

Tanzania's Experience

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By all standards, Tanzania's economy was in a deep macroeconomic crisis by the mid-1980s. The downturn in the economic performance, which started in the mid-1970s, manifested itself in imbalances in the external account, huge unsustainable budget deficits (financed by monetary accommodation), an accelerating rate of inflation, declining growth performance (and the consequent decreases in per capita incomes and consumption), falling savings, and the general deterioration of the social and physical infrastructure. The proximate causes were both of internal and external origin. Inappropriate pricing policies resulted in a downturn in the production of exportables and promoted misallocation of resources. These effects were compounded by the hostile external environment: adverse movements in the country's terms of trade, reduced inflow of foreign assistance, periodic droughts, the war with Idi Amin, and the break up of the East African community. The existence of the economic crisis was well-known and acknowledged by the authorities, and they attempted to correct the imbalances and restore economic growth within the overall social economic goals of the society as enshrined in the Arusha Declaration of 1967.

The main purpose of these remarks is to briefly review the performance of the recently completed Economic Recovery Program and in doing so to point out the pertinent lessons derived from its implementation. My comments will be divided into five main headings. First, I will outline the basic social economic policies of Tanzania as enshrined in the Arusha Declaration. The outline is important for one to appreciate and understand the nature and extent of policy interventions practiced in Tanzania. Second, a brief macroeconomic review of the period of the crisis, 1975–85, will be presented, followed by a brief outline of the home-based stabilization measures. The fourth part of my remarks will be devoted to the recently completed Economic Recovery Program of 1984/85 to 1988/89,

and last, I will draw some lessons from our experience in implementing the program.

Basic Tenets of Tanzania's Social and Economic Policies

Prior to 1967, the basic macroeconomic goals and policies pursued in Tanzania were identical to most other developing countries. Growth in per capita incomes and self-sufficiency in high-level manpower were the main economic goals. The role of the government was limited mainly to providing social overhead capital and to promoting a conducive investment climate in which the private sector can operate. But in 1967, a major policy shift transformed large aspects of the economy and institutions. This policy change is commonly known as the Arusha Declaration.

The main goals of the declaration are building an agricultural system based on collective villages, socialism, and self-reliance, and egalitarian distribution of incomes and opportunities. To accomplish these objectives, numerous institutional changes were introduced, for example, the nationalization of banks, insurance companies, export-import trade, and the main manufacturing enterprises. This resulted in the creation of numerous parastatals, which by the early 1980s accounted for 60 percent of total fixed investment and between 30 percent and 40 percent of the value added in the manufacturing sector.

An important feature that emerged from the Arusha Declaration was a system of direct controls on the macroeconomy. These included investment allocation, foreign-exchange licensing, credit, and price controls. The direct controls and allocation, supplemented with a few doses of market-oriented policies, were thus the main policy instruments used in the overall management of the economy for the period up to the mid-1980s.

Macroeconomic Review, 1975–85

The economic crisis that beset Tanzania is deep-rooted and started way back in the mid-1970s. For this presentation only the salient features of the economic performance for the period 1980–85, as compared with 1976–80, will be reviewed.

With respect to the overall economic performance, as measured by the growth of the gross domestic product (GDP), there was considerable deceleration of the growth performance during 1980–85. Overall, GDP increased, on average, merely by 1 percent a year, compared with a regis-

tered growth of 2.5 percent during 1976–80. With population growth estimated at 2.8 percent a year, there was considerable increase in the decline of per capita income. Output in the manufacturing sector tumbled by about 5 percent during 1980–85, despite the relative high investment in the sector during the 1970s. As a result, capacity utilization dropped to between 20 percent and 30 percent in the sector. Though agricultural performance rose by 3 percent during 1980–85 (against an increase of 1 percent experienced during 1975–80), export volumes did not increase, largely on account of relative price structures, which favored nontradable goods production.

Despite the economic crisis, the proportion of output invested did not significantly decline as it did in other countries. In actual fact, the ratio of investment rose by 16 percent during 1980–85, compared with 1975–80, to 26.6 percent of GDP. This additional capacity did not result in increased production, which suggests that investment was misallocated and its productivity was low. On the other hand, the proportion of personal consumption to output remained more or less static, but there was considerable upturn of government absorption. On the external front, the value of total exports decreased from \$500 million in 1980 to \$286 million by 1985. As a result, coupled with reduced external inflows, imports tumbled from \$1,200 million in 1980 to \$1,000 million by 1985. The external balance worsened and the country's dependence on foreign savings to finance domestic investment increased.

This increased external debt and debt-servicing difficulties. The overall external debt rose from \$2.6 billion (about 330 percent greater than exports of goods and services) in 1980 to \$3.9 billion (or about 880 percent greater than exports of goods and services) by 1985. As a result, the debt-service ratio—on a commitment basis—increased from 7.5 percent in 1980 to about 80 percent during 1985. Consequently, external payments arrears rose from \$65 million in 1980 to \$1,000 million by 1985.

As indicated above, the fiscal situation also deteriorated during the period. Growth rates in public expenditures by far exceeded revenue growth and resulted in large budget deficits. On average, about 40–50 percent of the deficit was financed by external grants and the remaining balance by domestic sources, particularly by the banking system. The bank financing of the deficit increased the growth of money supply and partly contributed to the general inflationary pressures experienced by the economy. The rate of inflation, which averaged 18.5 percent during 1975–80, rose to 30 percent during 1980–85.

“Home-Based” Stabilization Measures During 1975–85

Confronted with these adverse macroeconomic trends, the Government embarked on a series of adjustment measures that would restore economic growth and, at the same time, conform to the broad social economic goals of the Arusha Declaration. In particular, care was taken to ensure that the most vulnerable groups would be insulated and that adjustment would not compromise the overall development objectives nor increase income inequalities.

Before the crisis of the 1980s, two other shocks struck the economy: a drought in 1969/70, and in 1973/74 a drought and the adverse repercussions of the oil price hike. Though the economic performance during 1975–78 was favorable—thanks to the commodity beverage boom—the foundation for the crisis of the 1980s was laid nevertheless during these favorable times. The increased foreign exchange earnings encouraged the Government to liberalize the foreign trade regime; the result was an unprecedented increase in capital goods imports at a time when evidence of capacity underutilization was beginning to emerge. This was not all. The increased government revenues further increased public spending, mainly in development. When the commodity boom collapsed, foreign borrowing and deficit financing were relied upon to continue the spending pattern. All this exacerbated both internal and external imbalances. Thus when additional shocks struck the economy during 1978/79, its ability to recover was severely constrained by the existing imbalances.¹

In order to deal with the macroeconomic crisis, the Government launched two stabilization programs: the National Economic Survival Program (NESP) of 1980/81 and the Structural Adjustment Program (SAP) of 1982/83. In line with the Tanzanian official view of the crisis, NESP was designed to resolve the economic crisis within the context of policies and instruments that were in use then, in particular, the greater use of administrative controls. Its main objectives were:

(1) an aggressive export drive in order to increase substantially foreign exchange earnings;

¹These other shocks included the collapse of the East African Community, which necessitated the diversion of both human and financial resources from other priority areas to the transport and communication sectors—formerly a joint responsibility of the Community; the economic strains of the war with Idi Amin; and the oil price increase in 1979 and the associated recession in advanced countries, which resulted in further deterioration of Tanzania's terms of trade and import capacity.

(2) a judicious use of available foreign exchange so as to enhance future earning capacity, as well as to save on imports;

(3) the elimination of food shortages through inexpensive small-scale village irrigation projects and the cultivation of drought resistant food crops;

(4) the strict control of public spending by both government and parastatals;

(5) an emphasis on consolidation rather than expansion of new activities; and

(6) the expansion of the scope and capacity for self-reliance in all sectors of the economy and raising the productivity of the workers and farmers through appropriate incentives.

The objectives of the NESP clearly reflected a structural program that, to be successful, lacked basic elements of stabilization policies, including demand management. Yet, such a program needed an injection of foreign exchange if the productive capacity in the import-dependent industrial sector was to remain at a reasonable level of utilization. Refusal by the donor community and the Bretton Woods institutions (the International Monetary Fund (IMF) and the World Bank) to support the program rendered it ineffective and exacerbated the crisis.

The SAP, prepared in conjunction with an independent advisory group, for the period 1982/83–1984/85 did not differ significantly from the NESP in its diagnosis of the problems of the Tanzanian economy. Nevertheless, the SAP included stabilization policies—specifically stricter fiscal and monetary policies. Notwithstanding, SAP was not supported by the Bretton Woods institutions, because the active use of exchange rate policy was not considered a basic instrument.

The SAP was relatively successful, however, particularly during its last year of implementation when foreign trade was liberalized. Own-funded imports considerably reduced the shortage of consumer goods, and the foreign exchange retention system for exporters was a great catalyst for the upsurge in nontraditional exports. In addition, the removal of consumer subsidies and other fiscal measures considerably reduced the fiscal deficit. All these measures helped to bridge the gap between the international financial institutions and Tanzania on the appropriate adjustment strategy to be pursued in future.

Economic Recovery Program 1984/85–1988/89

The limited success of the three-year Structural Adjustment Program, coupled with the need to encourage external financial assistance and the

positive results of the liberalization measures enacted in 1984/85, sensitized the Government to formulate a far-reaching adjustment program that would not only stabilize the economy but also ensure the resurgence of growth performance. At the same time, the negotiations with the IMF and the World Bank to have a program that could be supported by the two institutions were continuing in tandem. Much has been written on our past differences with the IMF, and it is not my intention to dwell in detail on these issues. It may suffice to indicate that our differences were basically on three issues: the speed of adjustment policies (gradual versus shock treatment); the thrust of main policies (demand management versus structural "de-bottlenecking"); and the time frame for attaining the objectives of the program.

After various exchanges of view with these institutions, the Government launched a three-year Economic Recovery Program (ERP) in 1986/87. The ERP aimed at achieving a positive growth rate in real per capita income, reducing the rate of inflation, and restoring a sustainable balance of payments position. Its main thrust was to reduce distortions and encourage more efficient resource allocation while exercising fiscal and monetary restraint. The measures proposed included significant increases in producer prices, depreciation of the local currency, institutional changes in the marketing of agricultural produce, price decontrol, and tight fiscal and monetary policies.

Unlike the NESP and SAP, the ERP contained specific macroeconomic and sectoral policies and measures that were extensively discussed with the World Bank and the IMF. The objectives, goals, and policy stances of the ERP were the main springboard for the agreement with the IMF for an initial 18-month stand-by arrangement starting in July 1986, and with the World Bank for a program loan to support multisector rehabilitation, notably in the agricultural, industrial, and transportation sectors. For the first time ever, the Government presented its recovery program at a consultative group meeting of donors in Paris, in June 1986, and received wide support from the international community. Also for the first time, the Government sought debt relief under the auspices of the Paris Club and received an encouraging response.

In this program, the IMF and the World Bank had particularly close collaboration in the diagnosis of Tanzania's economic problems, and in the recommendations of adjustment policies. There was, therefore, for the first time, an agreement between the Fund and the Bank on the conditionalities that were imposed. The measures demanded for implementation included liberal price policies in the form of exchange rate depreciation, upward

adjustment of interest rates, enhanced retail price liberalization, and liberalization of trade and payments. In particular, the domestic currency was devalued by 57.5 percent in U.S. dollar terms, or by 135 percent in terms of local currency, with the Government being urged to establish an "equilibrium exchange rate" within one year. The exchange rate policy was to be accompanied by a substantial real increase in producer prices, a 50 percent increase in interest rates, and restrained fiscal and credit policies. As is the practice with Fund-supported programs, quantitative ceilings and performance criteria were established for the duration of the stand-by arrangement. These included reduction of external arrears, limitations on the levels of new external borrowing, domestic credit (both to government and specified parastatals), and overall central government deficit.

Review of Performance of ERP Policies and Lessons

At this point, it may be useful to review the performance of ERP policies and their effects on the main economic parameters. This review also helps to identify some of the lessons derived from the successes and failures of the program. For ease of presentation, the review will be based on both the program targets and the pre-program period of 1980–85.

During the period of the program, 1986–89, the overall economic performance recorded an upturn in growth performance. GDP rose, on average, by 3.9 percent compared with 1 percent during 1980–85 but less than the target growth rate of 5 percent. The productive sectors of the economy showed marked increases: agriculture rose by 4.8 percent (against 3.2 percent during 1980–85) and manufacturing rose by 2.7 percent (against a recorded decline of about 5 percent during 1980–85). This growth performance was facilitated by improved weather, higher producer prices (thanks to the depreciation of the currency), incentives (thanks to liberalization measures enacted in 1984/85), and increased inflow of external funds. There was no major improvement, however, in export volumes; this was due principally to institutional marketing problems, lack of adequate processing facilities, and transportation problems.

Against earlier expectations and worries, the rate of inflation, despite the depreciation of the local currency and price decontrol measures, declined from an average of 30 percent during 1980–85 to 26 percent by 1989. This unconventional result was partly due to bumper food production, liberalization measures of 1984/85 in which consumer prices were effectively priced at market clearing levels, and to the success in reducing fiscal deficit. Some disquieting features emerged nonetheless. During the

program period, the rate of capital formation declined by 0.3 percent against an increase of 4 percent during 1980–85. This disinvestment cast serious doubts on the objective of the government to continue the developmental momentum. Also, the serious deterioration of social overhead capital—schools, hospitals—and the apparent widening of income inequalities created tensions in the society with regard to the appropriateness of the adjustment program.

Lessons

Having briefly reviewed the performance of the ERP, I shall summarize under eight broad themes some of the lessons from the Tanzanian experience with structural adjustment programs.

Timeliness of Action

Delays in undertaking appropriate adjustment (structural or stabilization) policies exacerbate the problems that underlie an economic crisis, thereby entailing larger doses of action in future adjustment policies.

It is necessary to give cognizance to the interactions, and probably the vicious cycle, that exist between the real sector and misaligned financial variables. High inflation, for example, works in favor of nontradables and against export sectors, so that if sustained over a long period of time, it may wipe out the export capacity of a country, especially when exchange rate policy is rigid. This is what happened in Tanzania, necessitating large exchange rate depreciations and a very tight credit policy that made the recovery of the real sector even more difficult.

Identification of the “Lead” Sector

Given the limited financial resources, it is often necessary to concentrate resources first and foremost in the sectors that may lead economic recovery. It is critical that one be able to identify those lead sectors and balance the distribution of available resources among them. In Tanzania, there were probably some problems in balancing resources between the agricultural sector (which was identified as the lead sector in the program that began in 1986) and transport. As a consequence, increased agricultural output in 1986/87 could not be translated into increased exports and lower food prices in urban centers because infrastructural bottlenecks, especially transportation, hampered purchases from farmers and move-

ment of the crops from production to consuming centers at home and abroad. With large amounts of crops left in the hands of farmers and some rotting in unsheltered godowns of the Cooperative Unions, the impact of increased output on exports and domestic inflation was less than envisaged. One may therefore tend to think that, in circumstances like ours, *transportation* is probably the lead sector in an economy where it was dislocated by protracted economic crisis.

Supply Bottlenecks

Apart from transportation, other factors, including availability of processing capacity and efficient marketing arrangements, impinge on supply and on the translation of increased output into export proceeds. It has become evident that price incentives notwithstanding, the key determinants of export supply are efficient processing and marketing arrangements, as well as extension services and farm inputs. These were the main bottlenecks that set in motion the crisis in agricultural export production from 1979 or so.

Real Versus Financial Sector Adjustment

Savings mobilization and their efficient investment and allocation are best undertaken by an efficient financial system and constitute the main ingredients to economic growth. The question that arises in an economy where both the financial and the real sectors have been inefficient is one relating to the sequencing of the adjustment measures in the two sectors so as to permit maximum possible growth in the adjustment period without jeopardizing medium- and long-run growth prospects. Tanzania, and other developing countries have tended to emphasize reforms in the real sector, while financial reforms came on only slowly. The case of Tanzania has shown that this approach was a little misdirected and has had disastrous consequences on savings, investment, and long-term growth. It is imperative that adjustments in the real sector are taken in tandem with financial sector reforms, so that regulated real and financial sectors are turned competitive simultaneously. Divorcing the adjustments tends to perpetuate difficulties in the control of money supply and inflation, entailing more protraction of adjustment efforts than would have otherwise been required.

Overloading the Exchange Rate as a Policy Instrument

The stance of exchange rate policy, as discussed earlier, has been one of the major issues of disagreement between the IMF and the Tanzanian

authorities. The Tanzanian authorities, while recognizing the importance of the instrument in arresting the deterioration of the external balance, argued that its implementation should take cognizance of the actual situation obtained in the economy, in particular, the inadequacies of the other supporting structures—the transportation system, availability and adequacy of processing facilities, and the marketing system. These issues were not adequately taken into account during the implementation of exchange rate policies during ERP-I and, as a result, the export performance and the overall balance of payments position did not improve as envisaged. True, overall output of exportables increased, but this could not be translated into actual exports because of the weaknesses of the other supporting factors, for example, transportation. This has shown once again that exchange rate policy alone, unaccompanied by appropriate infrastructure, may not result in the intended objective of increased export earnings. Nor is this all. The overloading of exchange rate policy has also created serious problems, at the enterprise level, especially for those institutions—both private and public—that borrowed externally. Exchange rate changes, coupled with high interest rates, have made many of these enterprises insolvent. In turn, these changes have created major problems for banks and other financial institutions, as the borrowers are unable to meet their debt payments on schedule. The inability of borrowers to pay their due obligations, in turn, has increased the amount of nonperforming loans to the banking system, which is now insolvent and is to be restructured and reformed. Clearly, these problems could have been reduced to a more manageable level if the exchange rate stance had been conducted in more staggered manner.

Enforcement of Credit Ceilings

The existence of a multichannel, competitive marketing arrangement seems to be a prerequisite for effective control over domestic credit. This is especially so in an economy where credit developments are dominated by crop financing. Under such conditions, monopolistic and inefficient marketing institutions tempted protection from the government lest farmers be discouraged by crop pileups in the absence of alternative outlets. The results were unduly large operational losses that had to be met by government subsidies, implicitly or explicitly. In the Tanzanian case, the losses were transferred to the banking system through government guarantees; an action that fueled monetary expansion and inflation.

Social Dimensions of Stabilization Program

The stabilization program of 1986/87 to 1988/89, that is, ERP-1, was mainly aimed at arresting the downturn of the overall economic performance. To attain this objective, a greater proportion of government expenditures was allocated to the directly productive sectors of the economy, which resulted in a reduced share for the social sectors—for example, education, health, and rural water supply. This redirection of government priorities coupled with other adjustment measures undertaken during the recovery program increased hardships experienced by the most vulnerable groups of the economy—the poor, children, and women. In order to rectify this omission, the Government has launched a second three-year structural adjustment program—ERP-II—covering the period 1989/90 to 1991/92—with the twin objectives of promoting economic growth and taking account of the social dimensions of the adjustment measures. In this regard, government outlays will be redirected to social as well as economic activities. In particular, government expenditures allocated to education and health sectors will be significantly increased in real terms in order to arrest the deterioration in investment in human capital. The reorientation of the structural adjustment program was deemed to be necessary and essential, given the long-term social economic objectives of the government, as well as to ensure that the greater majority of the population would in fact benefit from the measures undertaken by the Government.

The Role of State, Private Sector, and Market Forces

The severity of the economic crisis and the financial requirements needed for the rehabilitation of the physical infrastructure of the economy, as well as for the parastatal sector, has also brought to the fore the need to redefine clearly the role of the government, or the state, in economic management. During the 1970s, it was government policy to control and own large sections of the productive sectors of the economy. Economic policy was mainly conducted by purely direct administrative measures. Now, however, government policy, because of the crisis and the limited resources available to the government, is to allow greater participation of the private sector—both domestic and foreign—in the economy. This redirection of policy also affects the crop-purchasing policy in which further liberalization has been implemented by making the marketing boards one of the agents of the cooperative sector. Through these changes, government policy is mainly directed to providing the social overhead capital

and the necessary environment for the private, as well as public, sector to operate efficiently. This is a major change in the management of economic policy that will help accelerate economic performance, given the limited administrative capacity to effectively direct and control the economy.

Concluding Remarks

Since 1986, the Government of Tanzania has adopted a far-reaching macroeconomic adjustment program, the objectives of which have been to restrain the downturn of economic performance and to restore both internal and external imbalances. Various economic policies were adopted to attain these main policy objectives. These, among others, included currency adjustments, monetary contraction, marketing reforms, price decontrol, fiscal retrenchment, and tariff reforms. Although the macroeconomic and structural objectives were not fully realized, progress was made in implementing various measures. Real GDP growth surpassed population growth; inflation decelerated substantially from 30 percent to 19 percent; and exports, particularly of nontraditional crops, increased.

Despite these reforms and improvements in the major macroeconomic indicators, Tanzania continues to face serious structural and financial problems. Growth is still inhibited by infrastructural bottlenecks, low domestic savings and investments, and inadequate banking and financial services. The external environment, epitomized by weaknesses in commodity prices, is still unfavorable. While the Government of Tanzania will continue, and indeed, intensify the pace of economic and social reforms, adequate external financing is needed to underpin the adjustment effects. The adequacy of external financing is crucial in view of the persisting debt problem and continued weak markets for primary commodities.