CHAPTER 2

From African Socialism to a Free Market Economy

Tanzania has experienced a transition from a one-party, socialist system with a centralized economy to a multiparty democracy with a free market economy. This chapter describes the political and economic developments since independence in 1961 and the role of IMF/World Bank-guided SAPs. It highlights Tanzania's current economic performance and presents prevailing policies directed at further liberalization, economic growth, and poverty alleviation.

President Julius K. Nyerere's 24-year socialist leadership from 1961 to 1985 bestowed a peaceful socioeconomic environment, despite great ethnic diversity and economic deficiencies that have typically led to political instability in many African countries. After independence, however, the promotion of economic development failed, making Tanzania one of the six poorest countries in the world for the last two decades. At varying levels of intensity, Tanzania has received a great deal of attention from the international donor community over the last three decades. However, the international business community has not sufficiently noticed or promoted Tanzania's economic potential.[7]

Many recent political and economic developments in Tanzania bode a prosperous future, at least in the medium term. Abundant natural resources, a peaceful socioeconomic environment, and successful steps toward liberalization and modernization of the economy augur the success of future development. Despite poor past economic performance, Tanzania need not be just another case of a planned economy that failed in its macroeconomic transition toward an open market economy.

[7] The Scandinavian countries were especially supportive of the African socialism experiment, as was, for example, the former German Democratic Republic until the Federal Republic of Germany started paying more attention to Tanzania. Private companies, by contrast, have been rather reluctant to invest in the country, and foreign direct investment played only a minor role in Tanzania's economic development throughout the 1970s and 1980s. Only recently, in conjunction with the ongoing privatization and liberalization process, have foreign companies reconsidered their financial engagement in Tanzania. This is especially true for South African investors since the end of apartheid and the improvement of South Africa's political and economic relationship with most countries in southern Africa.

The disappointing efforts of one decade of structural adjustment do not indicate irrevocable failure of beginning the process of convergence with other more developed economies. To achieve a substantial economic boom, however, Tanzania must overcome the negative economic consequences of earlier experiments in socialist planning and distinguish between the positive and negative elements of that legacy.

Economic Development before Structural Adjustment

This section reviews economic and political developments in Tanzania between independence in 1961 and 1985, when political reorientation led to the first IMF/World Bank-guided SAP in 1986. The section highlights the different states of the economy (1) immediately after independence, (2) under the socialist regime established by the Arusha Declaration in 1967, and (3) under the self-guided adjustment efforts of the early 1980s.

Independence, 1961

Eager for the political change that led to freedom and independence in 1961,[8] the new government was overextended and unprepared to guide and control the national economy. Consequently, the new leaders adopted the existing colonial-style economic structure. Although Tanzania was a British protectorate rather than a colony, and not as important to the United Kingdom as neighboring Kenya, agricultural production was clearly oriented toward Europe's demand for raw materials and basic products such as sisal, cotton, coffee, and tea. Between 1960 and 1962, agriculture contributed more than 50 percent to gross national product (GNP), and sisal, coffee, and cotton contributed about 60 percent to total foreign exchange earnings (Taube 1992). Tanzania neglected not only to satisfy its own national food requirements, but also to diversify its export products and promote light manufacturing for potential gains through import substitution before and shortly after independence.

Politicians were soon overtaken by the reality of severe deficiencies in the supply of food products, energy, housing, manufactured goods, and health and educational services, as well as intermediate inputs and implements for the agricultural sector. Between 1961 and 1966 Tanzania's economy operated primarily under free market conditions, and the government adopted the World Bank's "transformation approach" to agricultural development as a component of its first five-year plan (Wenzel and Wiedemann 1989).[9] However, between 1962 and 1963 Tanzania implemented the Agriculture Products Board Act, which reintroduced

[8] On December 9, 1961, and December 10, 1963, Tanganyika and Zanzibar, respectively, became independent. On April 26, 1964, Tanganyika and Zanzibar formed a confederation to become the United Republic of Tanzania (URT) and join the British Commonwealth of Nations.

[9] The transformation approach promoted modern, large-scale cash crop farms under the supervision of foreign agricultural experts, but it lacked the necessary financial support because of the sudden withdrawal of foreign aid by the former German Democratic Republic and the United Kingdom.

government marketing boards for “scheduled” crops. The National Agricultural Products Boards managed maize, wheat, rice, cashews, and oil seeds through market purchase; price regulation; and regulation of storage, transport, and processing (see Bryceson 1993).

Arusha Declaration, 1967

In 1967 the ruling government party, Chama cha Mapinduzi (CCM), passed the first national economic declaration establishing Tanzania’s era of economic socialism.[10] The Arusha Declaration, named for the location of the conference, clearly meant to address the deficiencies in Tanzania’s economic development, but it explicitly endorsed socialism and a planned economy, which the country’s new leaders thought appropriate at the time. With the best of intentions, a particular African style of socialism was formulated, embedded in traditions found in Tanzania’s family, village, and societal structures. Ujamaa, a Kiswahili word meaning familyhood and relationships, became the expression for Tanzania’s socioeconomic system and a synonym for Tanzanian socialism.[11]

Within the Ujamaa policy, the Ujamaa village was believed to be the most productive and efficient unit for fulfilling the requirements of a population scattered across a huge and widely inaccessible country. Even today, 85 percent of Tanzania’s population lives in rural areas and is mainly engaged in agricultural activities, generating about 50 percent of gross domestic product (GDP). Some households rely mostly on subsistence production because they are too isolated for extensive economic transactions. The Ujamaa policy incorporated Tanzania’s villagization program, which resettled almost 7 million people within one decade.[12] Villagers from remote areas were concentrated in large Ujamaa villages created in locations with greater accessibility to input and output markets. Improved economic infrastructure—such as transport systems, water and energy supply, and health and education facilities—was meant to increase the availability of productive inputs, the capacity of human capital, and the sales prospects for agricultural production. Accordingly, overall national productivity and efficiency in agricultural production would theoretically increase, leading to a rise in per capita income, improved equity of national income distribution, and increased economic welfare.

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[10] In 1967 the Tanzanian government consisted of the Tanganyika African National Union representing Tanganyika and the Afro Shiraze Party representing Zanzibar, which were separate parties until their unification in 1977. In January 1977 the CCM—the Revolutionary Party—was founded and became the Socialist Unit Party of Tanzania.

[11] The Arusha Declaration formulates the following economic principles: (1) public ownership of the major means of production, (2) preferences for cooperative ownership, (3) a “leadership code” to prevent officials from participating in private economic activities, (4) a policy of self-reliance with diminishing dependency on foreign capital, (5) the establishment of Ujamaa villages, (6) emphasis on food crop agriculture and rural development, and (7) public provision of health care and education (Wenzel and Wiedemann 1989).

[12] In 1973 the Tanganyika African National Union Biennial Conference passed the villagization campaign, which decreed that the entire rural population had to live in permanent villages by 1976.

The Ujamaa policy was motivated by the strong desire for self-reliance, based on the assumption that agriculture was the main impetus for overall economic development. Unfortunately, the authorities not only aimed to satisfy national food requirements through self-sufficiency, but also to fulfill all other domestic demand through domestic production. Consequently, through this self-reliant approach Tanzania forced its own withdrawal from international markets.

From 1969 to 1980, the economy operated under the second and third five-year plans following the economic development policy as codified in the Arusha Declaration. Ndulu (1994) characterizes 1961–80 as the first periodic thrust in economic development policy after independence that emphasized state-controlled modernization and structural transformation to reduce reliance on the external economy. Although Tanzania experienced reasonable macroeconomic performance until the mid-1970s,[13] unfavorable external conditions wiped out the previous economic achievements and led to the crisis period of 1980–85 (Ndulu 1994). Even the coffee boom Tanzania experienced between 1975 and 1977, when coffee prices tripled because of frost in Brazil, could not compensate for the negative consequences of the two oil price shocks in 1973/74 and 1979, the breakup of the East African Community in 1977, and the war with Uganda that began in October 1978 (Wenzel and Wiedemann 1989).[14]

Economic Breakdown and Self-Guided Adjustment Efforts

During the early 1980s, Tanzania's economic performance deteriorated continuously, and political leaders had to devise alternatives to socialist failures and a worsening world market situation. Despite all efforts under the Ujamaa policy, Tanzania's economy remained highly inefficient, resulting in low product quality by international standards. Moreover, the extremely overvalued exchange rate decreased the country's competitiveness in traditional agricultural export commodities, thereby diminishing export earnings.[15] In addition, Tanzania's terms of trade deteriorated severely during the early 1980s because of collapsing world market prices.[16] Consequently, the trade deficit increased, foreign capital inflows decreased, and overall indebtedness exceeded critical levels.

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[13] Annual average growth in real GDP was 3.9 percent during 1966–75, to which growth rates in sectoral value-added contributed as follows: agriculture 2.3 percent, economic services 4.8 percent, manufacturing 6.5 percent, and public services 9.5 percent. Inflation averaged 7.5 percent annually, and the external current account deficit averaged 4.5 percent during the same period.

[14] Along with the unfavorable external conditions Tanzania faced during the 1970s, the economy experienced its worst balance of payments crisis during 1978–80 because of both exogenous and endogenous factors (see Pfeiffer 1989 for an analysis of the balance of payments crisis and its underlying endogenous factors).

[15] The high rate of overvaluation resulted from a controlled and, therefore, quasi-fixed nominal exchange rate and several successive years of inflation.

[16] In 1980 the terms of trade had deteriorated by 11 percent compared with their 1973 level and by 21 percent compared with their 1966 level (Taube 1992), although coffee, for example, experienced another price boom in 1986 that caused temporarily favorable terms of trade.

After negotiations with the IMF on a standby arrangement loan failed in 1979, Tanzania launched its first self-guided National Economic Survival Program (NESP) in 1981. The objective of this program was the conditional liberalization of the economy, and it superseded the fourth five-year plan; however, the NESP basically retained the existing economic regime. In 1982 the government adopted a three-year SAP, prepared with the cooperation of the World Bank and based on the advice of the Tanzanian Advisory Group. This SAP was an exclusively national effort, that is, a homegrown SAP, without any World Bank or IMF financial support. At first, the SAP did not result in any significant changes in Tanzania's economic performance because the government was reluctant to implement the policy measures. It was not until fiscal year (FY) 1984/85 that Tanzania launched its first significant reform aimed at liberalizing the economy. The reform package contained the following main policy measures (Taube 1992; Wenzel and Wiedemann 1989):

- Agricultural producer prices were raised by 46–55 percent.
- Cooperation unions for crop marketing were reintroduced.
- The Tanzanian shilling was depreciated by 40 percent.
- The nominal government budget deficit was frozen at the prior year's amount.
- Government wages were raised by an average of 30 percent.
- Domestic trade of food products was liberalized.
- Consumer price subsidies for maize were eliminated.
- The Own-Fund Import Scheme, which allowed imports purchased with foreign currency deposited abroad, was initiated.

Although the international donor community welcomed these measures as a first step in the right direction, they only marginally affected overall economic performance. Consequently, the international organizations increased their pressure on the Tanzanian government to take further action and pursue a stricter coordination of its economic policies.

Structural Adjustment, Political Liberalization, and Economic Performance after 1986

This section first highlights the evolution of Tanzania's SAPs from 1986 until the present and then describes economic performance and the sectoral policies applied under structural adjustment. In addition, Appendix Table A.1 presents selected country data that provide a number of economic and social indicators relevant to this section.

Evolution of Structural Adjustment Programs from 1986

In the wake of political changes in 1985, when Ali Hassan Mwinyi became president after the 24-year rule of Mwalimu Julius K. Nyerere,[17] the new government

[17] Mwalimu is the Kiswahili word for teacher, which was President Nyerere's original occupation but became a respectful form of address for him.

adopted a three-year ERP (1987/88–1989/90) as announced in the 1986/87 budget.[18] The ERP's medium-term objectives were a positive growth rate in per capita income, a GDP target growth rate of 4.5 percent, an inflation rate below 10 percent in 1989/90, a fiscal government deficit below 13 percent of GDP, an adjustment of the exchange rate toward an "equilibrium" exchange rate in mid-1988, positive real interest rates by mid-1988, an increase of between 30 and 80 percent in nominal producer prices for cash crops, and decontrol of domestic prices over a period of three years. During the course of the ERP, Tanzania obtained an 18-month standby arrangement with the IMF in August 1986 and a Multisector Rehabilitation Credit from the IDA and donor governments in November 1986.[19] Furthermore, Tanzania became eligible for the rescheduling of loans in the so-called Paris Club, including the postponement and cancellation of existing principal and interest in October 1986. Finally, in July 1987, under the Structural Adjustment Facility, the IMF approved a 67.9 million Special Drawing Rights (SDR) loan in support of the ERP.[20]

As discussed by Taube (1992), the Tanzanian ERP of 1986/87–1989/90 reflects the theoretical debate on macroeconomic stabilization and structural adjustment in the 1980s. It had a medium-term horizon, and it aimed not only at outward orientation and monetary stability, but also at economic growth issues. The program tried to avoid excessive stabilization and aimed instead at expansionary stabilization and adjustment for growth.

The objectives of the ERP were incorporated in the 1988/89–1992/93 five-year development plan and were reinforced by the Economic and Social Action Program (ESAP) in 1989. Within the scope of the two programs, the government strove for a general reduction of state controls and the promotion of private sector activities. In this context, it declared the rehabilitation of key infrastructure components a priority to support future economic development, especially transportation facilities like roads, railways, and ports. The economy initially responded positively with an average annual GDP growth rate of around 4 percent during 1986–94. However, during its second term (1990–95), the Mwinyi administration showed a much lower commitment to reforms, which led to deteriorating macroeconomic management, worsening macroeconomic performance, and instability.[21] In reaction, the IMF, World Bank, and most bilateral donors sharply reduced their support, suspended payments for development projects

[18] The ERP documentation specifies four general objectives: (1) increase the output of food and export crops by providing appropriate incentives for production, improving market structures, and increasing the resources available to agriculture; (2) rehabilitate the physical infrastructure in support of directly productive activities; (3) increase capacity utilization in industry by allocating scarce foreign exchange to priority sectors and firms; and (4) restore internal and external balances by pursuing prudent fiscal, monetary, and trade policies (URT 1986).

[19] In particular, 64.2 million Special Drawing Rights (SDR) through the IMF; US$100 million through IDA; and US$50 million provided by the Federal Republic of Germany, the Netherlands, Switzerland, and the United Kingdom.

[20] The section mainly draws on Appendix 1 in Wenzel and Wiedemann 1989.

[21] Annual inflation, measured as a GDP deflator, increased from 21.8 to 25.3 to 40.6 percent during 1990–92; exports of goods and services at constant 1995 U.S. dollars declined from US$643.1 million in 1989 to US$592.4 million in 1990, US$385.4 million in 1991, and US$353.4 million in 1992; imports increased by 3 percent annually during the same period; and GDP at factor costs experienced an 8.4 percent decrease from 1991 to 1992.

and balance of payments assistance, and refused any further financial assistance (World Bank 1999a).

The first presidential and parliamentary multiparty elections in November 1995 confirmed the majority of the ruling CCM and elected President Benjamin Mkapa.[22] The Mkapa government immediately approached the IMF to revive Tanzania's economic reform efforts of the late 1980s, which first resulted in Tanzania's acceptance of the obligations of Article VIII, Sections 2, 3, and 4 of the IMF Articles of Agreement, effective from July 15, 1996.[23] By signing Article VIII, Tanzania regained the confidence of the international donor community in its serious commitment to pursue sound economic policies. In November 1996 the IMF approved a three-year credit under the Enhanced Structural Adjustment Facility (ESAF)[24] to support Tanzania's new ERP for 1996/97–1998/99.[25] The new ERP emphasized fiscal performance and structural reforms, namely:

- building administrative capacity for improving development management;
- maintaining a stable fiscal stance and using public resources more efficiently;
- promoting the private sector by deregulating investment and divesting parastatals;
- providing greater support for primary education and basic health care;
- supporting the development of basic infrastructure, especially to give impetus to rural agricultural development;
- restructuring the financial sector to respond to the needs of the private sector (World Bank 1999a).

The ongoing ERP is well under way, and the third and last tranche of the ESAF credit was disbursed in February 1999. The IMF and other donors have expressed their satisfaction with recent economic developments in Tanzania, especially considering the negative effects of the 1996/97 drought and the 1997/98 El Niño floods. During their Article IV consultations with Tanzania in February 1999,[26] IMF executive directors "commended the Tanzanian authorities for their steadfast implementation of prudent macroeconomic policies and progress in structural reforms during the past three years,

[22] The first local multiparty elections had already been held in late 1994.

[23] "IMF members accepting the obligations of Article VIII undertake to refrain from imposing restrictions on the making of payments and transfers for current international transactions or from engaging in discriminatory currency arrangements or multiple currency practices without IMF approval" (see IMF Press Release Number 96/42, July 25, 1996, at http://www.imf.org).

[24] "ESAF is a concessional IMF facility for assisting eligible members that are undertaking economic reform programs to strengthen their balance of payments and to improve their growth prospects. ESAF loans carry an interest rate of 0.5 percent per annum, and are repayable over 10 years, with a 5-1/2-year grace period" (see IMF Press Release Number 96/55, November 25, 1996, at http://www.imf.org).

[25] The total three-year credit had an original equivalent of SDR 161.6 million and was approved in three annual loans of SDR 51.4 million in November 1996, SDR 71.4 million in December 1997 (including an SDR 20 million increase to deal with the effects of the 1996/97 drought), and SDR 58.8 million in February 1999 (augmented by SDR 20 million to deal with the effects of the 1997/98 El Niño floods). Tanzania joined the IMF in 1962. Its current quota is SDR 146.9 million (see IMF Press Releases Numbers 96/55, 97/54, and 99/6 at http://www.imf.org).

[26] "Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year" (see IMF Public Information Notice 99/28 from March 31, 1999, at http://www.imf.org).

despite the severe economic disruptions caused by adverse weather conditions" (IMF 1999). In particular, the executive directors welcomed the continuous overall growth, increasing gross reserves, strong fiscal stance, tight monetary policies, and recent structural reforms, namely, introduction of the VAT on July 1, 1998; the effectiveness of the government's cash management system; and the progressing privatization of parastatal entities. However, the positive indications of an ongoing economic transition process and the first signs of improved macroeconomic stability should not detract from the indisputable necessity of further joint efforts between Tanzanian authorities, international financial institutions, and bilateral donors to promote further reform. A first promising sign of continual joint endeavor is the IMF's consideration of Tanzania's eligibility under the HIPC Initiative (IMF 1999).[27] Whatever the next multilateral loan is called and under which facility it might be scheduled, in the short and medium term Tanzania will depend heavily on another phase of international financial, as well as technical, assistance until its administrative capacity and economic structure allow for a more self-reliant and sustainable development path.

Economic Performance and Policies Applied under Structural Adjustment

This section provides an overview of Tanzania's economic performance under structural adjustment, focusing on recent developments, followed by a detailed description of sectoral, structural, and macroeconomic policies implemented during this period.[28]

General Economic Performance. According to the *Policy Framework Paper for 1998/99–2000/01*, published in January 1999, the general performance of the Tanzanian economy under the ERP 1996/97–1998/99 was satisfactory (IMF 1999; URT, IMF, and World Bank 1999; World Bank 1999b).[29] Since the mid-1990s, the Tanzanian government has pursued substantial structural policy reforms to achieve further trade liberalization, enhanced fiscal consolidation, streamlining of the civil service sector, privatization of parastatals, tight monetary growth, better delivery of social services, and poverty alleviation. Even though the 1996/97 drought and the 1997/98 El Niño floods had a negative effect on economic performance, real per capita income improved between 1995 and 1998, while inflation declined and the external position continued to strengthen.[30] Government savings were about 1 percent of GDP for both

[27] Tanzania's eligibility under the HIPC Initiative may be decided at the upcoming midterm review of the current ESAF arrangement.

[28] Tanzania's serious commitment to the transition process and the actions that have been taken to implement the economic reforms are summarized in Appendix Table A.2.

[29] The description of the current economic performance of the Tanzanian economy in this section draws heavily on the *Policy Framework Paper 1989/99–2000/01,* Public Information Notice Number 99/28 of the IMF, and Press Release Number 99/6 of the IMF, the most recent official documents available.

[30] According to the most recent available data in *World Development Indicators 2000*, GDP per capita, measured at purchasing power parity in current international dollars, increased from 461 to 472 to 473 to 480 for the years 1995–98; annual inflation with respect to consumer prices decreased from 28.4 to 21.0 to 16.1 to 12.8 percent during the same period; and the trade deficit in constant 1995 U.S. dollar decreased from US$984 million to US$800 million to US$589 million to US$417 million during 1995–98 (World Bank 2000b).

fiscal years; inflation was at an annual rate of 12 percent by the end of June 1998 and 7 percent by the end of December 1999, the lowest rate in 20 years; international gross reserves increased by more than 10 percent and outperformed the target of an equivalent of three months of imports of goods and nonfactor services (4.1 months by the end of December 1999); and the Tanzanian shilling nominally depreciated by only 7 percent against the U.S. dollar during 1997/98, which translates into a real appreciation given the inflation rate of 12 percent during this period. However, agricultural growth was far below target, mainly because of climate-related factors, and total GDP growth of 3.4 percent in 1997/98 could only be achieved through much higher growth in some nonagricultural sectors;[31] exports declined by 19 percent in 1997/98; the current account deficit, excluding official transfers, increased to 14.2 percent of GDP; and government revenue fell by 1.2 percentage points to 12.3 percent of GDP (IDA/IMF 2000).

GDP Development. The growth of GDP at factor costs during the prestructural adjustment period was characterized by high volatility. After moderate GDP growth from independence in 1961 until 1976, the average annual growth rate sank to 1 percent in 1977 and 1978, then recovered to previous levels in 1979 and 1980, and finally became negative in 1981 (–0.5 percent) and 1983 (–2.4 percent). However, in 1984 and 1985, the two last years before the implementation of the ERP, GDP growth was 3.4 and 4.6 percent, respectively, which amounts to an increase of 5.8 percentage points from 1983 to 1984.

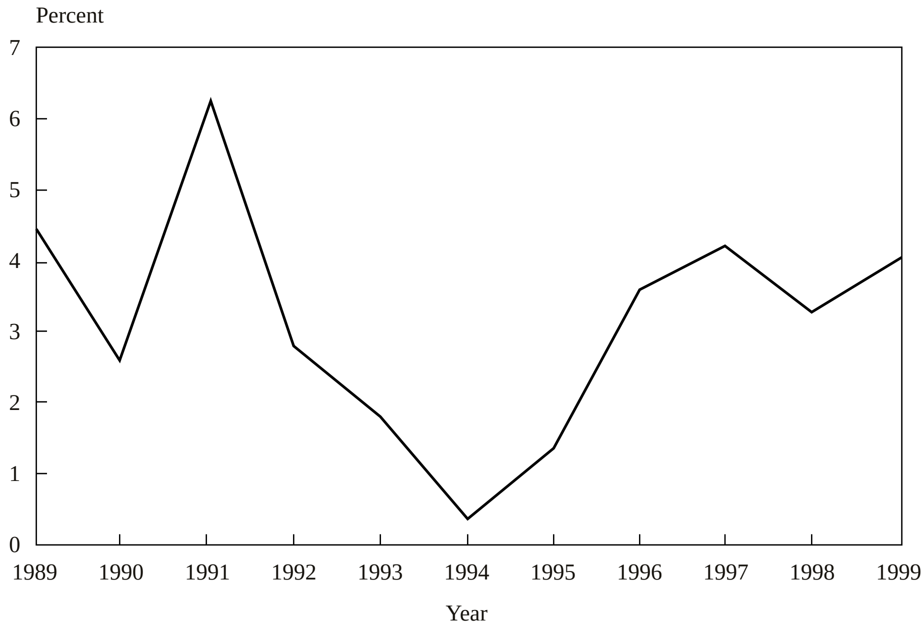
GDP increased substantially after implementation of the 1986 ERP, but collapsed during the early 1990s, the second term of the Mwinyi government (Figure 2.1). Following implementation of the 1996 ERP, GDP growth regained levels that translate into positive per capita growth, but remained below targets, mainly because of adverse weather conditions during FY 1996/97 and 1997/98. In FY 1998/99, GDP continued to grow at the previous year's level, and for the two following fiscal years it was projected to grow between 5.2 and 5.9 percent per year.

Although these growth rates look promising at first sight, Tanzania's population continues to grow at high annual rates.[32] Furthermore, with a real GDP per capita of current US$129.50 in 1995, which translates into a US$461 purchasing power parity, Tanzania has one of the lowest per capita GDP levels in the world. It requires substantial and continuous growth over a medium-term horizon even to reach the still poor SSA average of about US$500 in real GDP per capita (UNDP 1996; URT 1995c; URT 1996b; World Bank 1996b).

[31] Agricultural GDP growth slowed from 4.8 to 3.2 to 2.2 percent between 1996 and 1998, but still contributed between 46 and 48 percent to total value-added during this period (World Bank 2000b).

[32] Even though the population growth rate decreased by 0.1 percentage points annually during 1994 to 1998 from 3.0 to 2.6 percent, it still shows extremely high levels that constitute the gap between the real GDP growth rate and the per capita growth rate. If the annual real GDP growth rate falls below 2.6 percent, the per capita growth rate will be negative. However, this is not a well-substantiated figure, because the last census was in the mid-1980s.

Figure 2.1—Annual growth rate of GDP at factor costs, 1989–99



Source: BOT (1991): *Economic Bulletin*, vol. 29, no.3, Table 1.9.
Note: Figures are for total GDP at constant 1992 prices for the Tanzanian mainland, including an approximately 27 percent share of nonmonetary GDP for the relevant period. In consideration of an annual population growth rate of 2.8 to 3.0 percent, all total GDP growth rates lower than 2.8 to 3.0 percent translate to negative per capita GDP growth rates.

As mentioned in the *UNDP Development Co-operation 1995 Report*, agriculture remains the most important source of economic growth, but some nonagricultural activities show promising growth rates as well, especially the mining and tourism sectors:

> The positive growth performance in the economy was due mainly to strong growth in the agricultural sector, which comprised 55.2 percent of GDP and which experienced real growth of 7 percent during the year, but was shared by almost all sectors except public administration, construction and manufacturing. The economy's positive performance can be seen in the following sectors: Mining and Quarrying (5.9 percent); Electricity and Water (4.4 percent); Wholesale/Retail Trade, Hotels and Restaurants (5.7 percent); Transport and Communications (9.3 percent); and Finance, Insurance, Real Estate and Business Services (8 percent) (UNDP 1996, pp. 20–21).

Because of unfavorable weather conditions during the 1996/97 and 1997/98 cropping seasons and other potential setbacks in agricultural production for external or internal reasons, the shift from dominating growth in agriculture to dominating growth in nonagriculture continued in 1996–98.

Price and Market Reforms. In the context of the 1986 ERP, an additional Agricultural Adjustment Program was formulated to complement the macroeconomic adjustment process and generate a sufficient supply response. The main objectives of the program were to (1) liberalize the marketing and pricing of food grains, (2) initiate the liberalization of the major export crop markets, (3) remove the monopoly export power of the crop marketing boards, (4) restructure parastatals in agriculture, and (5) improve the efficiency of export crop tenders and auctions and crop processing industries (World Bank 1994a). Most domestic market controls on food crops were abolished in 1989, including the restrictions on the marketing and transportation of food grains. Producer prices for the main agricultural products were liberalized between FY 1991/92 and FY 1993/94. The marketing of nontraditional export crops was also liberalized in the late 1980s. In 1990 this liberalization was extended to traditional export crops such as coffee, tobacco, cashews, and cotton. During the 1991/92 marketing season, private traders were allowed to buy cashew nuts, and in 1993 private marketing of all major traditional export crops was permitted. The list of items subject to price controls was reduced from 400 to 2—petroleum products and electricity—throughout the liberalization process. In addition to price and market liberalization of agricultural commodities, subsidies for agricultural inputs such as fertilizer were phased out (World Bank 1996b).

Import Rationing. Permission to import from own funds—foreign currency deposited abroad—was given in 1984 and accounts for one-third of total imports today. In the context of the 1986 ERP, quantitative import restrictions were replaced with a system of open general licenses (OGLs). The negative list for imports under the OGLs was substantially reduced in 1992, and the share of nonoil imports subject to licensing under the OGLs was only 20 percent of total nonoil imports. In July 1993 the OGL negative list was further reduced and included goods for health or security reasons or because they were considered luxury goods. In February 1994 the negative list was further shortened and restricted to health- and security-related goods; crude petroleum and luxury goods no longer require import licenses (World Bank 1996b).

Tariff Rates. Before June 1988 the tariff system contained 20 different rates with a maximum tariff of 200 percent. The system was reduced to four nonzero tariff rates by 1990, and the maximum tariff rate was steadily reduced to 50 percent in July 1994 and to 30 percent in June 1997.[33] Despite the rate reductions, the share of collected import duties in total tax revenue increased from an

[33] The effective tariff schedule as of July 1996 is ad valorem for most items with four bands at 5, 10, 20, and 30 percent. Capital goods are taxed at 5–10 percent, and intermediate and consumer goods are taxed at 10–30 percent (IMF 1998).

average of 14.1 percent during the prereform period 1981/82–1985/86 to 26.3 percent during the reform years of 1986/87–1995/96 (URT, IMF, and World Bank 1999; World Bank 1996b). This substantial increase primarily reflects increased import volumes, but may also reflect more efficient tax collection following the tariff rate harmonization.

Export Taxes. Export taxation was suspended in 1982 and reintroduced with the 1996/97 budget for traditional goods (cotton, coffee, tobacco, tea, sisal, cashew nuts, and minerals) at a rate of 2 percent of their export value. Its expected contribution to total revenue collection was estimated at TSh 1,800 million or 0.3 percent.[34]

The reintroduction of an export tax on traditional export agriculture increased the degree of taxation of agriculture yet again, compounding other financial burdens placed on agricultural producers, such as the increase in the minimum wage,[35] increased duties on imported assembled vehicles, stamp duty (1 percent), and contributions to crop marketing authorities. Consequently, many producers are concerned about how agricultural products will sustain increased competitiveness in international markets (see Tanzanian government 1996/97 budget summary in Coopers and Lybrand 1996).

Input Subsidies. Fertilizer prices were highly subsidized during the preadjustment period. Because of subsidization, farmgate prices fell by around 50 percent between 1976 and 1984. Although explicit subsidies were abolished in 1984, "repeated currency devaluation overtook the increases in the fertilizer selling price permitted to the Tanzania Fertilizer Corporation so that by 1988/89 there was an implicit subsidy of up to 80 percent" (World Bank 1994b, p. 78). From 1990/91 onward the subsidy was phased out with 70, 55, 40, and 25 percent for the respective fiscal years and with zero subsidy since 1994/95. The elimination of fertilizer subsidies in combination with continued inflation and subsequent currency devaluation caused rapid increases in local input prices for the different varieties of fertilizer. In 1991/92, for example, the domestic market prices for fertilizer (in nominal terms) rose an average of 85 percent and from 32 to 91 percent in 1992/93.[36] However, despite these sharp price increases, the supply of fertilizer in the mid-1990s still did not meet demand, mainly as a result of extremely poor supply channels (World Bank 1994b).

Exchange Rate Policy and Foreign Exchange. The exchange rate was effectively unified in August 1993 when the official rate was set on the basis of rates prevailing in the foreign exchange auction introduced in July 1993. The foreign exchange

[34] Taken from a speech on FY 1996/97 by the minister for finance (see URT 1996b).

[35] The official monthly minimum wage increased from TSh 17,500 to TSh 30,000 in July 1996.

[36] The GDP deflator for this period ranges around 30 percent inflation annually.

market was further liberalized when the auction was replaced by an interbank market for foreign exchange in June 1994.

Furthermore, the surrender requirement on proceeds from nontraditional exports was abolished in July 1993 and for traditional exports (except coffee) in June 1994. The exchange system for payments and transfers for current international transactions has been completely liberalized, and no limits are imposed on current payments and transfers.[37] Administrative controls on imports have been removed, and trade restrictions on foreign exchange remain only for petroleum products and a few goods restricted for health and security reasons (URT, IMF, and World Bank 1999; URT, IMF, and World Bank 1996).

Table 2.1 presents the exchange rate development of the Tanzanian shilling since 1985 when the first ERP was implemented. The shilling experienced rapid devaluation between 1985 and 1989, followed by two years of mild depreciation and two years of moderate depreciation before the exchange rate market was fully liberalized in 1993/94. Since that time depreciation of the exchange rate shows a stable path at low levels. The liberalization of the foreign exchange market not only contributed to this stability, but improved political circumstances as well. The influence of the 1995 national elections on monthly exchange rate figures for 1995 and 1996 is shown in Table 2.2.

The first free and democratic elections in Tanzania under a multiparty system were held in October 1995. From a stable position during the first four months of 1995, the exchange rate depreciated during the pre-election period and then reappreciated after the elections, which restored the former united CCM party and elected Benjamin Mkapa as the new president.[38]

Domestic Tax Policies.[39] Total tax revenue declined substantially from prereform years until the first half of the 1990s. Tax revenues as a share of GDP declined during 1982–86 (16.5 percent), 1987–92 (14.2 percent), and 1993–96 (13.1 percent). Weaknesses in tax administration and the proliferation of exemptions caused the worst performance in FY 1992/93, with a revenue-GDP ratio of only 11.4 percent. The decline in performance was also caused by structural changes in the economy, as the composition of output shifted toward sectors that were more difficult to tax. For example, the GDP share of manufacturing and mining declined throughout the 1980s, while the GDP share of agriculture and the nonmonetary informal sector both increased.

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[37] A measure that is in accordance with the obligations of Article VIII, Sections 2, 3, and 4, of the IMF Articles of Agreement, accepted by Tanzania in July 1996.

[38] This information is based on BOT 1998, *Economic Bulletin* for the quarter ended September 30, 1998, vol. 28, no. 3, Table 4.3; OANDA (1999), Classic 164 Currency Converter, available at http://www.oanda.com, accessed May 30, 1999; and the author's calculations.

[39] Data on domestic tax policies are based on IMF (1996b); Coopers and Lybrand (1994, 1995); Tanzanian government budget summary 1994/95, 1995/96; and World Bank (1996b).

Table 2.1—Annual exchange rates, 1985–98

Year	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Rate	16	52	84	125	192	197	234	335	480	523	558	596	625	681
Percentage change	—	225	62	49	54	3	19	43	43	9	7	7	5	9

Source: BOT, several quarterly *Economic Bulletins;* author's calculations.
Note: Exchange rates are official mean selling rates for U.S. dollars in Tanzanian shillings for the end of each period. Data are rounded to the closest integer.
— Not available.

Table 2.2—Monthly exchange rates, 1995–96

Year	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
1995	538	545	545	551	581	603	601	616	614	610	586	558
1996	542	542	542	550	606	620	596	591	590	597	594	596

Source: BOT 1997, *Economic Bulletin* for the quarter ended December 31, 1996.
Note: Exchange rates are official mean selling rates for U.S. dollars in Tanzanian shillings for the end of each period. Data are rounded to the closest integer.

Domestic sales tax revenues declined from 8.2 percent of GDP during the prereform period to 3.6 percent of GDP during the reform period, while income tax revenues declined from 5.1 to 3.6 percent for the same periods. Although trade tax collection improved from 2.3 percent to 3.6 percent of GDP for these periods, the rise could not compensate for the losses in income and consumption taxes, which constitute more than 60 percent of total tax revenue for the periods under consideration.

Before the reform period, the sales tax schedule contained more than 26 rates with a maximum rate of 300 percent. Until 1995, the number of sales tax rates was gradually reduced first to seven and then only two ad valorem rates for imported and domestic goods (25 and 30 percent) and three rates for services (5, 10, and 15 percent).[40] Excise duty, generally 30 percent, is levied on petroleum products, alcoholic beverages, cigarettes, cosmetics and perfumes, and soft drinks. Since 1992/93 several measures have been applied to simplify the confusing tax structure, and tax rates have been substantially reduced. The list shown in Appendix Table A.4 summarizes the major steps of tax reforms in the 1990s.

Agricultural Stocking Behavior. The national Strategic Grain Reserve holds a total stock of 150,000 tons of staple food crops for emergency situations. Because Tanzania generally has a positive overall food balance, the annual emergency grain procurement targets can usually be fulfilled by domestic production. Tanzania does not rely on regular annual shipments of food aid. However, the adverse weather conditions of two recent cropping seasons (the 1996/97 drought and the 1997/98 El Niño floods) forced the government to request international assistance under the Food and Agriculture Organization of the United Nations/World Food Programme (FAO/WFP). Since early 1998, three FAO/WFP crop and food supply assessment missions have taken place to monitor the situation and implement assistance measures.[41]

Foreign Aid and Private Capital Flows. Throughout the first 10 years of structural adjustment between 1986 and the end of 1995, Tanzania accumulated a total medium- and long-term external debt of US$6.3 billion. About 50 percent of this debt was owed to bilateral official creditors, 40 percent to multilateral creditors, 3 percent to the IMF, and the remaining 7 percent to private financial institutions and suppliers. The major multilateral creditor was IDA, to whom Tanzania owed US$2.2 billion, 35 percent of its total debt, or 75 percent of its total multilateral debt.[42] During 1991–95, Tanzania borrowed on extremely concessional terms with an average commitment structure as follows: interest rate of 1.3 percent per year, repayment period of 36 years, grace period of 9 years, and a grant element of about 70 percent (IMF 1996a).

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[40] Some goods bear specific rates, however.

[41] For detailed information, refer to the three special reports on the *FAO/WFP Crop and Food Supply Assessment Mission to Tanzania,* February 19, 1998; August 3, 1998; and February 15, 1999 available at http://www.fao.org.

[42] Detailed information on the composition of the external debt can be found in World Bank 1996b, pp. 26–32.

Throughout the 1996 ERP period, Tanzania received substantial foreign assistance, and its debt position continued to worsen. The total debt stock reached nearly US$8 billion in 1996/97, or some 110 percent of GDP. Public debt service of US$316.3 million in 1996/97 was equivalent to 25.2 percent of export earnings. The IMF estimates total debt in 1998/99 at a similar absolute level as in 1996/97, even after the debt relief that followed recent IMF negotiations and the rescheduling of flows in accordance with the Naples terms of the Paris Club agreement. Assuming strong GDP growth, total debt will fall below 100 percent of GDP, and total public debt services will amount to 21.6 percent of export earnings instead of 29.1 percent without debt relief.[43]

The comparison of Tanzania's debt situation before and after the 1996 ERP reveals that the overall debt situation hardly improved through the SAPs. As soon as Tanzania regained the attention of the international donor community through its good governance and the application of reform policies, its balance of trade position deteriorated because of a new foreign capital influx. Tanzania has to be extremely careful in deciding where to invest this additional capital. A substantial share of this capital should be invested in sectors that will yield significant profits. In the long term, this should result in a reduction in the country's overall national indebtedness.

Land Policies (IMF1996b; URT 1995b; World Bank 1996b). The land surface of mainland Tanzania is approximately 881,300 square kilometers, while the islands of Zanzibar and Pemba make up an additional 2,000 square kilometers. Inland lakes comprise another 61,500 square kilometers. With the exception of a few mountains, most of the country forms a plateau at 1,020 to 1,650 meters above sea level. Forty-six percent of the total land area is forests and woodlands, while 40 percent is permanent pasture.[44]

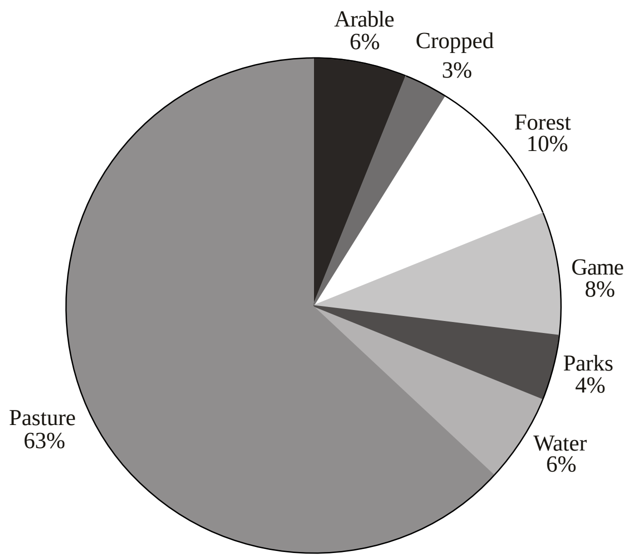
Although Tanzania has about 487,100 square kilometers of potentially arable land, 1992 Ministry of Agriculture statistics show that only 10.1 percent of this area is under cultivation. Of this area, nearly 93.4 percent (46,000 square kilometers) is used for small-scale farming by landholders who cultivate the land mainly under customary tenure. The remaining 6.6 percent is used for large-scale farming under granted rights of occupancy.

Figure 2.2 shows the actual land use of the total mainland Tanzania area, including water areas, accounting for 942,800 square kilometers. Only 3 percent of the total mainland Tanzania area is cropped, although an additional 6 percent is considered suitable for arable farming.

[43] For the most recent figures on Tanzania's debt situation and for a 15-year projection, see URT, IMF, and World Bank 1999. Because neither GDP nor foreign trade development can be projected reliably and because it is equally difficult to assume the volumes of loans throughout this period, these projections are somewhat arbitrary; however, a total debt stock representing only 52.4 percent of 2015/16 GDP while paying just 7.7 percent of export earnings in public debt service tempts one to hope.

[44] For a detailed description of the nine different physiographic regions and the seven different agroecological zones in Tanzania, refer to Appendix Table A.3.

Figure 2.2—Land use in mainland Tanzania



Source: World Bank (1994b).

Although land in Tanzania is not scarce, within the arable and cultivated areas the country faces increasing problems, such as soil fertility losses, soil erosion, deforestation, water pollution, and the development of industry and mining. The increasing pressure led to the adoption of a sustainable National Land Policy (NLP), which the cabinet approved in March 1995. The NLP declares that "all land in Tanzania is public land vested in the President as trustee on behalf of all citizens." The policy allows the individualization of village land, stating that "individuals should be allowed to obtain individual titles within areas not designated for" other uses (URT 1995b, p. 7). The NLP is viewed as an instrument of compromise to help heal the myriad grievances that have come to characterize land policy in Tanzania. Its success in making land tenure more secure will depend on how it is implemented. The most serious challenge to the NLP's implementation is the lack of administrative capacity and information, including insufficient land survey data.

However, compared with many other developing economies dominated by agriculture, Tanzania has a relative abundance of land and has some unexploited potential for future land use. Environmentally friendly and economically sustainable land use is all the more important as land ownership is the single most important safety net in Tanzania: 98 percent of all rural households own some land—5.18 acres on average according to the 1995 rural Participatory Poverty Assessment (PPA) survey.

Credit Policy—Rural Credit. Eighty-nine percent of the villages surveyed in the 1995 rural PPA survey mentioned lack of credit as a constraint to agricultural production. A total of 58.7 percent of households in the lowest expenditure quintile and 39.1 percent in the highest quintile reported that credit was not available during the 1993/94 season. The main sources of credit for those who did borrow were family, friends, traders, trade stores, private moneylenders, or cooperatives. Farmers in the lowest quintile borrowed to buy seasonal inputs (fertilizer, agrochemicals, and seeds). Farmers in the highest quintile borrowed primarily to hire labor to work on their land. Commercial credits in rural areas are relatively rare. In the PPA survey, 57 of 77 village focus groups that participated had no knowledge of the Cooperative and Rural Development Bank or the National Bank of Commerce, and 65 groups did not know about the postal bank (World Bank 1994b).

Private Banks. Even though the Financial and Banking Institution Act was approved in 1991, the first two private banks in Tanzania began operating only in late 1993. Their operations concentrated on trade financing and mobilizing foreign exchange deposits, mostly in the Dar es Salaam area. Five new private banks and several other private financial institutions have entered the market since mid-1995 and expanded private banking operations. The market share of private banks in domestic credit increased from about 3 percent in June 1994 to almost 30 percent in August 1996. The share of private banks in deposit mobilization rose from about 12 to 23 percent during the same period.

Interest Rate Structure. Both deposit and lending rates were deregulated in 1994. As a result, lending rates at first rose, but then fell below their pre-1994 levels. Unlike the lending rates, deposit rates edged down in 1995 because of predictions of a lower inflation rate. They have continued to fall steadily since deregulation, and their 1997 and 1998 levels did not even compensate for inflation. Comparing actual saving and lending rates reveals that while saving is hardly worthwhile, borrowing for investment purposes is fairly expensive and can be profitable only when marginal returns to investment exceed international levels. Table 2.3 details the development of the interest rate structure between 1992 and 1998.

General Domestic Credit Performance. During the last five years, the restructuring of parastatal enterprises has had a significant influence on credit performance. The importance of parastatal restructuring to the health of Tanzania's financial system is evident in that until 1990, about 80 percent of the loan portfolio of the National Bank of Commerce consisted of loans to only 20 borrowers, of which 19 were parastatal enterprises.

Table 2.3—Deposit and lending rates, 1992–98

Interest rate structure	1992	1993	1994	1995	1996	1997	1998[a]
Deposit rates							
Savings	26	24	24–26	15–27	11–22	7–13	2–12
Short term (1–3 months)	16	16–18	16–19	13–33	2–33	4–14	4–14
Fixed (3–6 months)	17–30	22–25	17–31	15–35	8–34	3–29	4–13
Lending rates							
Short term	18–31	22–31	28–39	28–45	28–46	21–28	15–28
Medium and long term	29–31	21–39	24–39	31–40	29–38	21–32	20–32
Housing mortgages	9–29	9–29	29–33	29–33	0[b]	0[b]	0[b]

Source: BOT (1998), *Economic Bulletin*, for the quarter ended March 31.
[a] End of September 1998.
[b] No mortgage rates after the collapse of Tanzanian Housing Bank.