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CONCEPT PAPER  
For  
A.I.D. DEVELOPMENT ASSISTANCE  
To  
TANZANIA

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"The only durable way of addressing the problems of declining living standards and increasing poverty is by reversing the deterioration in the country's economic fundamentals, which is the overall objective of the Economic Recovery Program." IBRD

## EXECUTIVE SUMMARY

Tanzania has pursued socialist economic policies since Independence. Until approximately 1978, the rewards in terms of employment, education and health services were impressive. In fact, however, they masked a steady deterioration of the economic infrastructure of the country. The social gains were unsustainable as their cost far exceeded the country's productive capacity. By the mid 1980's with the combination of fundamental, internal weaknesses compounded by external deterioration of the terms of trade, the country was insolvent and recovery efforts had to begin.

Following the lead of the IMF and World Bank, Tanzania's numerous donors are now collaborating on an Economic Recovery Program (ERP). Its goals are to stabilize the key macroeconomic factors (exchange rate, budget deficit and domestic credit market) in the near-term (mid-1988) and achieve full economic recovery by 1992. The latter will require rehabilitation and more efficient utilization of existing productive capacity. The Government of Tanzania, while not publicly disavowing socialist principles, has already begun to take concrete measures towards freeing up the economy and dismantling some of the pervasive government regulations and enterprises as specified in the ERP. These policies have started to trigger positive responses from producers and merchants, who are the key to the recovery.

However, many of the same physical and institutional constraints that hampered growth in the past still exist and will not disappear for some time to come. It should be remembered that there is a large body of Party, government, and parastatal officials who have a major ideological and financial stake in the status quo ante. It remains to be seen how much administrative power will be surrendered in favor of market mechanisms and how far de-nationalization will be pursued. At the same time, donors and the Government alike realize that ERP represents Tanzania's best chance to achieve economic solvency. Indications are that the GOT is committed to pursuing the ERP to the fullest extent possible.

USAID/Tanzania believes improving the transport of agricultural commodities is the most effective way the USG can assist in the immediate objective of attaining economic stabilization. Program assistance can relieve transport bottlenecks which constrain domestic marketing and exports now. Longer-term investment can strengthen the transport system to handle traffic growth. Careful attention to sector policy constraints will also enable AID to contribute to ongoing efforts to strengthen competition and the role of private enterprise in that sector. In the medium-term, after "stabilization" is attained, AID's emphasis might gradually shift to a more traditional set of activities in agricultural production.

During the first several years, AID assistance should be in a "program" mode to permit year-to-year flexibility and to minimize the management burden on AID and the GOT. We assume that USAID's staff will remain quite small. In addition, program assistance should minimize requirements for additive counterpart funding and recurrent costs usually associated with "project" assistance and which Tanzania consistently over the years has been unable to provide. At all costs we should avoid adding to the "white elephants" for which Tanzania is so famous.

We recommend that bilateral funds be used for a commodity import program (CIF) and a PL 480 program. The local currency generated from them will be directed towards GOT investment budget shortfalls and private sector credit requirements. These resources should be augmented with SARF funds for regional transportation projects and AID central and regional technical resources for activities in agriculture research and population planning.

As economic rehabilitation and recovery needs are met in the 1990's, AID should dedicate increasing attention to requirements for long-term growth with emphasis on agricultural production, agriculture research, population and tourism, all of which require long-term investment and demand consistent recurrent costs which Tanzania cannot afford now.

## I STATEMENT OF THE PROBLEM

### A. Economic Decline

Not only has Tanzania pursued a socialist economic and social development model since Independence, but it has been an intellectual leader in the Third World in this regard. The objective has been to achieve national unity and individual well-being through national self-reliance. Equitable distribution of income and social benefits has been a cornerstone of the policy.

The policy produced the desired results between 1967 and 1973 when large-scale industry, commerce and finance were nationalized. Farmers' cooperatives were replaced in 1976 by parastatals responsible for collecting, processing and marketing all major export crops. A series of national plans specifying investment goals and production targets and fixing commodity prices replaced market mechanisms. Concurrently the government embarked on an ambitious program of import-substitution industrialization.

Gross investment rose rapidly and real GDP grew by 4.4 percent per year. However, physical output lagged behind investment and GDP growth because of a rapid rise in investment in social services and public administration.

From 1973 to 1978 real GDP growth accelerated to 5.5 percent per year, due almost entirely, however, to rising world commodity prices, especially coffee and cotton.

Government fiscal and monetary policy contributed to the apparent prosperity and to the subsequent collapse. Expenditures outstripped revenues; fiscal deficits mounted; national debt, money supply, prices and imports all tripled during this six-year period. The trade deficit widened, reserves fell and Tanzania faced a serious balance of payments problem. By 1978 the Tanzanian economy was becoming insolvent and was especially vulnerable to any major shock.

Between 1978 and 1985 per capita GDP fell by about 12 percent. Output of industry and export-oriented agriculture declined. A series of shocks hit the economy during this period, including the second world oil price rise, the collapse of commodity prices, severe droughts and the Ugandan conflict.

The crisis persisted and deepened because the economy did not have the resilience to respond to the changing market conditions. Rigidities in the administered economic system introduced since 1967 were aggravated by measures taken to attempt to insulate the economy from the consequences of the external shocks.

By 1983 foreign commercial loans were unobtainable. The international donors were pressing for reforms and were cutting back assistance levels. Because of the Brooke Amendment the U.S. terminated new obligations that year. The Government, while still adhering to the principles and goals of the Arusha Declaration, realized it had failed to achieve its objectives and slowly began a process of economic reorientation which led to the adoption in mid-1986 of the Economic Recovery Program.

## B. Plans for Economic Recovery

### 1. Structural Adjustment Program (SAF)

The Government undertook economic reforms between 1982 and 1984 through a Structural Adjustment Program (SAF). Currency was devalued from TSh. 12 to TSh. 17 per dollar; agriculture producer prices were increased on average by 50 per cent; the grain purchasing monopoly of the National Milling Corporation was ended; crop authorities which handled export commodities from farm gate to export sale were dissolved; and procurement, storage and delivery of all crops were taken over by official cooperatives, with export crops delivered to marketing boards.

The SAF also involved reducing subsidies and raising controlled prices on many agricultural inputs and consumer goods. In addition, the Government imposed a freeze on hiring, consolidated some ministries by reducing the number from 22 to 15, and dissolved several inefficient government enterprises. Two schemes were introduced to ease the foreign exchange shortage. Private exporting enterprises were permitted to retain a part of their foreign exchange earnings, as well as to import goods using their own foreign exchange held abroad. (This latter scheme has proven to be the most successful aspect of Tanzania's recovery program to date.)

By mid-1985 the reform movement was stalled and the implementation of structural reform came to a virtual halt.

The policy and institutional measures adopted under the SAP were inadequate in both scope and intensity. The currency remained extremely overvalued. Incentives remained biased against agriculture and exports. The public sector remained very over-extended, particularly in view of scarcity of financial and human resources. Finally, agricultural production and exports continued to be hampered by marketing, processing and transport inefficiencies.

## 2. Economic Recovery Program (ERP)

Julius Nyerere stepped down from the Presidency in late 1985, and was succeeded by Ali Hassan Mwinyi. By mid-1986 the foreign exchange situation was desperate, and one by one each of the principal donors announced it would support no new programs until the GOT put its house in order and came to an agreement with the IMF. The Government initiated the Economic Recovery Program (ERP) in June 1986, in collaboration with the World Bank and IMF. An IMF Standby Agreement was concluded in August 1986 and a World Bank Multisector Rehabilitation Credit in November 1986. A Paris Club debt-rescheduling agreement was reached in September 1986.

The specific objectives of the ERP are to:

- increase the output of food and export crops by providing appropriate price and non-price incentives for production, improving marketing structures, and increasing budgetary and foreign exchange resources available to agriculture;
- direct investment resources towards rehabilitating the physical infrastructure of the country in support of directly productive activities;
- increase capacity utilization in industry through the allocation of scarce foreign exchange to priority sectors and firms; and
- pursue prudent fiscal, monetary and trade policies to restore domestic and external equilibrium, to ensure that production incentives are not eroded and that the efficiency of resource allocation is improved.

To achieve these objectives, the program envisages a number of policy changes including:

### A. Exchange and Trade Policies

(1) Flexible management of the exchange rate with the objective of reaching an equilibrium rate by mid-1988.

(2) Liberalization of the export earnings retention scheme, including its transferability.

(3) Substantial expansion of the list of commodities that can be imported with "own" foreign exchange or with retained exchange.

#### B. Pricing Policies

(1) Producer prices for export crops to be increased to a level equal to 60 percent of world export price or to provide a minimum real increase of 5 percent per annum, whichever is greater.

(2) Petroleum products to be priced so as not to involve consumer subsidies.

#### C. Fiscal Policies

(1) Overall budget deficit for 1986/87 to be limited to T.Shs. 17 billion (11.6 percent of estimated GDP).

(2) Implementation of various new revenue measures to yield about T.Shs. 2.5 billion, including taxes on petroleum products.

(3) Quarterly ceilings on overall deficit and on bank financing, as well as incentive targets on quarterly revenue and expenditures.

#### D. Monetary and Credit Policies

(1) Limit net domestic credit expansion in 1986/87 (July/June) to 12 percent; with quarterly ceilings.

(2) Place a quarterly ceiling on net bank credit to the government.

(3) Limit domestic bank financing to T.Shs. 2.5 billion per annum.

(4) Limit quarterly credit expansion to seven specified marketing boards (coffee, cotton, sisal, cashewnut, tea, tobacco and the NMC boards.)

(5) Limit broad money increase to 11 percent.

(6) Make real interest rates positive within two years (by mid-1988).

#### E. External Indebtedness

(1) GOT not to contract or guarantee any new, nonconcessional borrowing for more than one year and up to and including 15 years. Similar borrowing by production enterprises in the public sector to be limited to U.S. \$50 million.

(2) Reduction of existing arrears by U.S. \$ 50 million between July 1, 1986 to June 30, 1987. Also there should be no accumulation of any new arrears during the program period.

#### F. Public Enterprises and Parastatal Reforms

(1) Improvements in marketing of agricultural products and efficiency of the parastatals. The reforms are to cover internal grain transport, agricultural input supply and procurement.

(2) Government to identify selected enterprises which are crucial to the recovery of exports and production and to present a comprehensive reform package to improve their operations.

The ERP envisages that the Tanzanian economy will attain positive growth rates in per capita income, a sustainable external balance of payments position with both higher export and import levels, an acceptably low rate of inflation, and restored levels of physical and social infrastructure by the end of a medium-term period of 5 - 7 years. Success of the ERP depends on the GOT's determination to implement these strict reforms and their ability to convince the donor community to assist their efforts by providing additional inflows of external resources to support the domestic policy and institutional changes described above. To the extent that the GOT does not waiver from carrying out reforms and liberalization, the greater the likelihood the donors will assist. This assistance will ameliorate some of the harshness associated with the belt tightening envisioned and thus make the ERP more palatable domestically. Nevertheless, there should be no illusions that the fundamentally socialist policy orientation that Tanzania has followed over the past 2 decades will be disavowed or that the GOT will move aggressively toward market-oriented policies.

Some observers feel that the GOT may find it increasingly difficult to adhere to the ERP as it becomes necessary to tackle more intransigent problems. Our experience over the past year has shown that the GOT prizes consensus and political stability over everything else. Whenever they deem it necessary, government and party leaders fan out over the countryside to garner support, and innumerable meetings are held among the political, military and social leadership to attain consensus. The process is very slow but to date seems to work in that reforms when finally implemented are accepted without opposition and subsequent backlash.

## II DONOR COMMUNITY RESPONSE

Two meetings were held in Paris in 1986 on Tanzania's economy and resulted in important concrete measures being taken by the donors. In September, the "Paris Club" reached agreement on rescheduling Tanzania's debt, and earlier in June a Consultative Group pledged additional aid of \$130 million, raising the total annual donor assistance to over \$500 million.

Besides the donors having renewed their interest in assisting Tanzania, they also changed their modes and/or targets of assistance for new activities to meet the current requirements of the ERP. Discrete projects, which usually entail an immediate requirement for counterpart funds and local management and an additional recurrent cost and management burden, will be deferred for the most part and in the interim will be replaced by "program" assistance -- provision of urgently-needed inputs and rehabilitation of existing infrastructure to increase utilization. One recent study, however, concludes that there is some danger that many donors are directing their new assistance not to supporting the ERP but for budgetary support for their former projects which are not viable without continued external assistance.

### III U.S. GOVERNMENT RESPONSE

#### A. Measures Taken to Date

The U.S. participated in the CG in June 1986. We agreed to support Tanzania's reform efforts by participating in debt rescheduling which would remove the restriction of the Brooke Amendment, initiating some regional activities once Brooke was lifted, and considering providing FL-480 food.

In response to an urgent request from the GOT, a FL 480 agreement was signed in January 1987 which provides 25,000 tons of wheat flour to the National Milling Corporation. That is expected to generate approximately TShs. 450 million which will be allocated to support the ERP in a manner to be mutually agreed upon by AID and the GOT.

The Transfer Agreement and Letter of Understanding call for annual consultations in July 1987 (shortly after the annual Budget speech is made). At the GOT's request, AID agreed to consider Tanzania's performance in meeting the goals of the ERP when making decisions regarding any proposed future assistance (subject, of course, to the availability of funds).

The mechanics of debt-rescheduling are underway. If successful, detailed planning for resumption of a modest bilateral development assistance program can begin, as well as planning for assistance to the transportation sector to meet Southern Africa regional needs.

#### B. Rationale for Additional U.S. Assistance

##### 1. Historic Relationship

The U.S. made a major commitment to Tanzania's economic and social development beginning in the early 1960's. Although our assistance met with mixed success, it represented a significant contribution to the expansion of Tanzania's physical, institutional and human resources infrastructure. There is a considerable reservoir of good will which can contribute to the success of future programs. Resumption of U.S. aid would also be both a sign of support for and a tangible contribution to the effort the Mwinzi government is making to implement difficult economic reforms.

## 2. Southern Africa Strategy

Tanzania is important to the current SADCC transportation strategy. In 1985/86, Tanzania transhipped 984,000 tons for its neighbors. If South Africa's borders were closed to the Frontline States a great strain will be placed on other countries' road, rail and port capacity. The transit cargo traffic demand could increase to 4 million tons. Under no foreseeable circumstances could Tanzania handle more than half of that, and even such an increase would require a remarkable effort.

Even under normal conditions, traffic will expand as Southern African economies expand. As the Northern Corridor opens to traffic, Malawi alone expects to be sending an additional 255,000 tons by 1990. The entire region would benefit from improvements to Tanzania's transport sector as Tanzania's capacity to handle transit traffic efficiently could also decrease the Frontline States' foreign currency transportation costs. The entire region would benefit from improvements to Tanzania's transport sector.

## 3. Prospects for Economic Recovery and Growth

It is important to note that the ERF is clearly not a program of one-time measures to fix the economy, as was the SAP of 1982. It is an evolving program of adjustments including some very clear limits at the macro level (budget deficit and credit ceilings), incremental reforms (exchange rate, agriculture marketing), and measures yet to be determined (tariffs, transport, parastatals).

### a. Macroeconomic Problems and Measures

Success or failure of the ERF will depend on the Government's ability to reduce the budget deficit and to meet its international obligations, while giving the productive sectors the access to domestic credit and to foreign exchange needed for economic growth. Therefore, the execution of its foreign exchange, fiscal and monetary policies are the key indicators of prospects for recovery.

1) Foreign Exchange Problems - Foreign exchange availability to permit economic growth will require continued donor support for many years. The gap between imports and exports is expected to remain the same in dollar terms through 1991, although declining in relative terms. Imports in 1985 were \$972 million against exports of only \$375 million. In 1991 imports are projected at \$1,282 million against exports of \$674 million.

The import projections will permit only a modest renovation of the stock of imported capital. The projected export trend hopefully will be attained if new price and marketing stimuli continue to expand output of export crops as they did in 1986. However, because of the vagaries of weather and the instability of commodity prices, the value of exports is likely to exhibit large year-to-year fluctuations.

As an interim measure, until equilibrium in the exchange rate is

attained, the foreign exchange allocation system will be changed to rewarding efficient and high value-added enterprises. The IMF is closely monitoring the movement in the exchange rate, which in early March was TShs. 55 per \$1. Attainment of an equilibrium rate of exchange by mid-1988 seems politically unrealistic to some observers. The closer the rate gets to equilibrium, the greater the burden on parastatal enterprises, which receive an important subsidy by being allocated foreign exchange at the official rate. Some will be hurt in 1987 when efficiency and value-added criteria will be included in foreign exchange allocation decisions. A lot of political pressure to resist these moves may well result.

2) Fiscal and Monetary Policies - The budget deficit and its impact on the credit market may prove to be the most difficult of the macro-economic issues facing the Government. The overall deficit has amounted to about 10 percent of GDP in recent years. Approximately 60 percent of the deficit has been financed by domestic borrowing from the banking system which represented about two-thirds of total domestic credit. The private sector has thus been effectively crowded out by the public sector.

The 1986/87 budget deficit is projected to be TShs. 17 billion, or 11 percent of GDP. Although revenues are expected to rise by 60 percent and current expenditures by only 45 percent, the development budget will rise by 133 percent. The IMF-imposed deficit ceiling is TShs. 2.5 billion, or 15 percent of the budget deficit which can be financed through domestic banks -- a dramatic reversal from the recent practice of financing 60 percent of the deficit in that way. The remainder of the deficit will probably still have to be met largely by foreign donors, many of whom are now providing more of their assistance as budget support.

In the future this should leave a larger share of bank credit available to the private sector. The private sector will not feel the full impact immediately, however, because the IMF estimates that the Government will still retain 62 percent of outstanding domestic credit by June 1987 as compared to 66 percent in June 1985.

In the near-term, the private sector is facing a severe credit squeeze because total domestic credit expansion is limited to 12 percent this year. In the face of inflation of close to 30%, the economy faces a real contraction of credit. There is a distinct danger that the credit shortage in the near term will seriously handicap the resurgence of the private sector, upon whom recovery will depend. The latest IMF review confirms that Government ministries are being held to their budget ceilings. The scarcity of shillings has also helped to hold down the parallel market exchange rate. Prior to the ERF the parallel market rate was about 130 to the dollar. In early March of 1987, it was about 160 to the dollar.

#### b. Physical Bottlenecks and Institutional Problems

The GOT's economic and fiscal policies will succeed only if they trigger desired responses from producers and merchants, who face many

of the same physical and institutional constraints which hampered growth in the past and which will not disappear overnight.

Transportation is the greatest physical bottleneck to greater and more efficient production and marketing of agricultural products. Near-term measures being taken include increasing stocks of vehicles and spare parts, liberalizing internal trade restrictions and adjusting freight tariffs; longer-term projects are being prepared to rehabilitate the road and railway networks and the ports.

Government decision-makers are moving cautiously and pragmatically, wary of moving too far too fast. But there is evidence of steady movement, most notably in the trucking industry. The private sector now operates 79 percent of the trucking fleet and hauls 85 percent of freight traffic. It can negotiate some rates within regions, and bids competitively on interregional traffic. Private truckers dominate the lucrative long-haul routes and are moving increasingly into the less attractive farm-to-market haulage due to reduced tariff controls, expanding private fleet capacity and, in the longer-term, improved road maintenance. Private truckers are adding capacity at a faster rate than are parastatals and cooperatives.

It remains to be seen how much administrative power will be surrendered in favor of market mechanisms. Numerous restrictive regulations remain in place. The parastatals are virtually intact, export trade is still largely monopolized, and many road and rail freight rates are still set without regard to full cost recovery. Furthermore, the new agricultural cooperative system recently put in place to handle all crop marketing presents a major uncertainty in that important sector.

The Co-ops at their rebirth have a number of significant constraints to overcome. The first is credit. With the IMF-imposed credit restrictions they do not have the liquidity to pay farmers for their produce until after the Co-ops themselves have received payment. Yet farmers do not want to wait many months to receive their proceeds.

Next, the Co-ops have no authority to significantly adjust the prices they pay farmers to reflect quality or market conditions. In regard to transport the Co-ops often must either pay free market prices or not move the produce. However, their "operating expense" margin is based on official transportation costs.

Finally, the role and authority of the Co-ops varies somewhat from one part of the country to another depending on what the regional or district political powers will permit. In addition, the Co-ops suffer from limited managerial capacity. In short, the Co-op movement is too weak a reed upon which to place much support until the Tanzanians come to grips with these problems. While donor assistance could be helpful it would also be quite risky and prone to charges of meddling in internal Tanzanian political affairs.

On a more positive note, the Government officials directing this economic transformation seem committed to making it work.

Furthermore, private sector representatives express confidence in the motives and intentions of this Government and are looking forward to the future. Some have cited the reportedly imminent enactment of a new investment code as an event which would further bolster confidence. The average Tanzanian has witnessed real improvement in availability of food supplies and consumer goods and, we are told, consequently supports the Government's efforts at reform.

Much to our surprise the first 9 months of the ERF have not produced the severe economic dislocations which were so universally predicted. Credit may be tight but many businesspeople claim they can get what they need from the National Bank of Commerce (NBC). Since virtually all goods are sold at the parallel market price which has gone down slightly in recent months, prices of imported goods have remained stable, despite the creeping devaluation.

What has changed is the availability. As the private sector's confidence in the ERF has increased so has its investment in "own-funded" imports. The result is that the shops are filled with goods. For a price, many things that have not been available for years are now on the shelves. There is a hum of new commercial activity. New stores, bakeries and restaurants have been opening in recent months in Dar es Salaam. This is a remarkable contrast to the commercial stagnation of the first half of the 1980's.

#### IV. PROPOSED AID STRATEGY

AID is presented with an unusual opportunity in Tanzania. Since we no longer have any active projects on the mainland we are, unlike any other donor, not a captive to our recent history. We have an opportunity to review the entire spectrum and make our program decisions based on critical needs and opportunities rather than diverting resources to protect our flanks.

##### A. Program Objectives

We propose that AID's strategy include three related objectives, in descending order of priority.

##### 1. Support the Economic Recovery Program (ERP)

AID's overriding objective should be to support the ERP. It is a sound program, it has been well-managed to date, and it has the full support and close collaboration of the IMF, World Bank and the rest of the donor community.

The Bank has estimated that recovery will take five to seven years. We refer to that as the medium term. The first two years are considered to be the most critical period, characterized as a period of stabilization. In effect, stabilization will have been achieved by the target of mid-1988 to the extent that the foreign exchange rate is approaching equilibrium, inflation is receding, agricultural exports are increasing, food supply is stable, the government deficit

is being held to acceptable limits, the parastatal sector is diminishing, the private sector is gaining access to domestic credit and is investing, and the ERP is continuing to be supported by the donors. Recovery beyond the near-term stabilization period will constitute consolidation of initial gains, investment in institutional and infrastructure rehabilitation, and laying the groundwork for long-term growth.

By making a near-term contribution to meet a specific sector requirement, AID could set the stage for a longer-term commitment in that sector. This would be a way of demonstrating support for the economic reform program and gaining knowledge of the technical aspects of a sector, which will facilitate ongoing work in that field and permit continuity of AID staff specialists.

## 2. Improve Agriculture Transportation

Analyses conducted to date lead us to the conclusion that, within a strategy to support the ERP's near and medium-term goals, AID should concentrate its limited resources on efforts to expand agricultural production in general and exports in particular. The ERP's success will depend upon the economy being able to feed the population without excessive imports, as well as to generate sufficient foreign exchange to fuel recovery and growth and to meet rescheduled debt obligations. The debt-service ratio is expected to fall from 67 percent in 1986 to 36 percent by 1991 with the help of further debt rescheduling. During the same period, the annual financing gap is projected to decrease from \$501 million to \$202 million. That optimistic turnaround projected by the IMF will depend more on increased export earnings than on any dramatic decrease in debt-servicing obligations or gap-financing. The key is to ensure that additional food imports are not needed and that export earnings live up to the projections.

Agricultural commodities account for the bulk of Tanzania's merchandise exports. In 1986 six primary commodities (coffee, cotton, tea, cashewnuts, tobacco and sisal) represented 68 percent of those exports. While the relative importance of this agriculture export subsector will probably recede if non-traditional exports expand, it will remain quantitatively the largest export earner. Agricultural exports must expand if foreign exchange targets are to be met. The IMF and World Bank project export agriculture earnings to grow in constant dollars by approximately 40 percent between 1986 and 1991. If instead agriculture export earnings remain flat, the financing gap in 1991 would be approximately \$330 million instead of the projected \$202 million, and the debt-service ratio would be 44 percent.

Almost all of the projected growth in earnings will depend on larger volumes exported because world commodity prices are not expected to rise generally. Larger volumes will depend on farmers' responses to producer incentives, such as higher prices as a consequence of devaluation, timely distribution of inputs and improved marketing. Coffee, which accounts for about 60 percent of primary commodity exports and whose world price is highly volatile, is projected to grow

by 15 percent in volume over the next year (after falling by 15 percent in 1986), but only 9 percent in 1988, and 5 percent per year thereafter. Prices, however, have fallen 50% from the high in January 1986 to March 1987.

Concentrating on agriculture to expand merchandise exports in the near to medium term will benefit many Tanzanians directly. Coffee, cotton, tobacco and cashewnuts are grown predominantly by smallholders and many persons are employed in the cultivation, processing and marketing of all of the major export crops. Higher producer prices for the main export crops should substantially raise farm incomes and rural purchasing power.

Distribution and marketing of food crops, as well as the export crops is hampered by: (i) the inadequate road network, and its poor maintenance; (ii) the lack of all-weather roads, particularly in the southern surplus areas, restricting movements of food during the rainy season; (iii) the shortage of trucks, spare parts and tires to keep them operational; and (iv) the limited rail and shipping capacity. As a result, truck owners are reluctant to serve certain areas and will only do so for high tariffs. The private trucking industry, which accounts for a high proportion of the movements by road, has generally been unable to obtain needed parts and fuel. For vehicles to be rehabilitated, a greater allocation of foreign exchange must be made to this sector.

### 3. Strengthen Market Mechanisms and the Private Sector

Success of the ERF will require a strong contribution from the private sector in key economic activities, especially agricultural production, transport and marketing. Although the GOT and the Party are not likely to publicly disavow socialist principles and dismantle the pervasive state and parastatal enterprises in the near-term, some measures have been taken in that direction, such as:

- Restoration of cooperatives;
- Granting of long-term leases for large-scale commercial farming;
- "Deconfinement" of products in agriculture and industry;
- Elimination of some quantitative restrictions that restrict competition;
- Relaxation of domestic commodity movement regulations;
- Raising of interest rates;
- Introduction of competition in commercial banking, although banks still are parastatals; and
- Granting permission to private traders to export cardamon.

The policy framework, although far from perfect, gives considerable scope for expanded private sector participation in key sectors, and is continuing to evolve in that direction. Business people believe that government leaders are encouraging a greater role for the private sector and will make changes steadily to enhance the private sector's ability to compete for scarce capital and markets.

Despite this optimism regarding the Government's intentions, no one is totally confident that the Government will be able to sustain the gains made and stay the course. Business people are, therefore, reluctant to commit more than a part of their own capital to new investments. They will probably invest gradually in Tanzania, increasing their investment as time goes on and they gain greater confidence in the Mwinyi government. There are at least six serious political, institutional and economic obstacles to a rapid resurgence of the private sector.

- Limited access to foreign exchange. There has been virtually no foreign exchange available to private firms through official BOT channels; most firms must obtain it through the parallel market.

- Limited access to donor-financed inputs, which are mostly allotted to parastatals.

- Constrained domestic credit markets, with extremely limited longer-term loan or equity capital.

- Presence of a large body of Party, Government and parastatal officials and workers who have a major stake in the status quo ante.

- Lack of general business skills, especially accounting and financial management.

- Dominance of the commercial sector by Asian Tanzanians. A perception that they may benefit from economic liberalization at the expense of African Tanzanians could trigger a backlash and strengthen the parastatals, which are viewed as a mechanism to protect Africans from excessive profiteering.

Although still adverse economically and institutionally, the climate is more favorable than before for the private sector to expand its role in Tanzania, as is already evidenced by private expansion in transportation and commercial farming. GOT pragmatists implementing the ERP realize they must both provide incentives for the private sector to perform and curb the state sector. AID should make direct and indirect support of the private sector an explicit objective of its assistance. AID should also promote policies to strengthen market mechanisms and diminish the state sector's role in economic activities best served by the private sector. AID could also support the private sector by helping to rehabilitate public sector infrastructure (road, rail and port facilities) upon which it depends heavily.

## B. Alternative Strategies

### 1. Human Resources vs. Productive/Infrastructural Development

Like most developing countries, Tanzania has serious human resource constraints. In education, whereas Tanzania has achieved a 90% enrollment in its Universal Primary Education program, its secondary and tertiary level enrollments are still low. In health, Tanzania's infant mortality rate has fallen to 94/1000 births, and 70% of the population is now within 5 kilometers of a health facility; however, health services are still rudimentary and the life expectancy rate is

only 52 years. The annual growth rate of Tanzania's population is estimated at 3.3% (with a possible error of plus or minus .25%) and the country has not yet taken official steps to launch a child-spacing program. Finally, in the area of nutrition and food security, current estimates are that 40 - 60% of Tanzanian children are undernourished and that 11 of 20 regions are drought-prone.

It is clear that Tanzania's long-term economic development strategy must include human resource and equity objectives so that the Tanzanian people's social condition creates a synergy with rather than an impediment to sustained agricultural growth. For the near to medium-term, however, AID should focus its bilateral resources on assisting Tanzania to meet priority recovery targets. Since Tanzania's social services are not considered a major bottleneck to short-term recovery, few would maintain that an AID program tailored to the deficiencies of Tanzania's human resource base would directly support the GOT's implementation of the ERF. Hence, a program concentrating on long-range human resource development probably would not significantly promote short-term recovery as well. It also could involve major investment and recurrent costs, which would further exacerbate the current budget deficit and foreign exchange problems.

On the other hand, a bilateral AID program directed to productive/infrastructural development is likely to have important nutritional and health benefits, as well as agricultural production and income ones. The food and nutrition study prepared for USAID/T in April 1986, found that Tanzania produced adequate food to feed all of its population. Rather than a shortfall of supply, the report attributed Tanzania's significant child undernutrition and food insecurity to maldistribution on three levels: intra-family, intra-community, and inter-area (i.e., the movement of food between surplus and deficit areas is constrained). Improved transportation infrastructure and policies could ease these maldistribution problems, lower costs and improve food security. It could also improve people's health by facilitating access to secondary and tertiary health facilities.

While the critical nature of the ERF leads us to recommend that AID concentrate its bilateral resources on productive/infrastructural development in the near and medium-term, we also recommend the concurrent use of centrally-funded projects in the social services sectors to the extent feasible, to help avoid a deterioration in social services as a result of ERP austerity measures. It should be borne in mind, however, that tapping resources of central and regional projects which relieve the Mission of day-to-day management does place professional burdens on the Mission and it will have to be staffed appropriately. Certainly REDSO has and will play a large role in providing short-term assistance to the Mission. Nevertheless, as AID experience has shown repeatedly elsewhere there is no substitute for on the ground, long-term technical competence. A decision should be made either to make USAID/Tanzania a full service Mission or to constrict narrowly its focus and limit staffing appropriately. If the decision should be the latter then the Africa Bureau must exercise the internal discipline to exempt Tanzania from adding on activities to

~~meet the whims and fashions of the day.~~ Each additional management burden placed on the Mission creates pressures for additional USDH in the Tanzanian context. Each additional USDH creates a geometrical increase in local staff to provide administrative support. There are no other options; half-way measures will only lead to annual lobbying for increased personnel ceilings and greater pressure on the business O&E budget.

## 2. Agriculture Transport and Agriculture Production

As discussed earlier, success of the ERF will depend on curtailing food imports and significantly expanding foreign exchange earnings from agriculture exports, together with key GOT actions on the fiscal and monetary fronts, and continued donor support. The GOT-IMF-IBRD recovery strategy for the near to medium term is to increase financial incentives to producers, in order to maximize utilization of existing production capacity and technology. For agriculture that means to produce and export more commodities by utilizing more land, labor, inputs and transport. The strategy does not involve introduction of new production technologies or farming practices to producers during the recovery period, although they would certainly help.

Of the five necessary ingredients for success (price, land, labor, inputs and transport), government policies are providing the first; the farmers are responsible for the land and labor; cooperatives handle inputs for small-scale farmers and transport is handled by a number of groups. Inputs and transport can be assisted through a variety of programmatic vehicles including "program assistance" (CIP and budget support) and "projects".

We have inquired into the need for AID assistance for both provision of agriculture inputs and transport, and have identified transport for initial emphasis for several reasons. Transport equipment and infrastructure between farm and port are used to carry agriculture inputs and domestic food crops as well as export commodities, so we simultaneously achieve more than one objective. On the other hand, the new cooperative system which distributes inputs to small-scale farmers is still in a formative stage which makes it an inappropriate agent for program assistance during the current stabilization period. Moreover, other donors are providing agriculture inputs which seem to be consistent with Tanzania's current absorptive capacity. Hopefully, this will expand as the transportation and distribution systems improve.

Transport bottlenecks have been cited as the most pressing problem facing expansion of agriculture in the near to medium term. They are numerous and yet discrete, identifiable, quantifiable and susceptible to AID intervention through a variety of mechanisms. Although some interventions would have considerable institutional and managerial requirements for successful execution, none would require initiation of new institutions or depend on complex inter-institutional coordination. Some might involve the private sector exclusively.

For the longterm, we feel that Tanzania should focus on achieving agriculture production growth through application of improved technologies and practices. Sustained agriculture research is required for that. AID contributed substantially to those efforts in the past, with mixed results. We recommend that AID assist research programs here through regional programs as soon as Tanzania is no longer under Brooke, and consider participating again directly after several more years. A serious contribution would require a long-term intensive commitment which AID cannot make now. The World Bank is considering making such a commitment soon and AID can observe performance of that program, and even collaborate with the Bank through regional programs.

### C. Constraints

#### 1. Program Modes

There are several options for renewed AID assistance, each of which conveys a different level of intensity and technical and implementation involvement. These are best characterized as macro-level program assistance, sector-level program assistance and project assistance. We conclude that sector-level program assistance is most appropriate now. Given our guidance from AID/W to the Mission for preparing this Concept Paper, we base our recommendations on the following resources and constraints. The staffing levels would consist of approximately 3 USDH, 4 PSC's and 25 local hires. Our FY88 OE budget would be set at \$900,000. Program levels might consist of a medium size PL-480 program, bi-lateral assistance of approximately \$4 million (supplemented by AERFP funds if appropriate), and a tap into the SADCC initiative for transportation (subject to approval by Congress).

#### a. Macro-Level Programs

The most common forms are a cash transfer or a general commodity import program (CIP) for balance of payments support and assistance to developmental priorities.

- Advantages : This mode could be quick-disbursing, would require minimal GOT and AID management, impose no recurrent cost burden on the GOT, require no continued AID involvement and would respond to the near-term ERP priorities.

- Disadvantages: The small amount of AID's anticipated annual contribution would limit its influence at the macro-level, particularly since the GOT prefers to restrict macro level policy dialogue to the IBRD/IMF. The GOT is eager for the USG to determine its overall assistance levels based on how well Tanzania does in meeting the goals of the ERP, however. Visibility and identification with the United States of such assistance would also be minimal.

## b. Sector-Level Programs

Program assistance modes can be targetted on a particular sector in order to concentrate impact and can be focused on a limited set of policy issues about which AID may be able to exercise some influence.

- Advantages : Provision of budget support or CIP modes can be used for near-term impact. Specific policy constraints affecting sector performance can be identified for dialogue/conditionality. AID's contribution can be identified concretely for visibility and yet it need not represent a long-term AID commitment. If handled carefully, program sector support would provide AID the flexibility of expanding or decreasing assistance levels annually depending on both GOT policy performance and availability of AID funds. AID could use the opportunity of our annual consultation with the GOT to review recent macro-economic trends and to focus on future sectoral reform targets. Formulation of these targets, however, will require further study of the critical restraints in the sectors of interest to AID. AID assistance could be provided to the private sector instead of, or as well as, to the public sector and could also be provided as co-financing with other donor programs. AID resources could also be associated with training programs and studies of specific sector issues.

- Disadvantages : A potential risk in sector-level support lies in selecting a low priority sector or intervention. Because Tanzania's recovery program is in a very fluid state at this time and the outcome is uncertain, events are less predictable than under more stable conditions. Consequently, AID should proceed carefully. Program assistance to a sector also requires the existence of adequate technical and management capability to implement the assistance provided.

## c. Project Assistance

We considered the option of providing traditional project assistance, but recommend against it at this time.

- Advantages : Projects permit much greater control over outcomes because of the more intensive and sustained involvement by AID staff and consultants throughout their design, implementation and evaluation. By concentrating on a few specific projects AID would become very familiar with the technical subjects and issues affecting them, permitting substantive dialogue on related policies.

- Disadvantages : The principal disadvantage concerns the long-term commitment of human and financial resources that projects require. Because of uncertainty about GOT economic policy performance, and AID's own plans, a normal five to ten-year commitment of funds and staff to sustain projects is not now possible. Most projects also require counterpart contributions and have recurrent costs requirements, both of which should be minimized. Tanzania has already too many unfinished or unsuccessful projects scattered across the landscape. The last thing Tanzania needs is to start anything new. What is needed is to rehabilitate or support what has already been begun.

Nevertheless, it should be noted that Tanzania is facing a critical shortage of skilled mid-level managers as it attempts to identify and implement reforms. Hopefully, some technical assistance and training, directly related to specific reform efforts, can be provided in conjunction with the provision of balance of payments support.

## 2. Anticipated Program Resources (FY 88-92)

### a. Bilateral OYB

Current programming for FY88 and beyond estimates \$4-\$10 million per annum of bilateral development assistance for Tanzania. In the event that this is provided in the form of program assistance, Tanzanian shillings will be generated that USAID could have as an additional resource to support stabilization and recovery.

### b. Food Aid

AID and the GOT signed a PL-480 agreement under which 25,000 metric tons of wheat flour will be imported in FY 87, generating roughly 450 million Tanzanian shillings. It is quite possible there will be additional food assistance, probably in rice, in FY 88 and 89. If so, local currency resources would be generated from that source also, a portion of which might be used to defray some of USAID'S local currency operating expenses. We would support a general approach of programming local currency generations either for high priority, GOT budget development expenditures, or for local contributions to AID or other donors' projects, or possibly to private investment through intermediate financial institutions. Some time, however, will be needed for the government to sort out its own priorities and for us mutually to identify the best uses of this significant AID resource.

### c. Regional and Worldwide

#### 1. Southern Africa Regional Program (SARP)

The SARP includes roughly \$9 million of projected assistance to the Tazara Railway beginning in FY87. In addition, the Administration's Southern Africa Initiative proposes significant additional funding for regional transport over the next five years. If approved by Congress, a significant portion would undoubtedly be directed to Tanzania, especially in view of security concerns in Mozambique.

#### 2. AID/Washington Projects

AID has centrally managed technical resources which could enable USAID to provide some support for important longer-term development problems.

\* Population - several of the S&T Bureau Population Office grantees (Pathfinder and International Planned Parenthood Foundation) provide assistance to private Tanzanian family planning organizations. That support should be expanded, if possible.

\* Private Enterprise - The Africa Bureau and Private Enterprise Bureau can assist with sector-wide or problem-specific analyses which could support the Mission's strategy. PRE also has limited funds available to invest in private ventures, primarily via local financial institutions.

\* Africa Bureau provides support for participant training through its Africa Manpower Development Project (AMDF/II), now called Human Resources Development Project (HRDP). This is an important form of assistance which should be used in Tanzania to develop and expand the skilled manpower base. The Mission should support participant training through central, regional and bilateral funds.

\* Other - Most other central projects entail a combination of Mission financial contributions (buy-ins), host country contributions, recurrent costs and management time and skill. USAID/Tanzania cannot afford to dissipate its limited human and financial resources to take advantage of such assistance for several more years.

### 3. REDSO/ESA

The AID regional office in Nairobi manages a number of regionally-funded projects of which agricultural research may be the most relevant to Tanzania. Participation would enable AID to maintain a constructive relationship with the Tanzanian research community. This would facilitate a resumption of direct assistance in that field in the future, if appropriate. The Mission could provide some local currency funds to cover local costs of Tanzanian participation, perhaps in concert with an anticipated long-term agriculture research project.

### V. CONCLUSIONS AND RECOMMENDATIONS

An optimistic scenario foresees macro-economic stabilization achieved by mid-1988, recovery accomplished in mid 1990's -- fueled by progressive market-oriented policies and an expanding private sector.

A pessimistic scenario foresees backsliding on key policy issues, depressed export markets, resurgence of statist economic principles, failure to meet IMF conditions, disenchantment of the donor community and ensuing economic stagnation.

Reality will probably be somewhere in-between. While significant progress is being made, we should not delude ourselves that perfection is around the corner.

Success in achieving near-term ERP targets will act as a catalyst to donor support which in turn will determine, to a large extent, whether longer-term goals will be met. Success breeds more success. If Tanzania continues to meet the targets set out by the IMF and IBRD, AID should act promptly to help make the ERP a success, as outlined below.

A. Near Term - FY 1987 - FY 1988 (Stabilization)

AID's objective for the near term should be to help the GOT meet critical development budget needs, and alleviate the immediate foreign exchange shortage and credit squeeze, especially as they impact on the private sector.

1. Provide TSh. 450 million generated from the FL-480 food donation to the GOT for "on-budget" development expenditures for agriculture transport for which funds are not available. *for what?*
2. Provide most of the anticipated FY 1988 (\$4.0 to \$7.0 million) for a commodity import program (CIP) to finance transport equipment and spares. The CIP could be geared to the needs of truckers, railways, ports, road maintenance, or agricultural storage.
3. Local currency generated by the CIP could be applied to urgent GOT requirements for development budget costs to improve roads, railways or ports, or to private transporters or marketers as credit for investment and working capital, if an appropriate financial intermediary can be identified.
4. Tap into S&T Bureau Population projects to assist local organizations and undertake studies to determine future directions of population activities.

B. Medium Term - FY 1989 - FY 1992 (Recovery)

AID's objective should be to help expand agricultural production and to encourage growth of the private sector and concomitant reduction of state controls and the role of parastatals.

1. Provide \$5.0 to \$10.0 million per year of foreign exchange to assist private sector transporters via CIPs (equipment and spares), with a portion for rehabilitation of and maintenance equipment for roads, railways or ports important to relieve bottlenecks to agricultural exports.

Alternatively, if transportation and distribution systems improve rapidly, AID resources might be better utilized in providing agricultural inputs such as fertilizer to increase crop production. We currently project a fertilizer (DAP) gap of some 12,000 tons annually. However, at present even greater problem is the large quantities of fertilizer sitting in regional warehouses because of the inability to deliver it to farmers in a timely manner. In the 1986/7 season, for example, anticipated demand was 180,000 tons. The supply on hand was estimated at 190,000 tons of which only 130,000 tons were able to be distributed. Hence, we project transport to be the key constraint through the medium term.

2. Provide the local currency equivalent of the CIP program as loan or equity financing for private firms engaged in transport and marketing of agriculture products and in road rehabilitation and/or for public investment in rehabilitation and maintenance of key roads, railways and ports.

3. If food aid is continued in this period the local currency generated from its sale could be used for lending to private sector transport or marketing firms to expand, or reduce the costs of, marketing agricultural export and food crops. Alternatively, or additionally, some of the funds could support public sector transport infrastructure rehabilitation and maintenance.
4. Within the overall sector strategy some funds might be used to promote studies, in-country training, or other activities promoting greater understanding and dialogue on sector problems.

C. Long Term - FY 1993 - FY 2000 (Growth)

1. Transport - Assuming critical bottlenecks have been relieved by 1992, further AID participation in this sector may be appropriate to strengthen institutional and management capacity to build and sustain an expanding transport network geared to serving agricultural development objectives.
2. Agriculture Production - Attainment of Tanzania's economic and social development goals will depend upon expanding production of agricultural export and food crops. In the face of constrained world markets for the traditional export crops, development of non-traditional agricultural exports will be important. AID should look for opportunities to support that development via agricultural research and policies which will stimulate production of these products.
3. Tourism - Tourism holds great promise for improving Tanzania's balance of payments. The wild game parks, mountains and beaches represent a rare natural endowment which should be carefully exploited. Tanzania has taken positive but inadequate measures to preserve its wildlife and natural habitats while encouraging tourism. AID should consider providing assistance for planning and investing in appropriate development of that resource.
4. Population - Unless Tanzania makes a concerted effort to reduce the rate of growth of its population, future production gains will be negligible on a per capita basis, or negative as during the recent past, and social goals will not be met. AID must endeavor to strengthen national child-spacing programs through centrally-funded FVO programs initially and via bilateral programs in the longer term.

VI NEXT STEPS

Following approval to proceed with this strategy, USAID will initiate a series of actions outlined below:

1. FY 1987 PL 480 local currency - The Ministry of Finance and Planning will establish a joint committee to identify unfunded development budget requirements that meet our criteria. USAID will review their recommendations and reach agreement on a mutually acceptable set of activities.

2. FY 1988 CIF - USAID will prepare a PID & PAAD and obtain the services of a marketing consultant to make a detailed analysis of a limited set of agriculture transport-related import requirements which conform to the ERP objectives. Once the priority needs and users are identified, a REDSO commodity specialist should assist USAID to define the commodities to be imported and an appropriate mechanism.
3. Following the above immediate actions, USAID proposes to undertake a number of studies to better understand the constraints in AID's possible sectors of concentration:
  - a. Overall examination of agricultural sector reform agenda. USAID should continue its effort to understand the key agricultural policy concerns and critical bottlenecks.
  - b. Analysis of the GOT budget process.
  - c. Analysis of private sector transport industry.
  - d. Analysis of financial institutions to determine feasibility of providing local currency credit facilities to private sector transport and agriculture marketing companies.
  - e. Analysis of computerization requirements of key GOT government agencies and opportunities for USAID to provide assistance.
4. Development of an AEPRP program.

## STUDIES

The following background studies are not included as annexes. Copies are available from the Tanzania Desk.

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