source: URT, Ministry of Agriculture, Marketing Development Bureau, "Price Policy Recommendations for the July 1983-85 Agricultural Price Review: Summary".

TABLE 8 : TANZANIA: REAL EFFECTIVE EXCHANGE RATE

	Tanzania CPI	Basket of Currencies Weighted Average CPI	Official Exchange Rate Shs. (Shs)	Real Effective exchange Rate *
1972	100	100	8.3	8.3
1973	110.5	107.2	8.3	8.6
1974	131.7	120.3	8.7	9.2
1975	166.5	134.3	9.6	10.6
1976	178.0	145.1	9.6	10.5
1977	198.6	157.0	9.6	10.9
1978	221.2	167.5	9.6	11.4
1979	251.6	184.5	10.8	11.8
1980	327.8	208.5	10.8	13.8
1981	411.8	229.1	10.8	16.0
1982	530.0	243.7	12.2	19.6
1983	674.6	252.2	16.0	24.3
1984	916.2	262.6	21.6	32.0
1985	1154.4	270.5	21.6	38.2

*Real effective exchange rate (unadjusted for terms of trade) is computed asnnominal effective exchange rate adjusted for inflation differential between Tanzania and the basket of currencies.

**1972 is taken to be a purchasing power parity year.

Source: IMF, International Financial Statistics, 1970-1985, Bank of Tanzania, Annual Reports 1980-84, Economic Survey, 1984.

TABLE 9 : THE 1979 STABILIZATION PROGRAMME

Table 9a: (Million Shs.) Budgetary Deficit, 1979|80 target Vs actual

	Revenue and Grants	Expenditure and Net lending	Overall Budgetary deficit
Budget	10,584	14,477	-3893
Actual	10,077	14,413	-4336

Source: Tanzania Government 1980, Financial Programme 1979|80 Economic Survey 1984.

Table 9b: (Million Shs.) Domestic Credit 1979|80 target Vs actual

	Target	Actual
Domestic borrowing (net)	2043	3475
-of which from banking system	(1667)	(2804)
Foreign borrowing (net)	1850	1337

Source: Tanzania Government 1980, Financial Programme 1979|80 Economic Survey 1984.

Table 9c: External Sector (Million SDR)

	Target	Actual
Current Account deficit	133	270
Overall B.O.P. deficit	20	46
Payment Arrears Changes (1979 June - July 1980)		61

Source: Tanzania Government 1980, Financial Programme 1979|80.

TABLE 10a.1: FISCAL BALANCE: TARGETS OF SAP VERSUS PERFORMANCE

	1982|84		1984|85 Provisional		1984|85 Provisional	
	SAP	Actual	SAP	Actual	SAP	Actual
Recurrent Revenue	10500	12446	13645	14124	14300	18925
Recurrent Exp.	-14144	-14736	-15700	-16174	-17400	-21729
Surplus|deficit	-3644	-2290	-2900	-2050	-3100	-2804
Development exp.	-4816	-4479	-5100	-4733	-5400	-5366
Overall fiscal balance	-8560	-7215	-8000	-6783	-8500	-8170

TABLE 10a.2: FINANCING OF FISCAL DEFICIT: TARGETS VS. ACTUAL

			1983|84		1984|85	
	SAP	Actual	SAP	Actual	SAP	Actual
Net Bank Borrowing	3276	4295	2450	4510	2600	3032
Other local sources	1400	900	1000	512	1100	2464
External loans and grants*	3884	2020	4550	1761	4800	2674

* In the SAP target, we have included import support in the external loans and grants.

TABLE 10b: MONEY SUPPLY

	1982/83		1983/84		1984/85	
	SAP	Actual	SAP	Actual	SAP	Actual
MW (growth rate in %)	19.6	15.2	13.8	19.1	13.0	21.1
Domestic credit growth rate (%)	19.5			19.1		21.8

Source: BOT, DEVPLAN, SAP

TABLE 10c: EXTERNAL BALANCE (U.S. MILLION DOLLARS)

SOURCE OF FINANCE	1982/83		1983/84		1984/85	
	SAP	Actual	SAP	Actual	SAP	Actual
Exports (goods and services)	635	508.6	690-720	480.5	592-840	472.0
Net transfers	80	111.2	90	131.0	100	196.6
External Resources	740	343.1	840	289.4	886	223.3
Other capital, errors and Ommissions	-	-110.1	-	-176.9	-	-149.9
TOTAL	1455	852.8	1620-1650	723.6	1778-1826	742.9

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TABLE 10a (CONTD.)

SOURCE OF FINANCE	1982/83		1983/84		1984/85	
	SAP	Actual	SAP	Actual	SAP	Actual
Imports (goods and Services)	1395	1043.3	1524-1554	919.0	1658-1706	1007.1
Reduction in Arrears	60	-190.5	96	-195.4	120	-264.1

* Estimates for 1985, all actuals are taken as averages of two years calendar to conform to fiscal years used by SAP.

** Includes Long medium term loans and grants, suppliers credit and import support.

Source: Ministry of Finance, BOT, SAP.

TABLE 11: NON FUEL IMPORTS STRUCTURE (COMPOSITION BEFORE AND AFTER LIBERALIZATION) (%)

CATEGORY	1984 (Jan-March)	1984 (July-Sept.)	1984 (Sept-Dec.)	1985 (Jan-March)
Intermediate Goods	215	.226	.160	.147
Building Materials	.044	.018	.017	.018
Spares & Accessories	.139	.091	.046	.112
Machinery & Equipment	.312	.251	.289	.203
Consumer Goods	.288	.398	.474	.492
Miscellaneous	.002	.016	.014	.023

Source: Bank of Tanzania.