

FUNGIBILITY AND SUSTAINABILITY

Import Support to Tanzania



By JOSHUA DORIYE, HOWARD WHITE
AND MARC WUYTS

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Institute of Social Studies Advisory Service
The Hague

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PREFACE

SWEDEN HAS LONG BEEN a major donor to Tanzania and, in this context, has been a major player in the shift to a greater role for import support in Tanzania's aid programme. SIDA has also supported the linking of import support finance to a succession of structural adjustment programmes.

Import support in Tanzania has been subject to a series of evaluations. These have had a microeconomic focus, and have been largely favourable. However, donors are becoming increasingly concerned that Tanzania is not on track macroeconomically. Questions are beginning to be raised about the pace and direction of reform, and of aid's role in this process. It is in this context that SIDA commissioned us, working in close association with a Norwegian-financed team, to carry out a macroeconomically-oriented evaluation of import support in Tanzania.

We would like to thank all those people in The Hague, Stockholm, Oslo and Dar-es-Salaam (unfortunately too numerous to list by name) who have facilitated our work and our colleagues from the Trondheim team for their helpful collaboration. Of course, errors of presentation and interpretation are our own.

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The Hague, September 1993

MAP OF TANZANIA



EXECUTIVE SUMMARY

1. Aid flows have historically been very important in Tanzania. The country experienced an aid boom in the late 1970s, which peaked in 1980. This boom was followed by some years of relative isolation from the donor community, until the adoption of the Economic Recovery Programme in 1986. Since that year there has been a second aid boom of even greater magnitude than the first. There are signs, however, that donors (many of whose budgets are under pressure at home) are wearying and beginning to raise questions about aid's effectiveness in Tanzania: although aid flows are currently being sustained this may not be so in the longer run.
2. For political reasons, Sweden and Norway are both important donors to Tanzania. In the mid-seventies Sweden accounted for nearly one fifth of all ODA receipts – though by the late 1980s this figure had fallen to 10 per cent. Norway's share in Tanzania's aid inflows rose over the same period from 6 per cent to around 8 per cent.
3. In the late 1970s there was increasing recognition that rehabilitation and increasing capacity utilisation were more important concerns than further expansions to the capital stock (which could then not be maintained and/or utilised). Donors thus began to allocate funds to import support – foreign exchange (forex) for the importation of intermediate goods and items of capital equipment necessary to use existing plant.
4. Import support initially took the form of Commodity Import Support (CIS), which was allocated by the Treasury in consultation with donors to specific enterprises. However, the government's forex allocation largely supported ailing parastatals. Moreover the enterprises received a "double subsidy" from CIS – first from the premium in the official rate compared to that on parallel markets and, second, since many enterprises did not anyhow pay (in full or even at all) for their forex. CIS was therefore correctly perceived to be assisting the perpetuation of an inefficient industrial sector, rather than promoting its restructuring.

5. In response to the problems identified in CIS the donors moved to the market-based Open General Licence (OGL) system. These monies are intended to be distributed to importers on a "first come, first serve" principle. This principle, combined with successive devaluations of the Tanzanian shilling, is intended to ensure that the forex is received by the most productive users. An analysis of the uses of OGL shows that it does indeed go mostly to the private sector, and that most of the goods imported are either related to intermediate items for a range of uses, including about one third for incentive goods. A scepticism we ourselves expressed earlier that the nature of goods would not benefit the agricultural sector does not appear to be entirely warranted.
6. It is now proposed by the World Bank to abolish the OGL and to account import support against imports that have already taken place. Such a proposal will overcome many of the perceived problems in the OGL. Indeed, a separate OGL system is not sustainable following the unification of the exchange rate achieved earlier this month (August 1993). One outstanding issue is the treatment of arrears. We stand by our earlier recommendation of a review of the policy of blacklisting all those in arrears. In addition, the practicality (and rationale) for maintaining a negative list is open to doubt.
7. The remarkable feature of the longer term evolution of import volume is the absence of any (positive) trend over the period 1970 to the present. At most, import volume fluctuated around a constant value, reaching its low point during the crisis of the early 1980s. Consequently, against the background of GDP growth, the import coefficient of the economy fell in real terms over the period concerned. The capacity to import (the real purchasing power of exports in terms of the volume of imports it can buy), however, declined steadily over the period as a whole. In the 1970s and early 1980s, this decline was, to a large extent due to falling export volumes, while in the second half of the 1980s, export volume rose slightly, but the terms of trade fell, thus causing the capacity to import to decline further.
8. The aid boom of the 1970s based on investment support through project aid contributed significantly towards the crisis subsequently experienced during the early 1980s. While foreign aid slackened the budget constraint on investment and the importation of capital goods, the constraint on recurrent imports (consumer and intermediate goods) hardened considerably, partly as a result of the aid boom itself. The drive for capacity creation undermined its utilisation, particularly in industry, while the multiplier effects of investments shifted relative prices in agriculture in favour of food crops and away from cash (export) crops. Coupled with the steep rises in the price of oil, the consequent fall in export volume eroded the sustainability of economic growth.

9. Until 1988 import support took the form of commodity import support allocated on the basis of a list of agreed with the respective donors. A large proportion of CIS was allocated to a small number of large parastatals, a third of which are industrial parastatals. In terms of cash cover it appears that recoveries are more readily enforced for parastatals than for the private sector.
10. In its effects, import support counterpart revenue has led to decompression of recurrent expenditure (excluding debt service) and has more or less eliminated recourse to bank borrowing for deficit financing. Government revenue has also increased during the period of increased import support, reflecting improved overall economic growth. It should also be pointed out that import support was substituted for project aid.
11. The primary purpose of aid is the alleviation of poverty. This purpose will only be served if the direct and indirect effects reach areas of concern to the poor. Hence aid should be predominately rural rather than urban; agricultural rather than industrial; and social rather than economic infrastructure. Neither import support nor aid in general match up to these requirements. There is little indication that the "New Poverty Agenda", propounded by the World Bank, is being followed in Tanzania.
12. There are channels through which OGL can benefit the rural poor – largely through the provision of incentive goods and the facilitation of marketing of agricultural produce. It is desirable that aid continue to allow these kinds of imports. Nonetheless, our review suggests that there has been an undue neglect of poverty issues by government and donors. SIDA could well take the initiative in redressing the balance.
13. Our proposal is that aid monies be directed to sectors of benefit to the poor – we highlight primary education. Poverty lending is not very import intensive. Therefore the largest part of the aid will be required for local expenditures. The local funds will be raised by the sale of the donor forex by auction by the Bank of Tanzania – no conditions whatsoever should be attached to the use of these funds (so that the principle of not double-tying is not violated).
14. Adopting our proposal will result in a reduction in the share of Swedish aid designated as import support. This is our recommendation.

INTRODUCTION

There has been a resurgence of concern in the donor community about "aid effectiveness". There is a long history of microeconomic evaluations of projects using established techniques. But in the 1980s project aid declined in the face of rising programme aid, given or lent in support of structural adjustment policies. Since adjustment policies are intended to improve the macroeconomic performance of the country implementing those policies donors are turning their attention to aid's macroeconomic effects. This evaluation was carried out in this context: is Tanzania's macroeconomic performance acceptable and what part has aid played in this state of affairs?

Many readers of this report will have read our earlier attempt to answer these questions in the *Interim Report*. The *Final Report* takes our earlier analysis further and presents some additional material. In this introduction we highlight in particular what is new in this Report.

Chapter 2 outlines the history of aid flows to Tanzania and the evolution of import support. Added to this chapter are: a brief analysis of the structure of Tanzanian external debt, a discussion of policy reforms implemented since 1986, a comparison of import support programmes with the SPA Guidelines and an analysis of OGL based on the NORAD database. The last of these has led us to revise our comments with regard to the type of goods imported under OGL – about one third appear to be incentive goods or for the production of incentive goods.

The macroeconomic analysis in Chapters 3 and 4 is substantially rewritten from the *Interim Report* (we may in the *Final Report* reincorporate some of the earlier material). Chapter 3 focuses more specifically on the macroeconomic effects of import support versus project aid (investment support). In this context, we investigate the apparent lack of a relationship between aid and imports – demonstrated in the *Interim Report* – in more detail. In Chapter 4 we look more closely at the fiscal implications of Tanzania's aid receipts, and issues relating to counterpart funds.

Since the decision to abandon the OGL earlier this month, much of the discussion in the *Interim Report* is redundant¹ (and that which is relevant now appears in Chapter 2.

1) But we learn that the concerns we raised have been a part of the ongoing discussions over the future of import support.

But the more basic points we raised concerning OGL's sectoral and distributional impact remain important. The analysis in Chapter 5 extends our earlier discussion – more data are provided on income distribution in Tanzania and current attempts at poverty alleviation. We also elaborate our proposal for an alternative mode of import financing.

AID TO TANZANIA

2.1 Introduction

The history of aid to Tanzania is a chequered and controversial one. The Tanzanian government renounced aid from two main donors – the UK and West Germany – during the 1960s, was feted by many, notably Nordic donors, as the model for a new path to development in the seventies, became the scene for one of the most public, protracted and bitter conflicts between a developing country and the Fund in the early 1980s, and in 1986 began implementing sweeping reforms with the support of substantial aid-finance.

Part 2.2 briefly describes the pattern of aid to Tanzania – and how the above political shifts led first to an aid boom, which peaked in 1980, but then a rapid decline in inflows as disagreement with the Bank and the Fund deepened. Aid inflows boomed again following the adoption of the Economic Recovery Programme in 1986. As documented in Part 2.3, Sweden and Norway have both been important donors to Tanzania for most of the period since Independence.

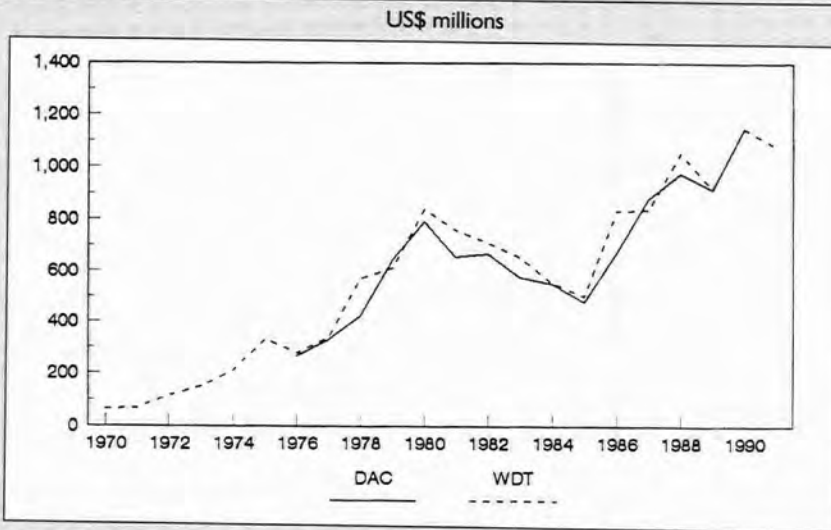
The type of aid received by Tanzania has, in common with many recipients, changed over the years. During the late 1980s aid has been oriented toward supporting the adjustment programme – in Part 2.4 we outline this programme and Part 2.5 discusses the switch in the type of aid, examining the theoretical rationale for import support aid and the actual evolution of such aid in the Swedish and Norwegian programmes. In Part 2.6 we compare the forms of import support provided to Tanzania with the guidelines for such aid drawn up by working groups under the auspices of the Special Programme of Assistance (SPA). Part 2.7 summarises the main points from this chapter.

2.2 Total Inflows to Tanzania

Aid and other inflows are shown in Figure 2.1 (which shows net receipts – that is inflows net of amortization, but not interest, payments).¹ Since aid is such a large part of the whole the two series are broadly similar. Apart from a slight dip in 1976, there was a sustained nominal rise in both aid and total inflows throughout the 1970s: this is the first aid boom which peaked in 1980. Inflows then dropped away quite steeply during

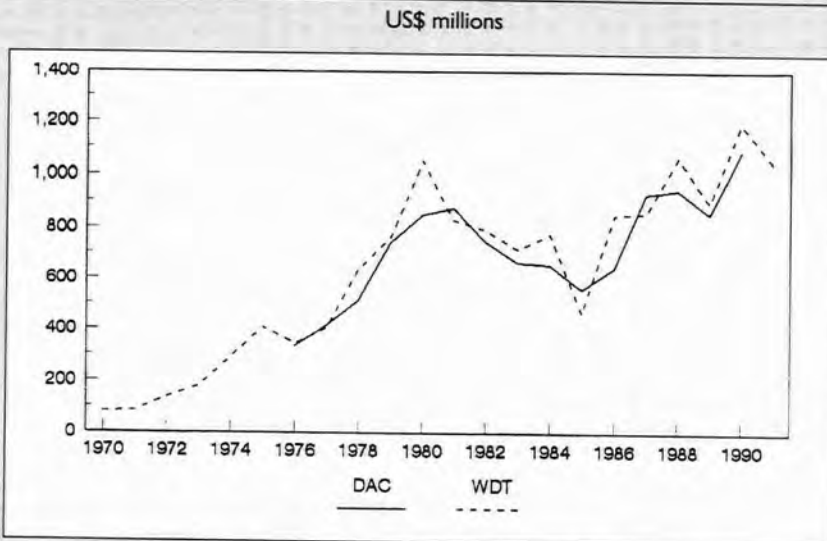
1) Definitions and sources of data are discussed in the Appendix to this chapter.

Figure 2.1 Net ODA Inflows



Sources: World Debt Tables diskette, 1992; DAC, various years

Figure 2.2 Total Net Receipts



Sources: World Debt Tables diskette, 1992; DAC, various years

the period 1980-85.

In 1986, when the ERP was adopted, flows again began to rise. In that and the following year nominal aid inflows were approximately equal to the former maximum attained in 1980. The sharp increase in 1988 took them well above this level. The rise has been less rapid since 1988 – with two declines in total net inflows (1989 and 1991).

A final trend to note from Figure 2.1 is the virtual disappearance of non-aid inflows. Indeed, these inflows have been negative in some recent years, so that net aid inflows are **greater** than net total inflows. We will analyse the changing composition of aid and other inflows shortly, but first it is important to look at the overall trend in real terms.

Since the inflows are foreign exchange used to purchase imports it is appropriate to obtain the real value of the series by deflating the nominal series by Tanzania's import price index². The deflated series for net aid and total inflows are shown in Figure 2.2. In real terms, the two aid booms, 1978 to 1980 and that dating from 1986, are still evident. But in real terms the second aid boom was by far the larger. The real value of aid (deflated by the dollar import price index) nearly doubled from 1985 to 1990 – increasing from US\$ 25.4 million to US\$ 7.7 million in constant 1987 prices³.

Despite the similarity of the overall pattern, there have been some significant shifts in the composition of foreign inflows to Tanzania. In the period to 1984, aid inflows constituted the majority of inflows, but other inflows typically accounted for 10 to 20 per cent of the total⁴. Much of the non-concessional monies utilised by Tanzania have been official (rather than private) flows. These funds have been either borrowings from the "hard windows" of the multilateral institutions – mostly the IBRD window of the World Bank and, to a lesser extent, the African Development Bank; purchases from the IMF; and, in the early 1980s, oil credits from Algeria, Angola, Iran and Iraq.

The fact that Tanzania has, in recent years, borrowed only from the soft windows of the multilateral development institutions (the IDA window of the World Bank and African Development Fund of the ADB) is one factor underlying the decreased share of non-aid since the mid-80s.

That aid receipts are, as mentioned above, **greater** than total receipts in some recent years is, in fact, largely a result of repayments made to IBRD (and, again to a lesser extent, ADB). Since 1986 IBRD net disbursements to Tanzania have been negative –

2) The inflows are in dollars. The World Bank's World Tables contains a dollar-based import price index for Tanzania, which is what is used here. For more recent years an implicit MP has been calculated using estimates of real import growth contained in the most recent Policy Framework Paper.

3) A recent World Bank study (not yet publicly available) has recalculated net transfers to a number of African countries taking account of terms of trade changes. These calculations show that Tanzania has **not** experienced an aid boom in the latter part of the 1980s. However, the rationale for the Bank's methodology remains unclear to us. Certainly the terms of trade affect forex availability – but this effect operates, as examined in more detail in Chapter 3, through the capacity to import.

4) The share of aid in net receipts has twice fallen below 80 per cent – to 73 per cent in 1974 when IMF purchases were of importance (see below) and to 71 per cent in 1984 when a large OPEC loan was received.

Table 2.1. Net inflows to Tanzania from World Bank's IBRD Window, 1986-1990 (US\$ million)

Year	Net inflow
1986	-19.3
1987	-19.4
1988	-22.0
1989	-23.0
1990	-26.0

Source: DAC Geographical Distribution of Financial Flows to Developing Countries (various years)

Table 2.2 Structure of External Debt in 1991

IN MILLIONS OF US\$	Total Debt	Gross Disbursements	Amortization	Interest
Aid	3,877.6	251.6	23.7	14.9
o/w multilateral	1,727.0	186.0	23.7	14.9
bilateral	2,150.6	65.6	0.0	0.0
Other official	1,659.1	4.6	39.1	18.4
o/w multilateral	241.2	3.7	35.9	18.4
bilateral	1,417.9	0.9	3.2	0.0
Other	487.1	30.3	28.4	2.1
Total	6,023.8	286.5	91.2	35.4

SHARES	Total Debt	Gross Disbursements	Amortization	Interest
Aid	64.4	87.8	26.0	42.1
o/w multilateral	28.7	64.9	26.0	42.1
bilateral	35.7	22.9	0.0	0.0
Other official	27.5	1.6	42.9	52.0
o/w multilateral	4.0	1.3	39.4	52.0
bilateral	23.5	0.3	3.5	0.0
Other	8.1	10.6	31.1	5.9
Total	100.0	100.0	100.0	100.0

Note: Other comprises all short-term debt, private long-term and use of IMF credits.

Source: World Debt Tables, 1992.

see Table 2.1. (The World Bank group – that is including IDA – is, however, a net contributor of capital to Tanzania).

But precisely because of their non-concessional nature, non-concessional flows retain an important part of Tanzania's overall debt. As Table 2.2 shows, in 1991 non-concessional official flows accounted for only 1.6 per cent of gross disbursements but 27.5 per cent of total external debt: they take an even more disproportionate share of debt service payments. The country has received substantial debt relief: at the four Paris Club meetings it has attended this relief has amounted to US\$ 2.5 billion, which is far more than many neighbouring countries (e.g. Malawi's US\$ 78 million; Nord *et al.* 1993: 9). However there is always the possibility that rescheduling will not continue, so that the burden of debt service will be high – according to estimates made for the July 1993 Consultative Group Meeting the debt service ratio⁵ will rise from 11 to 37 per cent at the expiry of the current agreement.

At the start of the 1970s Tanzania had a manageable current account – the deficit as a per cent of GDP was –1.3 per cent in 1970. In 1973/74 three events changed this situation: (i) the adverse effects on agricultural output of villagisation; (ii) bad weather conditions; and (iii) the oil price shock (Tanzania's import price index rose from 27.8 in 1972 to 57.5 in 1974). In 1974 the external current deficit to GDP ratio reached its lowest point of –12.5 per cent.

Funds from the IMF were the main source to finance this widened deficit – with drawings mostly made from the Fund's Oil Facility⁶. IMF purchases continued throughout the 1970s – increasing significantly at the time of the second oil shock in 1979/80.

The funds utilised from the Fund during the 1970s were from the "lower tranches", meaning that the IMF maintained a monitoring role, but that there were no stringent macroeconomic policy conditions attached to the receipt of funds (an attempt to draw from the Second Credit Tranche in 1975 failed as the agreed domestic credit ceiling was breached). Negotiations were begun in 1979 for further drawings, but the Tanzanian government suspended these in October as it found many of the conditions inappropriate and an infringement of Tanzania's autonomy. As Nyerere put it:

When did the IMF become an International Ministry of Finance? When did nations agree to surrender to it their power of decision making?

(quoted in Bank of Tanzania, 1981: 226)

Although drawings from existing agreements continued in 1980 and 1981 agreement was not reached and Tanzania was unable to receive any finance from the IMF again until 1986. (Since repayments continued to be made, the IMF was "taking money out" of Tanzania from 1981 to 1985).

As just described, both the World Bank and the IMF moved away from lending to

5) The debt service ratio is the value of total debt service (amortization plus interest) divided by exports.

6) In 1974 SDR 28.3 million out of SDR 49.4 million were from the First Oil Facility and the whole of the 1975 drawing of SDR 23.8 million came from the First and Second Oil Facilities (Bank of Tanzania, 1981: 224).

Tanzania in the early 1980s. Other donors—including Sweden—shared the multilaterals' reluctance so that the late 1970s aid boom soon became a slump. The aid/GDP ratio fell from its 1980 peak of 13.2 per cent to 5.4 per cent by 1985.

Private long-term inflows and short-term borrowings have been far less important. The share of private long-term inflows in total net receipts was highest (13 per cent) in 1970 and has—except for a modest recovery in 1980—fallen since then. Such inflows are now insignificant—and, indeed, the net position was negative in 1991. No short-term borrowings were recorded until 1985, when it is likely that the Government had little choice but to resort to this source of funds. More surprising are substantial short-term borrowings in 1987 and 1988.

It cannot be realistically expected that private flows will pick up in the near future. There is very little likelihood of private investment on anything but the tiniest scale. Commercial banks are also unlikely to be willing lenders of new money. Inflows on Tanzania's capital account will be restricted to aid monies—for which the prospects are uncertain, but in the short-run seem good.

It is not unusual for donors to become enthusiastic about aiding a country undertaking reforms that then to become disillusioned so that the country experiences a temporary aid boom (as Tanzania did in the late 1970s). In our interim report we suggested, on the basis of an apparent growing disquiet amongst donors at the pace of reform in Tanzania, that the second aid boom was probably over. We appear to have been wrong. At the Consultative Group meeting in Paris donors did indeed express concern over the reform programme, but then made pledges totalling US\$ 1.2 billion—an increase over the year before. The shortfall from donors who have cut their programmes (Sweden, Canada and Finland) has been more than compensated by increases by other donors. Nonetheless, donors are vocal in their questioning of the government's commitment to reform. Both because of this concern, and because we argue that restructuring is the only way to avoid dependence on growth to sustain the need for aid in the future, we now turn to consider adjustment policies in Tanzania.

2.3 Adjustment in Tanzania

In 1984 a structural adjustment programme was implemented by the government. The World Bank had been involved in the design of the programme, but the government did not agree to the proposals and so went ahead alone. Finally, in 1986, agreement was reached with the Bank and the Fund on the Economic Recovery Programme (ERP), which was financially supported by many donors. Many of these funds were channelled through the Multisector Rehabilitation Credit.

Table 2.3 shows the reforms that were planned and undertaken during the ERP and the follow up Economic and Social Action Programme (ESAP). It appears that the majority of the planned reforms have indeed taken place. Against this fact we should set the following three observations: (i) the pace of reform has frequently been slower

than originally intended – for example, exchange rate unification has only recently taken place; (ii) as pointed out by Basu and Morrissey (1993: 12), many of the conditions are vague, such as increasing emphasis on cost recovery; and (iii) in some important areas little has been achieved – notably the failure to meet monetary and credit targets; restructuring of parastatals; and following through agricultural reform so that the benefits reach the producers.

Donors are currently emphasising three areas of reform: (i) financial restructuring; (ii) public sector reform (which has come to focus on laying off workers); and (iii) privatisation. Some donors, notably the US, are also concerned that the move to a democratic political system should be accelerated. Of the areas of economic policy, the important separation of the commercial banks from government appears to be taking place during the middle of 1993. Although the target of 10,000 workers were laid off prior to the July 1993 CG meeting the majority of these sackings were immediately before the meeting and we hear that many of the staff have been reinstated; moreover, most sackings were of low level staff. A more serious systematic approach is required if the target of 20,000 a year for the next two years is to be met. Large scale privatisation is also likely to prove a more complex process than earlier reforms, in part because of the political repercussions of selling to either foreign investors or the large share that would be purchased by the resident Indian community in an unfettered market sale.

Despite these observations we would conclude that Tanzania **has** undertaken quite sizeable reforms. In the seven years from 1986 to 1993, the country has moved from having an economy in which practically every sector was run by the government to one in which market forces play a role in most key areas. A recent World Bank report calculates an index of macroeconomic policy performance for twenty-seven countries in sub-Saharan Africa, and calculates the change in this index between 1981-86 and 1987-91. Tanzania ranks fourth in this list: that is, it is one of the countries to have carried out the most extensive reforms. The speed of these changes may have been slower than donors desired, but the government has to contend with the political obstacles to reform.

Would these changes have occurred without the aid? There are two sides to this question: (i) would the government have attempted reform with the carrot of donor finance; and (ii) would reform have been possible without these funds? The second of these questions we consider later in the light of subsequent analysis. The first is difficult to answer – a recent review by one of the authors of this report of the adjustment literature (White and Lutik, 1993) concludes that no studies have really tackled the question of whether donor-support has been a necessary ingredient in the reform process in a systematic manner. However, in the case of Tanzania, we feel that the government would have attempted some reform in the late 1980s (there was little choice) but that the extent of these reforms would have been somewhat less than they have been.

Whatever the reluctance of academics to find a link between aid finance and

Table 2.3 Summary of reforms under ERP and ESAP

	ERP, 1986-1988	ESAP, 1989-1991
Exchange rate	Achieved: substantial and continued devaluation; introduction of OGL; reduction of retention rates.	Achieved: continued devaluation; expansion of OGL (move to negative list); abolition of retention scheme for non-traditional exports.
Trade liberalisation	Achieved: QRs removed by introduction of OGL; rationalisation of tariff system.	Achieved: reduction in tariffs; continuation of own funds.
Fiscal policy and public spending.	Achieved: improved efficiency of tax collection; public sector wage bill restrained; redirect spending to priority areas; repair transport infrastructure; medium term financial strategy; restrain external debt.	Achieved: broaden tax base; increase emphasis on cost recovery; redirect spending to recovery; repair transport infrastructure; restrain external debt. Slow progress: reduce public sector employment; strengthen budgetary planning.
Public enterprises	Achieved: limit borrowing; performance review. No progress: restructuring to increase productivity.	Achieved: limit borrowing. No progress: restructuring to increase productivity.
Money and financial sector	Little/slow progress: positive real interest rate. No progress: limit money/credit expansion.	Achieved: positive real interest rate; start of financial sector reforms.
Industrial policy	Achieved: improved forex allocation through OGL; capital allocations for rehabilitation. Slow progress: improve efficiency and capacity utilisation.	Achieved: improved investment incentives; reduced controls of private sector. Slow progress: improve efficiency and capacity utilisation.

Contd. Table 2.3 Summary of reforms under ERP and ESAP

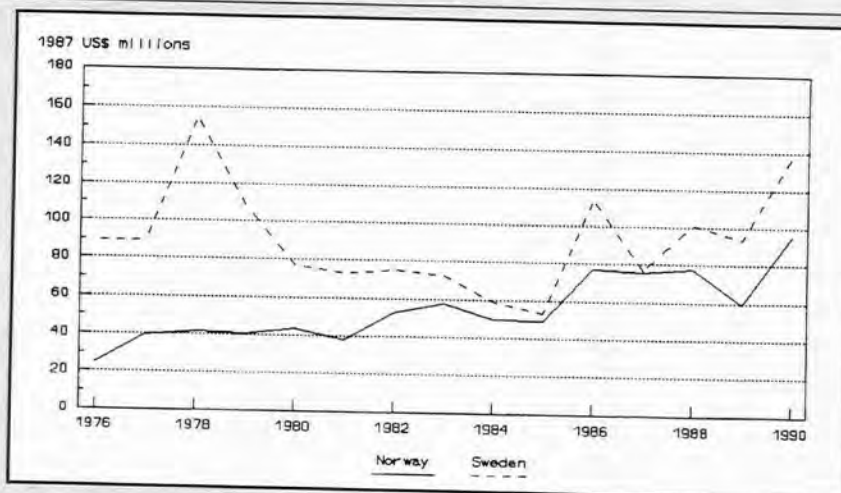
	ERP, 1986-1988	ESAP, 1989-1991
Energy policy		Slow progress: increase efficiency of power generation.
Agriculture	Little progress: improve efficiency of marketing boards. Not achieved: increase producer prices of export crops to 60-70% export price or real increase 5 per cent a year.	Achieved: restructure marketing boards; liberalise access to inputs.
Other	Achieved: eliminated/relaxed 388 out of 400 price controls; liberalised domestic distribution.	Achieved: decontrol domestic prices and distribution. Slow progress: improve social service delivery; establish environmental priorities
Source: Basu and Morrissey (1993: Tables 4 and 5).		

reforms, it is clearly something that donors believe in. Two trends were notably in the 1980s. First, the drift of the bilaterals to fall in behind the multilaterals in adopting policy conditionality. Second, the change in the nature of aid to forms deemed more appropriate to support adjustment. These trends are described in more detail in Parts 2.4 and 2.5.

2.4 Swedish and Norwegian Aid

From Independence the Tanzanian government adopted a policy of not compromising on points of principle in order to obtain aid. The first clash occasioned by this stance came on account of Germany's Hallstein Doctrine – that is the policy of denying aid to any country maintaining diplomatic relations with East Germany. Zanzibar had accorded East Germany diplomatic status prior to Union in 1984 and rather than

Figure 2.3 Real Swedish and Norwegian Aid
(Gross ODA, Constant 1987 US\$ millions)



Source: DAC (various) and World Tables

Table 2.4 Swedish and Norwegian aid to Tanzania

	Tanzania's share of donors ODA		Donor's share of Tanzania's ODA	
	Norway	Sweden	Norway	Sweden
1976-78			6.0	18.3
1979-82	15.2	12.6	6.6	11.4
1983-86	15.1	13.3	8.9	11.1
1987-90	13.0	9.1	7.7	10.2

Source: OECD Geographical Distribution of Financial Flows to Developing Countries (various years).

comply with Germany's request that this status be withdrawn the Tanzanian government asked Germany to terminate its aid programme. Aid was not resumed until the late 1960s, when Germany began to be more flexible with regard to application of the Doctrine.

The second clash was the breaking of diplomatic relations with Britain in December 1965 over the Rhodesian question. The British also attempted to retaliate against the Nationalisation of Buildings Act by blocking a 1972 World Bank loan. The UK aid programme was resumed in 1974.

The difficulties with major donors, combined with the lead role assumed by Nyerere following the Arusha Declaration in advocating African Socialism, led to a closer relationship with donors whose aid programmes were felt to be relatively free of political considerations and whose stronger social democratic tradition made them sympathetic to Tanzania's chosen development strategy. Hence aid from the Scandinavian countries, and also the Netherlands and Canada, came to play a more important part than in many other developing countries.

Official Swedish assistance to Tanzania began in 1963 – like most aid at this time it was concentrated in infrastructural development. By 1970 Tanzania was receiving about 13 per cent of Swedish aid: since then Tanzania has always been, in absolute terms, amongst the top three recipients of Swedish aid (DAC Report, 1991: 224). Despite the rapid increase in the total Swedish aid programme in the years 1972-75 Tanzania's share was maintained at about this level, so that the real value of aid to Tanzania grew by over one third at this time. At the time of this growth in aid assistance to the industrial sector – especially small scale industry – grew rapidly. Figure 2.3 shows Swedish aid (in dollars and deflated by Tanzania's MPI) since 1976.

Swedish aid fell away in the early 1980s and Sweden joined other donors in their disillusionment with Tanzania. Equally clearly, Sweden has participated in the subsequent aid boom, even so Tanzania's share of Swedish aid remains below the levels reached in the 1970s (Table 2.4).

Tanzania has taken an even larger share of Norway's aid than it has of Sweden's: over 15 per cent of Norway's gross ODA flows went to Tanzania in the first half of the 1980s. Though this share fell somewhat in the second part of the decade Tanzania remains the single largest recipient of Norwegian aid. Figure 2.3 also shows that Norway maintained its support during the "difficult period" in which most donors abandoned Tanzania.

Table 2.4 also shows the aid shares from the other way round – that is the importance of Sweden and Norway from the Tanzanian perspective. From this point of view Sweden emerges as the more important of the two.

2.5 Import Support and Other Programme Aid

In Zaire in 1960 there were 88,000 miles of motorable road; in 1985 there were only 12,000 miles (Davidson, 1992). The World Bank's 1989 Report, *Sub-Saharan Africa: From Crisis to Sustainable Growth*, listed ten countries – Tanzania amongst them – which had suffered from “de-industrialisation” during the 1970s and had capacity utilisation rates of as low as 30 per cent. Mbelle and Sterner (1991b) show that the elasticity of industrial output with respect to foreign exchange in Tanzania is much higher than that for either labour or capital.

Such data provide the rationale for import support. Foreign exchange shortages meant that the existing capital stock was not being maintained. Project aid would only provide more capital, increasing the requirement for imported supplies and spares – when these items could not anyhow be afforded for existing plant. Import support would therefore be available to enhance the rehabilitation and utilisation of existing investments (through the importation of intermediates or to replace capital components).

A theoretical exposition of this argument has recently been made by Doriye and Wuyts (1993), who demonstrate how the output of an economy such as Tanzania is indeed constrained by a shortage of intermediate and consumer goods, rather than a lack of investment. Their model has an important corollary – as long as structural parameters are unchanged then import support must assume a **growing** role in the overall aid programme. By contrast, donors assume import support to be a temporary measure. It can only be temporary if the aid is accompanied by a process of structural change, so that the economy either produces its own intermediate and consumer goods (import substitution) or earns the foreign exchange with which to purchase them from its own production.

We mention the above point here as it is a common theme in our report – an economy can only move away from requiring foreign capital to sustain its growth if it undergoes structural change. Only under certain conditions⁷ will an economy's reliance on foreign exchange to maintain growth (that is, the trade and savings gap close) diminish over time. If these conditions are not met we describe the economy as aid dependent – that is aid will be required indefinitely to sustain growth. A related and important issue is whether the aid assists the economy move out of aid dependence. We return to this theme in Chapters 3 and 6.

When import support was first adopted in the late 1970s it took the form labelled as Commodity Import Support (CIS) or “administrative allocation”. Donors, with varying degrees of consultation with the Tanzanian Government, selected sectors and/or firms to benefit from their import support. Some donors allowed much of the money to be administered largely by the Treasury (over 40 per cent of Sweden's CIS in the late 1980s was so-called “free quota”).

7) These conditions are contained in the background paper “Aid Dependence in Tanzania” in Volume II of this report.

The major concern that arose about CIS was that it was being used not to foster industrial restructuring, as of course it was intended to, but to preserve the existing, heavily protected, sector. This concern arose on account of the combined analysis of the recipients of the funds and the costs of those funds to the recipient.

A large proportion of CIS funds were allocated to the parastatal sector. Analysis we have carried out of Swedish CIS for the period 1988/89 to 1991/92 (by when donors were well aware of the problem) shows that three quarters of the funds were allocated to parastatals (Table 2.5). That this allocation need not be so is shown by the allocation of funds under the new Open General Licence (OGL) system (described below), for which the situation has been practically reversed. The USAID import support programme for roads has achieved an even higher share to the private sector.

Table 2.5 Allocation of Import Support

	Swedish CIS (1988-92)	OGL (1991-92)	Norwegian OGL (1990-91)	USAID CIS (1991-93)
Government	2.1	3.4	6.1	16.5 ¹
Parastatal	74.0	28.9	43.7	
Private	23.9	67.7	50.1	83.5

1) Note: Includes parastatal

Source: calculated from reports from Tanna Somiya to SIDA DCO, Dar-es-Salaam, Bank of Tanzania data, NORAD OGL database and USAID Office, Dar-es-Salaam.

The inefficiencies apparently intrinsic to much of the parastatal sector were well documented and so scarce foreign exchange was unlikely to be being well used. Indeed, a 1987 World Bank report on the industrial sector described the allocation system as "useless" and suggested that a random allocation would have been more efficient. A study of the textile sector over the period 1976-84 concluded that: "considerable reductions in cost could be realised if foreign currency were allocated according to efficiency criteria" (Mbelle and Sterner, 1991a: 37).

The second cause for complaint was that, not only were inefficient firms receiving the scarce forex, but that they were receiving it at subsidised rates. The subsidy operated through two channels. The import support aid was a gift to the government, **not** the importer who had to pay the local currency equivalent to the Treasury (cash cover or counterpart funds). The amount owing was calculated at the official rate – in the early 1980s the official rate was less than TSh10/\$, whereas the parallel market rate stood at over TSh30/\$ (figures are 1980-83 averages). The importer had to pay only one third of what the import bill would have been had the firm had to resort to the parallel market (as many in the private sector did).

But in fact the exchange rate was largely irrelevant, since the second component of

the subsidy was that many importers did not pay their cash cover. In some cases – notably the Tanzania Fertilizer Corporation – the government clearly chose CIS as its preferred means of subsidy to a chronically loss-making enterprise. The collection of cash cover by the Treasury remains a matter of dispute between the Tanzanian Government and donors to this day.

The donor response to the problems identified in CIS was to propose instead the “market-based” OGL. OGL was planned to be available to importers on a “first come, first serve” basis. The money would no longer be allocated by Treasury but administered by the Bank of Tanzania (BOT) and the commercial banks. BOT would issue import licences and, once the importer had obtained a letter of credit (LC) from his or her commercial bank, authorise the transfer of forex. The commercial bank would be responsible for paying cash cover to the BOT, who would then pay it to the Treasury.

Under the OGL the forex is in effect allocated to those importers that can obtain LCs from the commercial banks – this fact is clearer still under the change of procedures in early 1993 whereby the importer applies to the commercial bank for both the import licence and the LC. The control of the banks over allocation has been increased further still by the abolition of import licences for all goods except those on the negative list.

Importers complained that the banks do not adhere to the “first come, first serve” principle, though the banks deny this charge. It is difficult to obtain direct data on this question. It is well known that historically the Tanzanian banking system was better

Table 2.6 Source of Funds to the OGL

Donor	Multisector Rehabilitation	Industrial Rehabilitation & Trade	Agricultural Adjustment Programme	Financial Sector Adjustment	
	(1988)	(1989)	(1990)	Commitments	Disbursements
				(1991)	
World Bank	147.40	182.14	212.00	200.00	111.18
Sweden	7.00		50.00	10.00	10.00
Norway	3.00		74.73		
Switzerland	9.20	14.00		6.79	0.00
UK	15.20	13.00	23.00	36.00	18.00
Germany	17.30		6.00		
Netherlands	23.00	10.60	32.61		
Italy	50.00				
Saudi Arabia	4.00				
Finland	10.00	5.00		5.00	5.00
ADB	25.00	18.00		30.00	
Total	311.10	242.74	398.34	287.79	144.18

Source: Bank of Tanzania

regarded as an extension of government and that many loans were a matter of government directive. Financial sector restructuring, currently underway, is meant to eliminate such interventions. A new concern, to which we return in Chapter 3, is that the allocation of credit will be to short-term profit making activities, rather than more developmental undertakings.

When it first started OGL began with a "positive list" of the item eligible for importation under the scheme. Over time the list grew, so that it was eventually replaced with a "negative list". Under pressure from the World Bank and the IMF, but with some apparent reluctance on the part of government, the list has been shortened on a number of occasions.

Since the unification of the exchange rate in August the OGL as practised to date is not sustainable. What form it should take is still being discussed, and we make a contribution to this discussion in Part 2.6.

As shown in Table 2.6, many donors responded to the call to support the OGL and have given funds linked to successive sectoral adjustment programmes. Some donors have paid funds directly into the OGL, but for the last two programmes Sweden has adopted "parallel financing". We turn now to a more detailed presentation of Swedish import support.

Swedish Import Support

Like other countries, Tanzania receives a country allocation every year, which is distributed amongst the agreed activities for Swedish aid. As we shall see, import support has had a growing share of the country allocation. Added to this aid is usually a carry over from previously unutilised funds and then a number of items outside of the country allocation (emergency support, regional projects, funds directed through NGOs etc.). Balance of Payments support is one such extraordinary item – which includes both import support and debt relief, the second of which we discuss below.

Import support to Tanzania from Sweden was begun in 1978/79, and – as shown in Table 2.7 – has since that time grown in importance. Until 1990/91, all import support was commodity import support (CIS). Since that year an increasing proportion has gone into the Open General Licence (OGL), and it is intended that all import support funds should go through this window from 1992/93.

As shown in Table 2.8 Sweden, like other donors, exercised varying degrees of control over the use of the CIS funds. Over the period 1988/89-1991/92 SEK 36 million were allocated (4 per cent of total allocations) to the Small Industries Development Organisation (SIDO). These funds were passed on to various enterprises in the SIDO estates at Arusha, Moshi, Mbeya, Iringa and Musoma, the allocation being made by SIDO. Other import support money was project-related. And in 1990/91 some funds were targetted to the Forestry and Telecommunications sectors. The remaining funds (42 per cent of total allocations) are "free quota", some of which are earmarked for Zanzibar. Free quota funds are allocated by the Treasury, with the list being approved

Table 2.7 Swedish Aid to Tanzania (1978/79-94/95, SEK million)

	ALLOCATIONS			DISBURSEMENTS		
	Total	CIS	OGL	Total	CIS	OGL
1978/79			0,0	316,0	70,0	0,0
1979/80			0,0	316,0	82,0	0,0
1980/81			0,0	304,0	67,0	0,0
1981/82			0,0	466,0	161,0	0,0
1982/83			0,0	410,0	153,0	0,0
1983/84			0,0	489,0	156,0	0,0
1984/85			0,0	479,0	166,0	0,0
1985/86			0,0	420,0	231,0	0,0
1986/87			0,0	491,0	196,0	0,0
1987/88			0,0	441,2	175,6	0,0
1988/89	668,0		0,0	686,8	183,5	0,0
1989/90	617,0	212,3	0,0	890,4	106,9	0,0
1990/91	622,0	105,9	123,0	740,0	99,4	111,4
1991/92	668,0	25,0	235,0		20,6	202,6
1992/93	614,0	0,0	185,0	-	-	-
1993/94	582,0	0,0	200,0	-	-	-
1994/95	526,0	0,0	200,0	-	-	-

Notes: Allocation is country allocation plus balance carried over. It excludes additional items, which are mainly BoP (decided annually), regional funds and monies through NGOs.

Sources: Skarstein et al. (1988); Tanna Somiya (various); SIDA "Halvårsrapport Tanzania" (various); SIDA DCO, DSA; Bhaduri et al. (1993).

by SIDA.

Under the OGL system adopted by SIDA, having received an allocation an importer must establish a letter of credit from his or her domestic commercial bank in favour of the supplier which is lodged at Nordbanken. Nordbanken must approve the LC and will then pay the supplier. Nordbanken only draws the money down from the Swedish Central Bank at the time the disbursement is to be made – unutilised funds do not “sit” in an OGL account. The Swedish system differs on this point to that of other donors.

The Joint Evaluation Missions (JEMs) under the SPA (regular meetings of government and donor officials who monitor OGL) have recommended that donors should pass their records of OGL transactions to government. Such a record can only be generated by the commercial bank administering the funds. Den norske Bank does maintain a database which is regularly communicated to the NORAD office in Dar-es-Salaam. It is therefore possible to identify the beneficiaries of Norwegian OGL funds, which is not possible for other donors, who have not complied with the SPA's recommendation. The Norwegian data are used below to give a more detailed analysis of the use of OGL funds.

On the other hand, SIDA have employed a local accounting company, Tanna Somiya, to monitor cash cover collection. Tanna Somiya have produced annual reports since 1988/89 (from which Table 2.8 is produced). As mentioned above, the Treasury's

Table 2.8 SIDA Import Support (1988/89-91/92, Current SEK 000s)

YEAR	ALLOCATION	L/Cs ESTABLISHED	DISBURSED	CASH COVER COLLECTED	ARREARS (% DIS.)
1. Open General Licence					
1.1 1990/91	23,000	23,000	22,868	23,482	-3%
1.2 1990/91	100,000	89,558	88,642	0	100%
1.3 1991/92	235,000	259,311	202,569	50,531	75%
2. SIDA					
2.1 1988/89	10,000	8,108	7,165	1,995	72%
2.2 1989/90	11,000	5,210	2,838	2,867	-1%
2.3 1990/91	10,000	6,272	5,771	1,376	76%
2.4 1991/92	5,000	4,686	3,569	1,328	63%
3. Free quota (Zanzibar)					
3.1 1988/89	5,000	1,528	457	0	
3.2 1990/91	10,000	9,108	8,655	9,400	-9%
3.3 1991/92	10,000	10,531	9,953	9,825	1%
4. Free quota (Treasury)					
4.1 1988/89	107,500	101,221	NA	62,678	
4.2 1989/90	205,650	133,074	104,084	55,290	18%
4.3 1990/91	5,942	1,605	4,263	1,535	64%
4.4 1990/91	44,000	43,756	43,722	7,862	82%
5. Industry Project Related					
5.1 1988/89	89,800	0	NA	35,943	NA
5.2 1990/91	20,000	18,899	18,612	9,461	28%
5.3 1991/92	10,000	8,054	7,128	2,270	12%
6. Forestry					
6.1 1990/91	1,000	1,111	1,111	0	10%
7. Telecommunications					
7.1 1990/91	15,000	17,188	17,188	14,594	15%
8. Total					
8.1.1 1988/89	122,500	110,857	85,370	64,672	24%
8.1.2 1988/89	89,800	0	NA	35,943	NA
8.2 1989/90	216,650	138,283	106,922	58,157	18%
8.3 1990/91	228,942	210,497	210,832	67,710	65%
8.4 1991/92	260,000	282,583	223,219	63,954	70%

Notes: see next page.

Notes for Table 2.8:

- 1.1 Supplementary allocation from undisbursed 1989/90 CIS.
- 4.2 Arrears allow for SEK 30 million waiver to TFC.
- 4.3 Supplementary allocation. Some of "arrears" covered by over payments of cash cover in previous years.
- 5.2 SEK 3,922,489 not due.
- 5.3 SEK 4 million waiver.
- 6.2 No disbursement although orders placed – but payment schedule agreed with Treasury. SEK 1 million not due.
- 8.1.2 is project related, not included in total CIS allocation by TS.
- 8.2 Arrears allow for SEK 30 million waiver to TFC.
- 8.3 Cash cover does not include OGL, for which data unavailable.
- 8.4 Includes waiver for Industry of SEK 4 million.

Sources: compiled from reports prepared for SIDA by Tanna Somaiya & Co, Dar-es-Salaam **Table 2.10 Main recipients of Norwegian OGL**

failure to collect cash cover was one factor behind the switch from CIS to OGL. In fact, the arrears appear greater on OGL – but this does not accord with the overall evidence (presented in chapter 4, which suggests that cash cover collection is superior under OGL). CIS arrears are highest for SIDO and the Treasury's free quota and lowest for the allocation to Zanzibar.

Debt relief

Import support is the most important form of programme aid received by Tanzania, but there are other forms, of which debt relief has been quite significant. In 1986 Sweden created a fund for BoP support for debt distressed countries, this fund now being closely linked to the Special Programme of Assistance to Africa (SPA). The money is allocated on an annual basis in support of adjustment programmes approved by the World Bank and IMF. Tanzania has been a recipient of such funds, including debt relief on officially guaranteed debts from Sweden and repayment of World Bank loans. In view of the importance of debt relief, we devote some space to discussing its rationale and effects.

We should first distinguish between relief of debt held by the donor in question and relief of other debt. Much official debt was incurred at a time when aid was given on less concessional terms than it is today (nearly all bilateral aid to sub-Saharan Africa is now grants). Debt relief on past official loans is belated recognition of the fact that the aid should have been a grant in the first place – this form of debt relief is indeed called retroactive terms adjustment (RTA). If this is the rationale then the practice of showing the figures in the current aid budget is misleading – what is being done is in fact to increase the grant element of historical aid flows⁸. By the same logic, if debt relief is given against a previously non-concessional flow then the value of **past aid** is being increased.

8) Debt relief, but not rescheduling, appears in the donor's aid to the recipient.

The argument that debt relief is not current aid does not apply if the relief is given against another donor's debt – as Sweden has done for the World Bank. The World Bank discontinues all operations with countries which fall into arrears on IDA and IBRD loans. To repay this debt (and that to the IMF) is therefore the first call on a country's foreign exchange – not only to preserve access to Bank/Fund monies, but since many donors make continued support conditional on Bank/Fund approval.

The policy of some donors – including Sweden – to pay back Bank/Fund debt is of undoubted importance to the recipient. But there is a growing feeling in some quarters that the Bank should explicitly recognise its partial responsibility for the failure of programmes it designed and funded in the past by not collecting all the monies owing from the funding of those programmes. Such pressures are reduced – and the issue, which we believe to be a serious one, moved down the agenda – if other donors are willing to pay the Bank its money.

Debt relief may also be given on debt to the private sector. Many people find this offensive – thinking that the banks should pay the costs of their excessive lending in the past (e.g. Li, 1992). But this moral position does not reflect the political realities of debt relief. Although, since the Brady plan, banks are at last undertaking debt reduction rescheduling operations (previous reschedulings frequently increased the net present value of future repayment obligations) the fact is that many countries will continue to require relief from donors to assist with the burden of private debt.

The macroeconomic effects of debt relief vary. In the case of an excessive debt burden which the debtor had no intention of repaying then there is no impact on the beneficiary at all. In other cases the debt reduction can have both beneficial and harmful effects. The beneficial effects are that (i) if the recipient would have otherwise paid the debt itself the debt relief is equivalent to a gift of untied forex; and (ii) the reduction in the debt overhang may stimulate investment. On the negative side: (i) the reduction in outstanding debt may actually **increase** the amount the recipient is expected to pay (the debt Laffer curve); and (ii) there may have been no intention to pay so much of the debt so if the relief is deducted from aid that would have otherwise have been received forex availability is reduced.

Swedish debt relief has not been part of the country programme – so this last point cannot apply directly. But there may still be a less direct effect as the size of country programmes diminishes as more funds are allocated to regional activities. In future, however, debt relief is to be included in the country programme, so that increased debt relief will detract from other activities. We can also say that it is unlikely that Tanzania would pay its debt in the absence of the relief, so the relief is not providing additional forex. The exception is undertaking repayments to the Bank which, as indicated above, are necessary to secure continued inflows.

Norwegian OGL

As already mentioned, the NORAD OGL database allows a more detailed description of what the money is actually used for. We present an overview of this analysis here, which we draw upon in subsequent chapters. Mbelle and Karamagi used that database to classify imports as intermediate, capital and consumer. They also identified the SIC code of the importer and the SITC code of the goods (both at the two digit level). The allocation of these (share by value of goods imported) were reported in the Mbelle and Karamagi report. But we have found it useful to take the analysis more in depth to build a more concrete picture of the use of OGL funds.

Based on (i) an analysis of the list of items imported; and (ii) judgements as to categories of good it would be useful to separate, we devised a system to place all imports in 16 categories. These are shown in Table 2.9, along with the share (calculated as TShilling value of imports as per cent of TShilling value of whole programme) in the programme.

Table 2.9 Use of Norwegian OGL by type of good

Type of good	Share (% value)
Agricultural implements and parts	5.5
Other agricultural goods	1.1
Food and agricultural processing	7.5
Inputs for manufacture of soft drinks	2.7
Bikes and parts thereof	10.7
Soaps and inputs for soap production	5.7
Radios, cassettes, batteries and parts	2.6
Medicines	8.2
Vehicles and parts thereof	13.5
Other engines and parts thereof	4.1
Computers and accessories	0.8
Office equipment and educational supplies	2.7
Construction materials	3.8
Electrical machinery, goods and components	7.5
Other industrial intermediate goods	19.3
Other goods nes	4.4
Total	100.0

Source: NORAD OGL database, provided by Dr. Mbelle

The first two categories are items going directly to the agricultural sector – of which agricultural implements (including tractors) are the largest part. The third covers cash crop industries and food processing. The former have mostly resorted to import support for machinery and parts, and these may also be seen as important to agricultural revival. Food processing is most likely not so wholly reliant on local inputs.

Hence the share of total Norwegian OGL directly benefitting agriculture is probably a little over 10 per cent (which is consistent with the figure given by BOT for OGL as a whole – see Chapter 5).

Next come items that may fall under the broad category of incentive goods: soft drinks, bikes, soap, radios and medicines. Together these categories account for a quite considerable share of the programme (29.9 per cent). In the case of soap and soft drinks (and, to a lesser extent, radios) the imports are mostly for the manufacture of these items, so that the OGL funds have the doubly beneficial effect of stimulating domestic production of incentive goods. (And for each of these, the share may be underestimated, since some inputs may be purchased from intermediaries, and so could not be identified by the industry of end-use).

Improved supply of medicines is also, of course, important for the welfare of the population, especially given the poor state of the government distribution system. (Most, though not all, the pharmaceutical imports are by private enterprises). Unlike health, education needs seem to be left out from OGL – the few textbooks that have been imported are included under office supplies. Most of the goods in this category appear however to be for office, not school, use.

Transport goods – vehicles and parts – also have a substantial share. Both these and bicycles can play an important part in the facilitating the marketing of agricultural produce, though the extent to which this has been the case is undocumented. Again, the overall share of transport is broadly consistent with the BOT's figures.

Much of the talk about import support suggests it is intended for machinery, spare parts and other intermediates (mostly chemicals) – and our analysis shows that a large part of the OGL is indeed used to finance such imports. Including engines in this category gives a figure of around a third.

In summary, about a third each goes to each of the manufacture of incentive goods and to support other industrial production. The remaining third splits roughly equally between agriculture, transport and miscellaneous items⁹.

We can go still deeper in our analysis by considering the data presented in Table 2.10, which lists all importers who have received eight or more allocations of Norwegian OGL funds. Between them, the twenty-nine firms account for just under a third of the total Norwegian programme. The distribution by public/private and by type of good is similar to that observed for the programme as a whole. What is interesting here is to focus on the activities of the trading firms. These firms have strong orientation towards bikes and bike parts. Second to this they import a range of intermediate goods (and some other items such as hurricane lamps). Both these trading companies, and many of the other enterprises, are based in Dar es Salaam. But some of them (e.g. Matsushita, General Tyre, TOTAL and National Pharmaceutical) have their own outlets across the

9) A list provided by the EC shows that the goods imported under their OGL-like import support scheme (GIP) have a broadly similar composition (with perhaps a slightly stronger orientation towards intermediate goods).

COMPANY	OWNERSHIP	ALLOCATION		ITEMS IMPORTED
		No.	Share (% value)	
Agrotech	Private	9	0.3	Tools; miscellaneous intermediate goods
Bobby Soap	Private	9	0.9	Inputs for soap manufacture
Elys (T) Ltd	Private	9	0.2	Medicines
Fazal Karmali Sons	Private	18	1.3	Yeast; miscellaneous spare parts
Fidahussien & Co.	Private	13	0.6	Bikes and parts thereof; miscellaneous items
General Tyre	Public	55	2.8	Tyres; inputs for tyre manufacture
Gupta Trading	Private	8	0.2	Bikes and parts thereof; engine parts; tools
Heko Pharmacy	Private	8	0.2	Medicines
International Suppliers	Private	9	0.7	Miscellaneous intermediate goods
Inter Pharmacy Services	Private	12	0.3	Medicines
Jeje Industries	Private	26	1.6	Bikes and parts thereof; misc. intermediate goods
Kagera Sugar Ltd	Public	8	0.8	Machinery and parts
Kibo Match Company	Public	17	0.6	Intermediate inputs for match production
Lake Soap Ltd	Private	8	1.1	Inputs for soap manufacture
Lonhro-Tanz Holdings	Private	8	0.6	Tractors
Machole Traders	Private	11	0.4	Bikes; miscellaneous intermediate goods
Matsushita Electrical Co.	Private	11	2.7	Radios, cassettes, batteries and components
National Pharmaceutical Co	Public	18	1.4	Medicines
Shellys Ltd	Private	11	1.0	Pharmaceutical materials; misc. intermediate goods
Simba Plastics	Private	14	1.4	Intermediate goods
Seifi Impex Ltd	Private	8	0.3	Bikes and parts thereof; misc. intermediate goods
Steelcast	Private	13	0.8	Construction and other materials
Sunderiji Naji Ltd	Private	8	0.6	Bikes and parts thereof; misc. intermediate goods
Tanzania Cigarette Co	Public	8	0.8	Machine spares
TANESCO	Public	17	1.3	Machinery and spares
Tanz. and Italian Petrol Ref.	Public	17	1.3	Machinery and spares
Technical Trading	Private	13	1.1	Miscellaneous intermediate goods
TOTAL Tanzania Ltd	Private	8	0.4	Equipment and parts for petrol distribution
Zanzibar Milling	Private	8	4.3	Machinery and parts

Source: NORAD OGL database, provided by Dr.Mbelle.

Table 2.10. Main recipients of Norwegian OGL

country. The other trading firms are not national concerns, but act as wholesalers so that their goods may reach other areas.

In fact, the donors supporting OGL have not (aside from the issue of the negative list) been too concerned over the use of funds. The focus has been far more on the procedures by which the system has been administered.

2.6 Modalities of Import Support: An Assessment

In our interim report we discussed in some detail problems in the implementation of the OGL. Most of these issues have become redundant since abandonment of the OGL in August 1993. It is, however, still pertinent to assess import support to Tanzania against international guidelines for such aid.

SPA working groups have developed guidelines to improve the effectiveness of the use of both import support and counterpart funds. In this section we outline these guidelines, and compare the performance of the different import support schemes operating in Tanzania against these standards. In this review we raise those issues from our earlier analysis that are still of relevance.

The Guidelines for import support (adopted by donors at the SPA meeting of April

Table 2.11 Comparison of Import Support Programmes with SPA Guidelines

	OGL	Sweden	US	Netherlands	EC
<i>Enterprise efficiency</i>					
Policy conditionality	√	√	√	√	x
<i>Foreign exchange market</i>					
Market-based allocation	√	√	x	x	√
Unified rate/common					
procedures across windows	x	x	x	x	x
Common negative list	√	√	x	x	√
Apply blacklist	√	√	√	√	√
<i>Procurement and payment</i>					
Standardised procurement	√	x	x	x	√
Standardised audit	√	√	x	x	√
Untied	√	√	√	√	x
<i>Counterpart funds</i>					
Standardised procedures	√	√	x	x	√
Allocated within					
context of					
government budget	x	x	x	x	√
No earmarking	√	√	x	x	x

1992) identified four important areas for import support programmes: (i) enterprise efficiency; (ii) foreign exchange market efficiency; (iii) procurement and payment practices; and (iv) transparency and accountability. We look at each of these in turn, laying out the recommendations of the guidelines and discussing the practice of the various donors (summarised in Table 2.11)¹⁰.

Enterprise efficiency

To ensure that import support is used efficiently it should be used in an environment in which firms can compete according to the criterion of economic efficiency. It is not recommended that sectors or firms be precluded on the grounds of inefficiency, but rather that programmes should be in the context of agreed reforms (e.g. elimination of market distortions and subsidies to parastatals) that will ensure efficiency.

In Tanzania, OGL funds (and so, therefore, money from the World Bank, Norway, UK and other donors putting money through this channel) **have** been linked to various sectoral adjustment credits, and so satisfy the enterprise efficiency condition. Although Sweden has put its finance parallel to the OGL, with a separate agreement with the government, the conditionality has been of the same type (linked to meeting the targets laid out in the Policy Framework Paper). The USAID import support programme, whilst very different from the OGL in most respects, is linked to policy conditionality – for example, the first tranche of the private sector import support programme is conditional upon the BOT restricting itself to the functions of a central bank, and the commercial banking sector being allowed to operate in a genuinely commercial way.

Foreign exchange market efficiency

Efficiency in the forex market has two essential features: (i) a “realistic”, preferably unified, market rate; and (ii) procedures for processing applications should be transparent, not unduly bureaucratic and uniform. The period since the introduction of OGL has seen a narrowing of the premium between the official and bureaux and parallel rates. Moreover, the allocation system is market-based, and intended to be open to all importers. Therefore donors supporting the OGL – but not those retaining some form of CIS (Netherlands and US) – satisfy in part the forex market guidelines.

The guidelines are not satisfied to the extent that the OGL system still allows (in fact creates) a degree of market segmentation. Goods on the negative list and services may not be imported with OGL funds, whereas they can with own funds or through the bureaux – this fact drives a potential wedge between the official (OGL) and bureaux rates. (Although it is the case, at least, that donors supporting the OGL adopt a common negative list, as suggested by the guidelines – but again this is not so for donors using CIS). With the new system this segmentation will not exist so long as the demand for eligible imports exceeds the value of import support funds. Also the problem would not exist if the negative list were to be abolished.

10) The Japanese programme is not shown as we do not have adequate information. The programme is, however, of the CIS type and most probably satisfies few if any of the guidelines.

Table 2.12 Negative List Imports, 1990.

Items	Value (TShs)	Share (%)
Fruit, vegetables and plants	76 028 809	0.3
Food industry residues	65 445 644	0.2
Asbestos and fabricated asbestos	65 247 836	0.2
Ores, slags and ash	43 928 695	0.2
Wood tar and oil	58 164 660	0.2
Worn clothing and textiles	1 020 331 267	3.8
Coal lignite, peat, coke etc.	405 854 893	1.5
Crude oil petroleum	16 235 296 834	60.6
Explosives	330 913 415	1.2
Unused postage stamps, cards etc.	910 339 089	3.4
Guns, armored vehicles etc.	140 181 305	0.5
Alcoholic beverages	318 311 398	1.2
Perfumes and cosmetic oils	88 450 566	0.3
Luxury vehicles	6 480 308 777	24.2
Boats	447 709 381	1.7
Cameras	70 415 180	0.3
Other items	15 142 208	0.1
Total	26 772 069 957	100.0
Source: Bureau of Statistics		

Table 2.12 shows the items on the current negative list and the value of these goods imported in 1990, as well as their share in total negative list imports. Petroleum accounts for 60 per cent of negative list imports. It is a matter of policy if petroleum imports should continue to be controlled—but such a policy could be controlled by means other than the negative list. Nearly another 25 per cent is accounted for by luxury vehicles, which includes four wheel drive vehicles with a carrying capacity of less than nine persons; another 1.7 per cent is contributed by boats. We are not sure that any vehicles should appear on the negative list. What is left after taking away these items is, anyhow, less than 15 per cent of negative list imports. Since such imports are less than 15 per cent of total imports, the excluded items are around 2 per cent of total imports.

The negligible importance of these imports, combined with the fact that new system has no safeguards against fungibility and so economic analysis would suggest that some of the import support must be actually financing some negative list items, suggest that abandonment of the negative list is desirable. The bureaucracy required to administer the list will impose greater costs than any conceivable costs. Discouragement of the consumption of certain luxury items can be ensured by a differential sales tax. However, we realise that this issue is a contentious one. Our proposed reform of import support, given in Chapter 5, avoids the problem of the negative list altogether.

One area of agreement amongst all the donors has been on the blacklist, which excludes any importer in default for cash cover payments from having access to new

funds. We recommended before that a certain leniency be considered for some importers and do not change that recommendation here. Indeed, it is difficult to see how the blacklist itself can operate under the new system (though of course companies in arrears may be pursued through legal channels).

Procurement and payment practices

In countries in which there is functioning forex market donors should not link their funds to specific imports but account for these funds *ex post* against documentation provided by commercial banks and/or customs. Donors should also agree standardised procedures regarding requirements for *pro forma*s and ICB. Finally, additional monitoring should be provided through a functioning pre-shipment inspection (PSI) system and a service provided to importers to permit access to lowest-cost sources of goods.

Tanzania is moving towards a fully market-based allocation of forex. At the same time the World Bank's suggested new system proposes *ex post* linking as suggested by the guidelines – though the proposal is yet to be agreed by other donors. Donors supporting OGL and also the EC have adopted common procedures for procurement – with the exception that EC import support is tied to the purchase of EC-ACP goods, whereas OGL funds are not procurement tied.

Tanzania's PSI system has recently been evaluated by an SPA mission, though the results are not yet available. Proposals for a service to importers, operating through the Chamber of Commerce, have so far come to nothing.

Transparency and accountability

The guidelines state that independent auditing of the forex provided and counterpart funds collected are an important part of a good import support programme. Donors should facilitate the practice by adopting common accounting procedures – it is also recommended that the World Bank take the lead in monitoring audit compliance. Once again, funds through the OGL do have a common audit procedure, but the CIS programmes of course do not.

Counterpart funds

An earlier set of guidelines (adopted at the April 1991 SPA meeting) laid out principles for the use of counterpart funds. These guidelines cover two basic areas: (i) standardising procedures of the system of collecting, using and monitoring counterpart funds across donors; and (ii) the use of counterpart funds should be within framework of government budget. If the recipient has acceptable public expenditure planning then donors should allow counterpart funds to be general budget support – in other cases regular consultations with government should agree and monitor the use of the funds.

If the system of counterpart funds used by the OGL is taken as the standard then donors operating CIS – under which payment of funds is direct to the Treasury, rather than via the Central Bank – can be said to not be operating with standardised systems.

Judging the use of the funds is less simple. It does **not** appear to be the case the donors have consciously planned the volume and use of funds within the context of the overall government budget planning. (Indeed, the government and World Bank estimates of financing requirements differ quite considerably). However, there is some consensus that counterpart funds should be used to offset the need for deficit financing, rather than for incremental expenditures. However, funds raised through US import support **are** earmarked to specific expenditures (and ones which are mostly quite clearly incremental, such as a Business Services Bureau). Dutch funds are linked to social sector expenditures, although through a system of "soft tying" rather than earmarking to specific expenditures.

Implementing the guidelines

A number of actions have been agreed to help implement the guidelines. We concentrate on one of these of special relevance to Tanzania. In addition to Joint Evaluation Missions (JEMs) and the *aide memoire* they produce, country status reports should be prepared indicating the extent to which recipients are implementing the guidelines, and the extent to which donors' import support programmes are consistent with them. Since it is the donors that take the lead in determining what system is adopted, it is the latter if these – the consistency of donor programmes – that deserves the more immediate attention. We are not aware that such an assessment (similar to that in Table 2.11) has been made in the case of Tanzania. Given the apparent discrepancies that exist between donors we recommend that such reports are made to facilitate the move towards a standardised system.

2.7 Summary

Aid flows have historically been very important in Tanzania. The country experienced an aid boom in the late 1970s, which peaked in 1980. This boom was followed by some years of relative isolation from the donor community, until the adoption of the Economic Recovery Programme in 1986. Since that year there has been a second aid boom of even greater magnitude than the first. There are signs, however, that donors (many of whose budgets are under pressure at home) are wearying and beginning to raise questions about aid's effectiveness in Tanzania: although aid flows are currently being sustained this may not be so in the longer run.

For political reasons, Sweden and Norway are both important donors to Tanzania. In the mid-seventies Sweden accounted for nearly one fifth of all ODA receipts – though by the late 1980s this figure had fallen to 10 per cent. Norway's share in Tanzania's aid inflows rose over the same period from 6 per cent to around 8 per cent.

In the late 1970s there was increasing recognition that rehabilitation and increasing capacity utilisation were more important concerns than further expansions to the capital stock (which could then not be maintained and/or utilised). Donors thus began to allocate funds to import support – foreign exchange (forex) for the importation of

intermediate goods and items of capital equipment necessary to use existing plant.

Import support initially took the form of Commodity Import Support (CIS), which was allocated by the Treasury in consultation with donors to specific enterprises. However, the government's forex allocation largely supported ailing parastatals. Moreover, the enterprises received a "double subsidy" from CIS – first from the premium in the official rate compared to that on parallel markets and, second, since many enterprises did not anyhow pay (in full or even at all) for their forex. CIS was therefore correctly perceived to be assisting the perpetuation of an inefficient industrial sector, rather than promoting its restructuring.

In response to the problems identified in CIS the donors have moved to support of the market-based Open General Licence (OGL) system. These monies are intended to be distributed to importers on a "first come, first serve" principle. This principle, combined with successive devaluations of the Tanzanian shilling, is intended to ensure that the forex is received by the most productive users. An analysis of the uses of OGL shows that it does indeed go mostly to the private sector, and that most of the goods imported are either related to intermediate items for a range of uses. A scepticism we ourselves expressed earlier that the nature of goods would not benefit the agricultural sector does not appear to be entirely warranted.

It is now proposed by the World Bank to abolish the OGL and to account import support against imports that have already taken place. Such a proposal will overcome many of the perceived problems in the OGL. One outstanding issue is the treatment of arrears. The practicality (and rationale) for maintaining a negative list is also open to doubt.

Appendix:

SOURCES OF AID AND OTHER INFLOW DATA

The most widely accepted definition of aid is DAC's definition of Official Development Assistance (ODA). That is flows meeting the following criteria:

- official: from government to a developing country government or international agency;
- development: to be used for developmental purposes; and
- assistance (concessionality): having terms and conditions so that the grant element exceeds 25 per cent.

Flows meeting the first two, but not the third of these (which includes money through the World Bank's IBRD window) are Official Development Finance (ODF). ODF is one component of Other Official Flows (OOF), which covers all flows satisfying the first but not the third criterion.

There are three main sources from which aid and other inflow data can be gathered:

- *World Debt Tables (WDT)*, published by the World Bank from the data collected by its Debt Reporting System;
- the DAC publication *Geographical Distribution of Financial Flows to Developing Countries*, based on the returns to DAC by each of its members, and supplementary information collected by DAC; and
- national sources (national accounts, balance of payments and government finance statistics).

Each source has its advantages (and disadvantages). National accounts are useful for identifying aid flows in the government budget. On the other hand, in the case of Tanzania, it is difficult to isolate aid in the external account and so obtain a reconciled picture. Also the government accounts give incomplete coverage of the aid programme.

The main advantage of the DAC data is that it allows the identification of inflows by donor and, for recent years, a sectoral allocation of ODF. *World Debt Tables*, on the other hand, have more disaggregated information on non-aid inflows and allow an easier calculation of the different inflow concepts. The *WDT* series is also available for a longer period (1970-91, compared to 1976-90 for DAC). Ideally, then, we would like to be able to draw on both sources to illustrate different points. But we should be wary of adopting such an approach if the different sources give radically different pictures.

Figures A.2.1 and A.2.2 show the value of net ODA receipts and net receipts of all inflows from the two sources. In both cases – but especially that of ODA the two appear very similar. In the case of total inflows it appears, as might be suspected and is stated in *Geographical Distribution...* itself, the DAC figures slightly underestimate private inflows. The correlation coefficients between the two series are 0.97 and 0.93 for ODA and all inflows respectively.

A more formal test of the similarity of the two series is to regress one on another. If the slope coefficient from such a regression is unity then they change by the same magnitude and the use of either series would yield the same result if used in a regression analysis. To same that the two

series are the "same variable" then, in addition to the slope coefficient of unity the intercept should be zero. The results from these regressions are (standard errors in parentheses):

$$\text{ODA}^{WDT} = 67.92 + 0.96\text{ODA}^{DAC} \quad R^2 = 0.96$$

(47.6) (0.07)

$$\text{TOT}^{WDT} = 11.74 + 1.06\text{TOT}^{DAC} \quad R^2 = 0.86$$

(89.8) (0.11)

where ODA and TOT are net ODA and net total receipts and WDT and DAC indicate the source for the series.

In both cases the test for being the "same variable" is passed. The t-statistic for the null hypothesis that the slope coefficient is unity is

-0.57 and 0.50 for aid and total inflows, respectively – both well below the critical value at any usually accepted level of confidence. A joint test of these nulls gives F statistics of 3.65 and 2.65 for aid and total inflows respectively, compared to a critical value of 3.80 at the 5 per cent level.

On the basis of these results we draw on both DAC and WDT at different points in our analysis.

INVESTMENT SUPPORT VERSUS IMPORT SUPPORT

3.1 Introduction

This chapter deals with the interrelationships between aid **fungibility**, aid **dependence**, and the **type** of aid (investment versus import support) in the context of the Tanzanian experience. As we intend to show, the type of aid matters a great deal with respect to its effects on the macro economy.

Aid is meant, among other objectives, to increase economic growth. It can do so by increasing social and economic investment in the recipient country, but also, in certain conditions, by permitting greater capacity utilisation in an economy severely constrained by foreign exchange. In the former case, aid enhances capacity creation by supplementing domestic savings or by allowing for the importation of capital goods. This is aid as **investment support** which traditionally took the form of **project aid**. Often, in this case, the donor agency would finance the direct foreign exchange costs of the project while the recipient country was expected to meet the local resource costs from local savings. In the second case, aid finances imports of raw materials and incentive goods which could otherwise not have been imported. This is the classic form of aid as **import support** exemplified by CIS in the 1980s. The connection between both potential uses of aid is clear once we realise that the rate of growth of an economy's output (GDP) (approximately) equals the **sum** of the growth rate of capacity output (resulting from investment) and of the growth rate of capacity utilisation.

Both components in this sum do not always go hand in hand. The Tanzanian experience teaches us that the growth in capacity output can, in certain conditions, adversely affect capacity utilisation in the economy. Consequently, as more capacity becomes available, its utilisation rate falls, leading to a situation where both factors pull the economy in opposite directions. It follows, therefore, that any assessment of the macro impact of aid needs to take account of both its volume and its **composition** in the light of the nature of the constraints operative, at any given time, in the economy. These constraints, in turn, depend on whether aid renders the economy more aid dependent, or whether it enables the economy to embark on self-sustained growth.

But economic growth and development is not just a question of the quantitative interplay of macro aggregates. It also has to do with **agency**. In this respect, quite a

dramatic shift in development aid and policy took place over recent years: a shift in emphasis from a concept of the state as the principal agent of development towards a view which identifies the state as part of the problem. The latter view puts the emphasis squarely on market based solutions in which the private sector, and not the state, is seen as the prime mover behind economic growth. The question of agency, therefore, matters in the analysis of the type and form of aid and of its macro impact on the economy.

This chapter looks at both the conventional quantitative aspects of the impact of aid in the economy **and** on the perceived role of agency in shaping the mechanisms through which aid is allocated. In our opinion, it is important to integrate both these aspects into the analysis of import support since present policy discussions on this matter have as much to do with agency as with assessing quantity effects. For example, the shift from CIS to OGL can only be properly analysed by taking proper account of the role of agency in development. With respect to this, there appears to be quite some confusion still in policy discussions.

More specifically, in various discussions we held with representatives of donor agencies in Tanzania, it struck us that views on the future of import support could be widely divergent, even in the same discussion. At times, import support was seen as a **temporary** measure to relieve a severe import constraint on capacity **utilisation**. This is mostly the idea behind CIS. However, the move towards OGL was also seen as a definite step towards a more **market-based** system for allocating foreign aid. It was not always clear, however, whether import support in either of both forms was seen to be essentially a short-run quick-relief measure or whether it represents a definite shift towards a more lasting restructuring of the mechanisms through which aid is allocated. For some, import support is a necessary, but hopefully short bypass operation to enable donors to return subsequently to the more traditional form of project aid. Others, however, saw it as a new and lasting form of aid which enabled donors to shift aid resources mainly behind **private** sector development. In similar vein, the SIDA report on *Principles of Import Support* (January 1993:7) questions whether import support should be seen as a step on the way towards a new form of programme aid consisting of untied foreign exchange support which can be used for imports, domestic credit, local costs, etc. By doing so, the report broadens the question of agency – that is, it addresses not just the private/public dichotomy within the recipient country, but also the choice between tightly donor-steered project aid versus aid as a support for locally based (private) initiative and a vehicle to develop local management capabilities.

As to its structure, this chapter starts with a discussion of two key concepts which we shall use to analyse the macroeconomic effects of aid: aid fungibility and aid dependence. Next, in the light of this discussion, we briefly look at trends in import volume and in the import capacity of exports, after which we deal with the experience of the **aid boom** of the 1970s. This was the period where aid mainly consisted of investment support in the form of project aid. This period, therefore, may not appear to be all that

relevant to a discussion on the macro economics of import support. However, the discussion of the 1970s matters for two reasons. First, it shows how policies (enhanced by aid funded investment support) which aimed to achieve self-reliance ended up by creating greater aid dependence. And secondly, we argue that this process of increased aid dependence led to the necessity of shifting the composition of aid towards import support to prevent further economic stagnation and crisis. Our aim is not to give a comprehensive historical account of the experience of the 1970s, but to present an **interpretation** of this phase which allows us to draw some important lessons which remain valid in the present time. Finally, we look at the dynamics of import support – first CIS and subsequently OGL – under structural adjustment policies in the light of the problem of aid dependence.

3.2 Fungibility and Aid Dependence

As we know, policy design does not necessarily conform with its final outcomes. In fact, aid fungibility occurs when the donor's policy design in terms of the volume of aid allocation produces an unintended outcome. In this respect, it is useful to distinguish two kinds of fungibility: **aggregate** fungibility and **categorical** fungibility.

Aggregate versus categorical fungibility

Suppose that funds (A) are intended to be used to finance goods or activity X. Aggregate fungibility occurs if the increase in expenditure on X is less than the value of the funds (that is, $dX/dA < 1$). Suppose X may be sub-divided into items $X_1, X_2, \dots, X_n$ and that the funds are intended to be used for item X_1 . If expenditure on the other categories of item X ($X_2, \dots, X_n$) rises in response to the increased availability of funds there is categorical fungibility.

This distinction may appear unnecessary, as whether a case is described as aggregate or categorical fungibility rests on the perhaps arbitrary designation of expenditure items as X or non-X goods. In practice, the distinction proves easy to apply.

Consider the case of import support aid given to finance importation of intermediate goods. If the aid somehow reduces exports through whatever process at work or displaces foreign borrowing, imports rise by less than the value of the aid inflow. This is a case of aggregate fungibility. But if imports of consumer goods increase as a result of the aid, then there is categorical fungibility. Of course, both types of fungibility may occur at once.

The distinction is also useful in the discussion of aid's impact on fiscal policy. Aggregate fungibility exists if taxes or government borrowing fall when aid increases. There is categorical fungibility if non-developmental expenditures (such as military expenditure) rise with higher aid.

Hence, fungibility occurs when donor's policy intentions as to aid allocation are wholly or in part frustrated inasmuch as they result in a different outcome. The reasons for this different outcome may be twofold.

First, the recipient of the aid has different policy objectives from those of the donor and succeeds in altering the final outcome by reallocating own funds away from the activity targeted by donor aid. The classic example is when the donors intend to raise the investment ratio in the economy by furnishing investment support through aid, but the recipient government, in response, reduces its savings effort accordingly. Another example could be when a recipient government reduces its tax effort and relies instead on increased counterpart funds to finance government expenditures while donors' intentions were to close the fiscal deficit. Or, a further example is when a recipient government reduces its commercial borrowing from abroad as access to foreign aid improves.

Secondly, the inflow of foreign aid may produce unintended results which do not reflect policies of either the donor community or of the recipient government. For example, if the inflow of aid causes a decline in exports by purely economic mechanisms, imports will rise by less than intended by either the donor community or the recipient country's government.

Aid dependence

Turning now to the concept of aid dependence. As we shall argue, this refers to a situation or, better still, a process in which a country becomes **chronically** dependent on a continued inflow of foreign aid. To discuss this concept in more depth, however, it is useful to make use of the basic accounting framework for the macro analysis of foreign aid.

Hence, the starting point for our analysis are the internal and external balance identities. That is, the gap between gross national savings and investment (the savings gap) must be financed by the net inflow of foreign savings (the capital account), and that these both must equal the current account deficit (the trade gap). More formally:

$$\text{Savings gap} = \text{Current account} = \text{Capital account}$$

(3.1)

These identities must hold at all times. A change in either the current or capital accounts as a result of an aid inflow must therefore be accommodated by changes in other variables in the identities. Which variables adjust and by how much is the subject matter of the analysis of aid's macroeconomic impact.

We look first at the capital and current accounts and present empirical analysis of aid's impact on imports. We next focus on the internal balance condition and the response of investment.

The capital and current accounts

The capital and current accounts may be written in more detail as:

(3.2)

$$X + NTR + NFP - M = -(LTL^C + LTL^n + STL + OKI + dR)$$

where X is exports of goods and non-factor services, NTR net current transfers (which comprise official transfers (OT) – that is grant aid – and private current transfers, PCT), NFP net factor payments from abroad, M imports of goods and non-factor services, LTL^C net disbursements of concessional long-term capital, LTL^n net disbursements of non-concessional long-term capital, STL net short-term inflows, OKI net other capital inflows and dR the change in reserves. (A negative dR is a reduction in reserves, that is an “inflow” of capital to the capital account).

Aid may appear in either the capital or current account. Non-grant aid will appear as LTL^C . By the UN's *System of National Accounts* (SNA) grant aid intended for investment purposes should appear in the capital account as capital grants. Some economists dispute this method, arguing that only inflows carrying with them a repayment obligation should appear in the capital account. And in practice most countries do **not** follow the SNA recommendation but instead record all grant aid (that intended for both consumption and investment) as official transfers (OT), that is a part of net current transfers. NCT are a current account item but it is a common practice to treat OT as an “intermediary item” and report the current account with and without official transfers. Such a practice is commonly adopted by the World Bank and IMF and, as we shall see, it has important implications for the macroeconomic analysis of countries with high aid inflows.

Suppose that the aid inflow is non-concessional, so that there is an increase in LTL^C . For illustrative purposes, suppose that LTL^C increases by 100 units, so that the change in on the right hand side of equation (3.2) is -100. How is the identity in equation (3.2) preserved? The “conventional view” is that imports increase by the full value of the aid inflow – this is supposed to be a direct relationship. Hence, the conventional view assumes that there is no aggregate fungibility of aid. That is, the aid pays for the imported goods used in a development project, or in the case of import support pay for imports that would not have been otherwise imported. Therefore the identity is maintained by a current account deterioration of an identical amount to the value of the aid.

This last sentence contains an important point for the analysis of the economic performance of economies with high aid inflows. As just stated, if aid is a capital account item and this aid is used entirely for additional imports then the current account will worsen by the value of the aid inflow. It is not possible for an economy with high aid inflows to have a “healthy” trade balance – the aid **forces** there to be a gap.

A similar point may be made if the aid appears as a current account item. If there is an increase in grant aid of 100 units and this is fully used to pay for imports then there

is no impact on the level of either the current or capital accounts. However, as indicated above, the current account is often reported "before official transfers". One rationale for this practice is that their inclusion leads to too-rosy a picture – the "true" picture is felt to be that given without the grants. But if the grants are leading to a one-for-one increase in imports then it is in fact excluding them from the current account that gives the misleading picture.

The World Bank and IMF in particular present the accounts of aid recipients as if the current account deficit is given and then aid is required to fill the gap. There is scant recognition that, if aid is doing its job, then it is the aid that is **causing** the gap. It makes little sense to chastise a country with growing aid inflows for having a worsening current account.

This brings us to an important point with respect to the nature of aid dependence. The basic issue is **not** the value of the current account now (which moves more negative as a result of the inflow of aid), but whether the aid is facilitating a **process** of adjustment so that the required level of imports will be sustainable from domestically-generated foreign exchange earnings in the future. Hence, a meaningful discussion of aid dependence will need to look at the longer term implications of aid and not at its immediate short term impact in terms of 'worsening' the trade/savings gaps.

Before we turn to the question of aid dependence, note, however, that aid most likely will not lead to an increase in imports by the full value of the aid inflow. That is, there is likely to be aggregate fungibility. Rather than an increase in imports, the balance in equation (3.2) may also be preserved by any (or a combination) of the following mechanisms:

- a reduction in any of the other categories of foreign borrowing (LTLⁿ, OKI, STL);
- higher debt payments (so the net figures on capital account fall if these payments are amortization or NFP falls if they are for interest);
- accumulation of reserves (dR is therefore negative); or
- a reduction in exports.

We call the allocation of aid expenditure over these categories the way in which the current and capital accounts "accommodate" an aid inflow.

In the case of the first three accommodatory mechanisms the increase in the net capital inflow is less than the value of the aid inflow, and so the required increase in imports to maintain equation (3.2) is less than without such accommodation. In the extreme case aid entirely displaces other types of borrowing, is entirely added to reserves or used to repay debt so that there is **no** increase in imports as a result of higher aid.

The final possible accommodation of the aid inflow is through a reduction in exports – so that the increase in available forex is less than the value of the inflow. The ways in which aid may reduce exports has been the subject of recent academic literature that may be labelled "aid as Dutch disease". Generally, Dutch disease is said to result from movements in the real exchange rate.

In a floating exchange rate regime it is clear that the increase in the supply of forex caused by the aid flow will put pressure on the exchange rate to appreciate. This pressure will be offset to the extent that the aid funds are directly financing imports. But if the increase in imports is less than the aid there will be a net appreciation of the nominal exchange rate. Theory then postulates that this will lead to a reduction in export volume.

Historically most aid recipients, Tanzania among them, have had fixed exchange rates, and so the reduction of exports required to maintain balance is brought about by real rather than nominal exchange rate adjustment. The argument is as follows. Aid-financed activity results in an increase in demand, some of which falls on non-traded goods. There is therefore an increase in the price of non-traded goods. The price of traded goods is, by contrast, fixed on world markets (the small-country assumption) so that there is an increase in the price ratio P_N/P_T – this is by definition a real exchange rate appreciation. The real appreciation (or, to put the same thing another way, loss of competitiveness) leads to a reduction in exports. Below we investigate the concrete mechanisms through which a similar process was operative in the Tanzanian experience.

All these accommodatory mechanisms may apply if aid is either a capital or current account item. If aid is a grant and the aid fully finances higher imports then there need be no adjustment at all in the capital account. This is also the case if the difference between the increases in aid and imports respectively is accommodated by lower exports. On the other hand, if the grants substitute for capital account borrowings or are added to reserves then imports will not rise by the value of the higher aid.

Internal and external balance

We now consider how the internal (investment-savings) balance accommodates an aid inflow. Consider the case in which aid is a grant. Combining the definition:

$$GNS = GDS + NFP + NTR \quad (3.3)$$

where GNS and GDS are gross national and domestic savings respectively, with the first identity in equation (3.1) gives:

$$GDS + NTR + NFP - I = X + NTR + NFP - M \quad (3.4)$$

Suppose that the increase in NTR is fully accommodated within the current account – this is meant to happen by an increase in M of the same amount. The left hand side of equation (3.4) must therefore also remain the same. The orthodox view of how this happens is that investment increases by the value of the increment in aid with other variables (notably GDS) remaining unchanged. Simply put, the aid is fully (and directly) used to finance higher investment: in equation (3.4) the increase in NTR is

entirely offset by the one-for-one increase in investment so that there is no change in the net balance on the left-hand side.

Of course, once more, this assumes that there is no fungibility at work. In actual fact, investment may rise with less than the inflow of aid. That is, the aid flow is being accommodated in some way other than an increase in investment. One possible accommodatory mechanism is the basis of the critique made by Keith Griffin – giving rise to “the savings debate” – that aid causes a reduction in GDS. Therefore GNS rises by less than the value of the aid inflow. Since the left-hand side of equation (3.4) must remain unchanged investment will only rise by the value of the increase in GNS.

Before continuing we make a brief aside on an important limitation to Griffin’s argument. His argument is simply that some aid will be used for consumption rather than all being saved – indeed some aid is intended for consumption purposes. Therefore the rise in GNS is less than the rise in NTR which is only possible if GDS falls. This argument is more explicit if we write the definition of GDS:

$$GDS = GDP - C \quad (3.5)$$

where C is total (public and private) consumption. If consumption rises and GDP is unchanged then GDS **must** fall. So it is being assumed in Griffin’s argument that income does not increase as a result of the aid inflow. If aid leads to an increase in GDP in the current period then both consumption **and** GDS may rise – the negative relationship between the two only arises because Griffin holds GDP constant. (If savings do rise then the increase in investment caused by the aid inflow must be greater than the value of the aid flow). This point also underlines the limitation of the accounting framework discussed in this section of this report. It provides a conceptual framework, but the final analysis of aid’s impact is dependent upon the incorporation of behavioural relationships.

Dynamic conditions concerning aid dependence

With the aid of this macroeconomic accounting framework we have argued that aid dependence needs to be looked at from a longer term perspective. The mere existence of a large savings gap or a trade gap does not in itself show that the economy has become aid dependent. What matters is whether the inflow of aid facilitates a process of adjustment such that the required level of imports will be sustainable from domestically generated foreign exchange in the future and, similarly, that domestic investment can be supported by domestic savings and, possibly, commercial capital inflows.

Hence, to verify whether aid dependence is endemic or not in a given process of development we need to look at the savings and trade gaps in a dynamic perspective. Therefore, we propose to use two simple (yet somewhat crude) indicators to verify whether aid dependence is likely to occur or not.

First, as to the savings gap, sustainable growth without long term aid dependence

requires that the average savings ratio (when less than the investment ratio) rises over time so as to close the savings gap. In economic jargon, this means that the marginal propensity to save should exceed the average propensity to save in the process of adjustment. Obviously, when stating this condition we assume that the investment ratio is not unreasonably high given the context of the economy, a situation which may well occur in given circumstances as we shall see below.

Secondly, as to the trade gap, assuming that normally imports grow roughly at the rate of GDP, long term closure of this gap would require that exports (not just in volume, but also in terms of the volume of imports they can buy) grow faster than GDP. More generally, export growth should exceed import growth in a **longer run** perspective. What matters here is the long run tendency. Indeed, for example, a sudden jump in aid inflows may lead to rapid short run growth in imports which exceeds exports growth. However, since aid inflows are unlikely to continue growing in real terms at a high rate, this type of a one-step increase in volume does not affect long run tendencies and, hence, should be discounted.

Given the framework developed in this section we can now turn to an analysis of the dynamics of aid dependence in the Tanzanian context.

3.3 Import Volume versus Import Capacity of Exports

Fig 3.1 plots the long term evolution of import volume over the period 1970–91. The remarkable feature of this graph is the virtual absence of a trend. In fact, insofar as a trend exists, it is negative. However, since imports in recent years are likely to be **underrecorded**, it is probably fair to assume that, by and large, import volume fluctuated around a constant volume over a prolonged period of time. Hence, what

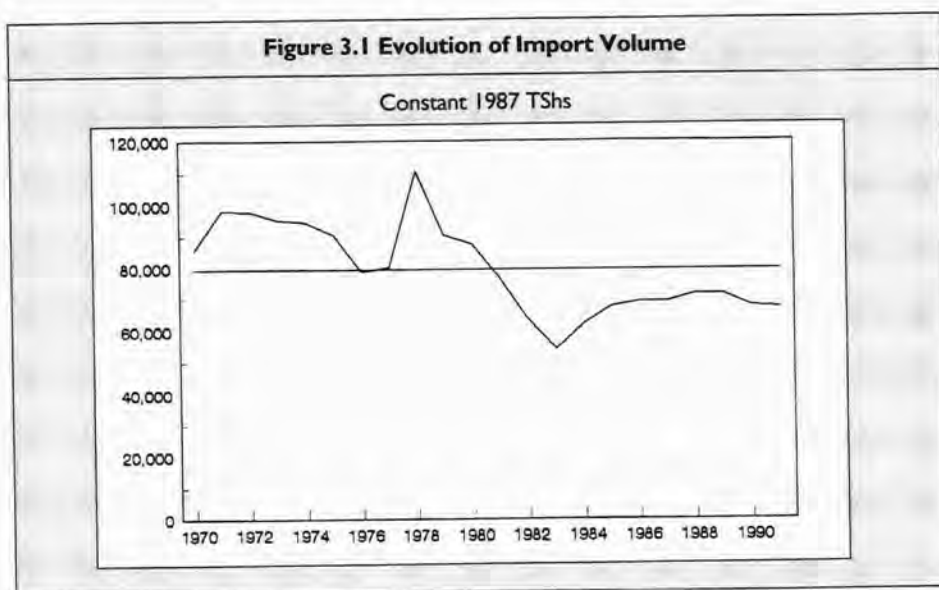
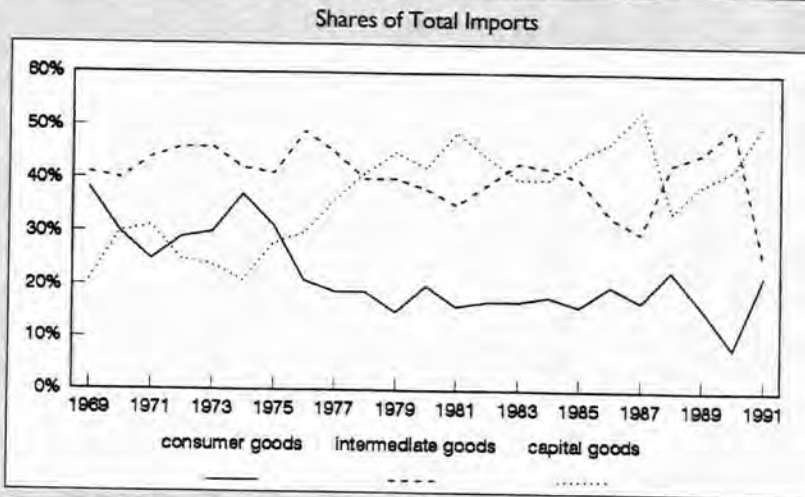


Figure 3.2 Composition of Imports



Source: Bureau of Statistics, Economic Surveys

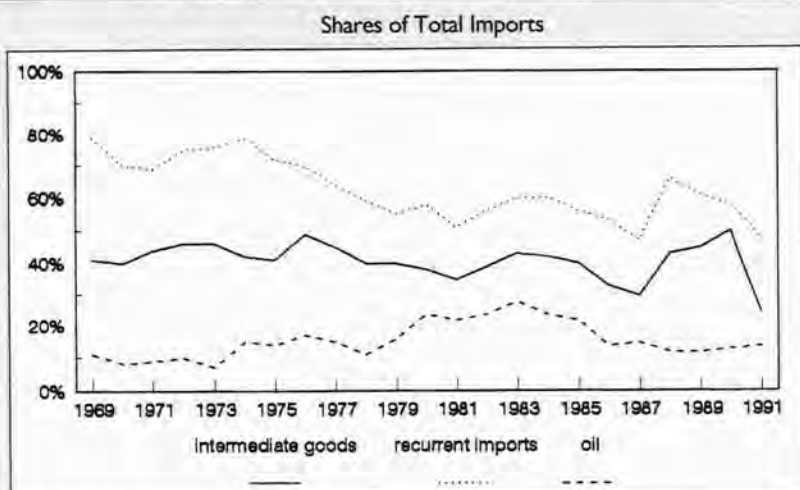
needs to be looked at is not the trend in import volume, but its fluctuations around a long term average as well as its changing composition (consumer, intermediate, and capital goods). As to fluctuations, the graph clearly shows the crisis in import compression during the early 1980s and the subsequent recovery towards its average value.

As far as the composition of imports is concerned, Fig 3.2 presents the overall picture. As can be seen from this graph, the share of capital goods rose steeply during the mid-1970s and remained high thereafter, notwithstanding the crisis years of the early 1980s. The share of consumer goods provides the mirror image: it fell markedly during the mid-1970 and remained low thereafter, while the share of intermediate goods remained largely constant (with some fluctuations).

This constancy of the share of intermediate goods is somewhat misleading. It is important to distinguish between oil imports and other intermediaries. Fig 3.3 provides a close up of recurrent imports (consumer goods and intermediate goods: oil and others). From this graph, it is clear that the share of oil crowded out the share of other intermediate goods during the late 1970s and early 1980s. This was the result of the rise in the price of oil in a situation where demand was inelastic. However, what remains to be explained is that, in this period, the share of recurrent imports actually fell. As we shall see below, this was the result of the economy's increased dependence on aid to finance imports and of the character of the aid provided – i.e. mainly, investment support in the form of project aid.

In short, import volume stagnated over the period as a whole but its composition showed a marked shift towards capital goods from the mid-1970s onwards. Notwithstanding the absence of a trend, there were nevertheless pronounced fluctuations in

Figure 3.3 Composition of Recurrent Imports



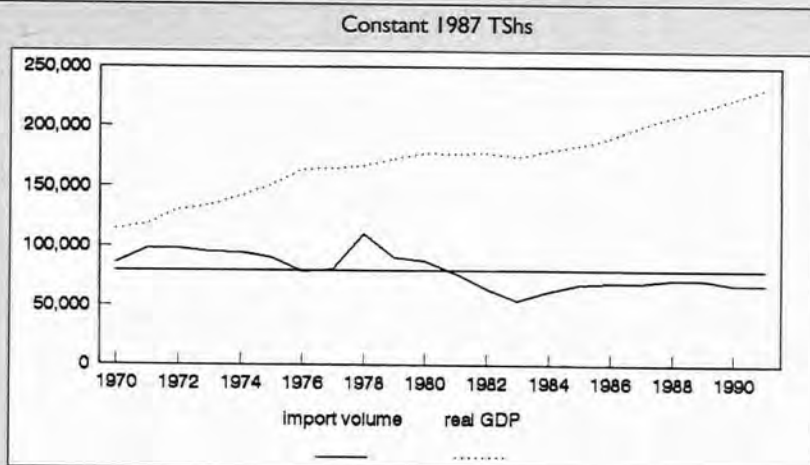
Source: Bureau of Statistics, Economic Surveys

the volume of imports over time. More specifically, the 1980s witnessed both crisis (import compression) and recovery in terms of import volume. For this reason, it is important to look at the 1980s from a longer term perspective. The evolution of import volume since the mid-1980s, taken on its own, gives the false perspective inasmuch as it suggests that the economy became more import dependent, while, in fact, import volume merely regained its previous level.

Against this background of a stagnating import volume, real output (GDP) grew over time, as shown in Fig 3.2. This suggests that, in real terms, the **import coefficient** actually **fell** over time. At first sight, this may appear as a success story of import substitution, although, in actual fact, the truth is exactly the opposite. The import constraint became increasingly more tight and restrictive. The adjusting factor was the sectoral composition of GDP. As will be shown in chapter 5, after an initial phase of manufacturing growth up to the mid-1970s, continued capacity creation in manufacturing jointly with the steep rises in the price of oil led to falling capacity utilisation in industry and, eventually, falling levels of output as well. This situation was only reversed when oil prices fell and the marked shift of aid towards import support, particularly CIS to industry, from the mid-1980s onwards. Hence, in the crisis of the late 1970s and early 1980s, oil crowded out other intermediate goods while capacity creation in industry went at the expense of its utilisation. As we shall argue below, foreign aid played a crucial role in this equation.

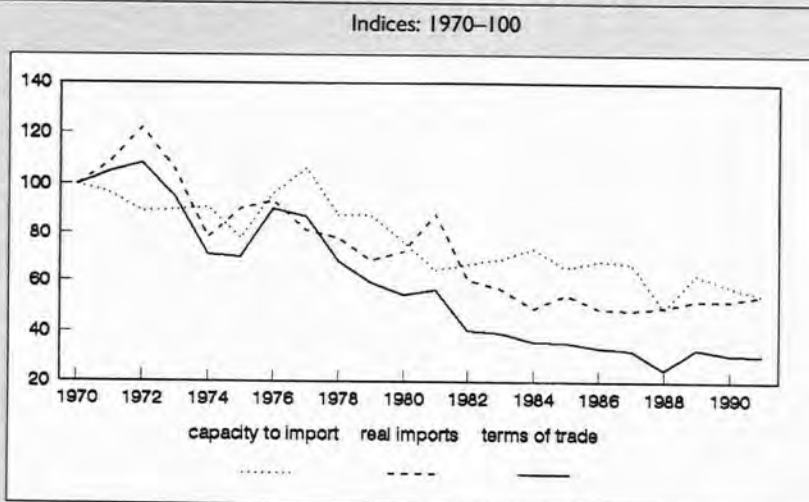
So much for the evolution of import volume. In Tanzania, imports are mainly paid for by exports or by an inflow of foreign saving – particularly, of foreign aid. The extent to which exports can pay for imports depends on the evolution of its volume and of the

Figure 3.4 GDP Growth and Import Volume



Sources: Bureau of Statistics, World Tables and IMF

Figure 3.5 Decomposing Capacity to Import



Sources: Bureau of Statistics, World Tables and IMF

terms of trade. Consequently, the growth in the import capacity of exports – that is, the real purchasing power of exports in terms of the volume of imports it can buy – approximately equals the sum of the growth in export volume and rate of change in the terms of trade. Fig 3.5 gives the evolution of real exports, the terms of trade and the import capacity of exports for Tanzania in the period 1970 to 1991.

As can be seen from this graph, with the exception of 1981, export volumes fell dramatically from the mid-1970s until the mid-1980s, after which it witnessed a modest rise. Hence, during this period, the falling export volumes were a major contributing factor to the collapse in the capacity to import of domestic exports. Since the mid-1980s, however, the modest rise in export production was offset by the falling terms of trade, thereby resulting in a further fall in import capacity.

It appears, therefore, that, with falling capacity to import from exports, the economy became increasingly **reliant** on foreign aid to finance its stagnating (but fluctuating) import bill. This can be seen from Fig 3.6. which plots import volume against real aid. If foreign aid simply were to add to imports, other things being equal, this plot would have a slope of unity (that is, 45°). Hence, if we take the first year (1970) in our data set as the starting point then this line will pass through that point: as seen in chapter 2 real aid has increased substantially since that time so that, other things being equal, we might have expected a similarly large increase in imports. If the points for later years lie above the 45° line this fact indicates that other sources of foreign exchange have increased and years that are below are those for which other sources are less than in the starting year.

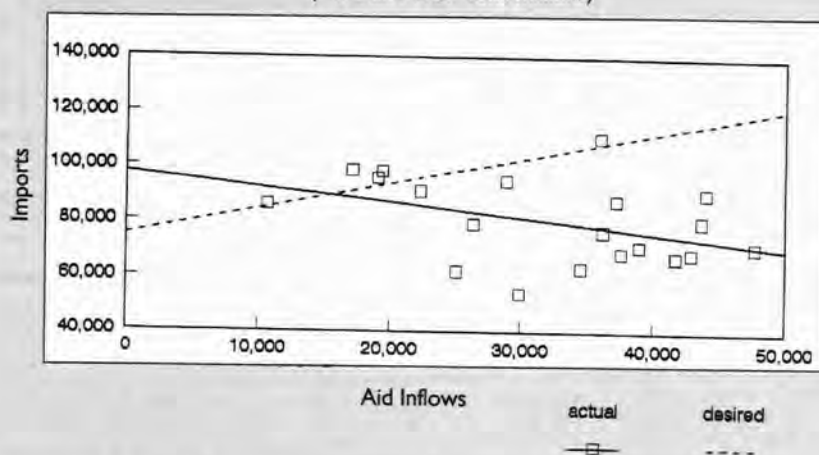
The plot is shown in Figure 3.1. We see that all but three points (which are the years 1971-73) lie below the 45° line – that is the increase in imports has been less than the value of the increase in aid. Indeed, far from having the slope of 1 that we expect if other things remained equal, the fitted line of imports on aid has a **negative** slope: despite the massive increases in aid since 1970 real imports have actually been lower in many years.

In fact, in view of our earlier analysis this result is not surprising. With stagnating import volumes we know that the inflow of aid at most managed to compensate for the secular fall in the import capacity of exports. This raises the important question as to whether this negative relationship between aid and the import capacity of exports is an unfortunate coincidence or whether it manifests causal mechanisms at work. In the latter case, aggregate fungibility would be at work. If so, fig 3.5 suggests that the mechanisms concerned must have been different in the 1970s and the early 1980s (when export volumes fell dramatically) than those at work since the second half of the 1980s (when the falling terms of trade accounted mainly for the fall in the import capacity of exports).

Furthermore, it is clear that for the period as a whole, one of our conditions for the absence of aid dependence is clearly violated: while imports stagnated, the growth in the import capacity of export was persistently negative and, hence, rendered the economy more and more aid dependent. However, whether causal mechanisms were/are at work which made or make the economy aid dependent is still needs to be investigated in more depth. This is the question we turn to next. First we look at the experience of the 1970s.

Figure 3.6 Aid and Imports, 1970-91

(Constant 1987 TShs millions)



Sources: National Accounts, World Tables and World Debt Tables

3.4 The 1970s¹ : Investment Hunger, Project Aid and Import Compression

It is our contention that the **aid-boom** of the 1990s, along with the Tanzanian government's (state-centered) investment policy, contributed significantly towards the crisis the economy subsequently experienced in the early 1980s. Stated differently, the aid-funded investment boom of the 1970s, particularly from the mid-1970s onwards, funded a process of development which undermined its own momentum and, consequently, led to its own demise. Our intention in this section is not to apportion blame, but to derive lessons from this experience which, we believe, continue to be relevant today.

Tanzania's development policy in the 1970s was essentially an **investment** strategy which took little account of its **recurrent** implications – both in industry and in public service. The overall context was rooted in a concept of a developmental state which was to assume responsibility for social and economic development. Its instruments were an expanding civil service financed by the central budget and the development of a parastatal sector in industry and in commerce. Its policy was import-substituting industrialization to be financed largely by cash (export) crop production of the

1) The material elaborated in this section is drawn from the following background papers: J. Doriye & M. Wuyts (1992) *Adjustment and Sustainable Recovery*, SOAS Economics Department Working paper no 6; J. Doriye & Wuyts (1993) *Foreign aid, import constraint and capacity utilisation: the case of Tanzania*, ISS mimeo; and M. Wuyts (1993) *A short Run Macro Model with demand & supply constraints*, technical appendix.

peasantry which was reorganised by ujamaa and, subsequently, the disastrous villagisation policies. These elements of Tanzania's development are well known and it is not our intention to go into much further detail into this overall context.

The point we intend to make, however, is that this particular process of development entailed some real contradictory elements within its own momentum. Essentially, while the budget constraint on investment **softened** throughout the 1970s, the budget constraint on recurrent costs (particularly, but not only, on imported consumer goods, raw materials and spare parts) **hardened** considerably as the decade proceeded. Moreover, the **tightening** of the latter constraint was, in part, the result of the investment **drive** propelled by the **slackening** of the former constraint. In this process, as we shall argue, the **adjusting** variable was the production of export crops which declined significantly in the second half of the 1970s. Furthermore, the steep rises in the price of oil caused a further, contingent hardening of the budget constraint on recurrent imports with fatal consequences. The oil price effectively came to determine the level of industrial output and the availability of consumer goods in the economy (Doriye and Wuyts, 1992). Meanwhile, the investment drive fuelled by donor funded investment support through project aid continued unabatedly, while capacity utilisation in manufacturing fell dramatically (Lipumba et. al., 1988).

Why was the production of export crops an **adjusting** factor in this process? To see this point, it is important to investigate how the demand multiplier effects of investment expenditures interacted with supply constraints in the economy (Wuyts, 1993).

To start with, in the Tanzanian context of the 1970s, the rate of investment was largely determined by the availability of external finance needed to pay for the import costs of domestic investments. In fact, foreign aid sets a limit to the domestic savings ratio if the import capacity of exports fails to expand or, worse still, contracts. A similar argument, formulated rather strongly, was put forward by the authors of the BOT report (1982) as follows:

In the absence of foreign exchange earnings in excess of recurrent import requirements, the 60-70 per cent direct import content of fixed investment will inevitably limit domestic savings to at most 30-40 percent of fixed investment, with their absolute level and ratio to GDP set primarily by availabilities of foreign loans and grants. (p.51: our emphasis).

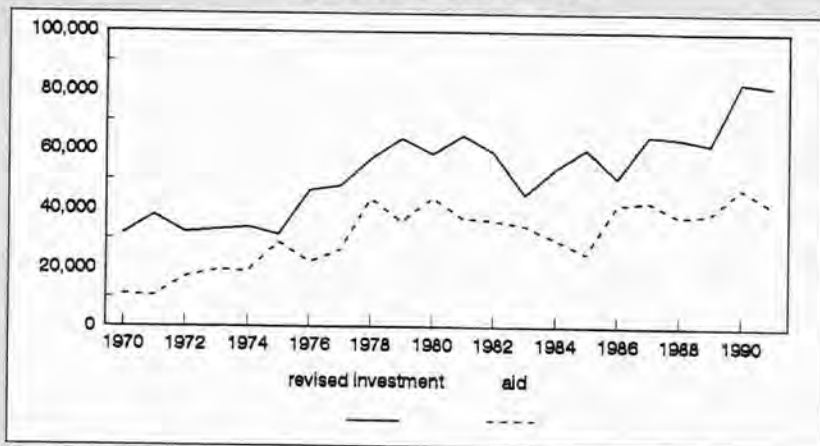
The arithmetic in this argument is not wholly correct since the authors appear to assume that the the availability of foreign aid automatically increases imports by the same extent. This does not necessarily follow. Nevertheless, the important point in the argument is that, in the 1970s, aid as investment support largely determined the level of investment. However, it appears to have been common practice that donors would fund the foreign exchange costs of investment projects, leaving the local counterpart to generate local finance to cover local resource costs. Doriye and Wuyts (1992: 30-32), for example, showed that there was a positive relationship between the level of external loans and grants to the state budget and the level of bank borrowing by government. In the absence of government savings, therefore, an increase in project aid brought

about an increase in the money supply as the government chose to borrow the necessary finance needed to cover local resource costs.

The recently available revision of the national accounts data for the period 1976 to 1985 (Staglin & Komba, 1992) appears to confirm this hypothesis as well. In fact, in the mid-1960s, the investment ratio (investment as % of GDP at market prices) was about 14 to 15%, while the savings ratio (savings as % of GDP at market prices) was about 10 to 11%, leaving a relatively small savings-investment gap of about 4% of GDP. After the Arusha declaration (particularly, during the 1970s) the investment ratio was stepped up. The old national income accounts recorded a rise in the investment ratio from about 14% in the mid 1960s to a peak of 27% in 1971, after which it dropped slightly, to increase again to an average of 25-26% in the late 1970s. However, the revised national income accounts (which involve closer consistency checking between national accounts, input-output data, balance of payments data, and the consumer budget survey) show that the investment ratio in the second half of the 1970s was, in fact, much higher, reaching levels above 30% during the late 1970s and early 1980s, up to 1983 when it dropped dramatically to about 16%. As to savings, the old national income accounts suggest that the savings ratio did not increase that much during the 1970s but was subject to large variations which in part, reflected terms of trade changes. The revised national income accounts, however, give a different picture of the savings ratio in the second half of the 1970s. For example, during the coffee boom of 1976/7, the savings ratio peaked at 25 to 26%, subsequently declined to still high levels within the 18 to 22% range up till 1981, after which the savings ratio collapsed down to 9% in 1985. As discussed in chapter 1, the period of the 1970s (and, particularly, in the second half of the 1970s) witnessed a pronounced aid boom fuelled by investment support.

Figure 3.7 Comparing Aid with Investment

1976-85 Revised Investment Series



Sources: World Tables and Revised National Accounts

This is shown in Fig 3.7. The availability of foreign finance fuelled the necessity to generate more local savings to finance local resource costs of the investment drive. Consequently, the savings ratio moved up along with the investment ratio.

The argument made above points at an inevitable consequence of an import substituting industrialisation strategy (or, for that matter, any other strategy) which fails to expand its export base, whether in agriculture or in industry, yet remains import dependent for its very successfulness. However, the argument, particularly as put forward in the quote from the BOT report, seems to suggest that the **recurrent import requirements** are somehow **given** in advance independently of the **level** and **rhythm** of domestic investment. This overlooks two important factors which affect the level of recurrent import requirements.

First, as new investments materialise and come on stream, recurrent costs (including recurrent imports needs), inevitably follow in its wake. Consequently, as the process continues, capacity creation will increasingly take place at the expense of its utilization if the import capacity of exports is constrained.

Secondly, and importantly, investment produces multiplier effects (either quantity or price multipliers, or a combination of both) which affect the level of **recurrent** spending, including imports. For example, an investment project which employs workers to build a railway will lead to increased demand for consumer goods as wages are spent in shops. This, in turn, necessitates the production of consumer goods which will stimulate further demand. Similarly, building materials bought locally for construction will boost income and, therefore, expenditures on consumer goods on the part of workers in the construction industry. Consequently, the level of recurrent spending (including the demand for recurrent imports) depends on the **level** of investment. Obviously, the multiplier effects in the domestic economy will be larger, the **lower** the direct import costs of investment projects. But even with 60 to 70% import content of investment, the multiplier effects generated by such investment **cannot be ignored** for two reasons which we shall now discuss.

First, the authors of the BOT report probably ignored the multiplier effects of investment on recurrent imports because these effects were, in part, **neutralised** through increasing **quantitative restrictions** on imports. As pressure on imports mounted, the lid on import demand was held on tight by restricting imports to those demands deemed essential. Therefore, imports were delinked from their dependence on the level of investment by cutting off demand. This provides grounds for the **illusion** that demand multiplier effects could conveniently be ignored in a supply constrained economy. Note, however, that, in a context of import liberalisation, it is important to take explicit account that investment projects inevitably imply a greater need for **derived** indirect imports of consumer goods or raw materials (Wuyts, 1993).

Second, as argued above, the multiplier effects emanating from the investment drive also increase the demand for domestically produced consumer goods (both food and manufactured consumer goods). Whether this increased demand meets with

increased supply or merely pushes up the price of consumer goods (in official or in parallel markets) depends on the effective supply elasticities in the sectors producing consumer goods. As far as manufacturing was concerned, initially capacity expansion through import substituting industrialisation provided the basis for a supply response. However, progressively, capacity creation went at the expense of its utilisation. The steep successive rises in the price of oil hardened the budget constraint on imported intermediate goods (and, hence, constrained local production) while investment, propelled by foreign aid, went on unabated. The result was falling capacity utilisation and, eventually, falling output levels in manufacturing (Doriye and Wuyts, 1993).

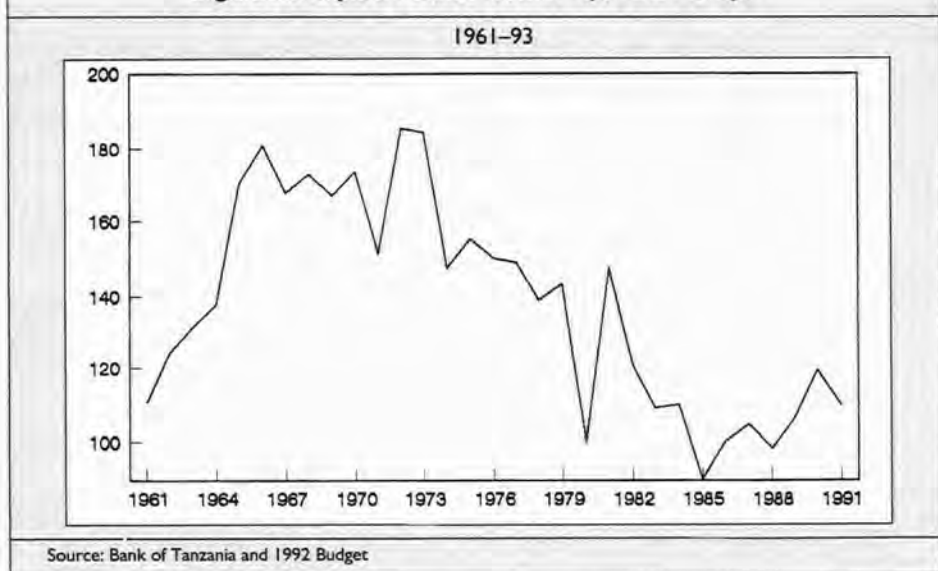
As to the supply of food, agricultural policy in the immediate post-Arusha period strongly favoured cash crops at the expense of food crops (Loxley, 1975; Raikes, 1986). This may appear puzzling in the light of the so-called "anti-export bias" of Tanzania's development strategy in the 1970s. It is important, however, to distinguish between policy intentions and its unintended outcomes. In the early post-Arusha years, the role of agriculture was, in part, seen to provide the necessary finance for the process of industrialisation and, hence, the production of export crops was a primary goal. Investment, however, concentrated on import substituting industrialisation and, hence, did not favour agriculture. This may account for the limits imposed on the overall supply response in agriculture. But there were also substitution effects at work. The very process of an investment drive in import-substituting industrialisation ended up by eroding the export capacity of the economy. To see this, it is necessary to take account of the multiplier effects of investment on the demand for food. For example, according to the revised national income accounts, direct private consumption expenditures on agricultural products accounted for about 43% of all private consumption expenditures. The rapid expansion of urban employment provided the basis for the increased demand for marketed food surpluses. In fact, the food crisis of 1974/5 gave the first warning signs which subsequently prompted agricultural policy to shift more in favour of food crop production by raising official food prices relatively to those of cash crops. However, as Raikes (1986, 122) pointed out:

*Official price policy is said to have favoured food crops since the mid-1970s and this has been held responsible for falling export crop production. But the real incentive to substitute food for export crops is more likely to have been the difference between the official price for export crops and the **unofficial** price of food crops.²*

Raikes did not fully explain, however, the macroeconomic process which fuelled the demand for food and propelled this growth of the parallel economy. In our opinion, this can only be done if the demand implications of the investment drive (fuelled by foreign aid) which aimed to '**force the pace**' are fully taken into account.

2) Lipumba and Ndulu (1989) provide interesting econometric evidence as to the role played by relative prices of food vis a vis cash crops in reducing the production of the latter. They show that the supply of export crops depended principally on the real exchange rate, the weather conditions and, importantly, on the relative price of cash crops vis a vis food crops.

Figure 3.8 Export Volume Index: Major Cash Crops



Consequently, price inflation in the official and, more importantly, the parallel markets of food dramatically shifted relative prices in favour of food crops. Furthermore, export producers were confronted with a virtually fixed nominal exchange rate while the real exchange rate appreciated markedly as inflation accelerated. Not surprisingly, as shown in Fig 3.8, export production fell significantly from the mid-1970s onwards as producers switch towards the production of food crops. Note that we are not arguing that the peasantry retreated into subsistence as incentives were blunted. Rather, the argument is that the peasantry responded to changing relative prices by shifting into the production of food, particular for the parallel markets. Nor do we deny that the lack of investment in agriculture as well as adverse institutional factors (such as the ill-conceived villagisation campaign) did not adversely affect agricultural production as a whole. Our argument is that, in the process, export production bore the brunt of the adjustment to a high rate of investment.

The investment drive, therefore, set in motion forces which ended up by eroding its own foundations. In this sense, a peculiar type of '**Dutch disease**' was at work in the Tanzanian context. Investment propelled by foreign aid necessitated a future flow of recurrent imports. However, the same process eroded the production of export crop production and, therefore, tightened the constraint on recurrent imports. The steep rise in the price of oil at the end of the 1970s merely gave the '**coup de grace**' to a process the momentum of which was unsustainable. The result was that the subsequent contraction in the supply of incentive goods meant that the state lost its capacity to organise a meaningful exchange with the peasantry.

What then are the lessons we can draw from this experience with respect to the role of foreign aid?

First, with the exception of food aid and the emergence of limited import support in the late 1970s, aid basically consisted of investment support in the context of project aid. Foreign aid, therefore, eased the budget constraint on investment but, in the process, contributed to a **hardening** of the budget constraint on recurrent imports and, hence, manufacturing output. This explains why, in section 3.3, we observed that the share of recurrent imports in total imports actually fell at a time (late 1970s; early 1980s) when goods scarcity turned into a veritable goods famine. Capacity creation in manufacturing went hand in hand with its **lower** utilisation. Perhaps this experience calls into question any attempts to **force the pace** with an investment strategy (relying on foreign aid) which does not take account of its recurrent implications.

Second, the going practice seems to have been that donors financed the **direct** import costs of investment, leaving the recipient country to finance local costs. This posed two severe problems.

- (1) In conditions of a hard foreign exchange constraint on recurrent imports, this type of aid ignores the **indirect** effects of such investment on import demand for consumer goods and raw materials. In Tanzania, in the 1970s, this demand was choked by increasing quantitative restrictions on imports. In conditions of import liberalisation, however, this option is not feasible and, hence, the multiplier effects on imports of increased investment cannot be ignored.
- (2) If the recipient government lacked sufficient savings to match local resource costs of the aid project, the policy choice is between refusing project aid or financing its local costs by inflationary means. Invariably, it seems, the latter road was chosen which rendered the money supply endogenous to the supply of aid funded investments. Similarly, the savings ratio becomes endogenous to the supply of foreign project aid and, effectively, private consumption expenditures becomes the adjusting item.

Third, it is important to distinguish between policy design and its often **unintended** outcomes. As we have seen, in the case of Tanzania, the emphasis on export production was an essential part of the strategy of import substituting industrialisation. What was overlooked, however, were the mechanisms through which the investment drive (which did not principally concern agriculture) produced demand effects which shifted agricultural output away from export production and towards the production of marketed surpluses of food. A conscious investment strategy which largely ignored agriculture combined with its unintended outcomes in terms of shifting relative prices in favour of food crops and shifting the supply of food away from official markets jointly accounted to a considerable extent for the erosion of the import capacity of domestic exports.

Fourth, it is easy to see how the shift towards commodity import support can ease the tension inherent in this momentum. On the one hand, insofar as it implies a

reduction in the rate of investment, it eases the pressure on demand. On the other hand, by increasing recurrent imports, it allows a recovery in manufacturing output in particular, and in the supply of incentive goods in general. This, in turn, gives substance to the exchange with the peasantry and, hence, can stimulate the production of marketed surpluses of food and of export crops. This is indeed what CIS intended to achieve and appears to have achieved in the second half of the 1980s.

Finally, what does this add up to in terms of the question of aid dependence? In fact, both conditions for the absence of aid dependence were essentially violated. While it is true that the savings ratio rose over time, it did so because it had become endogenous vis a vis the investment ratio (which, in turn, depended on the inflow of aid). Savings followed the rhythm of investment but did not close the gap. Furthermore, and importantly, the high rate of investment (propelled by foreign aid as investment support) eroded the capacity of the economy to expand its export volumes to pay for import needs. The net result was increased aid dependence of which the need for import support was the clearest manifestation.

3.5 The Shift to Import Support: Tactic or Strategy?

The 1980s witnessed a pronounced shift towards import support as the principal form of foreign aid. This section poses the question as to whether this should be seen as a temporary tactic or a step in the direction of a new strategy.

Obviously, at one level, as explained above, the shift to import support was a necessary temporary (tactical) measure to provide breathing space for an import-starved economy, particularly with respect to recurrent imports. As argued above, import support, in this case, eased the tension between capacity creation and its utilisation by shifting the balance in favour of the latter and, thereby, increasing the supply of commodities in the economy. This, jointly with increased imports of consumer goods, enabled to establish a more meaningful exchange with the peasantry which, in turn, stimulated agricultural production. The breathing space, thus provided, allowed the economy to adjust to more market-based policies which aimed/aim to restructure its future potential. To the extent that these policies actually work and, hence, export production picks up, the question is whether foreign aid should subsequently revert to its traditional form of project aid or assume new forms which provide greater market-based flexibility in aid allocation.

Indeed, it can be argued (see, for example, SIDA's report on the Principles of Import Support) that the shift towards more market-based policies also necessitates a different, more market based approach to foreign aid. In fact, the traditional form of project aid was characterised by the following basic features:

- (1) it concerned investment support;
- (2) it aimed to support public investment; and, finally,
- (3) it was considerably donor steered and rooted on administrative allocation.

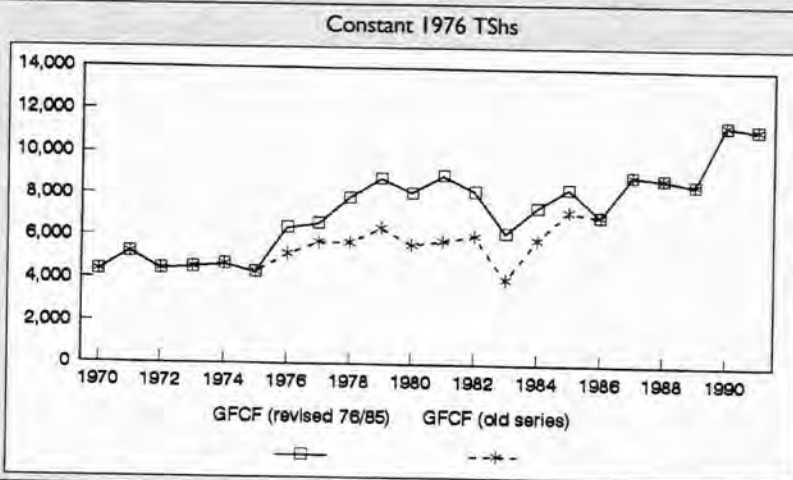
The present phase of structural adjustment, in contrast, puts the emphasis on market-based programme aid which supports the overall policy context and direction. The underlying assumptions of the policy package are therefore the following:

- (1) that market-based policies will enhance export production and lead to the growth in domestic import capacity;
- (2) that the principal agent to effect this change is the private sector rather than the state or the parastatals;
- (3) and, finally, that donors should seek to enhance market-based allocation of aid resources by putting resources principally behind private sector development while, at the same time, reducing the public sector deficit.

Put differently, the private sector should be the main beneficiary of the resource transfer, yet pay full cash cover to ensure that resources are efficiently allocated, while the allocation of counterpart funds to the government budget should enable the state to reduce its deficit (rather than boost expenditures or reduce taxes). The price mechanism then should ensure that resource allocation favours the recovery and growth of export production as well as stimulate private investment and savings. These are the essential elements of the policy design behind structural adjustment. The move from CIS (which largely retained the principle of donor-led administrative allocation) to the more market-based OGL system is a reflection of this approach to economic policy.

Of critical importance to this strategy is the actual behaviour of the private sector and its impact on the future evolution of the import capacity of exports. Data are scarce and often unreliable on this issue, but some indications can nevertheless be obtained with respect to present trends in private sector investment and activity as well as on export growth and its composition.

Figure 3.9 Gross Fixed Capital Formation



Sources: Bureau of Statistics, Revised National Accounts

The changing structure of investment

The period since the mid-1980s witnessed a steep rise in real investment, both in absolute terms and as a share of GDP as can be seen in Figure 3.9 and Figure 3.10. Fig 3.9 shows the evolution of investment as recorded by the standard series (1976-1991) of the national accounts as well as by the revised accounts for the period 1976-85. As can be seen from the graph, the revised series show a higher level of investment, particularly in the late 1970s and early 1980s, although the gap narrows towards 1985. Fig 3.10 and subsequent data in this section uses the old series (1976-1991) to maintain consistency across the period as a whole. In terms of shares of GDP, the series in current prices rose much more markedly than the one in constant prices. The reason is that investment depends to a large extent on imported goods. Consequently, the depreciation of the real exchange rate which changes domestic relative prices between traded and home goods leads to a steeper rise in the investment ratio than its growth in real terms would suggest.

The most striking feature of investment behaviour in recent years, however, is the changing balance between public and private sector capital formation. As can be seen from Figure 3.11, up to the early 1980s the share of the public sector (government and parastatal) in total capital formation was consistently more than half (55 per cent to 59 per cent). (Note, however, that the revised series of the national income accounts puts the share of private investment higher than that recorded in the old series. Since data for this revised series are not available since 1985, however, it is best to look at trends in overall composition of investment using the old series.) From 1984 onwards, however, the share of the private sector in total investment rose markedly to well over 60 per cent (with the exception of 1988 and 1989 when major parastatal investments took place), reaching nearly 70 per cent in 1990 and 1991. As to the public sector, the

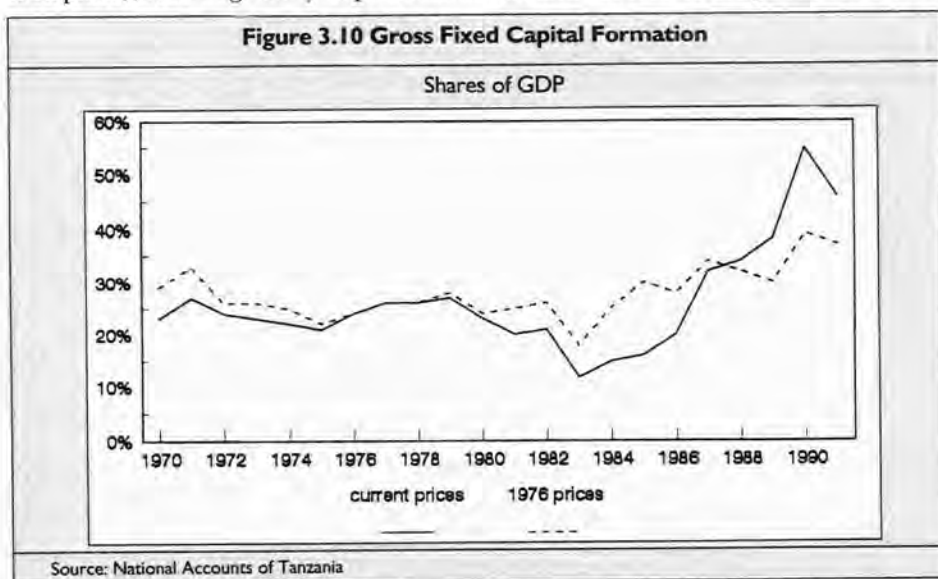
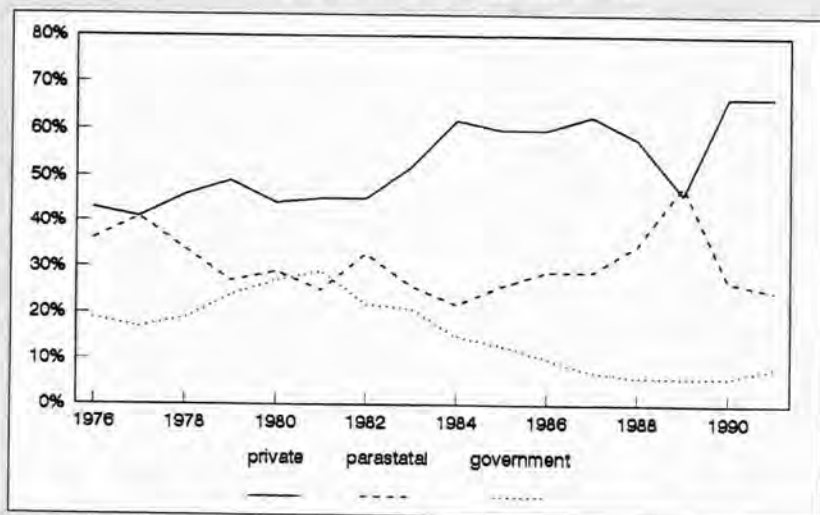


Figure 3.11 Public and Private Investment

Percentage of Gross Fixed Capital Formation



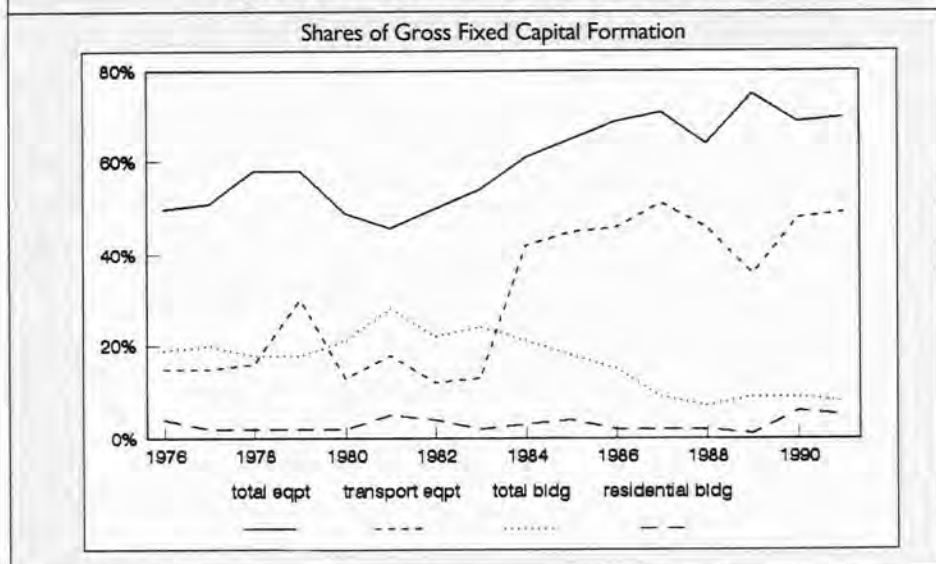
pattern of investment differed between government and parastatals. The share of government in total investment rose in the late 1970s from about 20 per cent to 29 per cent in 1981, and subsequently fell steadily to in between 6 per cent to 8 per cent at the end of the decade and early 1990s. The share of parastatal investment (the gap between total public sector and government investment) did not witness a similar decline (in fact, it rose significantly in 1988/9). Therefore, in the adjustment process in the 1980s, it was government investment which gave way to private and parastatal investment.

The question now arises as to how this change in quantity and composition across the public/private divide affected the nature of investment. This question can be answered in two ways: by looking at the changing pattern of investment in terms of type of asset (buildings; equipment; other works) and of sectoral composition (agriculture, manufacturing, etc).

As to the investment patterns across types of asset, Figure 3.12 shows the pronounced shift towards a greater share of investment in equipment in total investment: this share rose from 50 per cent in the mid-1970s to about 70 per cent in the late 1980s and early 1990s. Most equipment is imported and, hence, the increase in the share of equipment is, in part, also due to the depreciation of the real exchange rate (which increase prices of traded goods relatively to non-traded goods, of which local construction materials is an important component as far as investment is concerned.) Note, however, that investment data are rather shaky and derive mainly from import statistics plus data on local cement production.

However, undoubtedly the dominant feature in the changing patterns of investment is the shift towards investment in **transport** equipment. Its share in total

Figure 3.12 Capital Formation by Type of Asset

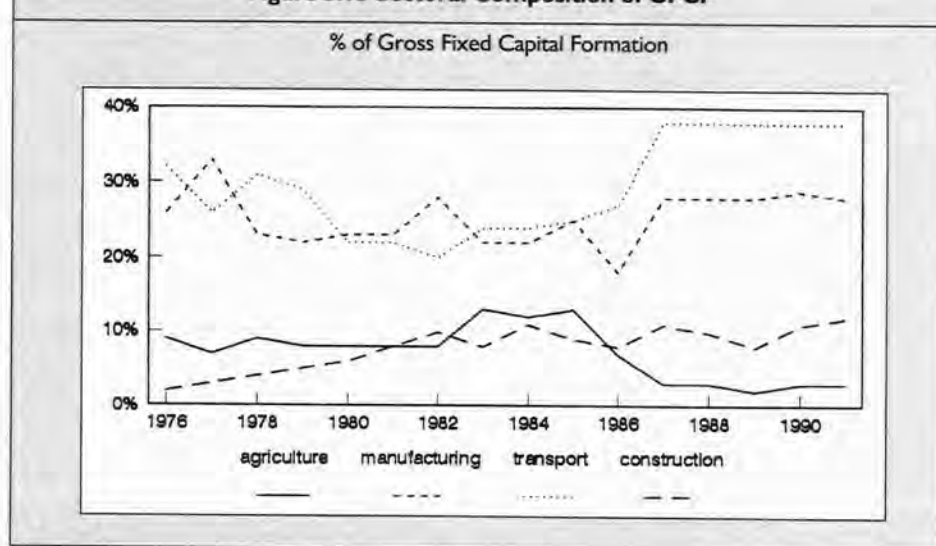


investment increased from about 15 per cent during the period 1976-83 to close to 50 per cent by the early 1990. Consequently, while the share of transport equipment rose steeply, the share of other equipment actually fell since the mid-1980s (with exception of 1989 when parastatal investment boomed). There is, therefore, undoubtedly a strong relationship between the shift from public to private investment and the shift towards investment in transport equipment. This might be an indication that the investment boom is mainly oriented towards more quick-yielding commercial investments (where transport equipment plays a major role) rather than more long run production-oriented investments. However, this boom in transport investment is probably not surprising given the the critical importance of this sector in the Tanzanian economy.

As to investment in other assets, the share of building dropped consistently since 1982 and subsequently levelled off by the early 1990s. Interestingly, however, within this category, residential buildings increased markedly in the early 1990s. Consequently, the share of residential building in total building rose markedly in the early 1990s. This also indicates that private investment, at least in part, appears to go towards quick-yielding ventures: building residential housing for purpose of charging rent rather than investing in productive capacity. The remaining category, other works (land improvements, roads and bridges, water supplies, etc), declined as a share in total investment in the mid-1980 and, subsequently, returned to its prior level.

As far as sectoral allocation of gross fixed capital formation is concerned, the shift towards transport is equally marked as is clear from Figure 3.13. Manufacturing roughly maintained its relative share, while construction, after its secular rise during the 1970s,

Figure 3.13 Sectoral Composition of GFCF



levelled out from 1984 onwards. Perhaps the most remarkable aspect is the dramatic fall in the share of agriculture in total investment since the mid-1980s. It dropped from a level of about 10 per cent during the 1970s and early 1980s to 2 per cent to 3 per cent in the period since 1987. Hence, the figures (shaky as they are) tend to indicate that **investment did not move towards agriculture at all**. This, in itself, is more worrying since it appears to accentuate the earlier trend away from investment in agriculture characteristic of the 1970s. As noted by Badhuri et al (1993), greater availability of incentive goods along with better weather conditions in recent years probably accounted for the expansion in agricultural output, but little investment appears as yet to take place to consolidate future output expansion.

While investment (particularly, private investment) increased, both in volume and as a share in GDP, there appeared to have been no commensurate increase in the savings ratio which remained historically low (10% of GDP or less) throughout the whole period of structural adjustment. Hence, the savings gap widened considerably throughout this period and, as yet, there is no indication of any reversal of this trend.

Informal sector activity

One aspect of Tanzanian economic development is the importance and evolution of the informal sector in the economy at large. Despite some interesting earlier academic work (Maliyamkono and Bagachwa, 1990), the dynamics of this sector remained largely unknown due to severe lack of reliable data. Recently, however, a first comprehensive sample survey of the Informal sector (excluding rural agriculture) has been completed for the year 1991 (Planning Commission & Ministry of Labour and Youth Development, 1993). This throws some light on the structure of this sector, but obviously it gives us as yet little idea about its underlying trends since it concerns a cross section analysis.

Table 3.1 Informal Sector Total Gross Output and Value Added (Rural and Urban) by Industry Group									
Industry Group	Share of Number of Enterprise	TShs million			TShs			Official Formal Economy's Value added	Inf. Sect. as % of Official GDP (1991)
		Annual Gross Output	Annual Value Added	Average Gross Output	Average Value Added	TShs Mill.			
Agric. & Fish	142 109	35 036	20 447	246 542	143 879	358 693	5.7		
Mining & Quarry	17 139	1 665	1 159	97 151	67 634	6 975	16.6		
Manufacturing	439 540	59 396	29 800	135 132	67 798	20 680	144.1		
Construction	116 496	14 577	10 864	125 128	93 256	14 416	74.4		
Trade/Rest/ Hotels	933 915	344 234	104 727	368 592	112 137	83 325	125.7		
Transport	49 379	13 796	6 114	279 399	123 814	47 017	13.0		
C.&P. Service	102 965	18 165	10 307	176 420	100 100	3 619	184.8		
Other	0	0	0	0	0	38 811			
Total	1 801 543	486 869	183 417	270 251	101 811	573 536	32		

Sources: 1991 I.S. Survey Data; Tanzania Economic Trends Vol. 5 Nos. 1 & 2, 1992

Sources: 1991 LS Survey Data; Tanzania Economic Trends Vol. 5 Nos. 1 & 2, 1992

What follows is a brief **summary** of key findings of this report (particularly, of chapter 3) insofar as it concerns our purposes here.

According to this survey, the value added of informal sector activity, thus defined (i.e., not including rural agriculture), amounts 32% of officially recorded GDP. At a value of TShs 489.9 billion, this is considerably more than the entire gross output of the

parastatal sector which was equal to T.shs 336.1 in 1991. In some key sectors, informal sector value added exceeds the value of added of the officially recorded economy by a significant margin: manufacturing (144% of official manufacturing GDP); trade, restaurants & hotels (125.7%) and community and private services (284.8%) (see Table 3.1). Interestingly, after trade, restaurants & hotels (57% of informal sector value added), manufacturing is the second largest sector with 16% of informal sector value added. (Ibid:pp. 1-14/15)

Employment patterns in the informal sector give us an insight into the more detailed type of activities in this sector. The leading business is the sale (and preparation) of local beer which alone provides 15% of all employment in the sector. Manufacturing of wood products comes second with 7% followed by little stalls selling roasted meat or fish with 6%. Patterns differ geographically: in Dar Es Salaam, the main business is the sale of cooked food which employs 15% of total informal employment in this town. Other main activities in Dar are restaurants, food stalls, fruits/vegetable sales and urban agriculture, including livestock. In other urban sectors, livestock keeping and urban agriculture employ the same proportion as cooked food in Dar. In rural areas, the sale of local beer leads with 18%. Other main activities in rural areas are fishing, manufacturing of wood products, mats plus fibre products and masonry. (Ibid: pp. 1-7/8)

Obviously, the distribution of activities across employment does not necessarily reflect its distribution in value added or gross output since productivity can be widely divergent across activities, establishments and localities (see Table 3.2). In general, labour productivity is higher in urban than in rural areas: average value added was Tshs 110,700 in urban areas as against Tshs 50,300 in rural areas. Not surprisingly, however, rural productivity is higher in agriculture and fishing as well as in mining and quarrying. These activities are clearly more local resource-based. As to urban areas, some activities like agriculture and fishing, mining and quarrying, construction and personal services show higher value added per person than the formal parastatal sector!

Although the urban areas account for only 11% of the total population, urban value added in the informal sector nevertheless accounts for 60% of its value added and hosts 36% of all establishments. The report lists two possible reasons for this pattern. First, both government (e.g. SIDO, NBC, CRDB) and NGOs who support this sector to some extent appear to prefer urban-based activities for reasons of ease of monitoring or less administrative costs. Secondly, urban locations offer infrastructural advantages with easier access to industrial inputs (**especially imports**) and more guaranteed markets. (Ibid. p. 1-15).

Unfortunately the informal sector survey does not allow us to assess the extent to which this sector is dependent on imports since the survey only records from **whom** informal establishments obtain their inputs, but not from **where**. Hence, for example, petrol bought at the local petrol station is recorded as a local supply rather than as an imported input. Clearly, a large part of informal sector activities (particularly rural but also a significant part of urban) depend on local resources or local industry, but an

Table 3.2 Informal Sector – Value Added Per Person

	Informal Sector (1991) Total Value Added ('000)	Total Employment	Value Added per Person	Parastatal Sector (1991) Value Added per worker
TOTAL	183 416 866	2 451 753	74 800	
Agri. & Fish	204 46 486	247 514	82 600	
Mining & Quarry	1 159 185	24 540	47 200	
Manufacturing	29 799 999	545 395	54 600	
Construction	10 863 981	167 790	64 700	
Trade/Rest./Hot.	104 726 664	1 249 501	83 800	
Transport	6 113 796	79 137	77 300	
C & P. Services"	10 306 755	137 876	74 800	
URBAN				
Total	110 027 991	994 094	110 700	685 680
Agr. & Fish	9 471 158	136 925	69 200	66 600
Mining & Quarry	894 073	20 219	44 200	38 477
Manufacturing	144 635 337	128 169	112 800	244 671
Construction	6 484 405	52 418	123 700	88 898
Trade/Rest./Hot.	68 507 063	580 981	117 900	1 369 548
Transport	3 184 298	12 338	258 100	722 491
C & P. Services	7 023 457	63 044	111 400	100 262
RURAL				
Total	73 388 775	1 457 659	50 300	
Agri. & Fish	10 975 328	110 589	99 200	
Mining & Quarry	265 112	4 321	61 400	
Manufacturing	15 336 462	417 226	36 800	
Construction	4 379 576	115 372	38 000	
Trade/Rest./Hot.	36 219 601	668 520	54 200	
Transport	2 929 498	66 799	43 900	
C & P. Services	3 283 298	74 832	43 900	

Source: Tanzania: The Informal Sector 1991, p. 1-27.

important part of urban-based activities will undoubtedly depend on imports (particularly, own-funded imports?) as well.

On the other hand, as could be expected, the informal sector (apart from some parts of mining) appears to show little export orientation. By and large, it concerns activities directed to local markets. Perhaps a further reason for this local focus is that the sector at large employs little capital. In general, fixed investment per establishment in informal sector activities tends to be very low and, equally, often very small amounts of working capital are turned over. In fact, the estimated gross fixed capital formation

Table 3.3 Informal Sector – Gross Output Per Unit of Investment

Total	Gross Output	Total Capital	Gross Output Per Unit of Investment
	('000 Tshs)	('000 Tshs)	('Tshs)
TOTAL	486 868 880	55 880 106	8.7
Agr. & Fish	35 305 809	5 162 083	6.8
Mining & Quarry	1 665 071	135 923	12.3
Manufacturing	59 395 778	10 404 870	5.7
Construction	14 576 855	1 316 091	11.1
Trade/Rest./Hot.	344 233 889	25 395 473	13.6
Transport	13 796 431	10 180 162	1.4
C. & P. Services	18 165 047	3 285 504	5.5
URBAN			
Total	310 976 086	25 822 565	12.0
Agr. & Fish	17 771 056	2 789 396	6.4
Mining & Quarry	1 074 834	110 694	9.7
Manufacturing	32 432 771	5 129 423	6.3
Construction	9 320 009	763 587	12.2
Trade/Rest./Hot.	229 725 042	12 376 549	18.6
Transport	7 546 504	3 117 930	2.4
C. & P. Services	13 105 870	1 534 986	8.5
RURAL			
Total	175 892 794	30 057 541	5.9
Agr. & Fish	17 264 753	2 372 687	7.3
Mining & Quarry	590 237	25 229	23.4
Manufacturing	26 963 007	5 275 447	5.1
Construction	5 256 846	552 504	9.5
Trade/Rest./Hot.	114 508 847	13 018 924	8.8
Transport	6 249 927	7 062 232	0.9
C. & P. Services	5 059 177	1 750 518	2.9

Source: Tanzania: The Informal Sector 1991, p. 1-27.

of this sector was only 2% of total official capital formation for the entire economy, although – as the report points out- this is probably an underestimate (since investments in buildings, livestock and construction may have been underrecorded). (Ibid: 1-14/5)

Table 3.3 gives the gross output per unit of investment (fixed and working capital) for informal sector activities. In urban areas the productivity of investment is highest in construction and least in transport. In rural areas it is highest in mining and quarrying and lowest in transport. The reason for the low score of transport is that it requires relatively more fixed investment than other sectors. Comparing tables 3.2 and

3.3 we note that both investment productivity and value added per person for the transport sector is higher in the urban than in the rural areas. This suggests that the more expensive investments in this sector (imported vehicles rather than push carts) may well be concentrated in the towns. (Ibid: 1-18)

Finally, a word of warning. The survey data give us a better idea of the importance of the informal sector in the economy but, obviously, they cannot throw much light on its growth in recent years. Hence it would be wrong to see these data as reflecting a newly emerging growth area which before did not exist. It is likely that the sector grew significantly in recent years but it is impossible to derive its rate of growth from cross section data.

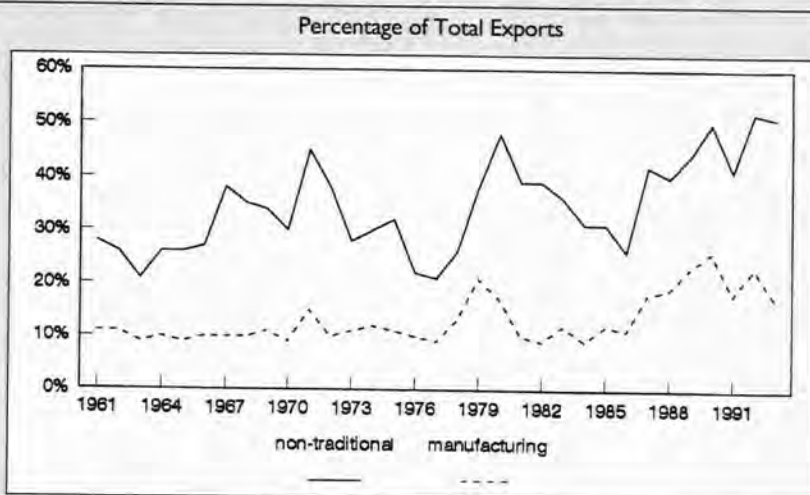
Export performance and aid dependence

As stated earlier, the period of structural adjustment reversed the downwards trend in the volume of exports and witnessed a modest revival of the country's export production. This is true both for exports in general (see Fig 3.5) as well as for exports of the major cash crops (see Fig 3.8). There is, however, a problem with the data since a significant amount of exports may well go unrecorded. For this reason, the World Bank suggests that own-funded imports are in fact mostly paid for by unrecorded exports and, hence, exports should be increased accordingly. This assumption may well be correct and, if so, the export to import ratio improves considerably. However, this argument is irrelevant as far as an analysis of **trends** in export volumes is concerned. Indeed, own-funded import (which started in 1984 as a result of liberalisation measures) have remained relatively constant in dollar terms (\$ 400 million) and, hence, probably declined slightly in volume. Hence, since 1984 there has been no noticeable trend in this category. As to the period before 1984, such unrecorded exports may well have taken place but did not, at the time, result in imports. Hence, it is impossible to assess whether exports expanded in 1984 as a result of the liberalisation measures or not.

Import capacity of exports failed to recover because of adverse movements in the terms of trade during the period concerned. Whether this is mere coincidence or the result of causal mechanisms is hard to assess at this time, but the possibility of the latter hypothesis cannot be easily dismissed.

Indeed, it can be argued that if a large number of countries all pursue export promoting policies involving the same limited set of primary commodities, the final outcome may well be a fall in the prices of such commodities (and, hence, a fall in their terms of trade). This is the 'fallacy of composition' argument which cautions against export promotion with a narrow specialisation in a small range of primary commodities. The World Bank's counterargument that African countries should try to **regain** their **relative** market shares for these respective commodities does not invalidate the 'fallacy of composition' argument which is derived from the consequences of an absolute expansion of supply. In the case of Tanzania, it seems prudent, therefore, to pursue a policy of diversification in export promotion.

Figure 3.14 Non-traditional & Manufacturing Exports



Source: Bank of Tanzania and 1992 Budget

This raises the question as to the performance of non-traditional (particularly, manufacturing) exports in the recent period. Fig 3.14 sheds some light on this issue. Again, once more, a long term trend provides a better picture than merely looking at the evolution of non-traditional exports in the 1980s. It is clear that the exports of non-traditional and of manufacturing goods have grown more rapidly since the crisis years 1981-84. However, if we look at it from a more longer run perspective, we note that the growth in the share of export of non-traditional and manufacturing goods in total exports is present but not not all that impressive. The late 1970s witnessed a growth in the exports of manufacturing goods, but, subsequently, this process was markedly interrupted in the crisis years. Part of the growth of manufacturing exports in the second half of the 1980s, therefore, was in fact a recovery to a level (expressed in % share of exports) existing before the crisis itself. Hence, the extent to which there are real signs of diversification is as yet hard to assess. This raises the question whether such diversification can be expected to come about spontaneously in response to market forces or whether there is a need for an explicit industrial strategy backed by public investment to create an **enabling environment** for export-oriented private manufacturing industry.

Finally, as to the problem of aid dependence, our analysis leads us to conclude that there are **as yet** no signs that the conditions for avoiding such dependence are satisfied. The saving ratio remains low relatively to a high rate of investment and the import capacity of exports continued to decline during the period of structural adjustment.

IMPORT SUPPORT: EFFECTS ON BUDGET AND CREDIT POLICY

4.1 Introduction

This chapter begins from where the previous one left off. The aim is to examine the effects of import support on Government budget and credit policy. The link between import support and these macro economic variables is through the counterpart funds generated by import support. Before examining the actual mechanisms through which this works, it is necessary to present the context in which the need for import support arose. The latter has been discussed in the previous chapter. We shall only recount those elements that are essential for our present argument.

When import support was introduced in 1979/80, it was essentially a departure from the normal form in which aid was provided. In this regard donors were being asked to finance importation of recurrent imports. This move was because domestic import capacity had fallen below the critical minimum necessary to operate the existing productive capacity of the economy. Since donors have always considered their role as being that of assisting recipient country to increase its productive capacity, import support was a departure from that basic principle. This departure was made on the grounds of dealing with an emergency situation believed to have arisen partly from the war with Uganda but also from deterioration in the terms of trade following the rise in world oil prices.

The Government's initial response was to seek a shift of project aid to import support. But since emergency aid carries with it the requirement that the recipient must be seen to be doing something about ending the emergency, import support unlike project aid, is conditional on policy reforms. In this regard the evidence that something was being done about the emergency required an agreement with the IMF. Since an agreement was not reached until July 1986, the end of the first aid boom (brought about by a change in Government policy) did not coincide with the second foreign aid boom described in the previous chapters. Accordingly in the intervening period (the early 1980s) adjustment took the form of import compression.

Counterpart funds are a product of import support in that they are local currency proceeds of a Sale of Commodities or cash obtained under the scheme. Since 1979/

80, counterpart funds have provided budgetary support. Prior to that date aid was provided to finance foreign exchange costs of development expenditure, while local currency costs were met partly from surpluses on the recurrent budget (government savings), non bank domestic borrowing and bank borrowing which was by far the most important source. By the late 1970s, government savings had virtually disappeared and an increasing proportion of recurrent expenditure was being financed through bank borrowing.

The pressure on the recurrent budget came from the growing need to service and maintain past investment in social administrative and economic infrastructure; itself a product of project aid. When the ability to finance recurrent costs fell below the critical minimum, recourse was made to bank borrowing. However, this action was clearly unsustainable as the inflationary pressures were seen to have gone beyond tolerable limits. As was the case with the external account two adjustment options were sought. The first was to persuade the donors to switch project aid to recurrent cost financing. However, for the same reasons that project foreign exchange was not switched to recurrent import financing, this did not happen on the desired magnitude also. Again as with the balance of payments adjustment took the form of expenditure compression.

It is against this background that we examine the macroeconomic impact of counterpart funds. Since the impact of import support on investment and growth has already been discussed in the preceding chapter the present focus will be on the effects of counterpart funds on the Government budget and on credit policy. The rest of this chapter is divided into four parts. Section 4.2 deals with the generation and management of counterpart funds while the following three sections will address the effects of counterpart funds on the budget, money supply and credit policy. The final section summarizes our argument.

4.2 Generation and Management of Counterpart Funds

Counterpart funds arise from sale of commodities or foreign currency provided under import support in domestic currency. Prior to the introduction of the open general license in 1988, import support was provided in the form of commodities which are a grant to the Government. These are partly used by the Government itself and the rest are sold to the commercial sector consisting of parastatals and private enterprises.

Let us consider the use of commodity import support (CIS) by a Government Ministry. In this case there is no cash transaction involved because the government does not sell itself the commodities provided to it through import support. Instead the exercise should reduce itself to simple accounting adjustments on both the expenditure and financing sides. The use of commodities should appear on the expenditure side while the value of the commodities used should appear as a financing item for the expenditure. Other things being equal, such use of commodity import support would increase budget deficit but also increase financing available by the same amount. This clarification is important because currently there appears to be some confusion about

cash cover treatment of commodity import support used directly by the Government. Treasury records (for whatever they are worth) show that Government ministries have cash cover arrears of about TShs 8,200 million for the period 1987/88–1990/91. If this is correct, then total import support counterpart revenue in the budget will have been underestimated by that amount.

The balance of commodity import support is sold to the public and private enterprises on the basis of a list agreed with the respective donors. Beneficiaries are supposed to pay 100% cash cover for the commodities they receive to the Treasury as soon as they are notified of allocation. In practice the recipients have often been able to negotiate credit terms with the Treasury. Some of the recipients have ultimately paid their cash cover requirements but others have not. Table 4.1 shows the allocation of import support for the period 1987/88 to 1992/93. The figures are based on reconstructed Treasury records prior to reconciliation with the recipients: their reliability is therefore uncertain.

Table 4.1 Allocation of Import Support			
1987/88 – 1992/93			
	Government	Parastatals	Private
Total (TShs millions)	9,200	77,030	41,433
Arrears			
TShs millions		34,710	24,706
% of allocations		45.0	59.6

However, they probably represent the correct relative orders of magnitude. The data confirm that the allocation of commodity import support has, on the whole, favoured the parastatal sector. Nevertheless, there are large variations among the main donors on the allocation of commodity import support. Of the nine main donors which account for 88% of total commodity import support the average allocation to parastatals is about 54%. However, as can be seen from Table 4.2, there are important donors whose commodity import support is mainly to the private sector; the United Kingdom, Netherlands, and Denmark fall in this category. Although the bulk of Swedish commodity import support was to the parastatal sector, it is noteworthy that Swedish aid to the private sector reached more firms than that of any other donor – 80 firms for Sweden as against 28 for the nearest donor. This in turn means that, on the average, individual firm allocations are smallest for Sweden than for any other donor. This raises the question of allocation criteria for commodity import support.

Officially the recipients of commodity import support were expected to meet one or more of three criteria, namely, that either they are revenue generators, producers of incentive goods and or infrastructural support. Swedish commodity import support would appear to have conformed with these criteria with regard to allocation to the

parastatal sector but not for the private sector. To a large extent Swedish import support to the private sector – and as shown in Chapter 2 – was directed at small enterprises which had been established by Swedish development aid under the auspices of the Small Industries Development Organization (SIDO). To that extent Swedish commodity import support to the private sector was allocated on different basis, namely, support to small scale enterprises; predominantly ‘graduates’ of an earlier development aid. In this regard Swedish commodity import support, like its development assistance to the private sector before it, is unique.

Table 4.2 Allocation of Commodity Import Support Between Parastatals and Private Sectors by Main Donors

	Total millions of TShs	Parastatal	Private
Sweden	19,777.7	80%	20%
Norway	11,787.4	57%	43%
Netherlands	21,226.1	41%	59%
Denmark	9,015.6	37%	63%
Finland	3,224.7	72%	28%
UK	6,750.0	8%	92%
Japan	14,916.8	71%	29%
Canada	12,446.1	79%	21%
Italy	7,349.2	51%	49%
Total	106,493.6	54.4%	45.6%

With regard to commodity import support to the parastatal sector there are two important facts which need to be recognized. The first relates to the coverage. Although at the inception of the reform process there were over 400 parastatal enterprises, the allocation of commodity import support is actually heavily concentrated in a few enterprises. Table 4.3 shows that over 70% of commodity import support went to fifteen parastatals. It is then clear that CIS was not as thinly spread as is often feared.

The second important fact about CIS allocation to parastatal enterprises is that the majority of the beneficiaries are not industrial parastatals. Of the top fifteen beneficiaries, only four are industrial parastatals; the rest being trading and infrastructural firms. Some of the industrial parastatals in the table are actually single firm industries; as such they have no domestic competitors private or public. It is clear that even though allocation of commodity import support was done administratively, it often took account of the strategic importance of the beneficiaries, if not necessarily their efficiency. Some of the beneficiaries such as General Tyre (EA) Ltd are probably as efficient as comparable firms in the East Africa region. In some instances targeting import support, has helped to speed up restructuring as has been the case of the

Table 4.3 Top Fifteen Parastatal Beneficiaries of CIS

(TShs million)		
	Allocation	Arrears
General Tyre (EA) Ltd	12,714	836
Aluminium Africa Ltd	8,053	1,566
Tanzania Fertilizer Company	6,534	6,534
Tanzania Posts and Telecommunication	5,332	2,263
Tanzania Coffee Marketing Board	4,576	2,847
Tanzania Motor Company	3,261	1,282
National Transport Company	3,258	961
Tanzania Railways Corporation	2,467	2,467
Tanzania Petroleum Development Corp.	2,127	554
Tanzania Portland Cement Co.	1,557	944
National Steel Corporation	1,466	559
Tanganyika Tegry Plastics	1,239	520
Tanzania Harbours Authority	1,006	—
Tanzania Electric Supply Company	1,479	933
British Petroleum (T) Ltd.	830	48
Total	55,899	22,314

Portland Cement Company. There is therefore, nothing inherently anti-restructuring in commodity import support; it all depends on the objectives attached to its application, and the policy context in which it occurs.

Turning to import support cash cover recovery we need to distinguish between cash cover on commodity import support and cash cover payments on foreign exchange provided under the open general license (OGL). The two components of import support were administered separately. While the CIS was directly administered by the Treasury, the OGL system was placed under the Bank of Tanzania. The two systems of administration also implied different mechanisms of cash cover recovery management.

In the case of commodity import support the beneficiaries were expected to pay cash cover directly to the Treasury on notification of allocation. However, by its nature commodity import support cash cover tends to be secondary to the objective of targeting the resources. That is to say, the beneficiaries were selected on the basis of criteria other than their liquidity or cash flow position. Accordingly, some of the beneficiaries were often without the necessary resources to be able to pay 100% cash cover up front. Whenever that has been the case there has been a tendency to work out a payment schedule on anticipated cash inflows. When these repayments are not realized cash cover payment arrears accumulate. Table 4.1 shows allocation of com-

commodity import support and arrears between parastatals and the private sector. It is clear from the Table that nearly three fifths of commodity import support to the private sector has its cash cover payments outstanding as against 45% for the parastatal sector. Over all, about 50% of cash cover on commodity import support to the parastatal and private sector is outstanding.

The situation is different with regards to OGL. Under this scheme, foreign exchange is sold to the Central Bank which then pays cash cover to the Treasury by crediting the exchequer account with it by the local currency value of the foreign exchange. From the point of view of the Government there is no cash cover payment outstanding. In this regard the administration of cash cover payments under the open general license has been by and large superior to that under commodity import support. Available information suggests that cash cover arrears on the OGL are a mere 8% of the total generated under the scheme.

4.3 Monetary Effects of Counterpart Funds

In this section we investigate the effects of counterpart funds collection on money supply. We begin by looking at commodity import support. In this case a commodity grant to the Government is sold to the commercial sector which in turn pays counterpart funds to the Government – either through payment by the private sector into Government account at the Central Bank or by crediting Government account with commercial banks. In the first case, the effect will be to reduce currency in the hands of the public as well as commercial bank reserves at the Central Bank. The reduction in the monetary base should then lead to a reduction in the money supply by a multiple of the monetary base. In the second case the effect will be to reduce private deposits and increase government deposits at the commercial banks. On the implicit assumption of 100% reserve requirements on government deposits at the commercial banks, a change in the structure of deposits ownership in favour of the government will lead to a multiple deposits contraction on the part of the commercial banks thereby reducing money supply.

In theory, therefore, the effect of counterpart funds payment by the commercial sector is expected to be deflationary in that stock of money in the economy will fall and, other things being equal, inflation should also fall. However, in practice it is unlikely this result is actually what obtained. In the first place since the cash cover was not fully collected, the deflationary effect of counterpart funds was less than the value of import support received. In addition, the assumption of lasting deflationary effects of counterpart funds is based on a further assumption that there is a long lag between receipts of counterpart funds and their spending by the Government. In the Tanzanian case this assumption is unwarranted primarily because such a lag was for practical purposes negligible. In fact the more likely situation was that the Central Bank provided advances as bridging finance for the Government in anticipation of cash receipts including counterpart funds.

It would have been surprising if counterpart funds had a deflationary effect in this context. This is because counterpart funds, as will be shown in the next section, had a definite monetary policy role which was inconsistent with the one ascribed to it in theory. The fact that they were meant to substitute for government bank borrowing implies little time lag between their receipt and expenditure.

Nevertheless, there is a real possibility that the whole process of counterpart funds management can become inflationary. This possibility can be demonstrated by the context in which cash cover arrears arise under the OGL system. As has already been pointed out under this system the Central Bank paid cash cover up front so that the budget received the full amount of the value of import support. The next stage is that the Central Bank sold foreign exchange to the commercial banks. Ideally the latter should pay full cash cover to the Central Bank. This would normally take the form of a fall in the commercial bank's balances or reserves at the Central Bank matched by an increase in their net foreign assets. The overall effect would be neutral. However, there was an occasion when the Central Bank did not collect the cash cover thereby making a net addition to commercial bank liquidity. This situation is the context in which counterpart funds can actually contribute to an inflationary situation.

Under the new system of foreign exchange allocation through the auction the possibility of this problem arising is remote. However, the transfer of the management of the commodity import support to the Central Bank carries similar dangers. As we have already pointed out the justification for maintaining commodity import support is the need to target some strategic institutions. Since not all the targeted beneficiaries are unlikely to be able to pay cash cover upfront some credit arrangements for their payment may have to be worked out. However, should the Central Bank pay cash cover upfront to the Government as was the case with the OGL and then allow the beneficiaries to stagger their cash cover payments, the effect will be inflationary. To avoid this situation, the burden of staggered cash cover payments should fall on the budget and never on the monetary system.

4.4 Counterpart Funds and Fiscal Behaviour

In examining the impact of counterpart funds, it is important to recall that as a result of adjustments prior to 1986 expenditures were compressed in real terms. This was in response to a deteriorating revenue position. Table 4.4 shows a sharp drop in recurrent revenue in real terms reaching its lowest level in 1985/86. This was matched by expenditure compression. Recurrent expenditure (excluding debt service) was down to less than three fifths of its 1979/80 level. The fall in development expenditure was even more severe.

Nevertheless, even though some reduction in bank borrowing did take place, it was not sufficient to stem inflationary pressures particularly because it was taking place at a time when output was either falling or stagnant. Under these conditions the aim of fiscal policy was to decompress expenditure without recourse to inflationary financing.

Table 4.4 shows the evolution of counterpart funds. The first point to note is that there was a sharp decrease in their volume in the early 1980s indicating disagreements with the donors on the nature and contents of adjustment policies. When in 1984/85, the Government belatedly introduced some of the measures earlier required by the Fund as a basis for agreement, there was a significant increase in import support underlining the sensitivity of this source of financing to appropriate policy changes. However, major increases in counterpart funds took place after June 1986 when an agreement was reached with the Fund. In the first year of the agreement alone import support counterpart funds increased four fold and continued to increase thereafter.

The effect of increased counterpart funds on various components of expenditure are shown in the first three columns of Table 4.4. To begin with, the first column shows total expenditure including debt servicing. It is evident that total expenditure has been decompressed but has not recovered yet to its pre-crisis levels. Recurrent expenditure excluding debt service has, on the other hand, actually increased to surpass the pre-crisis levels while development expenditure remains at about 25% of its level in 1978/79. The effect of import support counterpart funds in this regard has been to increase discretionary recurrent expenditure by switching resources away from the development budget.

Turning to the expenditure financing side a number of observations can be made. The first relates to domestic revenue. It can be seen that recurrent revenues which had earlier declined in real terms grew with an increased inflow of import support and has more or less recovered to its pre-crisis levels. The effect of import support on revenue is through its effects on various tax bases such as imports and domestic output. The question which arises is whether more domestic revenue could have been raised through the tax system than has been the case.

There is little doubt that officially there is dissatisfaction with the overall revenue performance so far. The evidence to this was the establishment of the Presidential Commission of Enquiry into Public Revenues, Taxation and Expenditure in 1989. While the Commission recommended a number of tax reform measures, its overall view was that the basic problem lies with the administration of revenue collection more than anything else. This view is borne by studies on revenue performance of different taxes. These studies distinguish between the elasticity of a tax and its buoyancy. While the former refers to the amount by which revenue from a tax changes in response to a change in its tax base (given the tax structure) tax buoyancy refers to total change in revenue from a particular tax. That is to say tax buoyancy is a sum of tax elasticity and changes in the tax rates. An analysis by Osoro (1992) of the elasticity and buoyancy of the Tanzanian tax system for the period 1979-89 indicates that the elasticity of the tax system was less than unity while the buoyancy was unity indicating that revenue growth was generated more by discretionary changes in the tax rates than by the elasticity of the tax system. This finding seems to suggest difficulties in revenue collection attributable to institutional capacity and poor working environment for tax collectors. The

Table 4.4: Effects of Counterpart Funds on the Budget

Year	Total expenditure	Recurrent exp. (incl debt serv)	Recurrent exp. (excl debt serv)	Development expenditure	Recurrent revenue	CIS	Loans & grants	Domestic borrowing	NCPI (deflator)
1976/77	7785	5022	4427	2763	5794	-	1804	1234	100
1977/78	8355	5258	4583	3097	6714	-	2014	898	110.6
1978/79	9685	5969	5009	3716	6056	-	1508	1516	128.6
1979/80	8791	5672	4069	3119	5588	506	1430	2214	158.6
1980/81	7371	5208	4385	2163	4281	437	3530	1841	200.2
1981/82	6982	5182	4598	1800	3778	410	1967	446	249.0
1982/83	5688	4369	3977	1319	3768	225	1697	664	333.9
1983/84	5090	3976	3408	1114	3368	152	2159	1368	401.0
1984/85	5117	3862	3718	1249	3341	222	1636	720	557.8
1985/86	4430	3335	2838	1095	3078	157	1498	864	715.8
1986/87	4306	3649	2988	657	3094	646	658	476	947.7
1987/88	5286	4533	4056	753	3833	814	798	399	1288.8
1988/89	5981	5158	3049	823	4438	1316	669	(112)	1586.8
1989/90	6529	5895	5895	634	5161	1639	294	638	1896.2
1990/91	8042	7096	5117	946	5994	1992	271	(406)	2287.2

Notes: 1) All the figures have been deflated using the National Consumer Price Index.

2) Total expenditure includes debt service.

3) Expenditure and financing items do not balance because of omission of other items and tax reserve certificates from the Table.

Source: Bank of Tanzania Economic and Operations Report (various years).

conclusion seems to be that while there is potential revenue capacity it is unlikely that it can be realized within the existing institutional framework.

The second observation with regard to the financing side relates to the extent to which recurrent revenue finances recurrent expenditure. Recurrent expenditure in column two of Table 4.4 consists of two components, namely, discretionary expenditure shown in the third column and debt servicing which is the difference between columns two and three. It can be seen that during the period 1986-91 while the overall recurrent budget recorded a deficit of about 7% annually, on the average, the discretionary recurrent budget was in surplus by nearly 15%. This figure indicates the extent of debt servicing burden on the recurrent budget.

With regard to other financing items shown in columns seven and eight of the table the effect of counterpart revenue is even clearer. Loans and grants which constituted the earlier form in which aid was provided declined sharply as import support took greater effect. While the data is believed to underrepresent direct to project aid there is no reason to assume that the recording of this kind of aid got worse during the ERP period. It would therefore appear that there was a clear shift away from project aid to import support and that this facilitated a recovery in recurrent expenditure.

Finally, the last column of the table shows the effects of counterpart funds on domestic borrowing the bulk of which was bank borrowing. It is to be recalled that one of the goals of Government policy was to reduce inflation and that although early adjustment efforts succeeded in compressing expenditure, they did not succeed in reducing bank borrowing and credit growth to acceptable levels. In this regard the effects of expansion in import support counterpart funds have been to reduce Government borrowing from the banking system. On this account, therefore, counterpart funds have supported anti-inflation policies. However, since Government bank borrowing is only one element in the overall credit growth, we now turn to the examination of the overall credit developments.

4.5 Foreign Exchange Allocation System and Credit Policy

Prior to 1988, the dominant form of foreign exchange allocation was administrative. Both the free foreign exchange resources and the commodity import support were allocated by the Central Bank and the Treasury respectively on the basis of prior application and screening which did not take into account market efficiency of the applicants. Since then, however, considerable progress has been made towards market based allocation of foreign exchange. This reform began with the introduction of the open general license in early 1988 followed by the enactment of a new foreign exchange legislation to provide a legal framework for the introduction of foreign exchange bureaux in 1992. The act also provided for individual holdings of foreign exchange account as well as cash which was previously prohibited. A further movement towards market based foreign exchange allocation was made in August 1993 when the exchange rate was unified and an auction system for foreign exchange in which foreign

exchange bureaux were invited to participate was introduced.

While there is little doubt that considerable progress has been made in the liberalization of the foreign exchange market, there are reservations about the viability of this process unless there is also a parallel liberalization of the domestic credit market. Historically, the financial system has been controlled by the Government which also owned the major institutions in that sector. This fact, coupled with the Government control and ownership of real sector activities, has tended to obviate market based allocation of credit. Instead credit was allocated in the context of Government's annual finance and credit plans thereby taking away the power of decision making over credit allocation from bank management. In this context the Central Bank credit also responded more to the financial requirements under the plan than on its assessment of the monetary and credit situation. If these are to be the conditions to prevail in the credit market, there is no doubt that liberalization of the foreign exchange market will be undermined through the credit allocation process.

However, since 1991, there has been a wide ranging programme of financial sector reforms. Under the new Banking and Financial Institutions Act the autonomy of management on credit allocation is provided for and entry of private banks is allowed. Since then the banks' managerial autonomy has increased in that initially they had the right to set their own interest rates subject to a minimum deposit rate set above the rate of inflation and a maximum lending rate. More recently these restrictive requirements have been removed so that the banks are free to set both their lending and deposit rates. This reform is believed to be essential for the banks to compete for customers in a multibanking environment following the entry of two international banks and the restructuring of existing ones. At the same time the relationship between the commercial banks and the Central Bank has been redefined in that the Central Bank operates through its rediscount window and can vary its rediscount rate on its assessment of the monetary situation.

It is therefore clear that the liberalization of the foreign exchange market is supported by that in the domestic credit market. The overall credit policy objectives are consistent with the measures outlined. From the outset, the policy had two basic objectives. First, considering that domestic credit was the source of excessive monetary expansion, the policy goal was to limit the overall growth. The second credit policy objective was to shift distribution of credit in favour of the private sector. Table 4.5 assesses progress on both accounts. It can be seen that little progress was made in controlling the overall credit growth and this has continued to be the source of continued excess liquidity in the economy.

With regard to the distribution of credit between public and private sectors it is clear that an overwhelming proportion is allocated to the public sector. Nevertheless, there has been an upward trend in the proportion of total claims on the private sector. This is an indication that the rate of increase of credit to the private sector is higher than the overall growth of credit. However, the dominance of the public sector in credit

allocation reflects its overall dominance in the economy. Accordingly, a significant change in the distribution of credit will occur with the restructuring of the public sector aimed at privatizing a major part of Government interest in the productive sectors of the economy. In this regard the liberalization of the domestic credit market will require not only the financial sector reform but also restructuring of the real side of the economy currently being undertaken in the context of parastatal sector and agricultural marketing reforms.

Table 4.5 Domestic Credit Growth and its Distribution by Sectors¹

	Total Credit (TShs MN)	Rate of Increase	Government²	Official Entities	Private Sector
1986	26474		14.2	71.8	11.0
1987	56137	112.0	6.5	83.0	10.4
1988	86933	54.8	15.3	66.0	18.2
1989	116672	34.2	11.2	67.6	21.2
1990	149850	28.4	7.8	60.5	31.5
1991	197939	32.1	5.4	67.2	27.3

1) Figures exclude other assets which are unclassified.

2) For 1988 claims on Government include some of the liabilities of the marketing Boards taken over by the Government.

Source: Bank of Tanzania: *Economic Bulletin*, Vol XXI No.3, December 1991, Appendix Table 12.

4.6 Summary

In this chapter we have examined the impact of counterpart funds on the budget, money supply and credit allocation. Counterpart funds are generated through the sale of import support in the form of commodities or foreign exchange. Until 1988, import support consisted of commodity import support which was administratively allocated to both the private and public sectors. On the whole a large proportion of commodity import support went to the parastatal sector. Within the latter allocation was concentrated in a few large parastatals which were considered of strategic importance. Only a few of these were industrial parastatals; the majority were trading and infrastructure related enterprises.

While the bulk of Swedish commodity import support was to the parastatal sector, the part that was allocated to the private sector is unique in two respects. First, it reached more enterprises (80 firms) than any other donor programme. This in turn means that average allocations per firm were also smallest for Swedish aid. Secondly, the criterion on which the allocation was based appears to be support to small enterprises. This is unique in that to a large extent Swedish assistance has always recognized the importance of small enterprise development well before the current resurgence of interest among other donors.

With regard to the monetary effects of counterpart funds our conclusion is that on the whole the effect is neutral. There are two reasons for this conclusion. First, about half of the counterpart funds were not collected, which would be inflationary if the funds were spent by government anyhow. But, second, a large part of the funds' impact on the budget was to reduce deficit financing – that is, there was no expenditure increase. Hence the net impact is neutral. It is unlikely that they would have been able to have a deflationary effect.

The impact of counterpart funds on the budget is twofold. First it has provided for recurrent expenditure recovery and has more or less obviated the need for Government's recourse to bank borrowing to finance budget deficit. Secondly, there has been revenue recovery associated with output growth largely induced by increased imports under the import support programme. However, revenue growth during this period appears to have been achieved more through discretionary tax measures rather than improved collection which is constrained by weak administrative capacity.

On the credit policy side there is genuine concern that unless there is parallel liberalization of the credit market the movement towards market based foreign exchange allocation system can become ineffective. However, financial sector reforms introduced in 1991 are designed to liberalize the domestic credit market. The recent entry of private international banks, the redefinition of the role of the Central Bank and the legal autonomy granted to publicly owned bank management are all indicators of an evolving liberal domestic credit market. Nevertheless, the bulk of domestic bank credit remains with the public sector and this situation is unlikely to change quickly before the completion of the restructuring programme of the real sector currently dominated by public enterprises.

AID, IMPORT SUPPORT AND DEVELOPMENT PRIORITIES IN TANZANIA

5.1 Introduction

The previous two chapters have analysed the macroeconomic consequences of the volume and types of aid received by Tanzania in the last two decades. We move now to a more general discussion of aid's relation to the development strategy being pursued. More specifically, we focus on two topics. Part 5.2 begins with an overview of the relative importance of the different sectors of the economy, focusing on their contribution to overall growth. This analysis is used to pose the question: is aid being used to assist the most important sectors of the economy? We also address the issue of whether the combination of liberalisation and more freely available forex from own funds and OGL have led to a process of deindustrialization, as has been claimed elsewhere (Bhaduri *et al.*).

The second topic – discussed in Parts 5.3 and 5.4 – is the related issue of whether aid to Tanzania, and import support in particular, have been an effective tool in alleviating poverty. Part 5.4 focuses more specifically on current efforts at poverty alleviation in Tanzania. On the basis of this discussion, and the analysis of Chapter 3, we are led to propose an alternative channel for Swedish aid to Tanzania – this scheme is laid out in Part 5.5. Part 5.6 concludes.

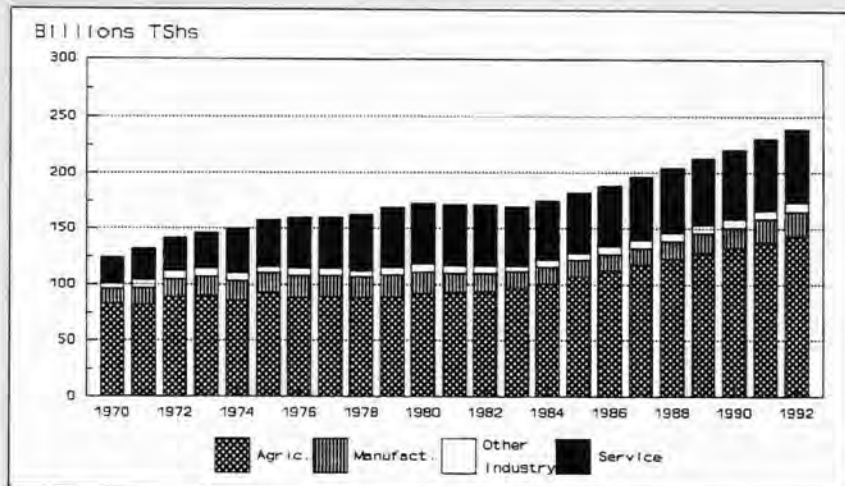
5.2 The Pattern of Growth in Tanzania

The gross domestic product (GDP) of a country is the sum of the value added of the different sectors of the economy. Figure 5.1 shows the real GDP for Tanzania for the period 1970-1992¹, distinguishing between four sectors: agriculture, manufacturing, other industry (which comprises mining, construction and utilities) and services. From this figure we may see the overwhelming importance of agriculture in the Tanzanian economy – accounting for more than half of value added. Agriculture's share of total

1) The figure shows GDP at factor cost – that is the sum of the sectoral value added, excluding net indirect taxes.

Figure 5.1 Real GDP by Sector, 1970-1992

(Billions of 1987 TShs)



employment is even greater – estimated at 85 per cent. It can be seen also that the sectoral value added of agriculture has increased over time, as has that of services. The manufacturing and other industry sectors, on the other hand, appear to have been quite stagnant – suggesting that these sectors have not contributed to the growth of the economy that can be observed in Figure 5.1.

The contribution of each sector can be analysed in a more formal manner through a decomposition of the sources of growth. The methodology for such a decomposition, and the full results, are given in Technical Appendix 1 (in Volume II of this report). As is shown in the Appendix, a sector's contribution to overall growth depends on two factors: (i) the sector's rate of growth; and (ii) its share of total value added. The first of these is obvious – the more rapidly a sector grows then the more it can contribute to growth. But the sector's share is also important – if a sector is very small then even substantial growth can only have a marginal impact on the economy as a whole.

The decomposition analysis may be carried out in one of two ways. The first is to calculate sectoral contributions to growth on a year-by-year basis and then calculate average values for selected periods. Such an analysis is presented in Table 5.1 (a): this table shows the average contribution to growth of each sector **within** each period. The second method is to sum sectoral value added across periods and decompose the sources of growth from one period to the next. This analysis, which shows the contribution to growth **between** periods, is shown in Table 5.2 (b).

From Table 5.1 (a) we see that the Tanzanian economy has grown at an acceptable rate (between 4 and 5 per cent a year) in the early 1970s and since the mid eighties. In

Table 5.1 Sources of Growth in Tanzania, 1971-92

(sectoral contributions to growth)				
A) PERIOD AVERAGES				
	1971-75	1976-80	1981-86	1987-92
GDP	4.6	1.8	1.5	4.1
Agriculture	1.5	-0.2	2.0	2.5
Manufacturing	0.5	0.3	-0.5	0.5
Other industry	0.1	0.1	0.0	0.1
Services	2.5	1.7	0.0	1.0
B) BETWEEN PERIOD GROWTH				
	1976-81	1981-86	1987-92	
GDP	17.2	6.3	23.3	
Agriculture	1.9	6.6	17.0	
Manufacturing	2.3	-2.2	1.4	
Other industry	-0.2	0.1	0.6	
Services	13.1	1.8	4.3	
<i>Note: 1981 is included in periods one and two as periods must be of equal length (six years).</i>				
Source: See Technical Appendix				

the intervening decade, since 1976, growth has been more modest. Since the population is growing at about 3 per cent each year, income per capita in Tanzania had been falling for the ten years prior to the adoption of the Economic Recovery Programme. During the 1970s much of what growth there was was accounted for by the service sector – a growth resulting from the dramatic expansion of public administration during this period (much of it related to the bureaucratic requirements of decentralisation). This pattern has changed in the 1980s with agricultural growth accounting for the largest part of the economy's expansion. Even in the 1970s the performance of the economy as a whole mirrored that of the agricultural sector quite closely. By contrast, the manufacturing sector has contributed little to growth: at best not much more than half a percentage point. This finding is not surprising; manufacturing value added is less than 10 per cent of the total, so the contribution to GDP growth of this sector is necessarily limited².

Similar conclusions emerge from the analysis of growth between periods. What is most striking from Table 5.1 (b) is that during the 1980s, and particularly since the introduction of the ERP, agriculture has accounted for most of the increase in output over the earlier period. The implications of the decomposition analysis are both positive and normative: the agricultural sector **is** the most important sector for the growth of the Tanzanian economy and this **must** be so: only by stimulating agriculture

2) The remarkable 12.0 per cent growth recorded by this sector in 1991 meant that it contributed 1.0 per cent of the economy's 4.3 per cent growth in that year. But in 1992 the contribution fell back to only 0.2 per cent (of overall growth of 3.8 per cent).

can the living standards of the majority of the population be increased. Does aid in general, and import support in particular follow this prescription?

Aid may assist sectoral development in one of two ways – either by the nature of the aid-financed activity stimulating growth or by the policies upon which the aid is conditional doing so. We consider each in turn.

5.3 The Impact of Aid at the Sectoral Level

Table 5.2 shows the sectoral allocation of aid for all official development finance (average figures for 1986-89), Norway (1992 disbursements) and Sweden (1991/92 disbursements). Whilst the figures have been constructed so as to be comparable, strict comparability cannot be ensured because of uncertainty as to the DAC classification used for the ODF figures. In particular: (i) it is not clear if DAC include **only** free-standing technical assistance in that category or also that which is project related; and (ii) it seems possible that sectoral adjustment credits have been allocated by DAC as funds to that sector whereas, in fact, most the monies are programme assistance (import support). (For example funds in support of TANAA may have been classified under agriculture). Therefore the share of import support in the total aid programme may be more than suggested the by share of programme assistance. The distribution of Norway's aid was "distorted" by the large amount (NOK 138.6 million) spent on the Pangani Falls redevelopment in 1992 – the share of import support has more typically been 30 to 40 per cent (i.e. a figure more comparable with that reported for Sweden).

Table 5.2 Sectoral Allocation of Aid

(per cent)	All ODF (1986-89)	Norway (1992)	Sweden (1991-92)
Social sectors	5	11	15
Economic infrastructure	20	55	18
Agriculture	13	11	5
Manufacturing	5	1	3
Other industry	3	0	0
Services	3	0	0
Technical cooperation	22	6	7
Programme assistance	18	13	46
Other	12	2	7

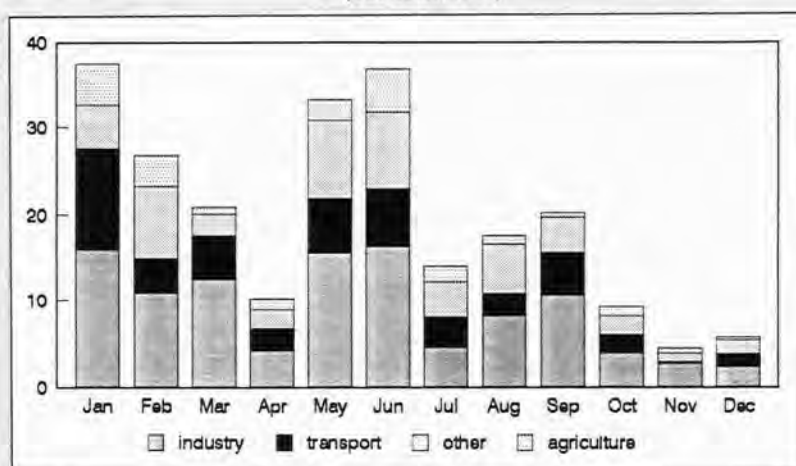
Sources: OECD *Geographical Distribution of Financial Flows to Developing Countries* (various); Royal Norwegian Embassy, *Tanzania and Norway Development Cooperation*, 1993; and Embassy of Sweden, *Swedish Development Cooperation with Tanzania*, 1992/93.

A similar pattern³ may be observed in the allocation of OGL funds, shown in Figure 5.2. In each month during 1992 30 to 60 per cent of OGL funds went to the benefit of

3) The data for this figure are LCs established. We believe these to be a reasonable guide to sectoral allocation, as there is no reason to believe there is a systematic bias in the ratio of establishment to utilisation.

Figure 5.2 Allocation of OGL funds by sector in 1992

(LCs established)



Source: Bank of Tanzania

industry – the average over the year was 45 per cent. The share of agriculture was much smaller – being at most 13 per cent and averaging only 10 per cent for the whole year. The large share of transport – over 20 per cent – is both notable and important.

Hence, although in the most recent period (1986-92), agriculture contributed over 60 per cent of the economy's growth it has received a far lower proportion of the aid. Table 5.2 (and Figure 5.1) suggest there has been an undue neglect of the agricultural sector – donors have put too much emphasis on developing aspects of the "modern sector" which leave the welfare of the majority of Tanzanians unaffected.

Of course, agriculture may benefit from aid not going directly to the sector itself: either from improvements in economic infrastructure and transportation or from the goods provided through import support or use of manufacturing output. For each of these it is important to distinguish between the aid programme in general and import support.

Much of the aid-financed investment in infrastructure has been in energy, much of which will not directly benefit the agricultural sector. The rehabilitation of the road network is an important part of enabling the marketing of agricultural produce, but evidence suggests that at least, if not more, important a constraint is the lack of adequate transportation. The use of OGL funds for transport (which the analysis of Norwegian OGL suggests is mostly for spare parts) is one way in which these funds are potentially beneficial to agricultural development. As noted in Chapter 2, some four wheel drive

vehicles (and boats) are included on the negative list, thus limiting the beneficial impact of OGL on agricultural marketing.

The second way in which aid may help agriculture is through the nature of the goods imported. Again, the evidence is that OGL may have been more beneficial in this respect than previous forms of aid. Our analysis of Norwegian OGL, reported in Chapter 2 (Table 2.9), showed that about one third of OGL funds are used either for the importation of, or to support the production of, incentive goods. We simply cannot say what share of these are reaching rural areas. We **do** however have evidence of increased goods availability – both from the most recent World Bank (1991) country economic report and from the reports of the villagers interviewed as part of the SIDA-financed study of rural perceptions of economic and political change in Tanzania (Booth *et al.*). It seems probable that OGL has usefully contributed to this increase.

Other forms of aid – including CIS – probably have not led to any significant increases in incentive goods. CIS was mostly used to support manufacturing production, rather than the import of finished products. As documented, the firms supported were mostly inefficient parastatals, so that CIS supported the pro-industry bias. Exceptions are Dutch import support, which was directed at the sugar and cotton sectors, and fertilizer imports. For some years donors supported the notoriously inefficient Tanzania Fertilizer Corporation (TFC). Since TFC had a monopoly on distribution it found it more profitable to import fertilizer for sale rather than making it itself – so that the transition from project-based support to import support led TFC to stop production. Some donors, including Norway, have continued to give import support funds earmarked for fertilizer.

In general, however, we draw two conclusions. Of the different forms that aid can take, the OGL system has a greater likelihood of resulting in indirect benefits for agricultural production than do other forms of aid. Nonetheless, the amount of aid that is directly targetted at agricultural production appears too small given the sector's importance to the economy's growth.

If the aid monies themselves have not been explicitly directed to the agricultural sector, what of the aid-supported policy reforms? Prior to ERP the productive potential of the sector was quite clearly inhibited by the controls imposed by government – most notably the pricing system administered by parastatals which failed to pass on world prices to peasant producers. One of the earliest sectoral adjustment credits – TANAA – was directed towards the removal of these controls, and subsequent policy discussions have continued to incorporate further reforms. Despite this fact, and as discussed in Chapter 2, the impact has thus far been slight. Booth *et al.* (1993) present both macro and micro evidence to confirm the position that the reforms have not “filtered down” – the main stumbling block being identified as the continued dominance of the agricultural marketing parastatals. Problems such as late or non-payment of producers remain.

Of the other reforms that have been implemented those liberalising the foreign

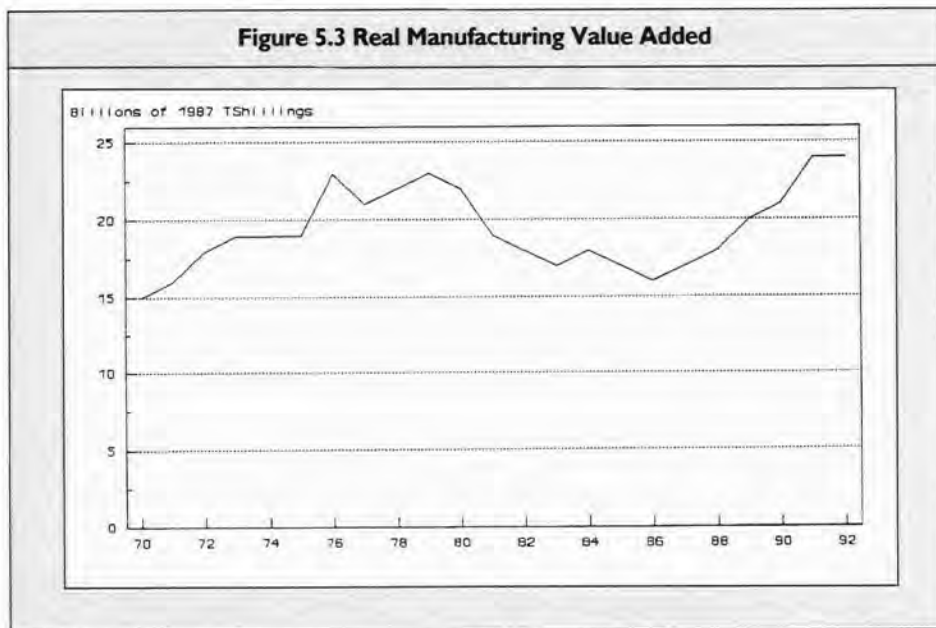
exchange market have the most importance for the sector – mostly for the reason discussed above, that is the importance of incentive goods in stimulating rural economic activity.

The conclusion must be that the reforms can potentially be of great benefit to the sector, but that their full potential is as yet some way from being realised. The impact of aid funds and reforms on the agricultural sector are closely linked with their effectiveness in poverty alleviation. But before we go on to discuss such issues we turn to a further sectoral issue – the performance of the manufacturing sector during the ERP period.

Deindustrialization in Tanzania?

Academics have expressed concern over African deindustrialization as a result of adjustment (for example, Stewart 1991). Such a concern has been expressed about Tanzania by a number of observers (Bhaduri *et al.*, 1993; and Rattso, 1993). It is difficult to see why.

Figure 5.3 shows real manufacturing value added. Real growth in the manufacturing sector since the inception of ERP has been impressive – most notably the 12 per cent recorded in the year to 1991. The quarterly index of manufacturing output published by the Bureau of Statistics gives a less optimistic picture (Figure 5.4) – nevertheless this series also shows a trend increase of just under one unit per quarter. The log regression gives a growth rate of just over 0.8 per cent a quarter – that is about 3.6 per cent a year.⁴



4) The fitted line in Figure 5.4 is from the linear, not log, regression since the former gives the better fit. (R^2 for log regression calculated by correlating exponential of fitted values with actual series).

Figure 5.4 Index of Manufacturing Output

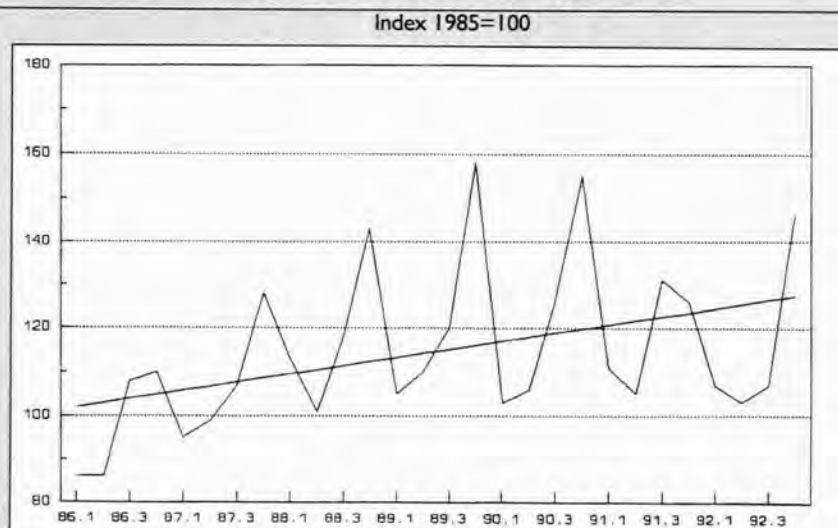
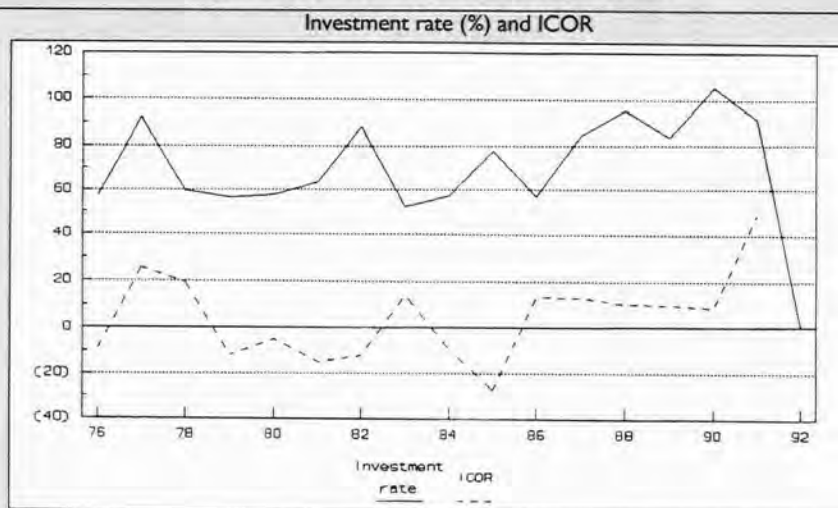


Figure 5.5 Source of Manufacturing Growth



There **has** been deindustrialization in Tanzania: not since liberalisation but, to the contrary, in the period preceding liberalisation, when manufacturing output plummeted. The roots of the decline lie in the extremely low productivity of sectoral investments, which is explained by three factors. First, the foreign exchange shortage, at its worst during the early 1980s, which resulted in very low levels of capacity utilisation. Second, deteriorating infrastructure disrupted production and supplies (which were at times further disrupted by the arbitrary nature of the resource allocation system). Third, many industrial projects were poorly conceived in design and badly imple-

mented. During the early 1980s the incremental capital output ratio (ICOR) for the manufacturing sector was negative (Figure 5.5).

Figure 5.5 also shows that there has been a substantial improvement in the ICOR – switching from negative to positive in the period since ERP was introduced. It is still, however, rather high – and took a sharp turn upwards in 1991 as growth from 1991-92 fell to 1.9 per cent (which has been attributed to the power shortages).

As shown in Figure 5.5 the sectoral investment rate has also risen in the later part of the 1980s. Hence the improved growth performance is attributable to both higher investment and the increased productivity of that investment. (The manufacturing investment rate appears to be extremely high – reaching over 100 per cent. This figure is consistent with other data, but must lead to some suspicion. But even allowing for error the percentage is symptomatic of the extreme inefficiency of the sector).⁵

The reasons given as to why aid may result in deindustrialization are two-fold. First, aid-financed goods displace demand for domestic output. Second, aid-related liberalisation destroys infant industries that are unfairly disadvantaged by the poor state of Tanzanian infrastructure.

The data in Table 5.3 give some insight to the first of these. For some industries, notably soap, import support has financed intermediates not final goods so that domestic output (which was quite clearly supply constrained, not demand constrained) has expanded. In some industries, such as fertilizer, domestic production has been displaced – but so it ought to have been given the well known hideous inefficiency of TFC. Another industry shown in the table that has probably been adversely affected

Table 5.3 Per cent change in output 1981-83 to 1989-91 for selected industries

Per cent change		Per cent change	
Kibuku	3,034.5	Blankets	-18.6
Cement	121.4	Hand hoes	-19.3
Containers	109.2	Textiles	-23.3
Soap	104.3	Beer	-23.4
Konyagi	68.0	Radiators	-25.5
Paint	57.7	Petroleum	-26.4
Fishnets	36.4	Aluminium	-39.8
Tyres and tubes	32.9	Batteries	-40.5
Iron sheets	30.9	Fertilizer	-44.0
Motor batteries	19.6	Radios	-50.6
Ploughs	9.5	Wheat flour	-63.1
Rolled Steel	-4.2	Packing materials	-66.6
Sugar	-8.7	Leather	-77.4
Sisal ropes	-15.9	Shoes	-83.0
Cigarettes	-16.1	Bike tyres and tubes	-87.5

Source: BOT Economic and Operations Report

5) $I_m/Y_m = I_m/I \times I/Y \times Y/Y_m$. In late 80s these ratios are, respectively, just under 0.3, just over 0.3 and $Y_m/Y = 0.08$. This gives a I_m/Y_m of $0.3 \times 0.3/0.08 = 112.5\%$.

by import support is bike tyres and tubes, since bike parts have been a substantial item under OGL (bikes and bike parts are 10 per cent of total Norwegian-financed OGL).

Other industries that have experienced declines will have done so because of the influx of foreign goods facilitated by both the introduction of own funds imports and subsequent reduction in tariffs. Beer is an example of this: not only have tariffs been reduced, but in the last two years Kenyan beer has enjoyed the preferential PTA tariff rate.

So at the level of individual industries the picture is a mixed one – some **have** suffered from either one or both of the effects mentioned above, whereas other industries have benefitted. The overall balance can be judged from the growth of the sector as a whole – which we find to be positive. Our data are thus consistent with the view that adjustment is now taking place within the sector so that less efficient enterprises are closing down. This is after all what “adjustment” means: some firms will go out of business, these are the costs of transition.

There remains the question, however, of if some firms are unfairly disadvantaged because of power shortages. The response to this problem should of course be to get the power supply system functioning rather than to continue subsidies or protection, though we recognise that the problem will not be solved overnight. Nevertheless, we would urge caution in reverting to protection on these grounds – any special protection afforded must be on the basis of this disadvantage being proven and with a definite time frame for the phasing out of support. One reason for this caution is that protection is costly for Tanzanian society as a whole, implying a regressive reallocation of resources. It is to this issue – or poverty and the distribution of benefits from aid – to which we now turn.

5.3 Import Support and Poverty Alleviation

The rhetoric of aid donors emphasises aid's role in reducing poverty – this is especially so for the Scandinavian donors. In his discussion of Swedish aid and the poor Berg wrote that:

The Swedish Government... should primarily be concerned about the effects of the poor, since they are the reason our government has been entrusted with the taxpayers' money

(Berg, 1986: 266)

The effects on the poor may be either direct – from aid programmes targetted at the poor – or indirect – *via* the benefits of growth spreading amongst the population at large. There is little evidence on the distributional implications of aid programmes – the most comprehensive study is by the Inter American Development Bank (IDB).

In the early 1980s the IDB adopted the policy objective that 50 per cent of their resources should be directed to the poor. In monitoring IDB's poverty performance a measure called the Coefficient of Income Distribution (CID) has been developed. The

Table 5.4 Sectoral CIDs for IDB projects – 1979-1986

	1979-82	1983-86	1979-86
Agriculture	74.1	48.3	64.0
Fisheries	35.6	59.2	43.1
Industry	27.2	26.0	25.0
Tourism	24.0	82.3	80.4
Mining	20.1	47.6	45.9
Energy	30.3	14.6	20.1
Transport	26.6	27.7	27.3
Communications	54.6	83.4	74.4
Urban development	83.5	74.6	76.3
Science and technology	—	91.2	91.2
Education	31.9	77.1	58.7
Health	87.2	87.3	87.2
Sanitation	51.4	45.6	47.6
Environment	45.0	—	45.0
Total	53.3	37.7	44.4

Source: Powers (1989: Table 3.4)

CID for a project is defined as the percent of net benefits accruing to the lower half of the income profile.⁶

Using the CIDs calculated from nearly 400 projects from the period 1979-1986 Powers (1989) reports sectoral CIDs (which are weighted averages). These figures, given in Table 5.4, show that projects in the industrial sector consistently yield the lowest proportion of benefits to the poor – an average of 25 per cent over the period as a whole, compared to 64 per cent for agriculture. The share of benefits accruing to the poor from economic infrastructure (energy and transport) projects is also low.

If a project yields less benefits to the poor than their current share of income then the project **worsens** income distribution. Although this evidence is taken from countries that are very different to Tanzania, the strength of the results are at least suggestive that aid to industry is, whatever its other merits, not directly progressive.⁷ The conclusion is mitigated to some extent by the finding that a large part of the support may increase the supply of incentive goods, though the geographical distribution of these goods is also important.

The study by Mbelle and Karamagi of Norwegian OGL funds reported the regional

6) Benefits accruing to government are excluded as it was not possible to determine the final beneficiary of government resources. Where the CID cannot be calculated using net benefits it is proxied by the, less satisfactory, measure of the share of the bottom 50 per cent in the total number of beneficiaries.

7) A further conclusion that we might draw is that there **should** be such evidence for Tanzania and that donors ought to be concerned that appropriate data are collected for such analysis.

Table 5.5 Regional Distribution of LCs Established for Norwegian OGL, 1990-1991

Location	Number of LCs Established	Per cent
Dar-es-Salaam	925	78.9
Arusha	89	7.6
Mwanza	37	3.2
Moshi	32	2.7
Zanzibar	32	2.7
Others	57	4.9
Total	1,172	100.0

Source: Mbelle and Karamagi (1992: 28).

distributional of LCs established. These data are reproduced in Table 5.5, and show that about 80 per cent of funds are drawn by LCs established in Dar-es-Salaam: our analysis of the main users of Norwegian funds supports this finding. We have no reason to believe that the geographical allocation of import support funds provided by other donors will be substantially different – indeed both BOT and NBC officials confirmed that “nearly all” applications are made in Dar-es-Salaam.

Of course, it cannot be concluded that the final use of goods is also in Dar-es-Salaam: indeed we noted in Chapter 2 that the trading firms may well supply distributors around the country. Nonetheless, the fact that such a proportion of requests originate there suggest that a not insubstantial substantial proportion of end use may well also be there. More generally we might observe that aid programmes in general – and Tanzania appears to be no exception – are over-concentrated in the capital, in both their direct and indirect effects.⁸ Yet only 5 per cent of Tanzania’s population are resident in the capital. Moreover, the regional accounts show Dar-es-Salaam to be by far the richest region: in 1991 its per capita GDP was over three times the national average and nine times that of the poorest regions (see Table 5.6).⁹ Data from across Africa show that most of the poor live in rural areas: in Mali 86 per cent of the poor are rural and in Uganda and Malawi the figures are 92 and 99 per cent respectively.

If the direct effects of the aid programme are poor are limited what of the indirect effects? We have argued in previous chapters that the renewed growth in Tanzania since the mid 1980s may be attributed to the aid money and reforms. Will the poor benefit from this growth? It is now commonplace to observe that growth is a necessary, but not

8) Some commentators ascribe a prime role to the rapid expansion of urban-based administration in explaining urban migration – and the consequent social problems – in Tanzania (see the discussion in van Donge, 1992)

9) The regional accounts are no doubt subject to quite large margins of error, but these cannot be sufficient to alter our argument.

Table 5.6 Regional GDP Per Capita, 1991 (TShillings)

Region	GDP per capita	Region	GDP per capita
Arusha	26,535	Mbeya	28,288
Coast	8,459	Morogoro	21,708
Dar-es-Salaam	72,876	Mtwara	12,347
Dodoma	12,947	Mwanza	14,113
Iringa	26,553	Rukwa	36,026
Kagera	20,110	Ruvuma	26,522
Kigoma	18,442	Shinyanga	17,858
Kilimanjaro	19,475	Singida	20,124
Lindi	8,348	Tabora	15,432
Mara	22,817	Tanga	21,009
		All Mainland	23,410

Source: National Accounts of Tanzania, 1976–1991

sufficient, condition for successful poverty alleviation. In the words of a recent World Bank report:

...there is no escaping the need for renewed growth, and significant growth, as the primary mechanism for alleviating poverty. But the pattern in which the growth occurs and the intersectoral allocations of expenditure within a growing economy are important determinants of how effective renewed growth is in alleviating poverty.

(World Bank, 1993: 1)

Statements such as this are nothing new – it has long been known that growth may not benefit the poor, and this fact provided the impetus for a shift towards basic needs and distributional concerns in the 1970s. Table 5.7 (see next page) is reproduced from one influential book produced at the time of this shift, the World Bank-IDS volume *Redistribution With Growth*. The table contrasts measures of the growth of national income for 1960s data using three different weighting systems.

The most conventionally reported figure – GNP growth – is a weighted average of the growth of income to each income group (say quintile) where the weights are each group's share of income in the base year. That is GNP growth is, by construction, a regressive measure of national welfare as it puts the highest weight on the richest groups. The table contrasts GNP growth with a figure in which each income group is given an equal weight (i.e. equal to its share in population) and "poverty weights" which give a higher weight to poorer groups.¹⁰

10) The weights used were 0.1, 0.3 and 0.6 for the top twenty, middle forty and lowest forty percent respectively.

Table 5.7 Growth and Income Distribution in Selected Countries in the 1960s.

	GNP growth	Equal weights	Poverty weights
Korea	9.3	9.0	9.0
Panama	8.2	6.7	5.6
Brazil	6.9	5.7	5.4
Mexico	7.6	7.0	6.9
Taiwan	6.8	9.4	10.4
Venezuela	6.4	4.7	4.2
Colombia	6.2	6.8	7.0
El Salvador	6.2	7.1	6.7
Philippines	5.4	5.5	5.4
Peru	5.4	5.2	4.6
Sri Lanka	5.0	6.4	7.2
Yugoslavia	4.8	4.7	4.6
India	4.5	4.1	4.0

Source: Chenery et al. (1974: 42)

Only in the case of three of the thirteen countries shown (Taiwan, Colombia and Sri Lanka) has the increase in national welfare been higher as measured by poverty weights compared to the regressive GNP growth measure. In the other countries the better off have benefitted disproportionately from growth. What of Tanzania?

Table 5.8 Distribution and Growth in Tanzania

	GNP weights	Equal weights	Poverty weights
1969 to 1975	4.7	4.8	4.8
1975 to 1991	1.8	-0.2	-1.0

Source: Calculated from World Bank: *World Tables*, *World Development Report* and *Social Indicators of Development*

We have available three point estimates of distribution in Tanzania: 1969, 1975 and 1991. The first two distributions are suspiciously similar so that one may be an extrapolation of the other.¹¹ The 1991 data are for expenditure shares. Nonetheless, bearing in mind these reservations the figures – shown in Table 5.8 – raise serious concern. For the period 1969-1975 income distribution appears hardly to have changed, so that the three measures are virtually identical. However, the 1991 data show a dramatic shift on favour of higher income groups. Indeed, real income fell for the bottom 40 per cent over the period 1975-1991: at a rate of over 3 per cent a year for the

11) Data given by Wagao and Kigoda (1993:14) suggest a worsening of income distribution between 1969 and 1976/77, with the Gini rising from 0.45 to 0.57

bottom 20 per cent. Hence the positive real GNP growth figure is turned into a negative if either equal or poverty weights are used.¹²

Series on rural living standards given by Wagao and Kigoda (1993: 18-20) show a sharp fall between 1976/77 and 1982/83 of more than 10 per cent a year in per capita terms and a stabilisation in real income since that time. Hence the incomes of the rural poor fell more than the average during the crisis years and have not risen with the national trend in the period of reform. These findings are consistent with the deteriorating income distribution reported above.

A further illustration of how growth may **not** benefit the poor is provided at the micro level by Mosley's (1987) study of trickle down from the Agricultural Development Project of Cajamarca in Peru. The analysis identified the direct and indirect project benefits accruing to the rich (top 10%), medium (next 50%), poor (next 30%) and destitute (bottom 10%), where indirect effects were calculated as the trickle down (and up) from consumption linkages. As Table 5.9 shows, the destitute received none of the direct benefits and their share of indirect benefits was a little over one per cent. The poor fare not much better – getting 14 per cent of the direct benefits and only 10 per cent of the indirect. As Berg says in the paper cited earlier: *"giving money to the rich is – at best – a circuitous way to help the poor"* (1986: 266).

Table 5.9 Distribution of Benefits in Cajamarca project		
(000s soles per annum)	Direct Benefits	Indirect Benefits
Rich	400	68
Medium	650	242
Poor	200	35
Destitute	0	4

(Source: Mosley (1987: 194))

The evidence we have given so far, from both Tanzania and from other countries, demonstrates that poverty alleviation cannot be taken for granted but must be a conscious part of a country's development strategy: there should be policies for growth, but it should be a growth which will benefit the poor.

What sort of growth it is that will benefit the poor has been elaborated in recent work on the "new poverty agenda" by the World Bank. In the late 1980s increased attention was paid to poverty issues within the Bank – leading to the 1990 *World Development Report* with a special focus on poverty. The *WDR* was followed by a Policy Paper, *Assistance Strategies to Reduce Poverty*, and – in 1992 – the *Poverty Handbook* and an Operational Directive on "Poverty Reduction". These documents proposed a "two prong" approach to poverty alleviation. The first prong is to facilitate a process of labour-intensive growth

12) The poverty weights used were 0.3, 0.25, 0.35 and 0.1 for the bottom 20, next 20, middle 40 and top 20 per cent respectively.

and the second to develop the human capital of the poor (through improved health and education) so that they may participate in the growth process. There should also be a safety net for the poor. What sort of an impact have these initiatives had in Tanzania?

5.4 Aid and Poverty Alleviation in Tanzania

A part of the renewed concern for poverty issues in the late 1980s manifested itself in the UNDP-World Bank Social Dimensions of Adjustment (SDA) project. In Tanzania an SDA Unit has been established in the Planning Commission. The project document envisaged four areas of activity: data collection, training, research activities and a fund for poverty alleviating projects. There have been activities in the first three of these areas, which are undoubtedly of benefit in policy formulation for poverty alleviation. But no donor support has been forthcoming for the last activity – the provision of funds actually aimed to reach the poor. The CID for the SDA project thus far is zero.

Personnel at the SDA office ascribe donor reluctance to contribute to the fund to a "donor fatigue". Some money was provided in the early 1990s for the Priority Social Action Programme (PSAP) and no evaluation has yet been made of these expenditures. Such an evaluation would clearly be a useful exercise for planning future poverty interventions, but especially so if the absence of an evaluation is all that is stopping further donor support to direct poverty intervention.

In addition to the SDA project there are a number of other initiatives – for example, NORAD are currently planning to finance a Grameen Bank style operation. However, we feel we must agree with Wagao and Kigoda (1993) when they say that existing interventions for poverty alleviation have had a limited impact because of the lack of an overall strategy for poverty alleviation. There have so far have only been piecemeal measures.

No mention has yet been made of how the World Bank itself is implementing its own poverty agenda. There is, in fact, not much to mention. The Poverty Assessment – the analytical foundation for the development of a poverty strategy – is still in the pipeline. Other donors should not wait for the Bank to take the lead in this area but push ahead with strengthening the poverty focus of their own aid programmes.

"Strengthening the poverty focus" will entail some sectoral reorientation. The new poverty agenda correctly emphasises improving the human capital of the poor through health and education. Yet Table 5.2 showed that the low sounding 15 per cent of Swedish aid to the social sectors is higher than that of the aid programme as a whole. SIDA decided some time ago to move out of the health sector as it was "over crowded", but retains a commitment to education if perceived institutional shortcomings can be satisfactorily addressed. We believe that the increase of resources to primary education is a matter of some urgency, and now devote some space to a discussion of the sector and its problems.

Primary Education

As already mentioned, the second prong of the two prong strategy for growth with poverty alleviation is enhancing the capacity of the poor to participate in growth. To achieve either this objective improvements are required in the health and educational status of the poor. Yet in Tanzania primary school enrollment ratios are falling and the level of educational facilities is appallingly low.

In 1978 a push was made for universal primary education (UPE): the number of primary school students enrolling in Standard 1 rose from 543,000 in 1977 to 878,000 the following year (but in 1979 fell back to 541,000). The 1978 cohort left primary education in 1984 – so that the absolute number of primary students actually fell from 1984 to 1985. There have been modest increase in 1989 and 1990, but the number of primary students is at roughly the 1980 level and about 95 per cent the peak reached in 1983.

Whilst the number of primary students has been more or less static over the decade, the population of children of school age has been growing – so that enrollment ratios must have fallen. That they **have** indeed fallen is borne out by all sources of data – though by how much is debated. Enrollment ratios may be measured in either gross or net terms: gross is total number of primary pupils divided by the number of 7-13 year olds; net has the same denominator but only includes pupils aged 7-13 years old in the numerator. Table 5.10 shows different estimates of these ratios. At the worst estimate, by the late 1980s, less than half of all 7-13 year olds were attending school – whereas 60 per cent had done so in the late 1970s.

Table 5.10 Gross and Net Enrolment Ratios in Mainland Tanzania, 1978 and 1988

	GER		NER	
	1978	1988	1978	1988
Ministry of Education	96.6 ¹	78.1	70.7	63.5
TADREG	95.0	74.0	60.0	47.0
Note: 1) Figure for 1980				
Source: TADREG (1992)				

Three main reasons have been identified for falling enrolment ratios:

- the absence of opportunities for suitable employment or secondary education upon completing primary education;
- the lack of community participation in and control over primary schools: more generally an alienation of the majority of the population from the state-sponsored development process; and
- the declining quality of the education delivered by the primary system.

It has been strongly argued in a recent SIDA-financed study on parental attitudes to education in rural areas by the Tanzania Development Research Group (TADREG,

1993) that it is the second of these that is the binding constraint on expanding primary schooling. They argue that:

Much still remains to be done before large-scale donor support to districts can be justified. The major issues are not administrative or technical, but political and institutional.

(TADREG, 1993: 6-7)

Any attempt by the state to further decentralise financial responsibility and managerial authority to local councils and increase community "contributions" without opening more space for democratic accountability will have the effect of further alienating parents from the school system. More parental involvement in running schools is of fundamental importance for future attempts to renovate the system.

(TADREG, 1993: 47)

It is also said that "the problem with primary schooling is as much the misuse as the inadequacy of resources" (TADREG, 1993: 5).

But it is difficult to see **from the material contained in the TADREG report itself** how the authors arrive at the above conclusions. The overwhelming impression given by the respondents in the study is that they are dissatisfied with the **quality** of education. From this fact it follows that they resent the contributions in cash and kind they are required to make, as they feel they are getting nothing in return. They similarly resent that so-called "self-reliance" activities are just a forced labour by students to increase the income of the teacher and/or school – because such activities are not proper education. Statements by respondents such as the following are common in the Report:

If they could assure us the quality of education of colonial times we would be ready to pay for it by working as casual labourers

(Parent from Korogwe in TADREG, 1993: 34)

That parents have good reason to be dissatisfied with the quality of education is clear from the data in Table 5.11, taken from an earlier TADREG report (1992). Educational resources are very poor indeed – it is difficult to imagine how a sound education could possibly be delivered under such circumstances. Some students have to make do with virtually no facilities – desks, textbooks or exercise books – whatsoever. In some areas of educational provision – particularly the number of Grade A teachers – there are also large urban-rural disparities.

An exploratory analysis in support of the view that the quality of education is an important determinant of the demand for education may be made using the district level data compiled by TADREG, by comparing the gross enrollment ratio (GER) with composite performance index (QUAL) for different districts reported in the 1992 TADREG report.¹³ The composite index is the average of five rankings for different measures (per cent of Grade A teachers in total teaching staff, teacher pupil ratio,

13) The performance index includes the net enrolment ratio. To the extent that this measure is correlated with the gross ratio there will necessarily be a correlation between the two. However, the relationship is stronger than one would expect from this fact alone.

Table 5.1 | Primary School Facilities in Mainland Tanzania, 1990

	Average	Minimum	Maximum
Pupils per teacher	35	14	60
Pupils per classroom¹	75	12	318
Pupils per desk	5.0	1.2	38.0
Pupils per textbook	3.6	0.2	20.0

Note: 1) Urban schools operate a two shift system.

Source: TADREG (1992)

recurrent budget per pupil, class size and net enrolment ratio) – so that the **lower** the index the higher the quality of education in that district. If educational quality affects the demand for education we would expect a negative relationship between GER and QUAL: as the quality of education rises (QUAL falls) then the enrollment ratio increases.

There is indeed a significant negative relationship between these two variables, as shown in the scatter plot in Figure 5.6 (drawn for the 91 districts for which data were available). The regression line is also shown.¹⁴

It seems likely therefore that it will not be possible to increase parental willingness to send children to school until such time as resources available to education are improved: this statement is contrary to the conclusion given by TADREG. We suggest instead that there is a need for donors to consider large scale intervention at the district level to improve the provision of educational resources. We also believe that this end is compatible with preserving the advantages identified for import support. The next section explains how.

5.5 Modalities for Swedish Aid: A Proposal

As was described in Chapter 2, a large share of Swedish aid in recent years has been in the form of import support. A concern of SIDA, in common with other donors, has been that accounting procedures are adopted to allow monitoring and enforcement of cash cover collection and that the money should not be used to fund items on the negative list. Some donors see these safeguards as particularly important in justifying the OGL system “back home”: it is important that aid funds cannot be directly used to finance luxury imports (regardless of the fact that fungibility will allow this to happen in practice).

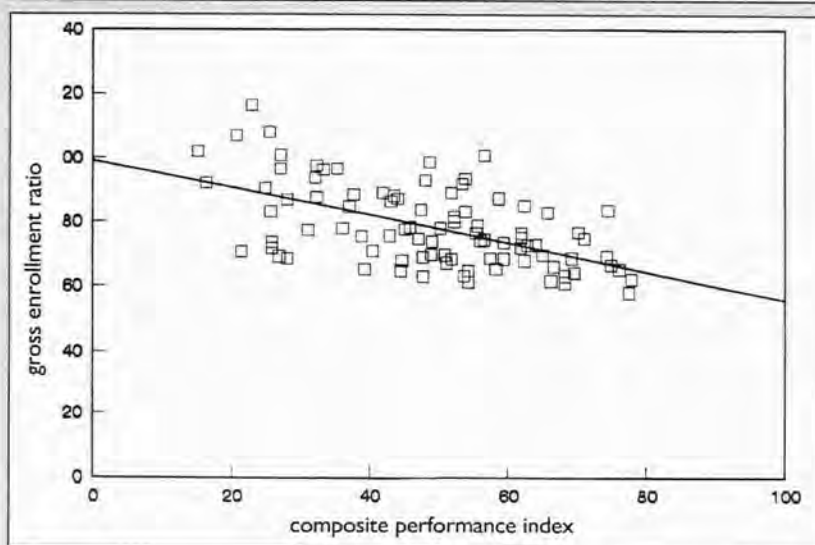
SIDA does not tie the use of the cash cover in any way whatsoever – the intention is that cash cover receipts by government should **not** lead to increments in expenditure but rather to reduce the need for deficit finance. Indeed, as mentioned in Chapter 3,

14) The formula for the regression line is (t-statistic in parenthesis)

$$\text{GER} = 99.3 - 0.43\text{QUAL} \quad R^2 = 0.30$$

(-6.21)

Figure 5.6 Educational Demand and Quality



the SIDA document *Principles of Import Support* rejects in principle double-tying: that is tying the use of both the forex and the counterpart funds.

We would propose a different system, or rather a series of choices that may be combined into a single system. First, the maintenance of donor funds as a separate forex window with different procedural and access requirements is incompatible with exchange rate unification. Only by channelling funds through a single system can unification be achieved. Such a procedure is now (August 1993) being proposed by the World Bank, with the intention that donors should match their funds against actual imports in an *ex post* manner. This system is viable so long as the value of eligible imports to be funded exceeds the aid funds put into the system. However, there is clearly great scope for fungibility under such a system and the fact that the aid funds actually finance imports in "non-essentials" may be very apparent. But we think this should not be of concern to the donors. Donors should be concerned not with the use of the forex but with the use of the counterpart funds. Why is this?

First, as argued in Chapter 3, an aid-financed economic expansion will lead to an increased demand for imports over and above the value of the aid provided, so that the aid does not relieve (but tightens) the forex shortage. If donors fund projects that are less import-intensive then this problem is less acute. Import support is 100% import intensive. The most recent data (shown in Table 5.12) show industry to be extremely import intensive. By contrast, these data show the social sectors to have no import requirements at all!

Table 5.12 Import Intensity by Sector

	1976	1980	1985
Agriculture	1.2	2.8	1.0
Agricultural processing	18.8	20.5	13.2
Other manufacturing	90.1	96.9	84.9
Other industry	10.5	18.7	22.4
Social services	0.0	0.0	0.0
Other services	3.5	3.9	2.0
Whole economy	13.7	15.9	9.8
<i>Note: Import intensity is defined as imports divided by gross output</i>			
<i>Source: Revised National Accounts of Tanzania</i>			

Whilst the figure of zero is clearly an understatement of these sectors import requirements, the requirements are low indeed. In education at least three quarters (and often more) of recurrent expenditure is on salaries. Most items used in schools – such as exercise books and pencils – are manufactured in Tanzania (although some of the raw material may be imported). A SIDA study of rural health clinics (Anderson-Brolin *et al.*, 1991) found up to 50 per cent of costs to drug purchases which are either imported or, if manufactured domestically, have a high import content. But 50 per cent is an over-estimate of the import content of rural health care since a part of the wage costs of these centres are met by outside agencies. A more realistic upper limit to the import component of health expenditure would be of the order of 20 per cent.

These figures are important since we suggest that a donor provide the forex equivalent of total project costs and the government retains that part of the forex that is required for the project and sells the rest.

With such a proposal forex is provided through an auction to the private sector, as proposed in our *Interim Report* and now put forward by the World Bank. But from the point of view of the donor, these funds are **not** being used for imports: the donor funds are the counterpart funds which are used for health, education or whatever. The whole of the aid has been used to support health – regardless of the fact that the process involved the sale of forex to raise local funds. By saying this – by concentrating on the use of the monies in country rather than the use of the forex, aid officials should be able to (quite honestly) justify the system to politicians and public at home.

But SIDA has, rightly, been concerned to limit increase in expenditure on account of the inflationary implications of deficit financing. This concern is well-founded. At the same time, the social sectors are in need of rehabilitation – which can be partly achieved through reallocation of expenditure but may also require some donor-backed expenditure increases.

A further change in modality may be from project to sector and/or district support. Project type interventions have proved unsustainable, partly because of the environ-

ment of institutional destruction in Tanzania. The ultimate concern of government and donors alike must be that there exist well run, efficient and sustainable social services which deliver the goods. Donors may therefore be better advised to think in terms of systems support rather than projects. In practice, such a mechanism would operate through a government-donor monitoring scheme operated at national and district level. The provision of donor funds would not be ear-marked to specific projects but rather to achieving agreed in targets (in sectoral spending levels, input delivery and, most importantly, output indicators). Systems building rather than the systems displacement caused by projects should be more sustainable – but attention needs to be paid to the recurrent cost implications of all activities (as suggested by the government's development of a rolling plan).¹⁵

Taken to its logical conclusion, our argument leads to the view that the donor need not be concerned to monitor the use of the aid monies at all but only (indirectly) its results. Table 5.11 showed the dismal state of primary school facilities in mainland Tanzania. Based on a frame of all primary schools a sample of 100 could be taken each year (or even six monthly) to monitor progress in these indicators of educational quality. The success of the aid funds would be judged on these grounds, and not an accounting of the use of each dollar in the ministerial bureaucracy.

Even with this sectoral support some outside assistance may be required in rehabilitation and delivery of technical services. Most such interventions – particularly in the social sector – are tied by donors. Whoever pays decides who should deliver the goods and services. This practice is contrary to the market-based allocation system donors support in other areas of economic decision making. All donors with an interest in a sector may be involved in the monitoring process. But this fact need not imply that they need be involved in project management. Where clearly defined, separable activities in the government programme ("projects") are to utilise external inputs the agency delivering these inputs should compete to do so. Donors wishing to remain involved in project management and implementation should expect to compete with other donors and private agencies for the right to do so, even if "their funds" are paying for the project.

There may still be some room for general balance of payments support in the bilateral programme. If this is channelled as debt relief on debt that Tanzania has to and would have paid (i.e. to the World Bank or IMF) then this money is equivalent to a gift of untied forex. Hence, in line with our arguments above, this is the most appropriate form of BoP support. If additional import support is required this may either be through the *ex post* identification of what the money was used for or even attached to particular commodities (e.g. paper) up to some certain minimum import requirement. However, the share of funds explicitly identified as import support should decline.

15) An example of how such a scheme may operate is provided by USAID's import support to the road sector. The counterpart funds are earmarked for a road fund for maintenance expenditure. These fund will be phased out by 1995. It is planned that by that time the fund will be sustained wholly from domestic revenues raised from vehicle-related taxes.

5.6 Conclusions

The primary purpose of aid is the alleviation of poverty. This purpose will only be served if the direct and indirect effects reach areas of concern to the poor. Hence aid should be predominately rural rather urban; agricultural rather than industrial; and social rather than economic infrastructure. Neither import support nor aid in general match up to these requirements.

There are channels through which OGL can benefit the rural poor – largely through the provision of incentive goods and the facilitation of marketing of agricultural produce. It is desirable that aid continue to allow these kinds of imports. Nonetheless, our review suggests that there has been an undue neglect of poverty issues by government and donors. SIDA could well take the initiative in redressing the balance.

Our proposal is that aid monies be directed to sectors of benefit to the poor – we highlight primary education. Poverty lending is not very import intensive. Therefore the largest part of the aid will be required for local expenditures. The local funds will be raised by the sale of the donor forex by auction by the Bank of Tanzania – no conditions whatsoever should be attached to the use of these funds (so that the principle of not double-tying is not violated).

Adopting our proposal will result in a reduction in the share of Swedish aid designated as import support. This is our recommendation.

Appendix

TERMS OF REFERENCE

TERMS OF REFERENCE FOR A JOINT EVALUATION OF IMPORT SUPPORT TO TANZANIA BY NORWAY AND SWEDEN

1. BACKGROUND FOR THE EVALUATION

Since the early 1980s import support programmes have constituted a major aid effort in Tanzania by Norway and Sweden, accounting for 30-50 per cent of the regular annual aid programmes. The high level of import support are to a large extent linked to the Tanzanian economic reform programme supported by the World Bank and IMF.

Norway and Sweden carried out evaluations of import support to Tanzania in 1988. Since then there has been a change from channeling the import support through the previous system based on administrative allocation, to the market-based Open General Licence (OGL) system. There is also a need to go beyond previous evaluations and address the impact of import support on the overall economy and its relevance to overall aid objects.

The two donors will undertake a joint evaluation primarily because of both donors support the OGL system in a similar way. A pre-study was carried out during August 1992. The main study will be carried out in the period January-August 1993.

2. OBJECTIVES

The main objectives of the study are to:

- 2.1 Evaluate the total import support to Tanzania and particularly the support via the OGL system. The import support shall be judged in terms of efficiency, effectiveness, impact, aid dependence and relevance to Tanzania's needs and to Norway's and Sweden's goals of support.
- 2.2 Evaluate the Norwegian and Swedish import support in relation to the same criteria.
- 2.3 Discuss the macroeconomic effects of import support in relation to the same criteria.
- 2.4 Present recommendations on future import support to Tanzania regarding critical factors of the economic policy framework, the balance between import support and other support including project support, and the administrative procedures for import support.

3. SCOPE AND FOCUS

The Main Study shall comprise the following tasks with emphasis on the macroeconomic issues:

- 3.1 Briefly delineate the explicit and implicit objectives of the Norwegian and Swedish import support to Tanzania during 1986-1992. Describe briefly the basis for the two donors' decisions to support the OGL system.
- 3.2 Examine and assess the effects of import support on the resource utilization of various categories of foreign exchange users in terms of:

- a. Financial and economic efficiency.
 - b. Capacity utilization, production technology, use of local resources and employment creation.
 - c. Social impact (distributions effects).
- 3.3 Estimate the real (or shadow) price of foreign exchange and the proportion of this price that actually has been paid by the foreign exchange users, and assess the effects of possible price differences on foreign exchange utilization.
- 3.4 Examine and assess whether the OGL system has been a more efficient means of implementing import support to Tanzania than the previous system based on administrative allocation. Hereunder, assess to what extent the two systems have succeeded in:
- a. Allocating the import support to users that have been able to utilize the imported goods efficiently in financial and economic terms and with a positive social impact ("right" users).
 - b. Delivering the types of imported goods agreed upon, at correct price and quality and in a timely and cost effective manner ("right" imports).
 - c. Collecting and transferring the full amount of counterpart funds to the Government.
- 3.5 Assess to what extent the credit allocation system and the general credit policy have effected the ability of the OGL system to function according to its intentions. Also identify and assess other aspects of the implementation of the Economic Recovery Programme policies that are considered important for the function of the OGL system, e.g. the exchange rate policy.
- 3.6 Assess the economic and social impact of counterpart funds from the import support on the Government Budget, including revenues, expenditures, fiscal deficit, aid dependency and fiscal policy. Hereunder, assess the impact on:
- a. The government's mobilization, allocation and utilization of the financial resources for development and other purposes.
 - b. The internal economic stability (e.g. Government budget balance, money supply, price level, interest level).
- 3.7 Assess the effects of import support through the OGL system and other non-project assistance on Tanzania's balance of payments. Hereunder:
- a. Examine trends in export and import structure that can throw light on the issues of productive use of foreign exchange (e.g. primary products, manufactured goods, services; consumer, intermediate and capital goods: private sector and government sector imports).
 - b. Examine trends in the flows of foreign financial resources on the balance payments, hereunder especially the approximate flows related to the own funds scheme. Assess the effects of import support on Tanzanian mobilization and utilization of foreign exchange. Also compile available data and if necessary, make estimates of the composition of various sources of foreign exchange, such as import support and own funds.
 - c. Assess the effects of the import support on the external economic stability (e.g. balance of trade, level of exchange rate, foreign exchange reserves).
- 3.8 Analyze and assess the economic and social development effects of total non-project assistance on the overall economy. Hereunder, the effect on:
- a. Domestic saving and investment ratios (e.g. to what degree has the support been additional to domestic saving and investment?).
 - b. Aggregate productivity (e.g. Incremental Capital Output Ratio-I.C.O.R) and choice of

- technology (e.g in terms of capital-saving, labour-saving or neutral technical change effects).
 - c. International competitiveness (e.g "Dutch disease" effects, export creation and import substitution).
 - d. Economic growth.
 - e. Absorption capacity and inflation.
- 3.9 Discuss the macroeconomic effects on the economy of import support vs. effects of other forms of assistance, including project support. Consider the appropriate balance between different forms of assistance.
 - 3.10 Consider the likely consequences for the productive sectors of a unified and fully market-based foreign exchange system.
 - 3.11 a) Discuss the statistical basis used and assess the extent to which lack of data, empirical economic models, and other knowledge about the Tanzanian economy, including the "parallel economy", constrain this evaluation. Discuss how this uncertainty may affect the evaluation's conclusions and recommendations.
 - b) Identify important gaps remaining in our knowledge about the impact support and the functioning of the OGL system in Tanzania. Discuss the need for further studies.
 - 3.12 Identify critical factors for support programmes to achieve intended effects on the Tanzanian economy, and examine changes in these factors since the introduction of the Economic Recovery Programme.
 - 3.13 Present lessons learned as well as recommendations or options related to findings on the above issues.

4. EVALUATION TEAM

The evaluation will be carried out by an independent evaluation team with expertise and experience that covers:

- Microeconomic analysis (i.e economic and financial analysis) of the industrial and agricultural sectors in developing countries, preferably from Tanzania.
- Macroeconomic management of the Tanzanian economy.
- Production of national accounts/balance of payments statistics and industries' statistics with experience preferably from Tanzania.
- Good knowledge about the Tanzanian economic policy and government system.

The study is envisaged to require a maximum of 15 man/months.

5. METHODS

The evaluation shall be undertaken in close cooperation with the Norwegian Ministry of Foreign Affairs, NORAD, SIDA and the Tanzanian authorities.

The evaluation study shall be based on project documents, evaluation studies and other relevant documents, statistical sources and field studies, as well as on interviews and discussions with key informants. Evaluation of the implementation of the import support (paragraph 3.4 above) and of its effect on the resource utilization of foreign exchange users (paragraph 3.2 above) shall as far as possible draw on available data and information of relevance without unnecessary collection of new primary data. Relevant sources of primary data and information are i.e reports and primary materials from:

- Ofstad, Arve (September 1992), "Evaluation of import support to Tanzania- Pre-study", Chr. Michelsen Institute, Bergen.

- Mbelle, A.V.Y. and Karamagi, I (December 1992), "Evaluation of the NORAD import support programme through the Open General Licence (OGL) System". A report submitted to NORAD.
- The World Bank sub-sector studies on the rehabilitation and restructuring of various industries in Tanzania:
First phase - the Industrial Rehabilitation and Trade Agreement (IRTAC) - comprising the leather, textile and edible oil sub-sectors.
Second phase - the Industrial Restructuring and Adjustment Credit (IRAC) - focusing on the metals and engineering, wood and paper, agroprocessing and the chemicals, fertilizers, plastics and rubber sub-sectors.
- World Bank/SPA multi-donor review mission, "Joint SPA mission to Tanzania for import support management" 1990 (October 1990), 1991 (October 1991) and 1992 (October 1992).
- Norwegian state audit's review of TANAA credit and joint financing.
- The World Bank's Public Expenditure Reviews (PER)

The evaluation team will consider the reliability and validity of data used in the above-mentioned studies.

6. REPORTING

The consultants shall submit the following reports in the course of the Study:

- a. Inception report; commenting and interpreting the terms of reference, describing how the various issues shall be answered and presenting a work plan.
- b. Draft final report; setting out the findings, analysis, conclusions and recommendations as required by these terms of reference.
- c. Final report after receipt of comments on the draft final report.

The final report shall be prepared according to the standardized format used for SIDA evaluation reports.

7. TIME SCHEDULE

The tentative time schedule for the evaluation is:

1992 Nov-Dec: Agreement on the T.O.R. for the evaluation. Selection of consultants.

1993 Ultimo Jan: Inception report including plan for operationalization of the T.O.R. and work plan.

Ultimo Feb-primio Apr: Field work in Tanzania.

April 15: Seminar and written report on preliminary findings in Norway.

May 29: Submission of draft final report to be commented on by the donors and the Government of Tanzania.

August: Submission of final report.

January 7, 1993

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Fungibility and Sustainability

Import Support to Tanzania

Tanzania is a major recipient of Swedish import support. SIDA and the Norwegian Ministry of Foreign affairs decided to evaluate Swedish and Norwegian import support to Tanzania in two parallel and unusually ambitious studies, and this is the SIDA-financed evaluation.

The authors find that the Open General Licence (OGL) System, under which the Government of Tanzania sold foreign currency from import support to buyers on first come, first served basis, functioned significantly better than the pre-1991 system. In August 1993, a new system with a single exchange rate was adopted by the Government with support from the World Bank; the new system will overcome many of the perceived problems of the OGL system.

The authors' analysis emphasizes the *fungibility* of import support; if Tanzania receives import support, the Government can use its own foreign currency – which would otherwise have financed imports – for some other purpose. The authors note that imports have not increased in Tanzania since 1970. During this period the real purchasing power of Tanzanian exports fell, implying that Tanzania cannot on its own finance the level of imports necessary to sustain economic growth.

The counterpart revenue from import support has enabled the Government of Tanzania to stop cutting Government expenditure and borrowing from the domestic banking system. Also, Government revenue has increased due to import-induced economic growth.

The OGL system has probably benefited the rural poor by increasing the supply of incentive goods and by making it easier to transport agricultural produce to market. The authors suggest that the poor would benefit even more if some import support was replaced with a new kind of aid: increased Government spending on primary education financed by the sale of foreign currency from Sweden.

Copies of this report can be ordered from SIDA, S-105 25 Stockholm, Sweden.

