Country Economic Report 2001:3

Tanzania 2000

Growth, Multilateral Debt Relief and Program Aid

Anders Danielsson
Godwin Mjema

Sida

SWEDISH INTERNATIONAL DEVELOPMENT
COOPERATION AGENCY

This country economic report on Tanzania is part of a series of annual studies, which are undertaken by the departments of economics of three Swedish universities in collaboration with the regional departments of Sida, under an agreement with the Division for Policy and Socio-Economic Analysis. The purpose of these studies is to improve Sida´s economic analysis and knowledge of the programme countries for Swedish development cooperation in order to enhance the effectiveness of programme as well as project support.

This report has been prepared by Anders Danielsson, Department of Economics, University of Lund and Godwin Mjema, Economic Research Bureau, University of Dar es Salaam

Jan Olsson
Head of Division for Policy and
Socio-Economic Analysis

Contents

Executive Summary

1. Tanzania's economy has reached stability. Inflation is low and falling and the fiscal deficit has, thanks to the cash budget, been virtually eliminated. Adjustment proceeds, if rather slowly, and is focused on privatization of remaining parastatals and civil service reform.

2. The major obstacles to smooth adjustment appear to be three. First, disappointing export performance in most sectors. Second, a sluggishness in structural change. Third, a blatant inability to raise increasing amounts of tax revenue. In addition, corruption is reportedly remaining on high levels.

3. While growth has increased in recent years, and short-term projections indicate further increases in that rate, its impact on poverty is still small. Urban poverty appears to be more responsive to growth than rural poverty and since most of the poor are found in rural areas, the impact of current growth is limited.

4. The limited impact of growth is reinforced by the impact of the cash budget on the quality and quantity of social services. In addition, it is likely that such services have deteriorated more in rural than in urban areas, thus adding to the already significant differences in rural and urban standards.

5. Current growth is geared towards tourism and mining, two sectors with limited linkage to the rest of the economy. Consequently, this growth pattern may be expected to increase income inequality, so even higher growth is required to have a given impact on income poverty. Rough calculations suggest that annual increases of real GDP in the neighbourhood of 8–9 percent may be required to reach the Government's poverty alleviation objectives.

6. Tanzania has received interim debt relief under the HIPC Initiative since April, 2000 and is expected to reach the completion point towards the end of this fiscal year. The HIPC Initiative provides debt relief over a 20-year period of about US$2 billion in NPV terms, about half of the existing debt.

7. The current agreement allows for the debt to triple in the coming fifteen-year period. Such a rapid increase of the debt will be sustainable only if the economy grows rapidly throughout this period.

8. The debt sustainability analysis in the Decision Point document show the necessary conditions for keeping the debt at a sustainable level. These include GDP growth of six percent per annum in real terms; growth of traditional exports of slightly less than that; and an increase of the export-to-GDP ratio from 13.6 percent in 1999 to 18.3 percent (on average) in 2009/18. This implies annual growth of non-traditional exports (in volume terms) in excess of 20 percent.

9. These projections differ substantially from the historical record of Tanzania. It is therefore notable that no risk analysis or contingency plan appear to accompany the HIPC agreement. As a failure of Tanzania to meet these projections implies that the country's debt situation will be unsustainable in 2020 and as such a situation may be due to either bad performance or unrealistic projections, an alternative plan of action is very much warranted. It should be in the interest of all stakeholders that a mutually agreed contingency plan is developed.

10. The multilateral debt fund (MDF) became obsolete as Tanzania started to receive interim debt relief under the HIPC initiative. Program aid continues to be delivered as budget support, through the PRBS facility.

11. The PRBS replaces the MDF, not only as a channel for delivering program aid, but also in design. The major reason for this is that most involved parties regard the MDF as a useful and efficient instrument for disbursing aid.

12. In return for program aid through the MDF/PRBS, the Government agrees to protect social sectors in the sense that it sees to that the amounts budgeted are also actually paid out. Analysis of the available data indicate that the MDF has worked in the sense that amounts actually paid out to social sectors increased after 1998 (the year when the MDF became operational); also the amounts paid out as percentage of amounts budgeted increased after 1998.

13. Limited data suggest however that in real terms allocations to primary education have not increased since 1995 and also that the share financed by donors has

increased. The apparent substitution of aid resources for own resources is contrary to intentions and measures should be taken to ensure that program aid resources are truly additional. The dialogue concerning these issues should however, be conducted in other fora than the PRBS so as not to jeopardize the simplicity and transparency of the facility.

1. Introduction*

This report surveys recent developments in Tanzania's macroeconomy, discusses the implications of the HIPC-eligibility (Tanzania is expected to reach the completion point later in this fiscal year, and receives interim relief since April 2000), tries to pin down how program aid under the multilateral debt relief facility has affected the status of social sectors. In addition, the report examines how the change of modality of that program aid—from multilateral debt relief to budget support—will affect the quality and quantity of social sector output. When discussing social sectors, we focus on primary education.

The report is structured in the following way. Chapter 2 outlines macroeconomic trends and tries to relate Tanzania's recent accomplishments to the objective of halving poverty before 2015. While stabilization has been more or less accomplished, we argue, that the difficult reforms that are necessary for higher growth are not yet in place; we also argue that the current growth pattern of the economy may not have a major impact on poverty, at least not in the medium run.

Chapter 3 examines the external debt in view of the multilateral debt relief. We argue that the HIPC initiative is often misunderstood in the public debate, and we make explicit the conditions that underlie the HIPC strategy.

Chapter 4 outlines the strategy and workings of the multilateral debt fund and how this will change when it is replaced by a budget support facility. Although we agree with participating donors that the structure of the MDF should be retained, we also point to a number of areas in which this particular form of program aid could be made more efficient.

---

* Previous versions of this report have been presented at the University of Dar es Salaam and the Swedish Embassy in Dar es Salaam and at Sida Stockholm. We are grateful to seminar participants for helpful comments. Interviews were conducted in September and December, 2000. We are particularly grateful to the interviewees—listed at the end of the report—who took time off their normal duties to talk to us. Remaining errors are ours. Comments are appreciated and should be addressed to Anders Danielson at anders.danielson@nek.lu.se

Chapter 5 examines briefly the state of the education sector with particular emphasis on primary education. The argument is that the stake-holders' recent emphasis on increasing the share of other charges in recurrent expenditures is sound, although it is a delicate balance to maintain, particularly in view of the low salaries paid to teachers. In addition we point to the skewed regional distribution of education resources and question whether this is optimal from a poverty-reduction point of view. Chapter 6 offers concluding remarks.

2. Macroeconomic Trends

2.1 The Short Run: Stabilization

In the past years, most macroeconomic indicators in Tanzania have improved considerably; and those that have deteriorated have done so chiefly because of exogenous events, e.g., the "el Nino" rains in 1998 and the ensuing drought. Table 1 provides an overview of some of the key data.

Table 1

Selected Economic Indicators, 1995–2000

	1995	1996	1997	1998	1999[a]	2000[b]
GDP (nominal bn TSh)	3 020	3 767	4 703	5 631	6 393	7 126
Real GDP growth	3.6	4.5	3.5	4	4.6	5.2
Real GDP growth per capita	0.7	1.6	0.7	1.2	1.8	2.3
Inflation	26.8	15.5	15.4	11.3	7	5
Revenue (% of GDP)	12.5	13.2	13.5	12.6	12.6	13.1
Current expenditure (% GDP)	14.5	13.8	14.3	13.6	13.4	14.4
Dev expenditure (%GDP)	2.5	0.9	2.9	3.8	4.8	4.9
Investment (%GDP)	19.8	17	15.2	15	15.5	16.4
o/w: public	*3.4*	*3.1*	*3.3*	*3*	*3.5*	*4*
o:w: private	*16.4*	*13.9*	*11.9*	*12.1*	*12*	*12.4*
Current account (% of GDP)	-8.1	-3.6	0.1	-4.4	-4	-4.2
Int'l reserves[c]	1.6	1.5	2.8	3.1	4.1	4.2

Sources: *HIPC Decision Point Document*, March, 2000; *Public Expenditure Review*, 1999, Vol. 1

[a] Preliminary

[b] Projection

[c] Months of imports

Growth of GDP is higher than it has been for over two decades, an estimated 5.2 percent in 2000. While per capita incomes are also growing in real terms, that growth is still low, due to a high rate of population growth (estimated at 2.8 percent).[1] Since poverty is widespread and probably has increased in the 1990s (despite positive per capita growth), it has been estimated that growth in the range 7–8 per cent in real terms is necessary to impact visibly on poverty levels (Danielson and Mjema, 2000).

Inflation has been reduced from almost 30 percent per annum in 1995 to an estimated 5 percent in 2000. Moreover, most of recent increases in prices are attributable to increases in food prices, which in turn have increased due to unfavourable weather conditions. The major reason for the success in bringing inflation down is undoubtedly the cash budget—the system by which the government is prohibited to spend, in any given month, more than it received in tax collections (plus budget support) the previous month. While the cash budget has had a negative impact on the workings of the public sector—in particular the quality of social sector output—it is rather clear that the reduction of inflation could not have been accomplished without this system.

The cash budget system removed the possibility of financing discrepancies between revenues and expenditures through borrowing from the central bank; in a sense, expenditures are the residual under a cash budget. Since the government has been unable to increase the revenue-to-GDP ratio in a consistent fashion, the cash budget implied that expenditures fell and reached an all-time low of 13.4 percent of GDP in 1999. An additional feature of the cash budget is a clear prioritisation of expenditures, with debt servicing and clearance of arrears having first priority, followed by personal emoluments (Danielson and Mjema, 1999). This means that the residual in the system has been "other charges"—the post under which expenditures on maintenance, running costs other than wages and salaries, and administration are recorded. As will become evident later on in the report, this has affected social sectors negatively and measures are currently being taken to correct for it.

[1] Note, however, that the rate of population growth is derived from the 1988 Population Census and may not be appropriate. A new census is planned for 2001/02.

Investments are picking up—both private and public. The increase in the latter is partly due to a renewed investment effort following the 1998 el Nino rains which ruined a sizeable part of the country's infrastructure. The increase in private investment is mainly due to increased inflows of foreign investments into three sectors: mining, tourism and purchases of privatised public entities. While the recent increase in private investments is to be welcomed, it is still very low and probably insufficient for the rates of growth that are envisaged for the near future (cf. below).

Finally, the current account does not appear to have improved very much. However, as noted above, unfavourable weather conditions in recent years decreased exports and increased imports. Even though this is a clear illustration of the fragility of Tanzania's success, it is not a consequence of bad policy; on the contrary, the government has been able to accumulate international reserves equivalent to over four months of imports which should be sufficient to cushion most future shocks without jeopardising the stability of the current situation.

Table 2

Accounting Budget Frame, percent of GDP (fiscal years)

	1995	1996	1997	1998	1999	2000
Revenue	**17.0**	**14.7**	**17.3**	**17.4**	**18.2**	**19.3**
Domestic	12.5	13.2	13.5	12.6	12.6	12.6
"Import support"	1.3	1.1	2.7	1.7	1.5	2.9
Project aid	1.8	0.7	1.5	3.5	4.1	4.0
Non-bank borrowing	0.2	-0.2	0.1	0.6	0.0	0.0
Bank borrowing	2.1	1.8	-1.1	-0.5	-0.2	-0.2
Other	-0.9	-1.9	0.6	-0.5	0.2	0.0
Rec Expenditure	**14.5**	**13.8**	**14.3**	**13.6**	**13.4**	**14.4**
Debt Service	4.7	3.3	3.5	3.9	4.6	3.4
Personal Emolument	4.4	4.1	4.6	4.7	4.4	4.4
Other Charges	5.4	6.4	6.2	5.0	4.4	6.6
Dev Expenditure	**2.5**	**0.9**	**2.9**	**3.8**	**4.8**	**4.9**

Notes: Fiscal years run from July to June ending in the year given in the table heading. Other charges (OC) include payment of arrears, designated items and OC proper. "Import support" covers all program aid, including debt relief, budget support and resources released under the OGL scheme.
Source: PER, 1999, Vol. 1

Most analysts—including the IMF; cf. the PIN of September 2000—regard stabilization in Tanzania as accomplished. What remains is consolidation. Moreover, the majority of analysts seem to agree on what has been accomplished and what are the remaining problems. To avoid excessive duplication of work, this section of the report therefore brief comments to the data presented. Any reader interested in more detailed analysis is referred to the relevant documents, in particular PER (1999, Vol. I Chs. 1–3 & Vol. II, Ch. 3), IDA/IMF (2000), IMF (1999, 2000) and the GOT (2000).

As often noted, a major problem in Tanzania's stabilization efforts has been the public budget. This goes for unrestricted spending as well as slow improvements in revenue collection. While some of these problems have been addressed through the cash budget system, public affairs are still a major problem, both with regard to revenue collection and to perceived corruption among officials—the judiciary, the police, and the Customs were singled out in the Warioba Report on corruption.

Some formal aspects of the budget are in Table 2. Corruption, by many singled out as the major cause hampering faster development in Tanzania, is by its very nature difficult to capture and the information is limited to formal aspects. There are, nevertheless, interesting features to note.

Tax revenue remains low at 12.6 percent of GDP. Although much has been done to remedy the situation—including the establishment of TRA, the introduction of VAT and the abolishment of discretionary exemptions—tax evasion and rampant corruption (particularly in Customs) prevent the tax ratio from increasing consistently. The other side of the coin is frequent complaints of tax harassment by complying businesses. The failure of the government to increase revenue collection substantially (to, say, 15–17 percent of GDP) is a major constraint on service delivery of adequate quality and quantity.

Expenditures have been contained, mainly because of the cash budget coupled with an inability to raise more revenue. It deserves to be noted that development expenditures appear to be on an upward trend (partly a reflection of increasing foreign aid after 1996) while both components of recurrent expenditures net of debt service are relatively constant. This observation runs counter to what is observed in some social sectors, notably education, where falling shares allocated to other charges are blamed for deteriorating quality of service delivery (cf. Chapter 5).

Consequently, the Tanzanian resource envelope is far from sufficient, mainly due to an inability to increase the tax ratio. While a more successful fight against corruption may do much to increase collections, the solution in the longer term is clearly a move towards a more streamlined and broad-based tax system. In this strategy, economic growth is the key to a sustained increase of revenue.

A consequence of the cash budget is that the scope and need for the government to borrow from the banking system has declined (and almost been eliminated). This implies in turn that the rate of growth money is no longer fuelled by the fiscal deficit that, as noted, has had a decisive and sustained impact of inflation. As Tables 3 and 4 clearly shows, the monetary accounts suggest that major changes are occurring in Tanzania's financial markets and the monetary policy of the BoT.

Table 3

Components of broad money (percent)

	1995	1996	1997	1998	1999	2000
Currency	32.4	31.5	31.1	30.0	31.6	27.9
TSh deposits	49.1	52.2	51.0	52.3	48.2	48.9
o/w: demand	*24.4*	*23.4*	*22.2*	*23.1*	*20.3*	*20.2*
o/w: time	*12.1*	*15.0*	*13.6*	*13.1*	*12.3*	*12.2*
o/w: savings	*12.5*	*13.8*	*15.1*	*16.1*	*15.6*	*16.5*
Forex deposits	18.5	16.3	18.0	17.7	20.2	23.2

Source: IMF (2000)

Table 3 decomposes broad money (i.e., M3). The most notable change over time is the growth of forex deposits—from 18.5 percent in 1995 to over 23 percent in the current year. The share of forex accounts has grown at the expense of both currency and Shilling accounts. In particular, it implies that the difference between the rates of different definitions of the money stock has widened. This is the major reason why the rate of growth of M2 has been consistently lower than the target while the reverse is true for M3. As the former is arguably more important for inflation, it suggests that the Bank of Tanzania has pursued a more strict monetary policy than planned.

Table 4 depicts the same phenomenon from a different angle. Net foreign assets have grown by over 300 percent since 1995 while net domestic assets have shrunk somewhat. The reasons for this is privatization and a spending cap on remaining parastatals—claims on the public sector (government excepted) have fallen by close to 90 percent under a five-year period.

Consequently, the Bank of Tanzania has taken the opportunity during the past few years to accumulate foreign assets. The rationale behind this is twofold. First, it allows for the accumulation of reserves, which is at the level of more than four months of imports. Second, it prevents the Shilling from appreciating against the dollar. Indeed, the nominal exchange rate has been stable around 800 for almost a year. While the Central Bank has no official target with respect to the nominal exchange rate, the stability in times when the dollar has appreciated against most major currency gives rise to a suspicion that the Central Bank is targeting the exchange rate after all.

Table 4

Monetary Survey (bn. TSh)

	1996	1997	1998	1999	2000	% change 95–00
NFA[a]	290.9	399	467	617.4	686.9	313.8
NDA[b]	571.3	571.9	603.7	643.8	559.8	-11.3
o/w: claims on gov't	*295.8*	*239.5*	*267.6*	*360.8*	*360.5*	29.1
o/w: credit to public[c]	*24.8*	*20.7*	*8.4*	*9.3*	*9.1*	-89.2
o/w: credit to private	*116.6*	*162.3*	*239.9*	*302.2*	*284.5*	74.0
Other	134.1	149.5	87.8	-28.5	-94.5	-191.1

Source: IMF (2000)
[a] Net Foreign Assets
[b] Net Domestic Assets
[c] Government excepted

And here is a dilemma for the Bank of Tanzania. For a long time the real exchange rate (which is the conventional way of proxying international competitiveness) has appreciated against neighbouring countries. The major reason for this has been higher inflation in Tanzania. Recently inflation is down below 6–7 percent so the inflation differential is virtually eradicated. One of the options for the Central Bank now is to boost competitiveness through managed depreciation of the nominal rate (this would be carried through by accelerated accumulation of reserves). However, there is a risk that depreciation jeopardises price stability. Consequently, the question is how to avoid the Scylla of inflation while dodging the Charybdis of deteriorating international competitiveness.

The one area in which stabilization has failed to materialise is the external balance (Table 5). Although a slight improvement can be seen in the last year, the current account has worsened for some years. Although almost entirely attributable to unfavourable weather conditions, it still illustrates the country's vulnerability to exogenous shocks.

However, even the external balance displays some positive development. Despite a growing trade deficit, the government has managed to improve her debt servicing record and accumulate a healthy level of reserves. This is partly due to rapidly growing (albeit from low levels) inflows of foreign direct investments. To make these continue is probably both necessary for sustaining the current development path and the major challenge for the government.

Table 5

Balance of Payments (US$ mn unless indicated)

	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
Exports	592.9	695.9	794.0	612.6	540.5	541.0
Imports	1,509.7	1,370.3	1,387.8	1,444.5	1,592.5	1,630.6
Trade balance	**-916.8**	**-674.4**	**-593.8**	**-831.9**	**-1,052.0**	**-1,089.6**
Service receipts	511.2	472.0	519.7	564.8	569.6	671.9
Service payments	658.8	759.3	793.2	918.0	877.2	911.3
Service balance	**-147.6**	**-287.3**	**-273.5**	**-353.2**	**-307.6**	**-239.4**
Private transfers	17.5	19.9	25.7	30.0	32.0	33.9
Current account (excl OT)	**-1,046.9**	**-941.8**	**-841.6**	**-1,155.1**	**-1,327.6**	**-1,295.1**
Project financing	474.8	523.8	567.1	580.1	595.4	606.2
Program financing	50.2	57.6	122.8	88.6	126.4	130.4
Official transfers	**525.0**	**581.4**	**689.9**	**668.7**	**721.8**	**736.6**
Current account (incl OT)	**-521.9**	**-360.4**	**-151.7**	**-486.4**	**-605.8**	**-558.5**
Capital account	**299.2**	**191.2**	**171.1**	**353.7**	**574.3**	**588.3**
Amortization	*322.3*	*354.4*	*317.0*	*274.7*	*274.2*	*223.1*
Direct investment	*104.1*	*134.1*	*150.0*	*165.0*	*178.8*	*183.0*
Overall balance	**-222.7**	**-169.2**	**19.4**	**-132.7**	**-31.5**	**29.8**
Memo:						
Gross official reserves*	1.6	1.5	2.8	2.9	3.3	4.1
Debt service due/exports**	43.3	45.8	37.9	43.8	41.5	28.9
Debt service paid/exports**	19.1	23.2	17.7	16.7	17.8	14.9

Sources: IMF (1999), (2000); IDA/IMF(1999)
* In months of imports
** In percent

2.2 The Medium Run: Growth and Structural Adjustment

As Table 1 shows, real GDP growth has been increasing and averaged four percent per annum since 1995. This implies that per capita incomes grow, but at a rate that is not likely to have a visible impact on poverty for some time to come.

Current projections envision a continued increase in growth up to six percent per annum in 2003. This means that per capita incomes in 2010 will be about a third higher than in 1999. A sizeable achievement, but far from what would be needed, given that official figures suggest that about half the population lives on less than 0.65 USD a day, one of the national poverty lines.[2]

It should also be noted that the rationale for projecting GDP to grow at six per cent per annum from 2003 and onwards is not obvious. It seems like a strange coincidence that if GDP grows at that rate from 2003 and onwards (assuming that population continues to grow at 2.8 percent per annum), poverty will, in terms of the current income distribution, be halved by 2025, which is line with the Government's *Development Vision 2025*. This of course suggests the possibility that the "projection" is not a projection per se, but rather a necessary condition for achieving pre-set objectives. The same figures for future growth appear in various documents as diverse as the *Policy Framework Paper*, the HIPC *Decision Point Document* and the *Poverty Reduction Strategy Paper* and thus appear to be universally acknowledged. This is a bit worrying as some strategies depend critically on the achievement of these rates; yet, no risk analysis or alternative strategies are to be found in the official publications.

Table 6 breaks down GDP in its expenditure components. Net exports have increased (or, to put it better, the trade deficit has shrunk). If the change in the external balance were the exogenous factor, one would normally expect this to be manifested either as falling investments or falling private consumption.[3] In Appendix table 6, however, the relation is between falling public consumption and a declining trade deficit. In fact, the declining trade deficit is associated to increasing levels of investments (at least in aggregate, from 1997) suggesting that the trade deficit is not the driving factor. The reasonable interpretation would be that the drastic cuts in public consumption triggered by the cash budget has led to declining imports. In other words, the cash

[2] The purchasing power of these 65 US cents is not directly comparable to their equivalent in the US, however, mainly because commodities in general and nontraded commodities in particular are less expensive in Tanzania than in the US. Taking this into account means the construction of purchasing power parities (PPPs). According to these terms, average incomes in Tanzania are higher, but poverty is still widespread.

[3] If a declining trade deficit is associated to falling investments, this would be interpreted as falling levels of capital goods imports. If the declining trade deficit is associated to falling private consumption, the interpretation would be either that imports of consumption goods have fallen or that exports have increased.

budget has diminished the government's dissavings and therefore allowed for a smaller trade deficit without affecting private consumption.

Table 6

GDP at market prices. Expenditure composition (%). 1992 prices

	1995	1996	1997	1998	1999
Private consumption	83.8	83.9	83.0	82.8	91.2
Public consumption	13.9	11.1	8.5	7.9	7.3
Gross capital formation	19.3	18.0	17.5	18.2	18.2
o/w: public investment[a]	*3.1*	*5.0*	*5.7*	*5.8*	*6.1*
o/w: private investment	*16.2*	*13.0*	*11.8*	*12.4*	*12.1*
Exports[b]	24.5	23.6	16.3	15.4	19.5
Imports	41.8	36.8	25.5	24.6	36.3

Source: Calculated from IMF (2000), Tables 3 and 6
[a] Central government plus public enterprises
[b] Includes unrecorded trade and statistical discrepancy

However, even though improved government finances have pulled the trade balance into improvement, there has been an impact on investments. Although gross domestic capital formation (GDCF) has hovered around 17–19 percent of GDP for some years, private investments as a share of GDP have declined more or less consistently since 1995. Since public investments are almost entirely driven by foreign project aid, the reason for a relatively constant GDCF is increasing project aid. Falling levels of private investments are worrying from many aspects. First and foremost, a sustained growth of income requires growth of capacity.[4] Second, falling levels of private investment are likely to be a signal that something is wrong in the economy. The two likely candidates in Tanzania are, first, lack of finance and, second, lack of confidence in the political and economic leadership, the major cause for the latter being expectations that demand will continue to be held down by strict policies.

Moreover, the aggregate figure for private investment in Table 6 is likely to underestimate the problem: Investments in some sectors are growing rapidly, so investments in other sectors are likely to be falling even faster than what Table 6

[4] Using global data, it can be shown that in the relatively short run (up to five years) the relation between investments and GDP growth is rather weak; however, in the longer run the relation approaches the 4-to-1 (i.e., 4 dollars of investments increases GDP by one dollar) ridiculed by e.g. Easterly (1999). Moreover, even though it is possible to find countries in which high and sustained levels of investments have failed to produce sustained growth, vice versa does not hold: all countries that experience high growth also have high investment levels.

reveals. Although data on sectoral investment rates have not been available, it is clear from sectoral growth rates data that most private investments are flowing into mining (Table 7), a sector which grew on average 15 percent per annum in the second half of the 1990s, and by over 14 percent per annum for the entire decade. In fact, the mining sector has doubled its share of GDP since 1990. However, as it accounted in 1999 for two percent of GDP, its rapid growth has a limited impact on GDP growth.[5]

Table 7

GDP at factor cost. Composition and sector growth. 1992 prices.

	1990 (%)	1995 (%)	1999 (%)	Growth, 90–95	Growth, 95–99
Agriculture	26.6	28.3	25.0	6.6	3.8
Manufacturing	8.8	7.9	7.6	2.8	4.6
Mining	0.9	1.4	1.9	14.1	15.0
Electricity	1.5	1.6	1.6	7.0	5.8
Construction	4.8	2.9	3.3	9.4	4.4
Trade	16.3	15.7	14.8	5.4	4.5
Transportation	4.6	5.3	4.9	3.2	4.8
Public administration	6.0	5.2	4.3	-2.1	-0.2
Financial services	5.7	5.7	5.5	-0.3	3.9
Other services	2.7	3.0	2.9	4.7	4.8
Imputed charge	-4.4	-4.8	-4.8	-1.3	4.3
Monetary GDP	73.5	72.2	73.1	5.1	4.2
Nonmonetary GDP	26.5	27.8	26.9	4.1	3.5

Source: IMF (2000), Table 1.

What is disturbing—and well recognised; cf. World Bank/IFPRI (2000)—is the fact that agriculture is one of the slowest growing sectors. Agriculture accounts for over half of GDP and is the mainstay of four-fifths of the population, so it is difficult to envision a development strategy that does not focus explicitly on that sector.[6] As noted above, agriculture—which to a large extent is rain-fed and uses traditional technology—is vulnerable to the weather and output swings are significant (particularly in the past few years, on account of the 1997/98 flooding and the 1998/99 drought). However, while one objective of the market-based economic

[5] If the mining sector accounts for 2 percent of GDP and grows at 15 percent per annum, the direct impact on GDP growth will be 0.3 percent per annum.

[6] The data in Appendix Table 7 seem to suggest that agriculture's share is only 25 percent of GDP, quite different from the figures in other sources such as BOT (1999). The reason seems to be that while the data in Appendix Table 7 include only production in agriculture, the convention is to also include other activities relevant for production and distribution of agricultural goods, such as distribution, marketing and some construction activities.

reforms was to increase agricultural output by increasing profitability of agricultural production, results are still not strong. One study argues that this is not because farmers are not responding to price signals, but that policies have failed to contain inflation sufficiently to improve international competitiveness. Consequently, farmers have been reluctant to switch to cash crop production and instead remained in food production, which increasingly is produced outside the formal economy (Danielson, 2000). While the reasons for a growing non-monetary sector are not clear, it would seem reasonable to assume that faster growth of monetary agriculture requires both large-scale investments in technology—which in turn is likely to demand heavy investments in infrastructure—and proper economic policies to prevent international competitiveness to deteriorate further.

2.3 The Long Run: Impact on Poverty

Despite positive growth in per capita incomes in the past years, several observers report deteriorating social indicators and possibly increasing levels of poverty in the 1990s. It deserves to be noted, however, that most observations are projections based on household surveys conducted in 1991 and 1993. Less comprehensive studies that cover more recent periods are available and they tend to confirm the trends projected from the earlier studies.[7]

In any case, it seems established that social indicators have deteriorated in the 1990s; in particular, primary school enrolment has fallen in the 1990s; infant and under-five mortality rates show a slight increase; and evidence of child malnutrition (both stunting and wasting) show no improvement over the past decade.[8] The Poverty Reduction Strategy Paper (PRSP), generated by the government in response to HIPC decision point conditions, suggest that poverty appears to have decreased during

---

[7] Sarris and van der Brink (1993); World Bank (1993), World Bank (1996). Later and less comprehensive studies include Narayan (1997) and two (unpublished) studies carries out by REPOA, one using the same format at the 1991 household budget survey covering households in rural Ruvuma, Dodoma and Mwanza, and one survey covering peri-urban households around Dar es Salaam. The 1991 household budget survey and the 1993 Human Resources Development Survey are extensively discussed in TAKWIMU (2000). The state of knowledge of poverty in Tanzania per 1996 is outlined in Danielson (1996).

[8] One major reason for deteriorating social indicators is of course the cash budget coupled with limited success in raining additional revenue; another one is delays in protecting social sector budget allocations. We shall have more to say about this in Chapter 5.

1983–91 and increased in the following decade. Moreover, poverty in Tanzania can be characterised in five dimensions (PRSP, p. 7–8):

- Poverty is largely a rural phenomenon
- The poor are concentrated in subsistence agriculture
- Urban poverty is wide-spread and increasing
- Vulnerable groups include the young, the old and large families
- While female-headed households do not have lower average incomes than male-headed, women are generally poorer than men are.

These observations lead to two reflections. First, since poverty is a rural phenomenon[9] it has to be fought in rural areas in general and in particular in subsistence agriculture. Second, since poverty appears to have increased in the 1990s—a period with positive per capita growth rates—the links between growth and poverty reduction is more complex than conventionally assumed.

The two reflections are interrelated. If poverty is a rural phenomenon and at the same time poverty has increased while the economy as a whole has grown, it means that growth has been concentrated in sectors or geographical areas were the poor do not benefit. In other words, economic growth is an unequal process and it would seem likely that an initial increase in income inequality is to be expected as a consequence of economic growth.[10] Recall Table 7 according to which production sectors displayed large variations in growth. In addition, regions have different levels of per capita incomes with a ratio of the richest to the poorest of 2.5.

Obviously, the poverty alleviation impact of a certain rate of growth will be different depending on the pattern of growth. It depends both on how the trickle-down process works and on how income distribution is affected. In addition, to properly measure the poverty alleviation impact of growth we need several successive budget surveys that ideally should be designed so as to make results commensurable. As noted above,

[9] While urban poverty is wide-spread and increasing, it is likely to be a consequence of deteriorating conditions in rural areas and consequently can be expected to decline as poverty is successfully fought in rural areas.

[10] Note that this does not have anything to do with the celebrated "Kuznets curve", i.e., the observation that a cross-country plot of some measure of inequality and per capita incomes will look like a U, turned up-side down. Kuznets study was on a sample of countries and it has proved difficult to generalize this observation (which is shaky as it is) to a time-series setting.

both major surveys are from the early 1990s and likely to be too close in time to allow for dynamic inferences. In addition, their designs are dissimilar.

However, it is possible to calculate the poverty impact of growth from the available information, if only under rather restrictive assumptions. This can be used as a baseline result, and the impact of various possible scenarios may be calculated. Table 8 provides information on the poverty elasticities for the two major budget surveys disaggregated by geographical region. It is important to keep in mind that these elasticities—i.e., the percentage change in poverty (i.e., the population below a poverty threshold) when mean income increases by one percent—are calculated for unchanged income inequality. Typically, this is not the case and, indeed, it was argued above that in Tanzania poverty has increased in the 1990s precisely because growth has increased inequalities. Hence, the results in the table should be interpreted as a base for comparing simulations, nothing else.

Table 8

Poverty Elasticities

	Stratum			
	Household Budget Survey. 1991			
	Dar es Salaam	Other Urban	Rural	Mainland
Food poverty	-3.90	-1.05	-1.18	-1.46
Basic needs poverty	-2.66	-0.84	-0.75	-0.69
	Human Resource Development Survey. 1993			
	Dar es Salaam	Other Urban	Rural	Mainland
Food poverty	-9.72	-5.29	-3.83	-3.14
Basic needs poverty	-2.56	-1.14	-2.81	-1.45

Source: TAKWIMU (2000), Table 50
Note: Elasticities are calculated on the assumption of an unchanged income distribution. The poverty elasticity is interpreted as the change in poverty relative to a change in mean income. Thus, the figure −3.90 which is the food poverty elasticity for Dar es Salaam in the 1991 Household Budget Survey, means that if mean income increases by one percent, the number of people in Dar es Salaam having lower expenditures than the food poverty line decreases by 3.9 percent.

Note that elasticities have been calculated against two different poverty thresholds—food poverty and basic needs poverty. The latter includes, apart from food, non-food items regarded as necessities. These include consumer durables, health and education, and other non-durables (details are in TAKWIMU (2000), Ch. 4). The basic needs poverty line is roughly 20–25 percent higher than the food poverty line.

Although the figures in Table 8 are surrounded by strong assumptions, several interesting features stand out. First, the results differ substantially between the two surveys. This is mainly due to differences in the expenditure distributions; generally, the 1991 Household Budget Survey is thought to provide the more realistic picture (i.e., results in later less comprehensive surveys are easier to reconcile with these).

Second, the impact of growth on poverty is different in different parts of the country. It is not surprising, for instance, to find that the elasticities are substantially higher for Dar es Salaam than for the rest of the country. What is a bit surprising, however, is that the rural elasticity in the 1991 HBS is higher than that for other urban areas. Generally, one would think that partial poverty elasticities (as the ones in Table 8) are higher (in absolute terms) in urban areas.

Third, while reliable poverty elasticities are not abundantly available for African countries, those that do exist suggest that the poverty impact of growth in Tanzania (outside Dar es Salaam) is relatively low. This means that a relatively high rate of growth is required to achieve a given reduction of poverty. This observation reinforces the argument made above that high economic growth in Tanzania is absolutely necessary to reduce poverty in a sustained manner.

However, as was noted above, the elasticities in Table 8 are valid only if income distribution remain unchanged during growth. This is not realistic. Growth is by its nature an uneven process, favouring certain sectors or regions (or groups of people) over other. To take that into account it is possible to calculate the rate of growth required to achieve the objective of the National Poverty Eradication Plan (on which the projections in the Poverty Reduction Strategy Paper appears to be based): to halve poverty by the year 2015. Using the results from the 1991 Household Budget Survey (which appears to be the most reliable), we compare the baseline in Table 8 to two different scenarios. One in which inequality increases by one percent per annum and one in which inequality decreases by one percent per annum. In both cases, inequality is measured by the Gini coefficient for which 0 represents complete equality and 1 complete inequality. The results are in Table 9.

The rationale for choosing these two scenarios is the following. Currently growth in Tanzania is geared towards mining and tourism. Both these sectors are geographically concentrated with limited linkages to the rest of the economy. If growth continues to be driven by these sectors, an increase in inequality is likely to follow. If, on the other hand, growth can be lead by smallholder agriculture, it is more likely to decrease inequality: the rural areas in general, and subsistence agriculture in particular, contain the majority of the poor. If they experience a disproportional growth of income, the Gini coefficient is likely to fall.

Table 9

Required Real GDP Growth to Halve Poverty by 2015. Three Scenarios

	Food Poverty	Basic Needs Poverty
One percent increase in inequality p.a.	6.5%	8.2%
No change in inequality	4.9%	7.3%
One percent decrease in inequality p.a.	3.3%	6.3%

Source: TAKWIMU (2000), Table 53
Note: Calculations based on the results from the 1991 Household Budget Survey. Inequality is measured as the Gini coefficient. Population is estimated to grow at 2.8 percent per annum.

The results are simulations and are thus indicative and not to be interpreted to the letter. In any case, the Table gives an idea of the rates of growth necessary under various assumptions. In addition, the current pattern of growth in Tanzania is perhaps such that the scenario in which inequality increases is the most realistic and, finally, it should be noted that required growth is very sensitive to what happens to inequality. In other words, should inequality increase more than one percent (say, two percent per annum), required growth to halve basic needs poverty increases to 9.1% in real terms.

2.4 Concluding Remarks

The Tanzanian economy has completed a difficult stabilization phase; what remains is to consolidate that achievement and to increase economic growth. Growth is important, not only because poverty is widespread and increasing, but also because unless the burden of stabilization is eased, popular support for the reforms may taper off. However, while stabilization has been successful, the same cannot be said for adjustment. Output in the key sectors is growing only slowly, prohibited by structural bottle-necks, and the government, keen to protect a stable economy, is unable to quickly launch the major investment programs needed to improve e.g., infra-structure. The key task in the medium run therefore appears to be an improvement of the tax regime: it is urgent that the tax revenue increases substantially.

It is quite clear from the analysis that high growth is necessary. Not only because Tanzania's income level is low in an international perspective, but also because poverty does not appear to be very responsive to growth; particularly not as long as growth is concentrated in sectors with limited linkage effects to the rest of the economy.

How, then, should growth be boosted without jeopardising the stability of the economy? There is surprisingly little discussion of this issue. One possibility is of course to recognise that Tanzania is a basically agricultural economy and is likely to remain so for the foreseeable future. This means that increased agricultural exports are likely to have a sizeable impact both on growth and, directly and indirectly, on poverty levels. One possibility, which is offered here as an item for discussion rather than as a fully-fledged recommendation, would be a managed depreciation of the currency. There are several indicators favouring such a move. First, inflation is low and basically driven by unfortunate weather in the past two or three years. The inflationary impact of letting the Shilling slide by, say, 20 percent against the dollar should not pose a threat to the Central Bank. Second, one reason for insufficient growth is the government's prudent policies—demand is growing relatively slowly; and why should producers increase output if there is no market for their produce? Third, the inflation history of Tanzania, and the recent appreciation of the US dollar, means that the real exchange rate has appreciated significantly vis-à-vis neighbouring countries with which Tanzanian producers compete on world markets. A nominal depreciation, particularly now when inflation appears under control, would remove that obstacle to export-driven growth—and in view of the simulations presented above increased growth in agriculture is likely to be instrumental for achieving the ambitious objectives formulated by Government.

3. Debt and Debt Relief in Tanzania

The extent to which external indebtedness and the servicing of debt constrains the Tanzanian economy has interested policy makers and analysts for some time now (see for example, Danielson et al, 1995, Danielson and Mjema, 1997, among others). Although estimates have varied, there is some consensus that the servicing the external debt affects negatively the country's saving and growth. That is why the HIPC Initiative, with its prospects for debt relief has been enthusiastically welcome. The expectation among many Tanzanian policy makers is that the current Initiative will go a long way in the direction of removing the constraints to economic growth and poverty reduction.

Tanzania reached the decision point under the enhanced HIPC Initiative in April 2000 and is expected to reach the completion point towards the end of the current fiscal year (which ends June 30, 2001). Tanzania's debt relief under the HIPC, combined with traditional debt relief mechanisms, is expected to roughly US $ 2 billion in NPV terms, about half of Tanzania's debt.

3.1 Debt Stock, Debt Servicing and Debt Relief, 1995–2000

This section provides an outline of how various indicators of the debt stock, debt servicing and debt relief is linked. As recent exchanges between British NGOs and the IMF (*Financial Times*, Letters August 11 and August 18, 2000) vividly illustrate, a clear picture of the existing situation is paramount or understanding this link.

Table 10 shows the structure of the external debt in Tanzania. In brief, the dollar value of the debt has decreased in the past few years, partly because of the cessation of arrears accumulation and partly because of bilateral debt relief. The latter is also reflected in the diminishing share of the debt being owned to bilaterals. The government has contracted virtually all debt, and the bulk of the loans have been used as balance of payment support and for infrastructure investments. Note finally that the debt ratio has declined, but is still very high (the net present value of debt to exports as of July 1999 was almost 400 percent, to be compared to the threshold value of 150 percent under the enhanced initiative).

Table 10

Structure of External Debt, USD million and percent

	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000
Total Debt	8,440.7	7,933.0	8,100.8	7,901.7	7,972.9	7,802.6
Disbursed debt	6,917.5	6,623.3	6,600.3	6,435.8	6,580.3	6,509.6
	Disbursed by creditor (percent of disbursed debt)					
Bilateral debt	49.5	48.6	46.1	43.6	42.5	38.8
Multilateral debt	43.7	45.1	47.6	49.3	50.6	53.7
Commercial debt	3.3	3.2	3.3	4.0	3.8	3.9
Other private creditors	3.5	3.1	3.0	3.1	3.0	3.6
	Debt by borrower (percent of disbursed debt)					
Central government	94.3	94.6	94.4	93.5	93.7	80.8
Public corporations	3.2	2.6	2.5	2.7	2.5	15.9
Private sector	2.5	2.8	3.0	3.8	3.8	3.3
	Disbursed by use(percent of disbursed debt)					
BOP support	27.3	25.5	23.1	23.2	23.0	18.7
Transport	19.2	19.5	20.3	20.3	20.3	21.5
Agriculture	14.7	14.6	14.4	14.2	14.6	15.6
Energy and mining	10.0	10.9	11.3	12.3	12.5	13.2
Industries	9.5	9.2	8.6	8.2	7.7	7.8
Social welfare	3.2	3.7	3.9	4.3	4.4	4.9
Finance and	3.1	2.9	2.8	2.6	3.3	3.7
Others	11.8	12.3	14.2	13.7	12.9	13.5
Memo:						
Debt Ratio (%)	190.52	147.89	140.48	106.9	109.06	n.a.

Source: External Debt Department Bank of Tanzania

Stylised facts about the debt situation

The information in Table 10 may be summarised as four propositions. These have tended to hold since the mid 1980s. They apply also to the 1995–2000 period.

(a) Most of the debt has been contracted by the government and channelled to the government and public corporations

Despite the economic reforms undertaken since the mid 1980s and much talk about the revival of the private sector the importance of this sector is not reflected at least in the distribution of the externally borrowed funds. The share of borrowed funds in total disbursed borrowed funds has remained below 3% during the 1995–1999 period. The criteria for allocation of these resources should have been efficiency in their utilisation.

(b) The balance of payments support and transport and communication sector have absorbed most externally borrowed funds

Nearly 50% of the debt money has been utilised for balance of payment support and in transport and communication sub sectors. Although the government has clearly stated that the social sector (education, health and water) was to receive top priority in terms of allocation of debt relief funds, that commitment is, at least currently not reflected in the allocation of the funds. The share of social welfare and education funds in total funds disbursed was 3% in FY 1994/95 but increased slightly to 4.8% in FY 1999/00.

(c) The ability of the country to service its outstanding debt has remained low

The servicing of Tanzania's debt (principal and interest payment) has remained low since the 1980s. This (low servicing of the debt) has been caused partly by the unsatisfactory export earnings performance.

(d) The country's total outstanding debt stock is still large and invites questions over its sustainability

Expressed as a share of GDP, the total debt stock in Tanzania was 190.52 in FY 1994/95. In FY 1999/00 it has decreased somehow to 110%. This (rather high) total debt stock- to GDP ratio is unsustainable for a poor country like Tanzania.

3.2 HIPC Initiative and the National Debt Strategy

The HIPC Initiative is a framework developed by the IMF and the World Bank to address the external debt problems of heavily indebted poor countries (HIPCs) like Tanzania. The HIPC initiative is based on six principles:

(a) the objective is to target overall debt sustainability on a case-by-case basis, focusing on the totality of a country's debt.

(b) actions should be envisaged only when the debtor has shown, through a track record, ability to put to good use the exceptional support provided.

(c) the new measures should be built, as much as possible, on existing mechanism

(d) additional action should be co-ordinated among all creditors involved, with broad and equitable participation

(e) action by multilateral creditors should preserve their financial integrity and preferred creditor status; and

(f) new external finance for the indebted countries should be on appropriately concessional terms.

The Tanzanian government, like governments of other HIPCs has welcomed the Initiative and has, accordingly prepared a strategy (the National Debt Strategy, NDS) to ensure that the debt problem is addressed appropriately. According to the NDS, Tanzania should continue to seek debt relief through new and traditional mechanisms for debt relief. The NDS like the HIPC Initiative recognises the need to build on existing debt reduction strategies and aims at:

(a) restoring orderly relations with all creditors with a view to settling all arrears or repayment and preventing the increase in outstanding debt
(b) reducing contractual debt service due to a manageable level of about 20 percent of debt service ratio
(c) preventing the build-up of an unsustainable level of debt and debt servicing in future

In line with the HIPC initiative the NDS has identified key areas where the debt relief money needs to be spent to have a maximum effect on poverty reduction. These areas are the education, health and water.

The concept of debt relief as extended to Tanzania and other poor indebted countries under the HIPC Initiative has to be clearly distinguished from debt cancellation or debt forgiveness. Whereas debt cancellation implies that the indebted country does not have to worry about servicing of the principal and interest a debt relief extended to highly indebted poor countries including Tanzania aims at creating a conducive environment for these countries to repay the debt in future (Ross, 1999).

The HIPC Initiative however has three distinctive features, which distinguishes it from earlier attempts to address the debt problem of developing countries. First it targets and addresses total (multilateral and bilateral) debt and, in so doing, adds to existing debt reduction strategies. Second for the first time there appears to be recognition of the linkage between increasing indebtedness and widespread poverty. The World Bank and the IMF have finally recognised that widespread poverty in indebted countries constrains their ability to repay debt. That is why the poverty question has to be addressed in the debt relief. Finally the (HIPC) Initiative tends to introduce an important aspect of good governance by introducing a consultative process involving main stakeholders in the debt relief process i.e. the creditors, the governments, the private sector and the non-governmental organisations. Hitherto, the debt negotiations were the domain of creditors and concerned governments alone. The magnitude of debt relief under the enhanced

HIPC Initiative is shown in Table 11. Note, however, that the last rows (debt indicators) are calculated on the rather optimistic assumptions outlined in Box 1.

Box 1

Baseline Assumption for Debt Sustainability Analysis

1. *Economic Growth.* 5.5 percent pa in 2000–02 and 6 percent pa thereafter. Agricultural growth: 6 percent pa; manufacturing: 7 percent pa; mining up to 20 percent pa. These projections are conditional on improvements in infrastructure, normal weather, and continuation of liberalisation and public sector reform.
2. Trade. Traditional export volumes growth of 4–6 percent pa. Growth of non-traditional exports (incl tourism and gold): > 6 percent pa. Ratio of exports of GNFS to GDP increases from 13.6 percent in 1999 to 18 percent in 2009, implying an annual rate of growth of export proceeds of 13.6 percent. Given that export prices are assumed to grow in line with the projections in *World Economic Outlook*, and that traditional export volumes grow at 4–6 percent pa, this implies that the *volume of non-traditional exports (particularly gold and tourism) grows in excess of 20 percent per annum, i.e., the size of these sectors should double in size approximately every fourth year*. Imports grow faster than GDP due to high demand for investment goods.
3. Capital account. Foreign direct investments grow in line with GDP. The financing gap remains large and is covered by continuing high inflows of ODA and concessional loans.

Source: IMF/IDA (2000), Box 5.

Table 11

Debt Servicing after HIPC Relief, USD million

	99/00[a]	00/01	01/02	02/03	03/04	04/05
Total Debt Service[b]	**235.5**	**153.3**	**141.8**	**143.8**	**148.5**	**158.2**
Principal	**167.4**	**97.5**	**82.3**	**80.4**	**81.4**	**81.4**
Multilateral	83.2	47.8	30.2	25.9	42.2	53.9
Official Bilateral	79.9	43	45.5	47.9	36.3	27.4
o/w: Paris club	*61.4*	*23.1*	*28.2*	*31*	*24.6*	*23.3*
Commercial	4.3	6.7	6.7	6.7	3.4	0
Interest	**66.2**	**56.3**	**63.4**	**66.6**	**70.4**	**74.5**
Multilateral	19.9	13.3	10.3	8.6	9.1	9.1
Official bilateral	43.4	33.4	38.8	37.3	35.9	35.1
Paris club	39.5	27.3	30.2	32.4	31.6	30.9
Commercial	1	1.5	1.1	0.7	0.4	0.4
New debt	3.1	8	12.3	16.8	21.2	25.5
Total debt service[c]	**295**	**317.8**	**310.9**	**362.7**	**258.8**	**259**
Debt service ratio[c]	24.8	24.6	20.9	25.6	13.7	12.5
Debt service ratio[b]	19.8	11.9	9.5	8.4	7.8	7.3

Source: IMF/IDA (2000), Table 12

[a] Estimate

[b] After HIPC relief

[c] Before HIPC relief

3.3 The HIPC Initiative: Panacea or Placebo?

The possibility of multilateral debt relief has largely been enthusiastically received in Tanzania. However, it is important to realise that the Initiative does not represent a solution to Tanzania's problem. At best, the debt relief associated to HIPC will pave the way for decreased poverty; at worst it will only represent a temporary solution. The reason is this.

Relief will be delivered under a twenty-year period. However, while Tanzania's obligations to service the existing debt decreases substantially as a consequence of this (cf. Table 11), her need for exceptional finance does not disappear. Table 12 shows the Decision Point document's calculations of how the external debt will develop up to 2018. The "old" debt stock (i.e., the debt in existence today) will decrease by approximately US$600 million (in NPV terms). However, to fill projected external gaps, new debt will be contracted. As a consequence, the total debt (again in NPV terms) will triple in 18 years, from roughly US$1.9 billion in 1999/00 to an average of US$5.9 billion in 2010/18.

Table 12

Net Present Value of External Debt After Rescheduling
(USD mn unless otherwise indicated)

	1999/00	2002/03	2005/06	1999/09 Averages	2010/18 Averages
NPV of total debt	1,876.9	2,616.6	3,279.0	2,943.5	5,885.4
NPV of old debt	1,674.5	1,57.7	1,510.0	1,553.2	1,041.6
NPV of new debt	202.4	959.0	1,768.7	1,390.5	4,843.8
Debt-to export[a]	165.4	174.9	154.8	163.3	141.8

Source: IMF/IDA (2000), p. 32

[a] NPV of debt stock to three-year average of export proceeds. For 1999/00 this includes interim relief and relief to be delivered at completion point.

A large debt is harmful to economic growth. Through rescheduling and forgiveness, the debt can be brought down to a sustainable level. This, in turn, should make high growth easier to attain. Growth increases the ability to repay, so even if the debt level does not decrease permanently as a consequence of debt relief, it declines temporarily, allowing the GDP to grow and thus makes a larger debt sustainable. (In Table 12, the last row shows how one of the major sustainability indicators—debt-to-exports—is projected to develop.) What seems often to be missing from the public discussion of these issues is the fact that HIPC relief was never meant to decrease the debt level permanently—it was meant to do so temporarily in order to allow for GDP to grow and thereby allowing the country to be able to carry a larger debt without adverse growth effects. Increasing the rate of economic growth is this instrumental to the HIPC process; without higher growth, the country risks being back at square one with a debt burden that is unsustainable.

The development of debt indicators is based on projections. Ideally, the calculations are made in the following sequence. First, realistic projections of key variables—GDP growth, export growth, etc—are made. Second, estimates of external inflows—foreign aid and foreign investments—are projected. Third, the amount of traditional (i.e., Paris Club) debt relief is estimated. Fourth, the amount of multilateral relief necessary to reach a sustainable position is determined.

The projections used are those listed in Box 1 on page 22. It should be noted that these are, historically, large numbers. Real GDP, for instance, has not increased by six percent per annum since the early 1970s, and never for almost two decades in a row. The basic argument is that ongoing liberalisation of the economy is likely to make the attainment of such high growth easier. As noted in Box 1, there are three core assumptions: that GDP grows at about 6 percent per annum; that traditional exports grows at about 4–6 percent per annum; and that the exports-to-GDP ratio increases from less than 14 percent in 1999 to 18 percent in 2009. Since GDP is projected to grow at 6 percent per annum, exports have to increase faster in order to increase the exports-to-GDP ratio. However, since traditional exports are assumed to increase at 4–6 percent per annum, it is non-traditional exports that have to grow fast. In fact, these assumptions imply that *the volume of non-traditional exports have to increase by over 20 percent per annum*—the non-traditional export sector has to double in size roughly every four years.

Currently, the major non-traditional exports are mining and tourism. Although space does not allow us to develop the argument in detail, it is difficult to see how these sectors can grow at such a rapid pace for a sustained period of time, or at the very least it would seem that such a rapid expansion would require massive injections of capital for infrastructure investments—and the Decision Point document gives no indication that provision for this has been made in the DSA calculations.

Consequently, there are reasons to critically examine the HIPC-projections and not take them at face value. The final point is of course based on the observation that if Tanzania fails to fulfil projections, her debt stock in 2020 (after full HIPC relief has been delivered) will be unsustainable with respect to at least one of the sustainability indicators. What happens then? The multilateral institutions are emphasising that the HIPC Initiative is the final exit: "grow or be doomed!" But failure to perform according to projections may of course be either because of bad performance or bad projections. It is not clear why Tanzania should be excluded from future relief actions if her failure to perform according to projections was because of excessively optimistic projections. In other words, there is a need for a plan of action to be implemented in case a country fails to live up to projections. All involved parties have an interest in having such a plan, which is mutually agreed.

4. From MDF to PRBS

In 1997, the Government asked donors to contribute to a debt fund, set up to facilitate timely servicing of Tanzania's multilateral debt. Initially, eight donors—Denmark, Finland, Ireland, the Netherlands, Norway Sweden, Switzerland and the UK—provided support amounting to approximately USD 100 million per annum. Recently, the EU has expressed interest in participating. The multilateral debt fund (MDF) has worked more or less according to intention and both government and donors are interested in continuing with this form of aid disbursements.

However, as Tanzania reached the decision point under the enhanced HIPC initiative and as she is expected to reach the completion point during the mid of 2001, the remaining debt servicing of the multilateral debt will not be sufficient to absorb the resources that have been contributed to the MDF. Therefore, in a joint initiative, the government and donors have proposed changing the MDF to a general fund for budget support—the poverty reduction budget support facility (PRBS). The idea is to retain the structure from the MDF as far as possible but to scrap the link to multilateral debt servicing. This chapter outlines the structure and workings of the MDF/PRBS, discusses potential weaknesses of the system and outlines a few suggestions for improvement.

4.1 How Program Aid Works

In principle, all program aid follows the same mechanism. There may be differences between modalities, depending on, for instance, how the donor specifies the use of resources, or how liberalised markets are but in principle the choice of modality is irrelevant for the working of program aid.[11]

Program aid—i.e., aid which is not linked to specific project activities but which is linked to the implementation of policy reforms in the recipient country (White, 2000a: 7–10)—may contribute to development objectives in two different ways: through the disbursement of funds and through economic policy change. While the latter is usually

[11] This requires a qualification. The choice of modality is clearly important for the donor (since it determines which flow the donor monitors), and the choice of modality may also be important for

Footnote continued on next page

seen as the most important channel, the former is important for the particular set-up of the MDF/PRBS facility.

Disbursement of program aid almost always gives rise to two flows of resources—one forex flow and one in local currency. The forex flow arises from the fact that disbursements are always made in foreign currency—usually the donor's own currency. This increases the availability of forex, and thus the capacity to import, in the recipient country.

The local currency flow is generated because the government is supposed to either use the forex directly or sell it in the forex market. If it is used directly for, e.g. import purposes, the local currency flow is defined as the revenue the government saved (i.e., did not convert to forex) in order to obtain imports. If it is sold, the local currency proceeds obtained by the government are defined as the local currency flow. These two flows—one in forex and one in local currency—are created by the act of program aid disbursement irrespective of whether the aid is denoted import support, budget support or debt relief.[12]

The mechanism through which program aid assists the country, on the other hand, depends crucially on the nature of the country's bottlenecks. In theory, it is customary to distinguish between countries that are hampered by a forex constraint and a savings constraint. In the former case, an additional inflow of forex relieves the constraint; in the latter, additional savings play the same role. Since program aid gives rise to dual flows, the modality does not matter: the constraint in question is addressed irrespective of under which modality the aid is disbursed.

Program aid may contribute to poverty alleviation (the overriding objective for most bilateral donors) through four main channels. First, it may increase investments by either allowing for the importation of more capital goods or by relaxing the

rationalizing aid to donor country tax-payers. From the point of view of contributing to the donor's development cooperation objectives, however, the choice of modality is in principle immaterial.

[12] Danielson and Nilsson (2000: Ch. 7) outlines in more detail possible qualifications to this. Major exceptions are (i) when the government allocate forex resources without bothering to collect the local currency (the counter-value) and (ii) when program aid is used to service debt which would not have been serviced in the absence of such aid. In both cases, the forex flow fails to give rise to a local currency flow.

government's budget constraint so that public investments increase. Second, by increasing utilisation of existing capacity, either by allowing for the importation of more spare parts or raw material or by allowing the government to increase expenditures on particular items such as infrastructure. Third, poverty may be alleviated by program aid if the government uses the free resources to increase expenditures on sectors essential for the poor, such as primary health, or water. Finally, poverty may be affected if the government uses the program aid for stabilization purposes and thereby increases private investments, economic growth and incomes of the poor.[13]

A major problem in assessing program aid is that of fungibility: what would imports or government expenditures have looked like in the absence of program aid? Clearly both would have been lower, but what about the structure? If donors state that the local currency flow of program aid should be used for expenditures on primary education, the actual pattern of expenditures cannot be evaluated against this unless we also know the counter-factual: what the pattern of expenditures would have looked like in the absence of program aid. This is usually regarded as a major problem and is likely to be a contributing reason to why bilateral donors are reluctant to use program aid as the dominant modality for disbursements.

Finally, it should be noted that economic growth is crucial for program aid and its objectives. Most conceivable mechanisms go through the link growth => poverty alleviation and consequently if growth fails to materialise so will poverty alleviation (which may be the case even if there is growth; cf. Chapter 2). However, if the donor requests that the recipient uses local currency funds for addressing poverty problems directly, the growth link may be circumvented. On the other hand, such aid is not sustainable in the absence of growth, as inadequate domestic resources in the recipient country have necessitated it in the first place.

One drawback of program aid in general is the potential impact on the exchange rate. Although usually referred to as Dutch Disease, we avoid that term here as it does not

[13] Several qualifications may be made with regard to these basic mechanisms. See Danielson and Nilsson (2000: Ch. 7) and White (2000b).

capture what is going on.[14] The real exchange rate—which is arguably a reasonable indicator of international competitiveness—consists of two components: the nominal exchange rate and the price level in relation to the price level in other countries. Consequently, to examine changes in international competitiveness one calculates the percentage change in the nominal exchange rate (defined as the price of forex, so an increase is a nominal deprecation) minus the inflation differential. A negative number signifies a real exchange appreciation.

An inflow of program aid may affect both components of the real exchange rate. First, an inflow of foreign exchange increases the supply of forex and consequently lowers the price of forex. This is tantamount to saying that an inflow of forex, ceteris paribus, appreciates the nominal exchange rate.

Second, an inflow of forex may also affect inflation. To see that note that the money supply is defined as $M = eR + DC_g + DC_p$ where e is the exchange rate, R the forex value of international reserves, DC domestic credit extended by the central bank and subscripts g and p stand for the government and the private sector, respectively. Here, a change in the money supply for a constant e) may be decomposed as

$$\Delta M = e\Delta R + \Delta DC_g + \Delta DC_g$$

An inflow of program aid is recorded as $\Delta R > 0$ so as a consequence $\Delta M > 0$ unless domestic credit declines. The most reasonable scenario would seem to be when DC_g declines by the same amount as eR increases. This is the case when the government uses the local currency generated through program aid to decrease borrowing from the central bank (in practice, the government's account at the Central Bank is credited with $e\Delta R$ and the government's expenditures are not affected by the inflow of aid).

[14] Dutch Disease refers to a situation in which an unexpected and large inflow of foreign exchange causes competitiveness to decline due to appreciation of the exchange rate. Although the phenomenon is potentially a problem for countries receiving such large inflows (in the form of aid, export proceeds, or foreign investment), it is certainly not a disease—it is simply an indication that the market for foreign exchange is working properly. Moreover, and this is usually overlooked in studies analyzing Dutch Disease, an appreciation of the exchange rate implies that the price of imports falls, so for open economies the growth impact of an appreciation is ambiguous.

The situation that is relevant for the current program aid agreements in Tanzania, however, is one in which the government is requested to spend the local currency generated from the disbursement of program aid. Consequently, government expenditures increase by $e\mathcal{R}$ and DC_g remains unaffected, so the money supply increases by the full local currency amount of program aid. To the extent that there is a relation between rates of growth of the money supply and the rate of inflation (and in the medium run, there often is), the disbursement of program aid will increase inflation and thus lead to a further appreciation of the real exchange rate.

As noted in Chapter 2, Tanzania has experienced gradual appreciation of the real exchange rate in the past three years or so (with minor exceptions). One reason for this is, of course, the accelerating inflow of program aid. The appreciation can be fought in two ways. The first is to "sterilise" the inflow of forex by decreasing domestic credit and thereby prevent the money supply from increasing. As government credit is the obvious target for such a strategy it would amount to refrain from using the local currency generated to expand expenditures in priority sectors. Obviously, this would run counter to the intentions of donors.

The second way is to adjust the nominal exchange rate—perhaps even to use a real exchange rate target. While the official policy of the bank of Tanzania is to let the market determine the value of the currency the stability of the TSh-US exchange rate in the face of appreciation of the latter clearly suggests that the current strategy is to stabilise the Shilling in relation to the dollar. Unfortunately, this implies real exchange appreciation, both because the US dollar has appreciated and because historically Tanzania's rate of inflation has exceeded that of neighbouring countries.

4.2 The Multilateral Debt Fund

The construction of the MDF was very simple. Donors paid in forex into an account at the Central Bank. The government withdrew funds as needed, i.e., as multilateral debts fell due. The condition stipulated by donors was that the government agreed to protect priority sectors, in the sense that these sectors received full funding as allocated in the budget.[15]

The system had several advantages. First, it was simple and thus transparent and relatively easy to monitor. Moreover, quarterly meetings between government and donors ensured that information was shared on a regular basis. Second, triggers were built in. Funds were earmarked for multilateral debt servicing and thus the government could withdraw funds only to the extent that it was required by the debt structure. Third, monitoring was relatively easy as the annual *Public Expenditure Review* as a matter of routine records budgetary allocations to sectors. Fourth, the system encouraged co-operation, both between donors and between participating donors and the government. While the government decides annually on priority sectors, donors have reserved the right to select sectors from those prioritised by the government. Consequently, while the government priorities govern the allocation of resources, donor priorities are also heeded. Fifth, as disbursement was not linked to activities by the recipient—i.e., money could "rest" in the account—no incentives were created for donors to circumvent the government in order to make disbursements timely to their own schedule.

No negative comments on the MDF were offered to us during interviews for this report. However, in principle, it could be argued that there are a number of aspects were improvement would be warranted. First, donor commitments have sometimes differed from actual disbursements. While we have not been able to trace this in detail, it seems clear that donors some times have made commitments that later have been revised. This is always a problem with program aid. While project aid commitments usually carries with it expenditure commitments, this is not the case with program aid. To the extent that committed amounts of program aid have entered the budget as income, unforeseen fluctuations have occurred as a consequence of revised commitments.

---

[15] It deserves to be pointed out, however, that there is no guarantee that all local currency funds released through the MDF are being used for social sectors. While some documents (notably the *Technical Note*) suggests that all local currency resources should be used for priority sectors, no such guarantees can be made: due to fungibility, it is impossible to trace resources and only broad conditions (as those agreed) can be binding.

Second, donors have not attempted to formally co-ordinate disbursements. Some donors disburse regularly during the year while others treat program aid as a residual and disburse the lion's share towards the end of their own fiscal year. Apparently, this has not caused any problems in Tanzania, mainly because participating donors have different fiscal years. Consequently, there has been no need for disbursement co-ordination. As will be argued later on, however, the switch from MDF to PRBS creates such a need.

Third, active participation among donors varies. Some donors are not—according to interviews—aware of the fact that priority sectors are selected in donor meetings/discussions.

Fourth, while the amount of funds disbursed into the MDF have been substantial—almost 10 percent of all aid going into Tanzania was channelled through that fund[16]—it has been insufficient, both in terms of multilateral debt service obligations and the needs of priority sectors. As there are many advantages of program aid, particularly of the co-ordinated form as in the MDF, more donors should be persuaded to participate. One apparent risk, of course is that participating donors form an exclusive "club" for discussions on priority sectors and the government strategies from which non-participants are excluded. In the longer run, this would run counter to all the attempts of improving donor co-ordination that are now flourishing.

However, it is our view that the MDF represented a major step towards improved donor-government relations and improved donor attitudes. One of the more important signs of progress is the clear statement that donors accept fungibility as a fact of program aid and will take no steps towards micro monitoring. Another sign of improved attitudes is that donors have refrained from parallel monitoring or detailed conditions (although interviews suggest that there has not been consensus on this issue).

[16] It deserves to be noted, however, that recent estimates put the share of total aid going through the government to approximately 40 percent. Although all such estimates are quite shaky, it suggest that a lot of funds cannot be coordinated by the government.

4.3 The Budget Support Facility

When Tanzania reached the HIPC decision point in April 2000, the IMF and the IDA commenced interim relief which will continue until the completion point is reached—most likely in the mid of 2001. The decision point document (IDA/IMF, 2000) states that "For the future continuation of bilateral assistance at its present levels, including MDF, will be essential to ensuring the additionality of HIPC Initiative assistance." In other words, should bilateral donors choose to reduce program assistance because Tanzania has reached the HIPC decision point, there is a clear risk that benefits of HIPC relief accrue to donor country tax payers rather than Tanzania. Consequently, the major argument for maintaining flows of program aid despite reduced levels of multilateral debt servicing is to ensure that multilateral debt relief is truly additional.

The proposed set-up of the budget support facility (the PRBS) is quite similar to that for the MDF. Quarterly meetings between government and participating donors are scheduled in which performance is reviewed and information concerning disbursement plans exchanged. Monies are released into the PRBS on the condition that budgeted allocations to priority sectors are being translated into actual transfers. As in the MDF, donors choose which sectors to favour from the set of priority sectors decided by Parliament. The monitoring process is not clear (and we return to this below), but it seems likely that indicators will come from the regular review exercises such as the *Public Expenditure Review*. In addition, both government and donors acknowledge the advantage of a simple and transparent construction, so conditions are limited to budget allocations on a sectoral level: no specifications regarding, for instance, regional distribution or the distribution between Personal Emoluments (PE) and Other Charges (OC) are being made.

However, the change from a debt relief facility to a budget support facility requires the consideration of a number of aspects. These are outlined here.

First, the MDF had a clear trigger mechanism—the structure of the multilateral debt. The government was allowed to draw on the MDF account as multilateral debts fell due. That trigger is now absent. This leads to a number of unresolved questions. First, line ministries are likely to need resources on a continuous basis. In the simplest case, one could even envisage that a fixed amount of recurrent resources—salaries and other charges—are needed every month. However, GoT resources are likely to fluctuate through the fiscal year, both because tax revenues fluctuate and because donors disburse into the PRBS in a rather uncoordinated fashion. This provides an opportunity for the PRBS to act as a cushion. Provided that GoT knows approximately the amount of money that will be forthcoming in a given year and provided that it also knows the seasonal fluctuations of tax revenue, it is possible to use counterpart funds to smoothen monthly disbursements to line ministries. This, however, requires that donors are able to co-ordinate disbursements.

Second, inflow of forex into the MDF account was associated to outflows from that account. This is no longer the case. In fact, total outflow of forex is likely to have diminished as interim HIPC-relief kicked in. This means that the risk that inflows of program aid may have an impact on the exchange rate has increased. It deserves to be pointed out that MDF-disbursements[17] are often large relative to the market. Thus for instance, the UK plans to disburse—in one tranche—about USD 60 million before April 2001. This should be compared to the total monthly amount trade on the interbank foreign exchange market (IFEM)—about USD 50 million. Since the annual amount disbursed into the MDF/PRBS is approximately equal to two months' trading on the IFEM, closer co-ordination between donors would seem warranted. However, the situation is complicated by the fact that some donors treat program aid in a residual fashion and thus tend to disburse the bulk of it towards the end of their fiscal years.

Third, while the absence of detailed conditionalites is a major advantage of the system, one problem is that there is a degree of uncertainty regarding which data to use. Often information's on budgetary allocations differ between sources (e.g., the Treasury, the IMF and the PER), and it would seem valuable if participants in the PRBS could agree on which source to rely on for assessing performance. However, as the integrated framework for financial management (with the Platinum software) comes into operation this problem will become obsolete.

[17] Several donors continue to disburse into the MDF-account because of prior commitments.

It should be noted that the transition from a MDF to a PRBS is taking place simultaneously to a marked shift from project finance to sector support. Although such programs, e.g., basket funding, are still in their infancy (in September 2000, basket funding programs were in existence in the health sector only), several donors have indicated their intention to supply an increasing amount of their assistance as sector support. Budget support with the added condition that priority sectors should be protected are easily integrated into such a framework, particularly when donors have a certain measure of influence of which sectors to prioritise.[18]

Consequently, the PRBS seems to offer a potential for improving social services without putting undue workloads on the government. Three remarks seem however appropriate. First, the Tanzanian budget is still run on a cash basis, which means that expenditure levels, rather than the fiscal balance, act as the residual. Without program aid, expenditure levels would be forced to swing with revenues. Since such swings are usually bad, it is in principle possible to have program aid cushion the effects. Unless participants are willing to keep sufficient program aid in the PRBS account to counter swings,[19] this would require close co-ordination between donors or, at the very least, credible commitments by donors.

Second, decentralisation is increasing the latitude of local government to decide of expenditure allocation. Although central government will continue to decide on overall allocation, decentralisation will mean that it becomes more interesting for donors to interact directly with local authorities. This should be kept in mind when analysing the potential impact of sector support.

Third, while donors put as a condition for program aid the sectoral allocation of public expenditure, it should be kept in mind that development expenditure is excluded: there is no conditions whatsoever in the MDF agreements regarding the amount of development expenditure to priority sectors. This does have some negative

---

[18] And if donors' and the government's views on which sectors to prioritize differ sharply, there is not 7much point in providing program aid, anyway.

[19] Fluctuations in tax collections occur for may reasons in Tanzania. The most important is that pertaining to seasonality in agricultural production and the associated fluctuations in exports and imports.

effects, including the fact that recurrent expenditures may be inefficient in the face of insufficient amounts of development expenditure.

Regardless of the remarks above, the continuation of program aid in the absence of multilateral debt servicing is welcome. It represents a form of aid which is efficient and which provides signals to the government that its polices are endorsed by the donor community.

5. Budget and Outcome for Primary Education

5. 1. Introduction

Right after Tanzania's political independence in 1961 the country, under the leadership of its first president, Julius Nyerere undertook measures to rid itself of the three social vices i.e. ignorance, disease and poverty. The provision of (primary) education was recognised to be a basic human right. Determined efforts were made, mainly with the support of bilateral donors to expand primary education sector in Tanzania during the late 1960s and 1970s. As a result of these efforts which included the Universal Primary Education (UPE) before the on-set of the economic crisis in the early 1980s, Tanzania managed to have the highest primary school and literacy rates in Sub-Saharan Africa. Unfortunately the expansion of basic education could not be followed up by similar expansion in the secondary and higher education sub-sectors. Furthermore with the on-set and lingering of the economic crisis in the 1980s the country could no longer afford to provide the basic education service to its citizens free of charge. The introduction of the cost sharing scheme, coupled with other factors related to infrastructural problems in the sector has led to a decline in Gross Enrolment Ratio in primary education from 83.8% in 1985 to about 62.2% in 1999 as Table 13 reveals. Furthermore, net enrolment has decreased even more due to increasing rates of dropout, and the enrolment in secondary education is one of the lowest in sub-Saharan Africa.

Table 13

Trends in Gross Enrolment Ratios in Tanzania: 1985–1999

Year	Primary	Secondary		Vocational	Higher
		Lower	Upper		Education
1985	83.8	1.3	0.56	-	0.56
1990	70.2	6.9	0.87	2.86	0.27
1995	67.7	7.0	1.19	2.86	0.37
1996	67.7	7.2	1.23	3.15	0.48
1997	67.7	7.2	1.48	3.19	0.53
1998	65.9	9.5	1.42	3.55	0.65
1999	62.2	7.4	1.60	3.28	0.79

Source: Ministry of Education and Culture, BEST.

5.2 Problems Facing the Primary Education Sector[20]

The sub-sector is under funded

The share of the government budget that goes to education sector in general and to primary education sub-sector has not reached 30%. This implies that the sector is under-funded compared to its size and in relation to other sub-Saharan African countries (cf. Table 14). The share of education budget that has gone into teacher education for example has not reached 3% during the entire 1995–2000 period. Moreover, when measured in constant prices, allocations have decreased. The sharp drop between 1995 and 1996 is likely to be due to the introduction of the cash budget. Note however that Table 14 suggests a relative improvement for primary education from 1998 and onwards (i.e., the first year when the MDF was operational): together with higher education, primary education is the only subsector for which the budgeted amount (in real terms) did not decrease.

Table 14

Expenditure in Education Sector in Tanzania 1995–2000: TSh mn, 1995 Prices
(% of total expenditure in parentheses)

	1995	1996	1997	1998	1999	2000[a]
			(a) TSh mn, 1995 Prices			
Total Education	79,165	65,365	67,977	67,526	64,976	66,234
Basic Education	49,174	42,653	43,391	43,489	45,635	43,604
Secondary Education	7,533	5,462	5,581	4,983	4,548	4,416
Teacher Education	2,013	1,205	1,392	1,666	1,521	1,490
Higher Education	15,922	13,916	11,970	14,464	15,585	14,903
Support	4,524	2,146	2,015	2,818	2,106	1,656
			(b): As Percent of Total Education Budget Except as Indicated			
Total Education[b]	26.6	25.1	22.9	22.8	24.2	25.0
Basic Education	62.1	65.2	66.5	64.4	66.0	67.0
Secondary Education	9.5	8.4	8.2	7.4	7.0	7.5
Teacher Education	2.5	1.8	2.0	2.5	2.3	2.5
Higher Education	20.1	21.3	20.7	21.4	20.0	21.0
Support	5.7	3.3	2.9	4.3	3.2	2.9

Source: Public Expenditure Reviews, 1998 and 1999.
[a] Projection
[b] Share of Total Budget allocated to education

A further analysis of the education budget shows that over 90% of the funds are used to cover personal emoluments (PE) (mainly staff salaries). This has left lesser funds to

[20] See also PER (1999, Vol. 1), Tables 6.10–6.12 for a succinct analysis of problems and remedies.

cover other charges (OC) (including funds for infrastructure maintenance and development activities). This is generally regarded as a major constraint on the sector. Details are in Table 15. Given the level of teacher salaries, it seems that increasing teacher-pupil ratios is the only viable option in the short to medium run.

Table 15

Share of PE and OC in the Education Budget: 1996–99

	1996	1997	1998	1999
Primary education				
Total budget (TSh mn)	**69,758**	**74,272**	**79,078**	**76,839**
Personal emoluments (TSh mn)	67,501	72,182	76,002	71,787
Other charges (TSh mn)	2,256	2,090	3,075	3,052
Personal emoluments (% of budget)	97	97	96	96
Other charges per student (TSh)	583	531	759	732
Secondary education				
Total budget (TSh mn)	**8,086**	**7,910**	**10,209**	**8,491**
Personal emoluments (TSh mn)	5,932	6,511	5,948	5,546
Other charges (TSh mn)	2,154	1,399	4,363	2,945
Personal emoluments (% of budget)	73	82	58	65
Other charges per student (TSh)	23,395	14,370	36,563	23,758
Teacher education				
Total budget(TSh mn)	**2,024**	**2,261**	**3,075**	**2,378**
Personal emoluments (TSh mn)	1,433	1,736	1,802	1,672
Other charges (TSh mn)	591	525	1,274	706
Personal emoluments (% of budget)	71	77	59	70
Other charges per student (TSh)	36,065	39,490	39,405	67,231

Source: *Public Expenditure Review*, 1999

Infrastructure Problems

The little allocation that has been directed to cover OC implies that it is difficult for most schools to construct new classrooms or staff houses. As a result the situation in most primary schools in Tanzania is such that there is critical shortage of key infrastructural elements. Table 16 provides some details.

Lack of basic textbooks

Apart from crowded classrooms most primary schools in Tanzania face critical shortage of textbooks. In almost all subjects, the textbook shortage as shown in Table 17 for Kibaha District in Coast region of Tanzania is glaring.

Table 16

Situation of Physical Infrastructure in Primary Schools in Tanzania

	Available	Required	Shortage	Deficit[a]
Classrooms	54,417	92,539	38,122	59%
Staff houses	24,404	111,581	87,177	22%
Toilets	46,319	153,114	106,775	30%
Desks	815,530	1,666,420	851,290	51%
Tables	69,734	189,612	119,879	37%
Chairs	71,370	206,593	135,223	35%
Cupboards	29,355	120,295	90,940	24%

Source: Ministry of Education and Culture.
[a] Availability as percentage of requirement

Table 17

Availability of Textbooks by Subject at Kibaha District, Tanzania

Subject	Text books Available	Shortage (%)
Civics	404	(88%)
Agricultural science	758	78%
Geography	859	(75%)
History	656	(81%)
English	2,997	(51%)
Mathematics	4271	(30%)
Science	3056	(50%)
Kiswahili	3934	(35%)
Domestic Science	895	(74%)

Source: School Mapping in Kibaha District, 1999.

Parents find it difficult to cope with increasing costs of primary education. This could be one of the reasons for rising primary school drop out rates.

The introduction of cost sharing system especially in primary education has implied additional costs to the parents. As Table 18 shows, the average unit cost at primary schools in Tanzania for the 1998/99 period was Tsh 17,322. This is relatively a high fee to be borne by rural based peasants.

Table 18

Average Unit Cost at Primary Schools in Tanzania 1998/99

Expenditure Categories	Tshs.	(%)
Fees	6,481	(13%)
Uniforms	9,965	(21%)
School Materials and Books	9,464	(21%)
Examinations and games	420	(0.1%)
Others contributions (buildings, desks)	4,398	(9%)
Other costs – lunch/catering/transport	17,322	(36%)
Total	895	(74%)

Source: Ministry of Education and Culture, *Education Status Report Survey*, 2000.

5.3 Allocations to Primary Education

Recall from Chapter 4 that the condition for multilateral debt relief through the MDF was that priority sectors should be protected in the sense that the government should ensure that budgeted allocations to these sectors were given priority. This condition will be maintained in the PRBS. At the time of writing the information for the fiscal year 1999/00 is not yet available, but the 1999 *Public Expenditure Review* shows that actual allocations to primary education have exceeded budgeted allocations (cf. PER, 1999, II: Table 6.3). For the coming three years, total allocations to primary education is projected to increase with about six percent per annum, while resources earmarked for teachers' salaries will increase with approximately five percent per annum. Consequently, the share of OC in the total budget for primary education is projected to increase from about 12 percent in FY 1999 to about 16 percent in 2002. Although this is far from sufficient for the needs of the sector, it represents a step in the correct direction. It is important, however, to realise two things. First, eventually the amount allocated to salaries needs to increase. The balance between increasing the share of OC and increasing the amount of money for salaries remains a delicate one in which the government will have to take into account not only the needs of schools, but also the deficiency of properly trained teachers in remote areas. Second, while it is important that the share of OC increases in the short to medium run, it is equally important that donors refrain from using the MDF (or the PRBS facility) for enforcing such an increase. One of the major advantages of the program support channel is that it is transparent and free of detailed and complicated conditionalities. To the extent that donors feel obliged to press for increased OC allocations, other channels will have to be used.

Finally, on the basis of limited data (not extending beyond 1997/98) it seems as if the share of allocation to primary education that is financed by donors have increased substantially. Data from the Ministry of Education suggest that the share of donor finance in basic education has increased from 1.6 percent in 1994/95 to almost 9 percent in 1997/98. The trend is similar in teacher education. If this trend has continued in 1998 and onwards, there are reasons to for donors to monitor it closely, because it would suggest the possibility that the government substitutes aid resources for tax revenues in financing primary education (and possibly other social sectors as well).

5.4 Regional Allocation of Funds

The past decade has seen a relatively rapid deterioration of the state of education in Tanzania. The major reason for this is that fewer funds have been allocated to the sectors and, perhaps also, that these resources have been inefficiently deployed. In recent years, Government and donors have responded to this, both by increasing allocations to the sector and by attempting to improve resource allocation.

In view of the determined action that has been taken to improve educational quality and quantity, it is surprising to find—particularly in view of the poverty-oriented focus of both Government and donors—that the regional allocation of resources for education is rather skewed in favour of rich regions.

Thus, for instance, the simple correlation coefficient between regional per capita income and share of personal emoluments (as percent of total budgeted PE) is –0.11, while the correlation coefficient between regional per capita income and OC per student (in Tsh) is 0.34, which means that regions with higher per capita income get a disproportionate amount of budget allocations for other charges. All recurrent resources (i.e., PE plus OC) to the education sector shows a correlation of 0.22 with 1998 regional per capita income.

These findings are somewhat surprising, for several reasons. First, to the extent that poverty is fought through the provision of education, one would expect allocations to be skewed in favour of relatively poor regions. Second, even if PE is allocated in favour of rich regions, OC should display the opposite pattern: the marginal productivity of money is arguably higher in regions with small education budgets, and increasing the allocations to these, should then have a larger impact in terms of educational quantity and quality. Third, by favouring rich regions the government is running a risk that the gap between rich and poor regions widens. Teachers are attracted to relatively well off regions, and thus draining poor (and remote) areas of valuable resources. Fourth, there appears to be no formal system for allocating resources on a regional basis: the information that we collected in the research for this report indicates that OC allocations are made on a "first-come-first-served" basis. Fifth, the particular regional allocation found for education cannot be found for other sectors. Thus, for instance, the correlation between regional per capita income and per capita development expenditure is −0.28 which suggests that overall, the development budget allocation favours relatively poorer regions.

5.5. Concluding Remarks

The introduction of the MDF apparently affected the allocation of resources between ministries. In particular, the allocations to social sectors have increased after 1998 and it is reasonable to infer that one reason for that is the condition in the MDF. Consequently, the modality for disbursing program aid since 1998 appears to have worked according to objectives, and there is little to suggest that this would change with the transition to the PRBS facility.

However, there are reasons to worry about the developments in the primary education sector (and, probably, in other social sectors as well). Budgetary allocations have not increased (in constant prices) since 1995, and since gross enrolment has increased, the allocation per student is likely to have decreased. Consequently, while the MDF has ensured that budgeted allocations have actually been paid out, per student allocations have declined, so primary education does not appear to be a priority sector in any meaningful sense of the term. One important reason for this, of course, is the cash budget, and the inability to raise sufficient revenue.

Moreover, the available data suggest that donors carry an increasing share of the financing burden (although we have not been able to find commensurable data for any year after 1997/98). If this trend has continued into later years, donors have to ask to what extent the government substitutes aid for tax revenue in the financing of priority sectors. If program aid is not truly additional, the efficiency of the MDF /PRBS in attaining donor objectives (i.e., poverty alleviation via the provision of improved and expanded social services) has to be questioned.

The major problem in primary education, however, is not fungibility of program aid, but the size of the resource envelope. While improvements can be made in the existing allocation, more resources are necessary to combat the existing output trends. While donors seem prepared to disburse additional amounts through the PRBS window, the only sustainable solution is that the government is able to allocate increasing amounts from its own funds. Consequently, increased tax efforts and increased economic growth are likely to be the two major constraints or a sustainable improvement of the primary education sector.

6. Conclusions

This report has dealt with three distinct aspects of Tanzania's economy: the current macroeconomic situation and prospects for the near future; the status and relevance of the HIPC initiative; and the workings of program aid modalities with particular attention paid to its impact on the financing of primary education. Major conclusions are as follows.

As for the macroeconomic situation, Tanzania has now entered a phase characterised by relative stability. Inflation is low and declining and the fiscal deficit has been virtually eliminated, largely thanks to the cash budget. However, although the situation represents a substantial improvement over recent years, a number of difficult issues remain. Chief among these is the rate of economic growth. Most analysts seem to agree that an increased rate of growth is necessary for visible poverty alleviation; projections point to a real GDP growth rate of 5.5–6 percent per annum in the coming years. However, existing household surveys suggest that the impact of growth on poverty is limited, particularly outside major urban areas and that substantially higher growth would be required. This finding is reinforced by the observation that the current growth pattern is geared towards mining and tourism—two sectors with limited links to areas in which the majority of the poor subsist. In fact, rough calculations indicate that to reach stated objectives with respect to poverty alleviation, the Government would be forced to find means to raise the annual real growth rate to somewhere in the neighbourhood of 8–9 percent.

This is the major challenge for the government. It is rendered even more difficult by disappointing performance by the export sector. Major traditional exports such as coffee and cotton are on the decline and expanding sectors—tourism and mining, and to some extent horticulture—are too small or growing too slowly to be able to make up for that decline. Finding new areas of export expansion should be one of the government's top priorities.

While high growth is important because it will in the longer run increase incomes of the poor, it also has beneficial side-effects. The most important of these is that tax revenues will also increase (although not necessarily at par with growth). The cash budget of 1996 limited the amount of resources available to most sectors and as a result, several social indicators have deteriorated in the late 1990s. To improve these is an integrated part of any poverty alleviation strategy and, given the Government's objective of decreasing aid dependence, the only way of doing it is by expanding tax revenue and spending on these sectors.

Tanzania reached the decision point under the enhanced HIPC Initiative in April 2000 and is expected to reach the completion point late in the current fiscal year. While this initiative represents a welcome addition to a resource-strapped economy, there are three points in the current agreement which have received far too little attention:

1. *The HIPC Initiative does not imply that the debt burden disappears*. On the contrary, Tanzania's external debt (in NPV terms) is expected to triple between 1999 and 2010/15. The debt burden will be smaller with HIPC relief than it would have been without it, but it will still grow fast, simply because the need for exceptional finance does not disappear. Consequently, to avoid an unsustainable debt situation in one or two decades from now, it is important that Tanzania enters a phase of high growth to be able to carry a larger debt. Hence, increased growth is important not only for poverty alleviation purposes, but also for the purpose of making permanent the benefits of multilateral debt relief.

2. *The projections on which the current agreement is based are extremely optimistic*. The volume of multilateral debt relief under the HIPC Initiative is determined with reference to (a) how much bilateral debt relief the country will get under Paris Club agreements and (b) the "carrying capacity" of the Tanzanian economy. The latter point, in turn, is calculated from projections regarding growth of GDP; imports, exports and inflows of foreign funds. In a historical perspective, the projections underlying the Tanzanian debt sustainability analysis (DSA) are very high, particularly for exports. Thus, from the explicit assumptions in the decision point DSA, it follows that the volume of non-traditional exports is expected to grow by about 20 percent per annum up to 2015. This implies that these sectors are expected to double in size every fourth year. The realism of this assumption may be questioned on several grounds. This leads to the third point:

3. *The current HIPC agreement seems to lack a contingency plan*. As noted, the amount of debt relief is based on projections of the economy's performance. Moreover, representatives for the multilateral institutions emphatically state that the HIPC Initiative is a "final exit", that there will be no "HIPC II". Consequently, if Tanzania is unable to perform according to projections, the country will have an unsustainable debt in 2020. It is not clear what will happen then. After all, failure to reach a sustainable debt situation may be because of unsatisfactory economic policies, but also because of unrealistic projections. Unless donors are prepared to leave the country to her own destiny should projections not hold, it is important to discuss openly and realistically what are the options in case there will be a divergence between projections and outcome.

As for program aid, the major finding in this report is that the MDF appears to have worked according to intentions and that there are no reasons to believe that the PRBS facility will not. It is important, however, to keep in mind that the objective of the fund has been to ensure that budgeted allocations to social sectors are actually disbursed; there are no stipulations regarding the volume of resources that the Government should allocate to these sectors. The limited data that were made available to us indicate two trends: (a) that the amount of resources (in constant prices) that are allocated to primary education has not increased significantly and (b) that donors' share of this amount has increased. Consequently the amount of own resources that the Government allocates to primary education appears to have decreased over time. This raises the question of the extent to which the Government substitutes aid for own resources in the financing of primary education. A challenge for donors in this respect is to ensure that such a substitution does not take place. However, the advantage of keeping the budget support facility clear and simple are substantial, so such action should use other appropriate channels.

List of Interviews

13/9	Ms Stödberg	Swedish Embassy
14/9	Mr van Rijn,	Dutch Embassy
	Mr Carlqvist	Swedish Embassy
	Mr Idama,	Ministry of Education
15/9	Mr Magotta	Education Coordination Unit
	Prof Omari	Faculty of Education, UDSM
18/9	Mr Etokudo	UNDP
	Prof J Semboja	REPOA
19/9	Visit to Bagamoyo District, Coast Region	
22/9	Mr Burki	SDC
	Ms Mahon	SDC
	Dr Tsikata	IMF
25/9	Mr Iraba	Ministry of Education
	Mr Magambo	Treasury
	Mr Shumbusho	Treasury
	Mrs Mapunjo	Treasury
	Ms Tinnes	NORAD
26/9	Mr Schmidt	EU
	Mr Shadruck	Vice-President's Office
	Mr C.Mkai	TAKWIMU
4/12	Ms Jema	TGNP
5/12	Mr Lindquist	Danish Embassy
5/12	Ms Shena	DfID

References

Ajayi, I. (1991) "Macroeconomic Approach to External Debt: The Case of Nigeria" *AERC Research Paper* No.8, Nairobi: AERC

Bank of Tanzania (1998): *Debt Portfolio*, Dar es Salaam: BoT

Bank of Tanzania (1999) *Economic and Operations Report*, Dar es Salaam: BoT

BOT (1999): *Economic Bulletin*, Vol. XXIX (2), Dar es Salaam: Bank of Tanzania

Danielson, A. (1996): *Tanzania 1995: Ten Years of Economic Reform*, Macroeconomic Report 1996:2, Stockholm: Sida

Danielson, A. (2000): *Agricultural Supply Response in Tanzania: Has Adjustment Really Worked?*, manuscript, Lund: Department of Economics

Danielson, A. and G. Mjema (1999): *Cost-Sharing in Development Projects: Principles, Practice and Problems*, Country Economic Report, 1998, Stockholm: Sida

Danielson, A. and G. Mjema (2000): *Obstacles to Private Sector Growth*, Country Economic Report, 1999, Stockholm: Sida

Danielson, A. and M. Nilsson (2000): *Trends and Turns in the 1990s*, Sida Evaluation Report, 99/17:9, Stockholm: Sida

Danielson, A, and G. D. Mjema (1996) " External Debt and Economic Growth in Tanzania" *African Development Review,* Vol. 6

Danielson, A., G. D. Mjema and F. M. Musonda (1994) "Aid and Debt Issues in Tanzania : Past Trends and Future Prospects" *Eastern Africa Economic Review*, Vol 6

Easterly, W. (1999) "The Ghost of Financing Gap: Testing the Growth Model Used in the International Financial Institutions" *Journal of Development Economics*, Vol. 60: 423–438

ECA (1997): *Financial Sector Reforms and Debt Management in Africa*, Vol.1, Addis Ababa: Economic Commission for Africa

GOT (2000): *Poverty Reduction Strategy Paper*, Dar es Salaam: Government of Tanzania

IDA/IMF (2000): *Decision Point Document Under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative*, Washington DC: IDA/IMF, March

IMF (1999): *ESAF Policy Framework Paper 1998/99–2000/01*, Washington DC: IMF (also available at http://www.imf.org/external/np/pfp/1999/tanzania/index.htm).

IMF (2000): *Tanzania: Statistical Annex*, IMF Staff Country Report, 00/122, September, Washington DC: IMF

Narayan, D. (1997): *Voices of the Poor: Poverty and Social Capital in Tanzania*, Washington DC: World Bank

PER (1999): *Public Expenditure Review* (2 vols), Dar es Salaam: GoT and Washington DC: World Bank

Ross, J. B.(1997): *Heavily Indebted Poor Countries (HIPC) Initiative: Implications for Africa*, Addis Ababa: Economic Commission for Africa

Sarris, A. and R. van der Brink (1993): *Economic Policy and Household Welfare During Crisis and Adjustment in Tanzania*, New York, NY: New York University Press

TAKWIMU (2000): *Developing a Poverty Baseline in Tanzania*, Dar es Salaam: National Bureau of Statistics

White, H. (2000*a*): *Dollars, Dialogue and Development*. Sida Evaluation Report 99/17, Stockholm: Sida

White, H. (2000*b*): *From Commodity Aid to Budget Support. Programme Aid and Its Modalities*, Sida Evaluation Report 99/17: 12, Stockholm: Sida

World Bank (1993): *Tanzania: A Poverty Profile*, Washington DC: World Bank

World Bank (1996): *Tanzania: The Challenge of Reforms: Growth, Incomes and Welfare*, (3 vols), Washington DC: World Bank

World Bank (1996*a*) The HIPC Initiative, Washington DC: The World Bank

World Bank/IFPRI (2000): *Agriculture in Tanzania Since 1986. Follower or Leader of Growth?* Washington DC: World Bank and International Food Policy Research Institute

Country Economic Reports

Country Economic Reports

Zimbabwe: Structural Adjustment and Productivity: A Study of the Manufacturing and Agricultural Sectors	1998:1
Uganda: Towards Results-Oriented Economic Management?	1998:2
Ethiopia: Regional and Business Sector Challenges	1998:3
Kenya: From Chaos to Prosperity?	1998:4
Angola: More Oil and Financial Problems	1998:5
Guinea-Bissau: Going into High Gear	1998:6
Cape Verde: The Economics of Mudança	1998:7
Vietnam and the Asian Crisis: Causes, consequences and cures	1998:8
Cambodia: The Challenge of Productive Employment Creation	1998:9
Sri Lanka: Institutions, Economic Policies and Economic Growth	1999:1
Tanzania: Cost-Sharing in Development Projects Principles, Practice and Problem	1999:2
Mozambique in a Post-Washington Consensus Perspective	1999:3
Moçambique: Numa Perspectiva do Consenso Pós-Washington	1999:3
Kenya:Economic Reorms with Labour Market Rigidities; The Kenya Experience	1999:4
Uganda: Uganda at the End of the 1990s: A Medium-Term Assessment	1999:5
Zimbabwe:Employment, Labour Market Reform and Trade Liberalisation Zimbabwe 1990-1997	1999:6

Country Economic Reports

Country Economic Reports

Cambodia 1999 – 2000 **Land, Labour and rural Livelihood in Focus**	**2001:1**
Poverty in Mozambique	**2001:2**
Tanzania 2000 **Growth, Multilateral Debt Relief and Program Aid**	**2001:3**

Sida

STYRELSEN FÖR INTERNATIONELLT UTVECKLINGSSAMARBETE
105 25 Stockholm, Sweden
Tel: 08-698 50 00. Fax: 08-20 88 64
Hemsida: http://www.sida.se

ISBN 91-586-8955-9
ISSN 1404-031X