TANZANIA'S BALANCE OF PAYMENTS PROBLEM (1961-84) ≈ ANALYSIS OF EXTERNAL AND INTERNAL CAUSES.

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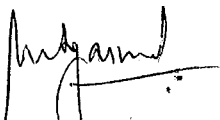for the award of the Degree of

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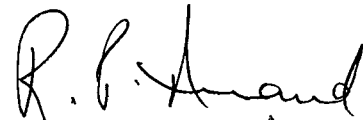
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DECLARATION

  Certified that the dissertation entitled,
"TANZANIA'S BALANCE OF PAYMENTS PROBLEM (1961-84):
AN ANALYSIS OF EXTERNAL AND INTERNAL CAUSES",
submitted by Ms.Mamta Shankar, in partial fulfilment
of the requirements for the award of the degree of
MASTER OF PHILOSOPHY, has not been previously
submitted for any other degree of this or any other
University and is her own work.

  We recommend that this dissertation may be
placed before the examiners for evaluation and
consideration.

(Dr.M.L.Agarwal)
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C O N T E N T S

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INTRODUCTION

Considerable interest has been generated in the Balance of Payment problems and Adjustment programmes designed to meet these problems in the developing countries in the 1970's and early 80's. The present study - given the backdrop of a persistent Balance of Payments problem in the period under consideration, the changing nature of its causes and the subsequent adjustment measures - carries out a case study of Tanzania. The stress, however, is on the underlying nature of the causes of the Balance of Payments problem in Tanzania in the 1961-84 period.

In the years under consideration, the payments position of the non-oil developing countries and particularly of the poorest of these countries has deteriorated sharply with large and persistent deficits on the current account becoming common place. This is not the only symptom of the crisis, though, developing countries also experienced a phenomenal increase in their external debt, dwindling foreign exchange reserves and undesirable controls on imports. These reflected major balance of payment disequilibria.

While in some countries domestic mismanagement has aggravated the problem -- whether manifested in expansionary government policies or in the inability to create a strong

supply base - for non-oil developing countries as a group, in the past two decades, the deteriorating external environment has assumed importance as a major causal factor behind their deficits.

Starting with higher oil and other import prices, sluggish demand for their exports due to world recession, rise in real interest rates, protectionism and more recently curtailment of external finance are the major external factors which formed this deteriorating external environment. These factors are exogenous in the sense that they are beyond policy control of a typical non-oil developing country.

At the same time, domestic policy measures also played a significant role in worsening the payment situation in many non-oil developing countries. In many non-oil developing countries, the inflationary demand management policies combined with rigid exchange rate policies, restrictions on trade and payments and inadequate supply side measures resulted in domestic demand pressures and cumulative losses in international competitiveness that also gave rise to current account and small balance of payments difficulties.

By analogous reasoning, changes in fiscal deficit,

real exchange rates, sectoral policies, income policy, etc.
- the domestic factors are within the control of the public
authorities, and can excerbate or mitigate Balance of
Payment difficulties within the domestic sphere. The
causal factors and transmission mechanism through which
deficits occur has been a subject of controversy since
the monetarist/structuralists debate of the 1950's and
1960's. Causal factors of inflationary pressures are also
included in this debate but they are not   dealt with
in detail in the present study.

Attributing current account deficits to external
and domestic factors is a difficult job because of the
widely varying country circumstances. Also, there might
be significant linkages between the two (Khan and Knight,
1983, p.823, Killick 1984, p. 30).

In the first chapter the notion of Balance of
Payment disequilibrium is first, defined, then indicators
based on the notion are discussed for the third world non-
oil developing countries as a whole. Various external and
internal factors which were held responsible for the
evolution of the current account deficit in the existing
literature are discussed in some detail. A lot of
discussion centres around the appropriate policy measures.

And a voluminous literature now exists on the choices made
by the developing countries and subsequently the problems
attached with each of these. As far as availability of
external finance is concerned, faced with a chronic non-
temporary deficit, a country can resort to borrowing from
international markets or from official leaders such as the
IMF. The latter, however, comes with a comprehensive
adjustment policy package. The developing countries can
also resort to adjustment policies to mitigate the balance
of payments problem. Adjustment measures with or without
external finance have also evolved in this period and
range from monetarist to structural stabilization measures.
The former is short term with stress on the demand side
and the latter is medium and long term with stress on the
supply side taking into account the structural bottlenecks.
The policy measures recommended by these schools are based
on their perception of the nature and causes of the problem.
Efforts have also been made to design suitable policies
which take into account external shocks. The last section
of chapter I is concerned with all this.

Given the backdrop of third world Balance of Payment
problem in the 1970s and early 80s a case study of Tanzania
is carried out in the remaining chapters. The central
objective of the country study is to discuss the 1961-73

period for contrasting purposes and backdrop, to summarize
the macro-economic experience of the country since the
early 1970's with emphasis on the interrelationship of
external factors, balance of payment difficulties and
domestic policy action and responses, to see which were
the most important factors underlying the evolution of the
current account deficit of the country in the 1973-84
period, to assess the country's efforts to achieve a
balance of payment adjustment in this period and, to
evaluate the extent to which the country's response to
these balance of payment difficulties frequently in the
form of the austerity programme adopted, may be causing
not only a temporary loss of output but also a more
permanent damage to its growth prospects.

Tanzania is a poor country which had limited access
to external commercial finance, it is heavily dependent
upon concessional flows, and it is on the list of the
'least developed'poorest' or 'low income countries'. Its
GDP per person fell by nearly 3 per cent in 1980, and it
now faces an external financial crisis. In 1980 oil
imports absorbed 40 per cent of total export earnings,
drought related foodgrain imports a further 20 per cent
and debt services another 9 per cent. By the end of 1980
net reserves were negative, and external payment arrears

had reached $ 286 million, half the value of merchandise exports.[1] The country has attracted internal and international concern because of poor growth performance and balance of payments crisis.

The overall economical performance and the trends in the Balance of Payments are discussed in detail in chapter II. The indicators to the Balance of Payments problem are outlined for the 1961-84 period. The 1961-84 period is divided into four sub-periods and for each period the trends in current, basic and overall balance are discussed. Various alternative hypotheses, if any, are also outlined in this chapter. The domestic policy responses are also discussed for each sub-period. Several cross-section and country studies were carried out to ascertain the importance of domestic and external factors in the 1973-84 period. An overview of the methodologies of source analysis would not be out of place here. Several empirical analyses of recent external shocks and policy responses to them in the developing countries, are now available. Their methodologies are broadly similar. All basically seek to decompose both external shocks and policy

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1   World Development Report, 1984 ,p.83.

responses, into their principal constituent elements.
(Balassa, 1980; World Bank, 1981; Balassa and Maccarthy,
1983; Mitra, 1983, 1984; Naya Kim and James, 1984).

The impact of external shocks is typically
estimated by comparing actual events with what would have
happened in the absence of these shocks. Thus the
negative effect of the shocks upon the current account of
the balance of payments, and their adverse impact reflected
in a worsening of the terms of trade, reduced export
demand (volume), and higher interest rates, can all be
estimated by reference to a counter factual world in which
these blows are assumed not to have occurred. The estimated
deterioration in the current account (relative to the
assumed counterfactual world) is then usually expressed
as a percentage of actual GNP. This however is of course,
a rather crude accounting procedure that gives little idea
of the complexity of interrelationships within an economy.
External factors and the policy response to them is usually
studied with reference to a short term period. Because
the impact of external shocks is felt immediately upon the
economy and the policy response must take place in the
short run.

Monetarist interpretation places heavy emphasis on

monetary factors in explaining Balance of Payment trends.

King (1979) analyses Kenyan data for 1967-73 based on a

financial flows model which is a Polak type of model and

as is well known, the most important policy implication

of this model is that, in equilibrium, changes in the value

of the foreign exchange reserves are inversely determined

by changes in domestic credit. The model when applied to

country data shows whether the postulated relationship is

valid or not in a particular country.

Postulated relationship between domestic and external
and the current account
variable can be tested empirically too. According to Khan

and Knight (1983, p.820) a number of studies, including

Reichmann (1978), Dell (1980), Dell and Lawrence (1980),

Killick (1981) have drawn conclusions from the 'stylised

facts' of developing countries' experience during the past

decade but have not subjected the available data to

standard empirical tests. The influences of external and

domestic factors on the evolution of the current accounts of

non-oil developing countries during the 1970's and early

1980s can be tested empirically. For Khan and Knight the

continuing controversy on the role of external and internal

factors stems, to a large extent, from the lack of formal

statistical testing of the basic relationship involved.

The analysis of the external and internal causes in

Tanzania utilizes two of the above mentioned methodologies.

In chapter III an attempt is made first to decompose the current account deficit into its principals explanatory variables with the help of a decomposition model. Later the significance of *some*principal underlying factors is estimated with the help of a simple regression model.

Chapter IV reports the summary of the main findings and some policy implications stemming from it.

Chapter - I

BALANCE OF PAYMENTS PROBLEM IN
DEVELOPING COUNTRIES:1973-84

The present chapter is divided into four sections.
In Section I the notion of Balance or Payment disequilibrium
is defined. Section II examines the indicators of the
Balance of Payment problems in developing countries in the
1973-84 decade. Section III outlines the sources of Balance
of Payment problems and Section IV discusses the policy
options available before countries facing Balance of Payment
problems.

I

Here Balance of Payment disequilibrium is the main
consideration and of overriding importance. So the notion
of Balance of Payment disequilibrium is first defined. This
will help in locating the indicators of the BOP problems.

Overall the Balance of Payment always balances, as a
matter of double entry book keeping the complete Balance of
Payment account sums to zero. Payments problems are therefore
compositional in nature and deficits refer to sub-totals.

The three most commonly used sub-totals are the
Balance on current account (visible trade in goods and services,

non-governmental transfer payments), the basic balance (the current account,plus official transfer,plus long term capital movements, and the overall balance (which include short term capital movements,.. errors and omissions and is that balance which must be matched by a corresponding change in official foreign exchange reserves).[1] All three sub-totals yield important information regarding the Balance of Payment - depending on country circumstances.

A current account deficit is the most commonly used indicator of Balance of Payment problems. The elasticities and the absorption approaches for example,focus on the current (trade) account. In these approaches balance of Payment problem is taken to be synonymous with a current account deficit, but this is a very narrow and potentially misleading indicator.

The deficit may be temporary, it may be offset by capital inflows and therefore may not be much of a problem. It is a problem when it has to be financed by depleting reserves or when borrowing capacity is limited (i.e. when

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1   Killick, Tony (ed.), The Quest for Economic Stabilization, IMF and the Third World, (Heinmann Educational Books, London, 1984), p.16.

capital inflows are unreliable and when repayments have to be earned later on).

On the contrary absence of a current account deficit also does not imply that Balance or Payment is robust. This happens when current account balance may only be maintained by pursuing domestic policies, which reduce the domestic demand (this has adverse consequences on economic welfare), or by imposing import controls,which have adverse impact on economic development.

Thus it can be concluded on the basis of the above discussion that current account deficit as an indicator,is narrow and not sufficient. Other sub-totals have to be seen before declaring the BOP as unviable,simply on the basis of a persistent current account deficit.

The other commonly used sub-totals are 'basic' and 'overall' balance,as said earlier. The basic balance on current and long term capital account which relate to long run equilibrium has been defined as follows:[2]

"Basic Balance is achieved when a country is earning sufficient foreign exchange to do what it wants to do on

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2   ORD, H.W. and Livingstone, I.(ed.), "Economies of
      Eastern Africa", Heinmann Educational Books, INC,1980
      p.433.

current and long-term capital account, without requiring accomodation through short-term borrowing or running down exchange reserves or requiring recourse to undesirable economic policies such as deflating domestic demand or restrictions on trade and capital movements inconsistent with the country's international obligations."

Further, if the basic balance can only be improved by recourse to such measures, then the Balance of Payment can be said to be in disequilibrium. By paying attention to the Basic balance rather than to the current account, recognition is given to a country's foreign exchange budget rather than the current income transactions.

Of course in the very long run, equilibrium may be defined more narrowly as a zero current balance, if a country cannot indefinitely borrow long term capital without repayment, so that at some stage a current account surplus will be needed. But since developing countries have been borrowing long term capital from countries enjoying current account surpluses which ameliorates their current account difficulties the zero basic balance is a useful indicator and a negative basic balance shows the degree of disequilibrium to be accomodated by short term borrowings or use of foreign exchange reserves.

The basic balance is not however, always a good guide

to the health of a country's balance of payments. It is
often difficult to distinguish clearly between autonomous
and accomodating transactions among capital movements.[3]
Johnson[4] also points out that "it is necessary to distinguish
between 'Autonomous' and 'Accomodating' transactions -
those which are the result of the free and voluntary choices
of individual transactions, within whatever restrictions
are imposed by economic variables or policy on their
behaviour and 'induced' or accomodating international
transactions - those which are undertaken by the foreign
exchange authorities to reconcile the free choices of the
individual transactions." It is when the authorities have
to resort to the latter that disequilibrium occurs.

The 'overall balance' takes into account the short-
term borrowing which is usually accomodating in nature.
Therefore the overall balance serves as a useful indicator
of the problem. Many countries measure a balance of payment
disequilibrium by the size of the movement in the exchange
reserves. This indicates the accomodating finance required
to match the overall balance of payments in all other
current and capital transactions.

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3   Ibid.

4 H. G. Johnson, "Towards a general Theory of the Balance of Payments"
   Economic Growth and international Trade, London, 1958.

For developing countries like those in Eastern Africa the basic balance of current transactions and long term capital movements will normally indicate directly, the extent to which the country is using its foreign exchange reserves, since short-term capital movements outside the Central Bank or other monetary institutions will not be very important.[5]

From the above discussion we can conclude that Balance of Payment disequilibrium is reflected in persistent current account deficit, accomodating finance need, undesirable controls on trade and payments and dwindling foreign exchange reserves position. Of late, Killick and Jennifer Sharply give Balance of Payment a comprehensive definition[6] (movement away from it is disequilibrium).

'Balance of Payments disequilibrium exists when in a normal year, the basic balance (or that balance chosen almost appropriate for the country in question) approximates zero in conditions where there are no major unwanted restrictions on trade and payments, external debt and debt servicing are not regarded as too large, foreign exchange reserves are regarded as adequate and the equilibrium does

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5   Ord, H.W. and Livingstone, I, b.2.

6   Killick Tony (ed.), b.1.

depend on the maintenance of unwantedly deflationary domestic policies!

The above discussion of balance of Payment sub-totals and definitions will help in locating suitable indicators to the problems of Balance of Payment, worsening especially in the 1973-84 period.

Before the indicators are examined it would be useful to distinguish between a temporary disequilibrium, which should normally be financed by the accumulation or decumulation of reserves and what the IMF calls fundamental disequilibrium - a persistent tendency to experience unwanted payments deficits which cannot be financed indefinitely and thus call for more fundamental corrective measures.

Indicators of the Balance of Payments
Problems of Developing Countries (1973-84)

The previous section discussed in what sense a
country can have a Balance of Payment problem and also what
indicators will reveal Balance of Payment problems. In the
present section those very indicators will be examined. For
developing countries the evidence exists both for temporary
and persistent disequilibria. (Dell and Lawrence,1980,Killick,
1984).

Temporary disequilibria would impose welfare costs
in a number of ways. In countries most vulnerable to sudden
disturbances, the export earnings are unstable, the fluctuating
reserves destabilize money supply and sudden measures to
cope up with payments crisis may lead to uncertainties and
riskiness. However it is the trend of persistent deficits
which is of more concern here, and we turn to the evidence on this.

It is well known that less Developed Countries (LDC's)
other than major oil exporters, have persistently recorded
current account deficits and that these increased greatly
(in absolute terms and in terms of deficit to import ratio)
after the oil price increases in 1973 and 1979. (Table1.1)

Table 1.1

SUMMARY OF PAYMENTS BALANCES ON CURRENT ACCOUNT :1973-1981 (US $ bn.)

	1973	1974	1975	1976	1977	1978	1979	1980	1981
Industrial Countries	(17.7)	13.9	(17.9)	2.6	5.7	(29.8)	10.2	44.8	3.7
Major oil exporters	(6.7)	(68.3)	(35.4)	(40.3)	(30.8)	(2.9)	(69.8)	(115.0)	(70.8)
All non-oil developing countries	11.6	37.0	46.5	32.0	28.3	39.2	58.9	86.2	99.0
of which:									
(a) net oil exporters	2.6	5.1	9.9	7.7	6.5	7.9	8.5	11.0	20.6
(b) net oil importers	9.0	31.9	36.6	24.3	22.8	30.6	48.8	72.7	80.5
of which:									
- major exporters of manufactures	3.7	19.1	19.6	12.2	7.9	9.9	21.5	32.4	36.0
- low income countries	4.0	7.5	7.5	4.1	3.6	7.5	10.0	14.5	14.3
- other net oil importers	1.3	5.2	9.5	7.9	11.3	13.2	17.4	25.8	30.2

Source : Killick, 1984; Table 2.2, p.21.

In many of the studies which analyse the Balance of
Payment trends of 1973-74 period, (Killick, 1984; Dell and
Lawrence, 1980; Helleiner, 1986) this has been highlighted
by looking at the deficits of country groupings - industrial
countries, oil exporters, non-oil developing countries.
This reflected imbalances,   between the country
grouping i.e. oil exporters enjoyed surplus, industrial
countries experienced decline in surplus and unprecedented
increase in deficits was experienced by the developing
countries. (Table 1.2).

The current account position is not a sufficient
indicator of the state of developing country Balance of Payment.
In the two definitions mentioned in the previous section,
Balance of Payment equilibrium was defined as conditional
upon the absence of unwanted control on imports and capital
transactions. This kind of control can sometimes affect
developmental activity (of imports of capital goods, machinery)
which are essential for the process of development. Dell and
Lawrence (1980) undertook a detailed study of the ways in
which 13 LDCs adjusted to the oil crisis of 1974-75 and
found that 8 of these had been forced into policies which
compressed developmental imports below the quantity normally
required at current levels of activity. Usually the low
income LDCs were the most affected.

Table 1.2

CURRENT ACCOUNT BALANCE AND IT'S FINANCING
1970-83 (billions of current dollars)

Country Group and item	1970	1980	1981	1982	1983
Developing Countries					
Net exports of goods and non-factor services	- 9.8	-55.2	-80.5	87.1	10.9
Net factor income	- 3.6	-16.4	-30.0	43.2	48.1
Interest payments on medium and long term loans	- 2.7	-32.7	-41.2	48.4	49.0
Current account (excludes official transfers)	12.7	69.6	107.8	97.6	86.2
Financing					
Official transfers	2.4	1..6	11.7	10.8	11.1
Medium and long term loans					
Official	3.7	21.5	21.2	21.4	17.6
Private	4.6	35.7	49.6	31.5	39.9
Oil importers					
Net exports of goods and non-factor services	- 8.9	-69.3	-70.5	-46.9	-26.0
Net factor income	- 1.5	- 4.3	-14.4	-21.8	-23.0
Interest payments on medium and long-term loans	- 2.0	-21.3	-26.7	-31.7	-32.3
Current account (excludes official transfers)	- 9.8	-70.3	-81.8	-65.6	-46.1
Financing					
Official transfers	1.8	9.6	9.4	9.0	8.9
Medium and long term loans					
Official	2.9	16.9	16.5	15.9	13.9
Private	3.7	24.6	30.8	22.0	11.1
Oil Exporters					
Net exports of goods and non-factor services	- 0.9	14.2	-10.0	-10.1	15.1
Net factor income	- 2.1	-12.1	-15.6	-21.4	-25.8
Interest payments on medium and long term loans	- 0.7	-11.5	-14.5	-16.7	-16.7
Current account (excludes official transfers)	- 2.9	1.7	-26.1	-32.1	-10.0
Financing : Official transfers	0.6	2.2	2.3	1.8	2.2
Medium and long term loans					
Official	0.8	4.6	4.7	5.5	3.6
Private	0.9	11.1	18.8	11.6	28.9

Source : Hellinier, G.K., 1986, p.879.

As far as foreign exchange reserves are concerned, they increased during the 1970s, but did not keep pace with the rising import bill. Between 1973-81 the reserves ratio for all NODC's was halved from 32% of imports of goods and services in 1973 to 17% in 1981, and reserves ratio of low income oil importing LDCs fell from 24% to 19% over this period, even though greater instability of their trade creates a case for a large cushion of reserves.[7]

The 1973-84 period also saw a rise in the level of external indebtness of non-oil developing countries. Financing of current account deficit of the magnitude mentioned above was mostly done by borrowing. (Table 1.3).

What was more significant was that there was a rise in the indebtness to private financial institutions in 1973-81 period. This creditor composition coupled with rising real rates of interest, led to an increase in debt servicing burden of developing countries (Table 1.)

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[7]   Killick, Tony (ed.), The Quest for Economic Stabilization, IMF and the Third World, Hein mann Educational Books, London, 1984, pp.22-23.

Table 1.3

EXTERNAL DEBT AND DEBT SERVICING OF NON-OIL LDCs,
1977 and 1981

	All non-oil LDCs		Major exporters of manufactures-non oil LDCs		Low income-non-oil LDCs	
	1973	1981	1973	1981	1973	1981
1. Total external debt ($ bn and %)	96.8(100%)	436.9(100%)	38.3(100%)	169.1(100%)	21.6(100%)	79.7(100%)
of which :						
(a) Official creditors	48.3(49.9)	175.2(40.1%)	10.7(27.9%)	36.5(21.6)	19.2(88.9)	66.1(82.9)
(b) Private financial creditors	34.6(35.7%)	224.6(51.4%)	20.6(53.8)	112.5(66.5%)	1.2(5.5%)	9.7(12.2%)
(c) Other private creditors	13.9(14.4%)	37.1(8.5%)	7.0(18.3%)	20.1(11.9%)	1.2(5.6%)	4.0(5.0%)
2. Debt servicing ($ bn)	15.3	92.3	7.8	40.0	1.4	8.3
of which:						
(a) amortisation	10.7	54.8	5.3	23.2	0.9	5.7
(b) interest	4.6	37.5	2.5	17.2	0.5	2.6
3. Ratios to exports						
(a) Total debt	88.7	103.2	73.1	79.5	189.9	220.3
(b) Total debt servicing	14.0	21.0	14.8	18.8	12.6	14.1
(c) Interest payments	4.2	8.5	4.7	8.1	4.5	4.3

Source : Killick, (ed.), 1984, p.26.

In the period after 1981 there were massive
arrears on external payments·necessitating in some
cases partial or total suspension of debt-servicing
and ad-hoc official and private rescheduling arrange-
ments. The former net inflow of resources from the
industrial to the developing countries has now been
reversed, as interest payments on accumulated external
debt exceeds net new inflow of foreign capital. Table
(1.2) shows sharp contraction in flows of private capital
to the oil-importing developing countries from 1981
onwards, the modest decline in official finance during
the same period and increase in interest payments on
debts.

The indicators mentioned above suggest that the
Less Developed Countries especially non-oil developing
countries suffered from increasing payments crises in
the 1970s and early 80s. In this period the NODCs
saw deteriorating external environment. It is however
misleading to attribute all of the external imbalances
within the country grouping to global influences. The
developing countries themselves are also responsible
for their balance of payments difficulties. The

experience too, varies from country to country. Familiarity
and understanding of the transmission mechanism of these
external and internal causes is necessary to analyse the
Balance of Payment problems and to design better policy
measures. In the next section we move on to the analysis
of sources of BOP problems of LDC's (especially non-oil
LDCs) based on the existing literature.

III

SOURCES OF BALANCE OF PAYMENT PROBLEMS
IN THE NODC'S IN 1973-74 PERIOD

The previous section examined the magnitude of the
Balance of Payments problem. It gave an idea of the impact
of adverse external environment on the Balance of Payment
of NODC's. But this needs further scrutiny as it forms
the central theme of this work.

A plethora of work exists which demonstrates the
various external and domestic causes of the disequilibrium
in developing countries and the mechanism by which external
and internal disturbances are transmitted to the economy.
It is clear that once appropriate diagnosis has been
conducted, and the policy measures adopted in tune with
the causes, it will lead to faster adjustment in the
ravaged economies while policies unrelated to fundamental

causes of payments disequilibrium may improve the Balance of Payment, there is a strong presumption that the policies dealing directly with the root causes of the problem will achieve similar results at a smaller cost in terms of growth and development. For instance domestic demand deflation will almost certainly reduce the demand for imports, but it will tend to increase unemployment. n the other hand if such policies are adapted which will increase the competitiveness of tradeables may induce a similar improvement by encouraging export growth rather than relying so heavily on import contraction.[8] We can now discuss the various external and domestic factors.

Domestic Factors

Domestic or endogenous factors are those which national authorities can control, for example fiscal deficits, and money supply. Among the domestic factors, those generating demand/pressures are said to have been important in affecting the current account position of NODC's. It is argued often that the excess domestic demand generally

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8   Graham Bird, "Balance of Payment Policy", in Killick, ed., "Quest for Economic Stabilization", heinmann Educational Books, London, 1984, p.92.

manifests itself in worsening of the Balance of Payment and a rise in the domestic inflation rate.

Fiscal Factors

While the causes of excess demand can be many, it is argued here that in NODC's the rise in aggregate demand can often be traced back to expansionary government policies that result in fiscal deficits. There exists a positive relationship between fiscal deficit and current account deficits. This is revealed within the framework of National Income identity

$$(G-T) + (I-S) = (M-X)$$
(Symbols stand for their usual meanings)

This identity for the public, private and trade sectors focuses on the relationship between government deficits, inflation and the balance of payments. The influence of budget deficit on inflation and the Balance of Payment can be explained in the following manner. Increased government spending will lead to increase in expenditure and rise in nominal GDP, and as incomes expand so will demand for imports. A part of government expenditures will go directly to imports. Similarly if personal taxes

or excise taxes are reduced, consumers will spend more,
partly on imported items. Larger budget deficits are
likely to strengthen domestic demand pressures which may
also divert production from exports to the home market.
Domestic absorption of exportables will also rise.
(Conversely the Balance of Payment and inflation can affect
the size of the budget deficit).

The New Cambridge approach points out that the
private sector surplus or deficit (I-S) is small and
stable and thererore any increase (decrease) in the govern-
ment deficit (G-T) will result in an increase (decrease)
in the trade deficit. The reason behind expansionary
fiscal policies is often an inadequate tax base as many
LDC's are too poor and too politically volatile for a
high tax burden to be possible; even if an adequate tax
base is available, the administration may be unable to
take advantage of it. So the governments in LDC's may
feel they have little choice but to run persistent
deficits if they are to maintain welfare services, and
continue with public investment regarded as necessary
for development.

There is a growing literature which offers politico-
economic explanations of the persistence of disequilibria.
In these explanations attempt is made to enquire further

into the political impulses behind the budget deficit and
into the options that will realistically open to the
government. As political considerations make it difficult
for the authorities to undertake unpopular measures such
as reducing the government wage bill, cutting back on
social services or abolishing subsidies on food, export
sectors, etc., not surprisingly, LDC's tend to have large
government deficits. The fiscal position of NODC's as a
proportion of GDP worsened from 2% in 1973 to 3% in
1973-76 and later 3½% in 1979-81. The steady rise in the
fiscal deficit was evidently associated with the worsening
current account position of NODC's. (Khan and Knight,1983).

Furthermore, in the NODC's the fiscal deficit is
generally matched by a corresponding rise in domestic
liquidity, which then expands private nominal demand and
reinforces the negative impact on current account. In
the NODC's the absence of a well-developed domestic
capital market precludes the sale of substantial amount
of public debt to the non-bank sector, so that the
government has to rely on borrowings from the banking
system or increasing its foreign debt to meet its financing
requirements. (Khan and Knight, 1983). As a result of
such methods of financing, the fiscal deficit will lead

directly to increase the monetary base ana also create

inflationary pressure. Inflation was endemic in most

NODC's during the 1973-84 period. The link between fiscal

and monetary expansion having/spelt out, what remains to be

been

seen is the transmission mechanism through which expansion

in domestic liquidity affects Balance of Payments.

Monetary Factors

The monetary approach to Balance of Payment explains

it exclusively in terms of domestic monetary disequilibrium.

The absorption approach runs, in real terms but the monetary

approach views monetary aspects as the essence of the matter.

Monetary approach assumes fixed exchange rates ana a

linearly homogenous relation between nominal demand for

money ana nominal income. The nominal supply of money is

the product of the money multiplier ana the monetary base,

with the latter comprising a domestic component, consisting

of domestic credit created by the monetary authorities and of

an international component consisting of the domestic

holdings of international reserves. Given a tendency towards

equilibrium in the monetary sector of the economy, and

9   Adapted from
Graham Bird in Killick (ed.), Quest for Economic
Stabilization, n.l p.95.

assuming a constant money multiplier, it follows that changes in reserves (taken as the measure of the state of the balance of Payment) strictly reflect any imbalance between the change in the domestic demand and supply of money. Excess demand for money will be met by a net inflow of reserves, i.e. a balance of Payment surplus, while excess creation of domestic credit will be reflected in a payments deficit. It is the change in reserves which, in the long run restores monetary equilibrium, once stock equilibrium is restored,the flow of the reserves will cease.

A great deal of research on the monetary approach to the balance of Payment has also emanated from the IMF's Research Department and has been conducted in the context of developing countries. Prominent among them is the Polak model.[10] The model can be empirically tested, and when applied to country data snows whether the changes in the value of the foreign exchange reserves are inversely determined by changes in domestic credit or not. (King 1979, Killick, 1984). The implications of the above analysis for policy measures, the IMF's adherence to it,

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10   Polak J.J., "Monetary Analysis of Income Formation and Payments Problems", IMF Staff Papers, November 1957.

and the controversy generated by this are discussed in the last section.

Real Exchange Rates

Another domestic factor that is closely associated with such fiscal deficits, and which operates through the rise in domestic inflation is an appreciation of the real effective exchange rate. It has been argued that there was a tendency for nominal exchange rate changes in many developing countries to be less,than would have been needed to offset the excess of domestic inflation rates over inflation in the rest of the world in general to lag behind changes in the domestic price level, resulting in appreciation in the real effective exchange rate. (Khan and Knight, 1983). This tendency would imply the existence of a positive relationship between domestic demand pressures, inflation, and real effective exchange rates. (Aghelvi, 1982; Khan and Knight, 1982). This is not always true that external factors such as terms of trade may also exert an influence on the real exchange rates. For example a worsening of terms of trade owing to an increase in import prices would raise the domestic price level which in turn would lead to appreciation in current exchange rates,if no corrective measures are taken.

The real exchange rate is an index of relative
domestic and world prices expressed in terms of a common
currency, that is, the index of the number of units of
domestic currency per unit of foreign currency multiplied
by the ratio of a domestic price index to a foreign price
index. Thus, when the real exchange rate is rising over
time, it is said to appreciate, and when it is falling it
is said to depreciate.[11]

An increase in the real effective exchange rate is
clearly a fundamental determinant of the deterioration
in a country's current account, since other things being
equal,it tends to raise the demand for imports and to
reduce foreign demand for exports. This happens because
it not only makes imports artificially cheaper for
consumers and exports relatively dearer for producers
but also reduces the external competitiveness of a
country and thereby causes losses of domestic production
and employment. On the basis of these effects, it seems
legitimate to view movements in the real effective exchange
rates along with fiscal and monetary factors as useful
summary indicators of the domestic factors that typically

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11   World Development Report, 1987, p.101.

would be expected to influence the current account. We close the discussion on domestic factors with a brief discription of structural factors.

Structural Factors

The structural factors were highlighted specially in the context of Latin American economies.[12] Some of the structural features shared by developing countries typically are, heavy reliance on primary product exports for foreign exchange and fiscal revenues; weak domestic financial structures; large urban populations employed in export - related commerce and service activities; land tenure systems that inhibited full exploitation of the land's potential, income inequality, small industrial base etc. (Apart from these, all economies have features peculiar to themselves).

With this kind of structure, if growth of export earnings is low, due to sluggish and fluctuating demand, plus there is an increasing demand for imported inputs (In countries where import substitution policies are carried out), balance of payment problems will surface.

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12 The Structuralist debate of the 1950s & 60's.

To sum up, historical developments in many developing economies had resulted in structures of production and trade and institutional features that inhibited smooth alterations in supply, in response to the changes in aggregate demand, leading to inflationary and payments pressure.

External Factors

In contrast to the internal factors, external factors emerge from the external environment that the country faces and are beyond the control of government policies. In the years under consideration, the developing countries have been buffeted by a series of 'external shocks' - oil price increases, global price inflation, recession, high real interest rates and exchange rate instabilities, protectionism and more recently, the interruption of supplies of external finance. Due to these developments the international economic environment since 1973 has been highly volatile and uncertain.

The behaviour of external variables and their adverse impact can be judged from the following two tables. For the 1972-76 period, the data in Dell and Lawrence (1980, p.11) throws further light on the relative importance of external and domestic factors and, in addition, permit a clearer differentiation of the pre and post-oil shock periods.

Table 1.4

PRINCIPAL CAUSAL FACTORS IN YEAR TO YEAR
DETERIORATIONS IN THE TRADE ACCOUNTS OF
NON-OIL LDC's, 1972-76 (PERCENTAGE OF TOTAL)[a]

Primary Causal Factor	1962-72	1973-76
Increase in import quantities	41	15
Increase in import prices	8	33
Decrease in export quantities	35	21
Decrease in export prices	17	31
Total[b]	100	100

Source : Dell and Lawrence 1980, Table 1.6, page 1.

Notes : a; Their figures have been reworked to exclude
those observations for which no primary cause
was identified.

b; subject to rounding errors.

(Adapted from Killick 1984; p.33).

Table 1.5

SOURCES OF DETERIORATION IN THE CURRENT
ACCOUNT OF NON-OIL DEVELOPING COUNTRIES,
1979-82 (billion of dollars)

	1978	1979	1980	1981	1982	Cumulative 1979-82
Actual Trade balance	-36.6	-51.3	-74.3	-79.6	-52.2	-
Adjusted trade balance*		-46.3	-57.3	-47.8	8.8	-
Oil effect**		5.0	17.0	18.6	14.8	55.4
World recession effect$^@$		-	-	13.2	46.2	59.4
Export volume$^\&$		-	-	-	23.2	23.2
Terms of trade$^{\&\&}$		-	-	13.2	21.3	34.5
Interest payments on debt service (gross)	-19.4	-28.0	-40.4	-55.1	-59.2	-
Interest rate effect (gross)$^\circ$		- 1.1	0.5	11.4	23.0	33.8
Interest rate effect (net)$^{\circ\circ}$		- 0.5	0.2	6.5	14.0	20.2
Actual current account	-41.3	-61.0	-89.0	-107.7	-86.6	-
Adjusted current account$^{\circ\circ\circ}$	-41.3	-56.5	-71.8	-69.4	-11.8	-

Source : Fishlow (1984), p.36.

*   Adjusted trade balance; Actual trade balance minus sum of oil and recession effects.

**   Oil effect: Actual cost of net imports of oil (using oil import price of industrialized countries) minus estimated cost using oil price that varies after 1978 with export prices of oil-importing countries.

@   World recession effect: Composite terms of trade and volume effects (does not add because of interaction).

&   Export volume; Non-oil export value times cumulative negative percentage deviation between actual export volume of oil-importing countries and volume predicted by 3.2% industrialized country growth in 1980-82.

&&   Terms of trade: Cumulative negative percentage deviation between actual non-oil terms of trade (export price of non-oil

Table 1.5 continues....

oil-importing countries; import prices of oil-
exporting countries in 1973-74, 1979-80, non-oil countries
in other years) and terms of trade predicted by
3.2% OECD growth and declaration of industrialized-
country inflation at 1 percentage point per year
beginning in 1979.

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Interest rate effect : Based on difference between
the 1975-78 average real interest rate and actual
real rates. For short-term interest payments, the
US prime rate was used. Interest on long-term and
medium-term loans was calculated by using the real
US prime rate with a weight of 1/3 and the OECD
long-term fixed interest rate with a weight of 2/3,
corresponding to portfolio weights reported in OECD.
External Debt of Developing Countries (Paris, 1982).
Rates were applied to average annual debt, obtained
by using average of year-end debts. Net interest effect
includes the offsetting earnings from short-term
assets. This method approximates well the actual
gross and net interest payments reported in IMF,
World Economic Outlook (Washington, D.C., 1983).

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Adjusted current account : Actual current account
minus sum of oil effect, recession effect, and
net interest effect.

(Adapted from Helleiner, 1986, p.885)

The most striking thing about the data presented in the above table is the great divergence between the two periods. The record for 1962-72 draws attention to the important influence of domestic factors. (Export and import volumes can be treated as endogeneous variables). For 1973-76, increases in import prices and decreases in ex port prices between them assume significance. For the 1979-82 period, the figures calculated in one recent attempt to estimate the absolute impact of the major components of external shocks in the aggregate of all non-oil developing countries over the 1979-82 period are given in Table 1.2. It demonstrates the changing relative importance of the 'oil effect', terms of trade deterioration and export volume decline under the heading of 'world recession effect', and interest rate effects, the influence of oil is seen to be falling and that of recession and interest rates, rising over time. The above mentioned external factors exert an impact on the Balance of Payments in the following ways.

Terms of Trade Effect

Khan and Knight (1983, p.835) find terms of trade as the single most important variable 'explaining' recent

experience with current account imbalance in 32 Non-oil Developing Countries. According to them the terms of trade of NODC's taken as a group,fell at an average rate of about 2 percent a year over the 1973-81 period. During the preceding ten years period (1963-72) the terms of trade of this group had improved at an average rate of 1/2 per cent a year.

A considerable part of the terms of trade deterioration was due to the increase in the world prices of energy products in 1973-74 period and further substantial increase that occurred in 1979-80. The terms of trade of industrial countries also fell,since petroleum products represent a relatively larger share in the total import of industrial countries. The surge in oil prices worsened the terms of trade of oil-importing developing countries. The only gainers in the 1970's were the group of oil exporting countries which experienced an improvement in terms of trade.

When measured against a 1971-73 base as a percentage of GNP, the effect of changes in the prices of exports in relation to imports on the balance of payments over the 1974-81 period ranged from an unfavourable average of 6 to 7 percent a year for some middle income Latin American primary producers, to a favourable 10% or more a year

tor some oil exporting developing countries (World
Development Report, 1984, p.25).

The Recession Effect

There was a pronounced decline in the average
growth rate of real GNP of industrial countries in 1978-81
period. The growth in industrial countries had a direct impact
on current account through its influence on the exports
of NODC's. Real GNP growth rates of industrial countries
between the 1963-72 period averaged 4.7 per cent. In the
1973-81 period it averaged only 2.8% (Khan and Knight,
1983, p.824). This exerted an unfavourable impact on the
balance of payments of the NODC's in 1974-81 period.

The growth rate in industrial countries also has
an indirect effect on the primary commodity prices (Goreux,
1980; Chu and Morrison, 1983). When the industrial
countries grow rapidly, then demand for raw materials
also grows and usually leads to a rise in the primary
commodity prices relative to manufactured goods.
Conversely, recession in the industrial countries generally
reduces the prices of the exportables of developing
countries and worsens their current account position. It
is possible that the primary commodity prices which
increased between 1973-81, would have increased even

more but for a decline in the average growth rate of real GNP in industrial countries. (Khan and Knight, 1983)

The Effects of Protectionism

Increased protectionism in industrial countries against developing countries' exports reduces the export earnings that developing countries would otherwise obtain. In aggregate, exports from oil-importing developing countries have infact grown faster than world trade in general since 1974, (in volume terms), with less protectionism they would have done that to a larger degree. (World Development Report, 1985, pp.37-38).

Together the above mentioned three factors capture the external factors emanating from the goods market. The following external factors originating from the capital market also exerted unfavourable impact on the NODC's balance of payments in this period.

Real Interest Rate Effect

Real interest rate rise was also found to be a major factor affecting the current account of NODC's in the 1970's, as it led to an increase in the servicing payment on the external debt.

Debt service had not been found a very serious problem for many NODC's prior to 1975 because conditions in the international credit markets were generally favourable and a large proportion of outstanding debt, had been given to the low income countries at concessionary rates. Nominal interest rates on the external debt of many NODC's, when adjusted by the increase in their export prices, yielded real interest rates that were low or negative during this period.

In 1978 this picture changed quite drastically. Owing to adverse terms of trade shocks and weakness in export market growth, the NODC stock of external debt, particularly, short terms debt, rose sharply. In addition, interest rates in international capital markets were climbing to post-war highs at a time when developing countrie's export prices began to weaken. Real interest rates on external debt became positive and averaged about 3% a year during 1978-81 period. The high real interest rates that generally prevailed after 1978 exerted their strongest impact on the debt services burdens of these countries whose stocks of external debt was relatively large; these were obviously the countries that had already experienced substantial current account deficits and had resorted to foreign financing in earlier years.[13]

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13   Khan and Knight, IMF STAFF Papers, 1983.

Curtailment of External Finance

More recently since 1982 there was a sharp
reduction in the inflow of commercial capital. The former
net flow of resources from the industrialized to the
developing countries has now been reversed as interest
payments on accumulated external debt exceed net new
inflows of foreign capital (Helleiner U.K., World Develop-
ment Report, 1986, p.878). This coupled with the real
interest rate hikes,sums up the movement in factors,
originating from the capital markets which had an adverse
impact on the BOP.

Discussion of sources of payments problems provides
support,both to those who stress the importance of
domestic policies for Balance of Payment management and
to those who emphasize the malign influence of exogenous
factors. (Khan and Knight, 1983; Cline and Weintraub,1981;
Killick, 1984). Thus the distinction between external
and domestic causes,emerges as specially relevant for
the post 1973 period.

IV

BALANCE OF PAYMENTS ADJUSTMENT

Broadly, both external and internal factors are responsible for BOP problems. These results suggest the importance of exercising circumspection in attributing the need for stabilization to any one cause. Economic stabilization can be defined as an improvement in the balance between supply and demand in an economy, aimed at moderating inflationary pressures and strengthening the balance of payments. The implementation of the stabilization programme presupposes the existence of serious economic problems which necessitate a back redirection of the economic policies.

Over the past two decades a large number of stabilization programmes have been undertaken, based to a great extent, on the macro-economic theory of open economies, developed during the 1950s and 1960s. Since then, however, the scope and methods of stabilization policy have gradually evolved and expanded. A series of external shocks have complicated the problem of economic management in general, and the implementation of stabilization programmes in particular. This part of the chapter is concerned with some general issues related to economic stabilization.

Faced with a chronic non-temporary deficit, whether of external or domestic origin, a country can borrow from The International capital Markets or from official lenders such as the "International Monetary Fund" (IMF)— The latter however comes with a comprehensive adjustment policy package — and resort to Adjustment policies, to mitigate the Balance of Payments problems.

A voluminous literature now exists on the choices made by the developing countries and subsequently the problems attached to each of these. As suggested by the previous section, significant changes occurred in the years under consideration, regarding the underlying causes of the payments problem. Many studies now list the changes in the nature of choices to be made in view of the growing importance of the deteriorating external environment. They list the changes in the nature of adjustment policies too. (Dell and Lawrence, 1980; Helleiner, 1988; Paul Kruegman, 198%; Killick, 1984; Balassa, 1983).

External finance is recommended in the economies ravaged by the External Shocks, since in this case developing countries suffer from problems due to factors for which they cannot be held responsible. As far as

the source of finance is concerned, in the post first oil
shock period, private bank loans dominated other sources
or the developing country finance. (Table 1.6)

Table 1.6

FINANCIAL FLOWS TO DEVELOPING COUNTRIES
(billions of 1980 dollars)

Year	Total	Official development ment assistance	Private			
			Total	Direct private invest- ment	Portfolio	Export credits
1956-60	21.9	13.2	8.7	-	-	-
1961-70	29.0	16.2	11.5	6.0	2.6	2.9
1971-80	76.6	28.1[a]	38.1	10.7	19.9	7.4

Note: Data between periods are not strictly comparable
because of redefinition. Dollars have been deflated
by GDP deflator for industrial countries.

a $ 19.8 billion excluding assistance from the Council
for Mutual Economic Assistance and the Organization
of Petroleum Exporting Countries.

Sources: 1956-60: OECD, Development Assistance and Efforts
in 1961 of the Members of the Development Assistance
Committee (September 1962); 1961-70: OECD, Development
Assistance, 1971 Review (1971); 1971-80: OECD,
Development Cooperation, 1981 Review (1983).

Source : A.Fishlow (1988).

The supply condition of private finance was very
favourable in the 1973-79 period. Interest rates (LIBOR)
in which the debt was contracted were low, and the sudden

increase in the surpluses of the oil-exporting countries
to the order of $ 60 billion in 1974 - added to the global
supply of lonable funds as a result of higher propensities
to save in those countries, and because of a strong desire
for liquidity, the Eurocurrency Market was a preferred
habitat for such surpluses. When these funds were borrowed
by the developing countries,the oil surpluses were recycled.[14]

This mode of financing was precarious since the
maturity of the loans ranged mostly between six and ten
years. The interest rates, moreover, were readjustable
every six months in accordance with the changes in the
LIBOR (London Inter Bank Offer Rates). The consequences
of variability in exchange rates had to be borne by
lenders as well, because the dollar in which most of the
loan contracts were denominated - was no longer fixed.

The vulnerability of the choice of the developing
countries, especially the major borrowers, was exposed
with the second round of oil price rise (1979) and
associated recession in the industrial countries, as
contractionary policies were sought to contain cost-
induced inflation. An essential element of the new economic

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14   A.Fishlow in Dornbusch and Helmars(ed.),The open
        Economies ,EOI, 1988.

        pp.197-8.

strategy was reliance on a tight monetary policy which induced higher nominal and real interest rates. This lead to an increase in the interest payments on present and past stock of debt. The higher the interest rate, the fewer the opportunities to use finance as an instrument for adjustment. Also,for given rates of export growth, higher interest rates make countries less creditworthy by reducing the coverage or such fixed payments.

External debt increased,between the beginning of 1980 and the end of 1982,at an annual rate of 16 per cent, and the problem became so acute for some countries that Mexico for example, in 1982,could no longer service its debt.[15] The debt problem took crisis proportions when several borrowers were forced to reschedule their debts from 1980 onwards. Briefly, these were the problems associated with private commercial borrowings in the period under consideration.

The other major source of Balance of Payments financing is the IMF, since one of the principal functions of the IMF is to assist member countries which are experiencing serious payments disequilibria. The pattern

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15   Ibid.

of drawings under the various Fund facilities has varied
both, over time and across the countries. The chief
means by which it has provided support in the past is
through stand-by arrangements, by which the Fund can
assure a member that it will be able to borrow foreign
exchange during a specified period and up to a specified
amount subject to the terms of the arrangement of the 114
new stand-bys approved by the Fund in 1976/77 - 1981/82,
108 were with developing countries. (Table 1.7)

A member's access to Fund resources is expressed
in terms of tranches, equal to 25% of its quota to the
Fund. The first of these , the 'reserve tranche' is
available on request automatically and is unconditional.
The next is first credit tranche, which is subject to
minimal conditions. The Fund also has other low conditionality
facilities such as compensatory Financing Facility. Credit
tranche drawings represented, easily the largest source
of finance until 1972. Compensatory Finance Facility
(CFF) played a major role till 1976. This chiefly provided
assistance to primary product exporters, experiencing
payments deficits arising from export shortfalls due to
sudden falls in world prices, harvest failures, etc.

Table 1.7

USE OF FUND RESOURCES BY NON-OIL DEVELOPING COUNTRIES

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Total Purchases	475.5	823.7	410.1	1940.5	2474.5	3835.0	1035.2	1210.7	1769.9	3752.7	7081.7
Reserve Tranche	98.5	178.2	68.2	329.1	359.1	212.5	30.7	100.6	98.0	359.1	310.4
Comp.Financ Export shortfalls	69.5	299.5	113.5	107.2	188.5	1863.1	240.5	479.0	572.0	980.4	1230.5
Comp.Financ.Cereal Import Excesses	-	-	-	-	-	-	-	-	-	-	12.0
Buffer Stock	11.8	6.4	-	-	4.7	-	--	36.1	13.9	-	-
Oil Facility	-	-	-	939.7	1579.4	891.8	-	-	-	-	-
Credit Tranche Ordinary Resources	295.8	339.6	228.5	564.6	335.2	777.6	555.3	421.0	647.7	855.5	1662.2
Credit Tranche SFF	-	-	-	-	-	-	-	-	205.4	943.1	1468.9
Credit Tranche EAR	-	-	-	-	-	-	-	-	-	-	305.5
Extended Facility Ord.Resources	-	-	-	-	7.7	90.0	208.8	174.0	131.5	339.3	1040.8

Table 1.7 continues...

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Extended Facility SFF	-	-	-	-	-	-	-	-	101.5	275.2	570.8
Extended Facility EAR	-	-	-	-	-	-	-	-	-	-	480.6
Gold Distributions	-	-	-	-	-	-	87.5	55.4	60.3	4.0	-
Total Repurchases	432.1	502.5	488.3	449.0	415.9	871.9	1293.1	1887.8	1710.6	1906.4	1611.7
Repurchases of Purchases	426.8	494.6	475.0	433.7	399.5	865.8	1290.6	1989.4	1612.5	1860.0	1592.5

Source : Killick (ed.), The Quest for Economic Stabilization, 1984, p.154.

In 1976, however, there was a major change in the
relative use of various IMF facilities. (Table 1.). The
Oil Facility (OF) funded by IMF borrowings from OPEC
surplus countries and certain industrial countries, was
created to assist countries whose BOP's had been seriously
effected by the oil crisis of 1974/5. It was very
important between 1974-76 and was discontinued later.
The Compensatory Finance Facility was larger
after 1976, as compared to the 1971-75 period. (Table 1.8).

After 1976, the credit tranche and Extended Fund
Finance (EFF) drawings supplemented by the SFF (supplemen-
tary Fund Finance) became the most significant source of
Fund Finance for non-oil LDCs. The EFF was set up in 1974
to meet the needs of countries in special circumstances
of balance of payments difficulty, requiring support over
a longer period than normally covered by the stand-bys.
To qualify for the SFF, which became operational in 1979,
a member must (i) require assistance in excess of the
amounts available to it in the credit tranches, (ii) have
a problem which requires a long period, and (iii) first
obtain an upper-tranche or an extended credit.

The Fund, therefore, sought to adapt to the new
problems created by the oil shocks and the world recession
in a number of ways: increases in its lending power, the

creation of new facilities and enlargement of existing ones, increased use of EFF. However, the grant of some of the Fund credits, the so-called upper credit tranches is conditional on the member government, satisfying the Fund that the credit is in support of an adequate programme of domestic policies designed to remedy the payments deficit and is thus a subject of debate. The core of an 'agreed' programme comprises of a number of 'performance criteria' which are written into a letter of intent from the member and continuing access to the credit is conditional upon adequate progress in the fulfilment of these criteria. Performance criteria vary from case to case but typically include quarterly ceilings on total domestic credit expansion and on the credit to the public sector, and ceilings on certain foreign borrowings. Exchange rate depreciation, liberalization of trade and payments may also be included in the programmes, most frequently as pre-conditions for an agreement. (Killick 1984,pp.3-4).

Both the inadequacy of the Finance provided by the IMF and the policy measures recommended by it have come under considerable attack in this period. Presently we shall restrict the discussion to the former. The debate over conditionality not only involves a discussion on the nature of the higher credit tranche conditionality, but

also on the Balance between the low and high conditionality
resources within the Fund. 'Low conditionality resources
are in low proportion to the total, because of the particular
methods that members have adapted for enlarging the access
to the Fund's resources - that is, by increasing access
as a percentage of quota rather than by increasing the
quota itself. The result is that of 600% of quota available
only 25% are available for low conditionality finance
whereas if the quota had been increased six fold it would
have applied to the equivalent of 150 per cent of the
current quotas'.[16] Also, the Fund has leverage on deficit
countries needing IMF support but it has no equivalent
influence over countries whose domestic policies result in
persistent payments surpluses. Dell and Lawrence (1980,
pp.12-13) suggest that 'Developed countries should transfer
their structural surpluses to deficit countries in the
form of lendings! Khan and Knight (1983, p.820) consider
the issue of surplus transfer as essentially normative
about how the international monetary system should ensure
·some degree of symmetry between various countries in
undertaking Balance of Payments adjustments.

In defense of the IMF financing two points can be
made. The need for balance of payments financing in the

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context of more supply-oriented adjusted programs was
recognized, in principle, by the IMF with its Extended
Facility (and also by the World Bank with its structural
adjustment loans). Its adequacy however is questioned.
Secondly it is to be remembered that official finance
plays a major role vis-a-vis private lending agencies.
It restores their confidence in the developing countries,
especially major debtors, which are receiving official
conditional assistance. Official and private finance
are complementary rather than competitive here.[17] The
discussion or problems attached with private external
finance and adequacy of official finance in BOP financing
of NODCs brings us to the last part of our chapter, i.e.
the nature and scope of the Adjustment Policies. A
voluminous literature now exists on the nature of
stabilization policies implemented in the post 1973 period
and their efficacy, Of special relevance to this study
is, the modification required when external factors along
with domestic factors assume importance in causing
Balance of Payment problems, as suggested by the existing
literature.

In the previous section the importance of designing

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17   Richard Eckaus, Observations on the Conditionality
      of International Financial Institutions, World
      Development, 1982, pp.767-780.

corrective measures in tandem with the root causes of the problem was emphasized. For effective balance of Payment management, the tools available fall both in the domestic as well as in the external sector. These are mainly Fiscal, Monetary, Financial, exchange rate and commercial policies.

Traditional analysis emphasizes the improvement of the Balance between aggregate demand and aggregate supply. Much of the debate over appropriate policies centres around the importance of making distinction between the supply side and the demand side policies (Crockett 1981, Khan and Knight, 1982). Since the current account of the Balance of Payment is equal to the difference between the domestic output and the domestic absorption, an improvement in the Balance of Payment on current account involves restricting the aggregate domestic demand relative to the aggregate supply. An objective which can be achieved either by expanding supply or by restraining demand. The debate between 'Monetarist' and 'Structuralists' centred around this theme.

The Monetarist view as discussed in Section III has been that, inflation and attendant balance of payment problems are caused by allowing aggregate demand to run

ahead of supply. According to them stabilization can be approached, only in a framework where the demand is restricted to the available supply. The familiar demand side policy measures are of two kinds:

(1) Expenditure Switching - devaluation and commercial policies.

(2) Expenditure Reducing - Monetary and Fiscal policies.

To improve the current account position devaluation, and restrictive monetary and fiscal policies are recommended. These are assumed to take care of overvalued exchange rates and Monetary and Fiscal expansion without going into the exact mechanism by which these policies affect the current account in detail, the interdependence of the three policies and its implication for stabilization is briefly commented upon.

Fiscal policy needs to be judged alongside the other main tools of macroeconomic policy. Monetary policy and exchange rate policy. Macro-economic imbalances are often addressed by tightening the monetary policy. To tighten monetary conditions, governments are usually forced to impose higher reserve requirements on banks or to induce the banking system to hold more government bonds. This leads to a rise in the interest rates and

restricts private borrowing and hence investment. Tight money is thus a poor substitute for fiscal discipline.

Exchange rate policy on its own is also unlikely to be successful at stabilization. Public deficits often result in real exchange rate overvaluation because the additional pressure on domestic demand drives up the wages and prices. A tight monetary policy reinforces this tendency by raising domestic interest rates and attracting capital inflows. Devaluation of the currency without an accompanying fiscal correction will eventually be offset by an increase in the domestic prices and affect the real exchange rates only temporarily. Similarly when wages and domestic prices do not fall readily in nominal terms, a fiscal contraction without a nominal devaluation is also unlikely to change the exchange rate (World Development Report, 1989)

Demand oriented policies (which also form the core of the conditionality of the 'upper credit tranche' IMF finances) have been criticized on the grounds that, they improve the Balance of Payment and price situation)at the cost of other macro-economic variables i.e. economic growth, income distribution, full employment. The IMF too has published studies which purport to study the efficacy of its programs in developing countries.[Reichmann and Stillson, 1978; Reichmann, 1978; Donovan, 1982].

Taking into account all this Killick (1984, p.265)
summarises the impact of IMF stabilization programmes
which consisted of demand oriented policies as follows :

- Some improvement in the current account, but
  not statistically significant.

- programmes have not generally had strong
  deflationary effects but there are indications
  that negative growth effects were stronger in
  the most recent years.

- they have complex effects on income distribution.

- there are indications that Fund programmes do result
  in a larger inflow of capital from other sources
  but the effect is not large.

This digression shows the kind of controversy
generated by demand oriented policies. As opposed to the
Monetarist views, 'Structuralists' stress on focus on
removing supply bottlenecks and other structural rigidities,
so that the overall output capacity can be raised. In
this way the excess demand would be reduced too. In
this view demand restraint is reflected in the short run
mainly in a drop in the domestic output, this drop in
turn acts to discourage investment which reduces the
economy's long run capacity to earn foreign exchange.

To the extent that an imbalance between demand
and supply in an economy results in undesired inflation
and payments deficits, structural improvements in
supply capacity are obviously more appealing way of
dealing with the situation than measures that simply
reduce the demand. (Crockett, 1981, p.56).

The main supply side measures that can be
employed in the context of stabilization programmes here
are those that tend to reduce price distortions, improve
the allocation of resources, and mobilize voluntary
savings (Crockett, 1981, Khan and Knight, 1982,
Khatkhate, 1983).

The distinction between demand side and supply side
policies and their appropriate roles in economic stabili-
zation must be clearly understood if they are to be
effectively combined. The primary objective of a supply
oriented stabilization programme as opposed to demand
oriented improvement in current account or overall balance
i.e. the expansion of aggregate domestic supply typically
involves heavy imports of both working capital and fixed
capital goods. So that current account does not improve .
Secondly while the demand side policies have a familiar
macro-economic character, supply side policies often

have micro-economic flavor. Also the latter work over a longer term horizon.

But the distinction between the demand side and the supply side policies can never be perfectly water tight. This is particularly true of measures like devaluation. It is both a demand side and a supply side policy to the extent that domestic absorption falls alongwith the fact that the incentive to produce tradeable goods increases.

Andrew Crockett[18] argues that a choice between two mutually exclusive theories does not have to be made. Level of aggregate demand and the economic structure within which that demand operates, both play an important role in exacerbating the Balance of Payment difficulty. However he later writes[19] that even though it is possible to reconcile monetarists and structuralist views, this possibility has not prevented a continuing discussion about the relative importance of excess demand and structural rigidities in generating inflation and causing payment difficulties. Differences in the analytical viewpoint on this issue have naturally been reflected in a debate on the appropriateness

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18   IMF Staff Papers, 1981 ,p.55.

19   Ibid, p.56.

of particular policies designed to achieve stabilization. Various external and domestic factors were discussed in the previous section.

The distinction and the analysis of their relative importance is significant for the following reasons : First and foremost the non-oil developing countries are not responsible for the Balance of Payment crisis in the 70's and early 80's as external factors which affected them were not within policy control. Secondly, continuing stress on curb on domestic expansionary policies by those, like the IMF, in a deteriorating external environment, to improve Balance of Payment and inflationary disequilibria, can have high costs in terms of increased unemployment and impair development. It has been argued that when exogenous factors come into the picture, the period of adjustment and the design of the policies in this case are liable to be different from the measures required to cope with excessive domestic money creation. Thirdly, protectionism in the export markets of developing countries, imposes limitations on the government in carrying out corrective measures. Fourthly it exposes the instability to which the open non-oil developing countries are vulnerable.

The second reason mentioned above needs further elaboration. Faced with a current account deficit of external origin or domestic origin a country can resort to External Finance. The problems attached to this were already discussed in the beginning of this section. It has been argued[20] more specifically in the context of temporary adverse external shocks, that they should be met with financing rather than adjustment. Adjustment policy can be a matter of choosing between unpleasant alternatives. Because to adjust to an adverse shock requires a cut in living standards and often turns out to investor some sacrifice of longer-run growth prospects as well clearly to incur these costs unnecessarily for a shock that is only temporary would be a mistake.

But trying to meet a permanent or long lived shock by financing, however, not only postpones the necessary adjustment but also makes that adjustment harder because of the additional debt accumulated during the intervel. But it is often unclear how sustained an external shock will turn out to be. Faced with that uncertainty, countries often opt initially for a mix of financing and adjustment.

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20   Paul Kruegman in Dombusch and Helmers,(ed.),p.14 p.66.

The IMF initially viewed the distinction between exogenous and endogenous causation as rather unhelpful and has preferred to emphasise the distinction between temporary and permanent payments problems.[21] Although this distinction is useful in identifying cases where adjustment is required, it does implicitly suggest that a design of the appropriate adjustment is largely independent of causation. However, when selecting the most cost-effective payment policy, causation is very important.

A cost effective programme is one which achieves the desired improvement in the BOP in ways that minimise any impairment of the government's ability to achieve its other socio-economic goals.[22]

But now Balance of Payment financing in the context of more supply oriented adjustment program (in economies ravaged by external shocks) is increasingly being recognized (at least in principle) both by the IMF (with its Extended Facility) (and the World Bank with its Structural Adjustment Loans).

Growth oriented adjustment - as it is referred to - is now receiving attention. New prominance has been assigned

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21   Killick, n.1, p.99.

22   Ibid, p.18.

to program lending, geared to medium and long term develop

mental objectives by the World Bank. (Helleiner, 1986, p.875).

The policies to be applied in a deteriorating external

environment too range from demand restraint to more supply

oriented structural Adjustment Measures (Paul Kruegman,1988,

Balassa, 1980). Recently growth oriented Adjustment is

medium and long term in perspective is increasingly being

recognized to meet BOP difficulties generated by external

shocks.

This has to do with the need for investment, external

resources and time, in a process of restructuring toward

increased export competitiveness and efficient import

substitution,

Chapter - II

BALANCE OF PAYMENT PROBLEM IN
TANZANIA, 1961-1984

Though paucity of data has been a constraining
factor, a very long period (1961-84) has been chosen for
the analysis of Balance of Payment trends and government
policy responses. The period chosen has been divided
into four sub-periods to facilitate detailed analysis.
In order to assess the impact of the deteriorating external
environment in the 1973-84 decade, it will be useful to
survey briefly the patterns of economic development in
the preceding decade.

Problem Free External Sector : Economic Indicators, Balance of Payment Trends and Evolution of Government Policy, 1961-67

In the first few years after independence Tanzania
had a relatively problem free external sector. The
dominant economic activity was agriculture which constituted
more than 50% of Gross Domestic Product (GDP). Industrial
sector constituted only 8.4% of GDP in 1967.[1] The GDP
figures indicated a compound rate of growth in market

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[1] Green, Ruegsire, Van Arcadie, Economic Shocks
and National Policy Making in Tanzania (New York
Pergamon, 1980, pp.1-5.

agricultural output (at constant prices) of 7.4% per annum over the 1960/2-1966 period. Growth in the monetary component of GDP was 5.2 per cent per annum in the same period.

The production structure was reflected in the trade pattern of the economy. At the outset the economy was characterized by heavy dependence on primary commodity export, openness - both in the sense of having high export and import to GDP ratios (Table 2.1) in this period and also in the sense of having import and foreign exchange policies that were not restrictive, and high degree of internal and external stability.

In the first six years after independence (1961-67) Tanzania ran trade surpluses. The current account balance was positive in 1963 and 64 and ran negligible deficits in the remaining years. (Table 2.1).

As far as the trade account is concerned, Tanzania's export pattern shows high degree of concentration in few primary commodities - sisal, coffee and cotton. Other primary exports which were important were cashewnuts, tea and tobacco. Diamond was the only significant non agricultural export.

Table 2.1

	1961	1962	1963	1964	1965	1966	1967
Merchandise exports (fob) mn US $ (a)	152.1	151.6	185.9	213.0	199.0	259.2	244.4
Merchandise imports (fob) mn US $ (b)	-128.4	-133.0	-136.7	-152.5	-167.4	-219.1	-212.5
Trade account (a+b) mn US $	23.7	18.6	49.2	60.5	31.6	40.1	31.9
Current account deficit (mn US $)	-	-4.9	18.1	31.6	-1.9	-6.0	-2.4
Current account deficit to GDP ratio	-	-8%	2.6%	4%	-.2%	-6%	-.2%
Share of major exports (sisal cotton) coffee) in total X's (in %age)	55.9	56.8	62.9	53.2	47.5	46.9	38.5
Import to1 GDP ratio (in %age)	-	-	-	18.04	19.8	20.8	19.2
Share of exports as a % of area (world) imports						.12	.11
Foreign exchange in US mn $						57	58
Non-gold reserves to imports ratio						13.4	14.3
Terms of Trade	126.6	138.4	144.6	133.9	114.4	113.3	105.9

Source: IFS Yearbook, 1988 ; World Tables, 1988.
IFS Supplement on Trade Statistics, various issues.

The export volume indices showed a continuous increase in export volume in this period till 1964. Exports fell by 8.3% in 1965 and 4.9% in 1967. The share of Tanzania's exports in world trade was very low in this period. The export unit value index maintained the upward trend till 1964 but declined later on. (Table 2.2).

Imports consisted of manufactured goods,mineral oils, machinary and transport equipment. By end use classification imports mostly consisted of non-food consumer goods in 1965 and 1966 but fell in 1967. The share of intermediate goods and capital goods increased in 1967. (Table 2.3)

Imports maintained an upward trend both in value and volume terms in this period (except for 1967). As a result the terms of trade which improved till 1963 declined afterwards. Thus in this period trade surpluses were accompanied by declining terms of trade.

In this period Tanzania's bulk of official foreign aid came from former colonial powers. As the table shows nearly all of the capital budget came from external sources. (Table 2.4). The data sources used does not contain figure on debt and foreign exchange reserves of

Table 2.2

	Annual % Changes						
	1961	1962	1963	1964	1965	1966	1967
Exports							
Value	-10.8	6.0	22.1	26.0	- 8.3	28.1	-4.9
Volume	- 7.7	4.7	6.2	24.7	4.2	28.1	-3.8
Unit value	- 3.4	1.2	14.9	1.0	-12.0	-	-1.1
Imports							
Value	.4	11.4	-	56.2	11.7	20.2	-3.4
Volume	4.6	7.1	-9.1	43.2	8.5	19.1	-8.6
Unit value	-4.0	-5.3	10.0	9.1	3.0	1.0	5.8

Source :   International Financial Statistics, (IFS)
            Supplement on Trade Statistics, various issues.

Table 2.3

IMPORTS : END USE CLASSIFICATION

	1965	1966	1967
Consumer goods	42.6	47.3	35.6
Food	9.0	9.4	9.2
Others	33.6	37.9	26.3
Intermediate goods	24.5	33.5	40.7
Petroleum products	6.0	6.4	8.7
Building and construction material	15.2	6.1	13.8
Others	3.3	21.1	18.2
Capital goods	32.9	19.2	23.7
Transport	30.7	7.4	8.3
Other equipment	2.2	11.8	15.4
Total	100.0	100.0	100.0

Source: Basic Economic Report on Tanzania, 1977.
The World Bank, Table 3.8, p.161.

Table 2.4

TANZANIA : GOVERNMENT CAPITAL BUDGET
SOURCE OF FUNDS (mn sh.)

	1961/62	1962/63	1963/64	1964/65	1965/66	1966/67
External loans	143.0	104.3	51.5	78.5	83.5	127.3
Internal borrowings	3.8	9.1	93.8	125.3	146.4	167.1
Total	146.8	113.4	145.3	203.8	229.9	294.4

Source: Kabokoko (1987), "Planning and Self Reliance in Tanzania, KPI, London and New York, p.183.

Tanzania. But the country presumably did not suffer from external debt problem. Therefore Balance of Payment problem as defined and as generally understood were largely inconsequential in this period. However, the typical dependence on a few primary products exports meant that the economy was subject to large fluctuations in foreign exchange earnings and vulnerable to secular decline in terms of trade.[2]

Price situation - which is the other indicator of macro-economics imbalance remained stable in the first half of 1960-70 decade.[3]

The post-colonial evolution of the economic structure was substantially influenced by public policy. This involved both efforts to develop an institutional framework appropriate for planned economic growth and a radical evolution in policy associated particularly with the major change in direction in 1967, following the Arusha Declaration.

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[2]   Green et al 1980.

[3]   Ibid. Dar-es-Salaam based wage earners, retail price index, which had registered on a 2% cumulative increase over 1961-65 period.

The first five year plan (1964-69) was a
conventional development plan with an emphasis on
industrial development largely through private
investment supported by government infrastructure
incentives, acceptance of dependence on foreign
initiatives and the development of agriculture largely
within the context of the existing structure of rural
economic organisation. However, some quantification
of social targets (such as increased life expectancy),
a series of fully-owned and joint venture parastatal
in several fields including banking and external sector
were launched, as initial steps towards building up
a significant public sector involvement in directly
productive activity.

As far as the external sector is concerned, the
economy was fairly open - as said earlier - and the
first major step towards a restricting the openness of
the economy was taken in 1965, when foreign exchange
control was introduced between East Africa on the one
hand and the rest of the world on the other. This led
to reductions in financial outflows and placed domestic
funds under some control of policy action. In 1966,
a Central Bank, the Bank of Tanzania was established

with powers to perform the associated conventional functions. Exchange control powers were transferred to it. In relation to exchange rate policy, the shilling was maintained at a fixed relation with pound sterling.

To sum up the developments in the period 1961-67, Tanzania's exports in this period mainly consisted of primary commodities and imports of essential consumer goods in this period. It was only towards the end of this period that Tanzania started importing capital goods.

The policies were also not restricted in this period and the economy was marked by high degree of internal and external stability. With this backdrop the turbulent years ahead can now be examined.

Onset of Problems : Balance of Payment Trends and Government Policy Response (1968-73)

The next sub-period chosen is 1968-73 as in this period for the first time after Independence earlier trends in Balance of Payments were reversed. Several authors (Green, 1980, Weaver and Anderson, 1981) have suggested that Tanzania suffered from a mini crisis in Balance of Payment in 1970-72, before deteriorating

external environment started playing an important role in the Balance of Payment problem. For them it was an 'endogenously generated' crisis which reflected underlying factors and long term trends.

In the last few years of 1960's deceleration in marketed agricultural output growth was observed. Over the period 1965/67 - 1970/72 the growth rate in marketed agricultural output had fallen to 35% per annum. Subsistence agricultural output growth rose. Overall G.D.P. growth was 4.9% in 1965/67 - 1970/72 period. Agriculture still maintained a high share in total output. The agricultural growth rate at 3.6% was ahead of population growth in the same period. Substantial food imports were thus not necessary in this period.

The manufacturing sector rose from low base and the value added grew by 10% in this period. The performance of the productive sectors was once again reflected in the trade sector. Exports diversified in this period due to diversification in production; But imports still consisted of manufacturing, and exports of predominantly primary commodities.

As far as balance of Payment was concerned, the performance was marked by a definite periodicity. Till 1969 **Balance** of Payment was relatively favourable. 1970-72 was marked by a crisis, 1973 was again relatively favourable. Trade account surplus shrank in 1968 and 1969 and turned negative from 1970 onwards. The trade and current account deficit registered large increases in 1971 and 1973 both in absolute terms and in terms of current account to GDP ratio (Table 2.5).

Imports registered a persistent upward trend in this period with trends in import to GDP ratio for this period higher than that of the 1961-67 period. (Table 2.5). The effect of gathering momentum of development activity is indicated by the fact that imports of manufactured goods (especially metal manufactures and of machinery) increased both in value and volume terms. Imports of manufactured goods maintained a very high share in total imports of this period. As the Table 2.6 of end use classification of imports shows the share of consumer goods fell as compared to the previous sub-period. The share of intermediate and capital goods rose.

Table 2.5

	1968	1969	1970	1971	1972	1973
Trade account in mn US $(a+b)	8.1	22.3	-37.6	-83.3	-43.6	-74.2
Merchandise exports(fob)(a)	238.0	240.4	245.9	262.0	316.2	363.6
Merchandise imports(fob)(b)	-229.9	218.1	-283.5	-345.3	-359.8	-437.8
Current account deficit	- 6.1	25.2	- 35.6	- 99.8	- 65.7	-107.5
Current account to GDP ratio	- .6%	2.2%	- 2.8%	- 7.3%	- 4.2%	- 5,8%
Share of major exports (sisal,coffee,cotton in Total X)	41.2%	37.1%	41.1%	31.6%	37.4%	40.7%
Import to GDP ratio	23.3%	20.7%	24.8%	27.8%	25.8%	26.55%
Budget deficit to GDP ratio	- 3.9%	-4.9%	-4.1%	-7%	-5%	-2.8%
Money supply growth rate	15.8%	17.9%	4.9%	19.3%	14.5%	19.2%
Foreign exchange reserves in US mn $	73	76	56	42	105	123
Non-gold reserves to import ratio (in weeks)	14.4	17.2	11.9	9.3	11.3	14.9
CPI changes (%)	15.8	17.9	4.9	19.3	14.5	19.2
Share of exports as % of total area (world)imports	.11	.09	.09	.08	.8	.06
Terms of trade	111.8	109.6	105.9	111.0	92.4	97.4

Source : Same as Table 2.1

Table 2.6

IMPORTS BY END USE CLASSIFICATION (%)

	1968	1969	1970	1971	1972
Consumer goods	39.8	37.5	30.3	25.3	28.8
Food	8.9	8.7	7.7	6.7	11.5
Others	30.9	28.9	22.3	15.6	7.2
Intermediate goods	37.2	40.6	40.4	44.6	45.9
Petroleum	9.1	10.2	8.5	9.4	10.4
Building and construction material	7.7	8.2	9.2	11.7	12.7
Others	20.3	22.2	22.7	22.9	22.8
Capital goods	23.0	21.8	29.6	30.7	25.4
Transport equipment	8.2	6.8	8.1	9.0	6.7
Other equipment	14.7	15.0	21.5	21.7	18.6
Total	100	100	100	100	100

Source: Same as Table 2.3.

Overall import volume index rose in 1970 and 1971 substantially (26.7% and 22.0%). The import unit value index registered persistent increase throughout the period (except 1968 and 1971) with large increases registering in 1973 (27.1%) (Table 2.7). This movement in value and volume of import led to increase in import bill.

Corresponding to this export volume index showed substantial rise only in 1972. The export unit value index also registered large increase only in 1973 The share of 3 major export crops (corfee, cotton, sisal) in total exports fell as compared to the previous period. There was an expansion in the output of a number of secondary commodities (cashewnut, tea and tobacco). Uptil then the export performance was rather poor. (Table 2.8). Aid in this sub-period was higher than in the previous sub-period. (Table 2.9). Prior to 1974, Tanzania made no use of (IMF) Fund facilities.

Since Tanzania maintained a recurrent budget surplus and except for a brief period in 1970-72 relatively low rates of growth of domestic credit formation, as well as fairly adequate reserve levels with external debt financed largely by concessional transfers, The IMF missions were thus not very critical.

Table 2.7

	Annual % changes					
	1968	1969	1970	1971	1972	1973
Exports						
Value	- 4.3	2.2	2.3	6.4	20.9	13.5
Volume	- 3.2	2.2	1.1	3.6	25.8	-15.2
Unit value	- 1.1	-	1.2	2.8	-3.9	33.9
Imports						
Value	12.0	-6.4	32.7	19.6	5.8	23
Volume	19.6	-8.2	26.7	22.0	-8.4	-3
Unit value	-6.4	1.9	4.8	-2.0	15.4	27

Source: IFS Supplement on Trade Statistics,
various issues.

Table 2.8

%age Change in Three Major Export Crops (Value & Volume)

	1968	1969	1970	1971	1972	1973
Volume						
Coffee	9.0	0	-9.4	-20.7	55.0	9.3
Cotton	3.8	-10.2	7.3	-10.9	18.5	5.7
Sisal	-7.6	- 8.9	26.9	-26.0	4.7	25.9
Value						
Coffee	4.2	4.0	33.3	- 9.4	10.3	18.7
Cotton	10.2	9.2	0	8.1	16.9	4.8
Sisal	-13.6	10.5	9.5	0	10.5	109.5

Source: Same as Table 2.7.

Table 2.9

FOREIGN AID(mn.sh.)

	1967-1968	1968-1969	1969-1970	1970-1971	1971-1972	1972-1973*
External loans	81.5	122.7	121.5	269.7	347.4	635.9
External grants	2.5	0.1	0.4	0.1	37.8	110.7
Total foreign aid	84.0	122.8	121.9	269.8	385.2	746.6

* Estimates

Source: Same as Table 2.4, Table 8, p.27.

The foreign exchange reserves came down from US $ 76 million peak in 1969 to US $ 46 million in 1971. The Cover provided by the reserves to weeks of imports fell dramatically to 2-3 months in 1970-71. (Table 2.5).

The Tanzanian shilling was fixed to US $ (1 US $ = 7.143 shilling). The money supply growth rate was very high in the crisis year 1971 (19.3%) (Table 2.5) and so was the Budget deficit to GDP ratio (7%). Prices maintained an upward trend. By conventional standards there was little price inflation to worry about but this coupled with developments in the Balance of Payments was causing concern.

The developments suggest that deterioration in the Balance of Payments in 1970-71 period could be because of increase in volume and value of imports (above previous period trends) when exports earning and aid were insufficient to contribute to import capability. The fiscal and monetary expansion in this period too put pressures from the demand side in an economy where supply side was rather weak.

Four lines of explanations are given of the deterioration in the external balance (Green, et al, p.9).

Firstly there was a rise in government investment and
developmental activities. Imports of metal, of metal
manufacture and of machinery and transport equipment
increased between 1969-71. Second, a number of short-
term problem of administration and decision-making
weaknesses are said to have contributed to deterioration
of Balance of Payments. The third explanation claims
that the difficulties emerging before 1973 were indicative
of underlying failures of strategy and policy and there-
fore had long-term implications. In particular the
failure of output growth to accelerate in response to
the impressive expansion in capital formation and a
tendency for the services sectors, inducting public
services, to grow faster than overall GDP, could be argued
as indicating low level of effectiveness in the investment
programmes. The fourth source of difficulty suggested
was poor export performance. There was little by way
of a strategy and no sense of urgency with regard to the
need to diversify the export base and to promote new
exports.

In response to the economic difficulties
which emerged after 1970, there was a development of
new policy tools,[4] including the introduction of foreign

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4   Weaver and Anderson, Stabilization and Development
     of the Tanzanian Economy in the 1970's, in Cline and
     Weintraub (ed.) 1981, "Economic Stabilization in Developing Countries"
     The Brookings Institutions, Washington D.C.

exchange budgeting through import licencing (it was
transferred to Bank of Tanzania) and exchange control.

The government secured the services of a Swiss
firm to monitor prices for key exports and imports. A
credit budgeting system was initiated involving domestic
lending by commercial banks and central banks. The
government began regulating the uses made of surpluses
earned by all public enterprises and strengthened the
role of price commission (NPC) in setting prices and
established a new trading structure to handle domestic
and international trade (e.g. Board of International
Trade, National Milling Corporation, etc.).

One of the important effects of the policies was
to check the growth of import bills. The quantity of
imports fell from 1971 to 1972, although the import
values rose as import unit values rose in this period.
(Table 2.5). However, there was a recovery in the
growth of export volume in 1972 (Table 2.5). As a result
the negative balance on current account was reduced
from -99.8 US $ to -65.7 $ a level at which the balance
on capital account was sufficient to allow a substantial
accumulation of reserves.

By 1973 reserves had reached upto US $ 123 million.
Also Tanzania could finance 3-4 weeks of imports from
official reserves. The capital flight which was taking
place in 1970-71 (indicated by large size of net error
and omission in 1970 and of non-loan capital in 1971)
was curbed as a result of effective exchange control
measures particularly with respect to movements to
Kenya.

To summarize the situation at the end of this
sub period, the Tanzanian economy was emerging from a
difficult period. It had not incurred a large burden
of external debt, and while its export performance was
not very impressive its underlying balance-of-Payments
situation did not look particularly worrisome.

A Brief Record of Overall Economic
Performance (1974-77)

The overall growth of G.D.P. since 1973 has been
put at 4% per annum. With the population growing by
around 3.3% per annum, this implies an increase in per
capita G.D.P. of only 0.7% per annum. There was a change
in the structure of the economy away from the productive
monetary sector and towards subsistence and service
activities. Excluding public administration, commercial
services and trade, the monetary sector grew only by
2.3% per annum during 1973-79, well below the population
growth rate.[5]

Agriculture continued to be the dominant sector
in the Tanzanian economy, accounting for a fairly stable
40% of the G.D.P. at 1966 prices, and paid 80% of export
earning. Public administration the fastest growing
sector at 1966 press, has increased its share of G.D.P.
from 11% in 1966 to 17% in 1979. Since 1973, mining,
manufacturing transport and communications have all
declined in relative importance and together accounted
for only 21% of the G.D.P. in 1979.[6]

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5   Tanzania Country Economic Memorandum, (CEM)
     The World Bank, 1981.

6   Ibid.

Subsistence agriculture grew at 7.1% per annum
and monetary agriculture by only 2.1% per annum. As a
result, the marketed production of major crops sold
through official channels actually fell during the 1970's.
A number of underlying trends in crop production can be
discerned. Firstly there has been a shift in the annual
crops away from cotton and into maize. The production
of minor cereals and beans, tobacco and sugar increased
in this period. The production of cotton, coffee, sisal,
cashews and cloves, however, declined.[7]

Tanzania had a small industrial base at the time
of independence. There was really no well defined
industrial strategy until the Arusha Declaration in 1967,
after which greater emphasis was placed on expanding the
role of the public sector and reducing dependence on
foreign investment. This general direction of industrial
strategy was clearly drafted in the Basic Economic
Strategy (BIS) in the mid 1970s. The BIS gave priority
to industries supplying minimum mass consumption needs
and producing intermediate goods entering into a wide
range of industrial products. Preference was to be given

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7   Ibid.

to industries using local inputs and geared to the requirements of the domestic market, although the role of agricultural processing for export was also recognized.

Despite the adoption of this strategy, the performance of the industrial sector has continued to deteriorate. From 1973 to 1979, the manufacturing value added grew by only 1.7% per annum in real terms. (CEM 1980). The poor performance of the industrial sector was reflected in a rising incremental capital output ratio. Despite the emphasis on the development of the industries producing capital and intermediate goods, the dominant activity remained the production of consumer goods: by the mid-1970's, basic consumer goods - viz. food processing, beverages, tobacco, cotton, textiles and shoes - still accounted for more than one-half of value added and two thirds of employment in manufacturing. Manufactured exports steadily declined, while import content of manufacturing continued to rise. (CEM, 1981). The weakening of productive sectors hence reflected on Balance of Payments.

On the demand side both budgetary deficits and money supply increased in the crisis year 1974/75 and then gradually declined in 1976/77. (Table 2.10). The growth of the government sector since 1967 has been

dramatic. Total central government budgetary expenditures
as a proportion of GDP increased from 17 per cent in
1965/66-1966/67 to 33 per cent in 1974/75-1975/76 according
to the Basic Economic Report on Tanzania, (1977). The
responsibilities of the government grew due to the 1972
decentralization. Aside from general administration and
defense, the main services provided by government are
education, health, water supply, high ways and agricultural
extensions. The Basic Economic Report identified as a
growing problem, the high proportion of recurrent
expenditure going for personal emolument (61% in 1973/74
and 74% of the budgeted figure for 1975/76). The freeze
on wages since then has reversed this trend and this
component has dropped to 42% in 1977/78.

Balance of Payments

Despite the emergence of an external constraint
over 1970-72, Tanzania had not yet experienced a major
Balance of Payment crisis, and by 1973 it could be seen
as having weathered that period's difficulties. But by
the end of 1973, the country was seen as entering a
difficult phase, as far as Balance of Payments was
concerned. In 1974 the Tanzanian economy was buffetted
by an economic crisis of unprecedented proportions.
The following indicators will reveal this.

Tanzania suffered persistent trade account deficits since 1974. There was a quantum jump in 1974 over the 1973 figure but the deficit reduced significantly in 1976-77.

Table 2.10

	1974	1975	1976	1977
Trade account in mn US $ (a+b)	-261.2	-297.1	- 65.2	-108.2
Merchandise ex exports(FOB)(a)	399.2	372.9	490.4	538.6
Merchandise imports(FOB)(b)	-660.4	-670.0	-555.6	-646.7
Current account deficit	-285.3	-230.0	- 34.5	- 71.4
Current account deficit/G.D.P.(in%)	- 12.8	- 8.9	- 1.2	- 2.0
Share of major exports in total exports (in%)	45.6	39.2	58.02	12.6
Imports/GDP (in %)	33.6	30.03	21.9	21.34
Share of exports in total world imports	.05	.05	.05	.05
Non-gold reserves/ imports (in weeks)	5.6	3.6	6.6	16.3
Foreign exchange in mn US $	46.9	67	106	263.4
Money supply (% of change)	24.3	23.4	26.0	19.3
CPI change (in %)	19.2	26.5	6.9	11.6
Budget deficit(in%)	- 5.4	- 9.8	- 7.4	- 3.0
Terms of Trade	107.3	89.7	109.4	117. 9

Source: Same as Table 2.1.

There was a very large increase in the value of imports in 1974 (51.6%). The unit value index of imports registered a 46 per cent increase in 1974 over 1973. The volume of imports increased only by 4%. (Table 2.11). There was a fourfold increase in the price of oil in the world market in 1974. The effect of oil price increase was not only direct, indirect effects on other import prices such as shipping rates, plastics and fertilizers, also took their toll. The increase in petroleum prices and, the general world inflation in manufactured capital goods raised average import prices for Tanzania. Due to rise in value terms the share of petroleum in total imports increased from 10.8% in 1973 to 18.5% in 1974. (Table 2.12) Other categories which showed large increases in value terms were chemicals and fertilizers, manufactured goods machinery and transport equipment.

Late in 1973 the rains failed in several regions. By 1974 the drought had intensified and the output of maize, paddy and wheat fell. To bridge the yawning foodgrain deficit the government was compelled to import large amounts of foodgrains in 1974 much of it at the

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8   'Weaver and Anderson, h.4 _

Table 2.11

PERCENTAGE CHANGE

	1974	1975	1976	1977
Exports				
Value	9.8	-7.7	18.0	15.3
Volume	-31.8	6.7	9.0	-16.9
Unit value	61.0	-13.5	8.3	38.7
Imports				
Value	51.6	3.2	-17.9	16.6
Volume	3.7	-.2	-7.6	2.3
Unit Value	46.2	3.4	-11.1	13.9

Source: Same as Table 2.2.

Table 2.12

Trade by Commodity Sections (%age of Total)

	1974	1975	1976	1977
Exports				
Food Beverage Tobacco	36.4	53.0	58.6	67.2
Raw material fuel	39.0	28.2	24.6	20.5
Fuels	10.5	5.6	4.3	3.2
Manufactured	14.0	13.0	12.1	9.0
Imports				
Food, beverage, tobacco	18.3	18.0	8.1	8.7
Raw material fuel	3.7	3.9	5.8	4.3
Fuels	18.5	10.8	18.6	13.3
Manufactured goods	59.5	67.8	67.5	73.7

Source: Same as Table 2.3

Table 2.13

MAJOR FOODGRAIN IMPORTS

	1973	1974	1975	1976
Maize volume (in quintals)	34,950	2,535,451	2,995,113	1,556,470
Value in shilling	2,513,324	351,893,850	285,731,051	66,411,314
Wheat volume (in quintals)	-	600,215	1,571,562	30,761
Value in shilling	-	95,938,345	161,243,698	4,769,584
Rice volume (in quintals)	80,582	711,896	639,813	87,923
Value	10,230,979	267,779,276	239480904	25,315,870

Source: Green, Rwegsire, Van Arcadie, Economic Shocks and National Policy Making in Tanzania (New York, Pergamon, 1980), pp.1-5.

Table 2.14

TOTAL RECEIPTS (in mn.of 1980 US $)

	1974	1975	1976	1977
Aid	148.87	332.97	331.65	393.36

Source: Paul Collier, Aid and Economic Performance in Tanzania, 1988, p.25.

higher commercial prices then prevailing in the world
markets. The bulk of 1974-75 food imports was made up
of maize, wheat and rice (Table 2.13).

Due to rise in several import categories the
import to GDP ratio in this period increased. (Table 2.10)
But the import bill in 1974 behaved quite differently
from the moderate increases in the total import quantities
because of the price increases of food grains and
petroleum products.

The export value increased but the export volume
(index) fell in 1974. The increase in value came mainly
from increase in unit prices. The drought also took toll
of Tanzania's exports. Export volume of coffee, cotton
and sisal declined by 31.6%, 16.5%, 18.7% respectively
and overall export volume declined by 31.8 per cent
(Table 2.11).

The share of Tanzanian exports in total world
exports declined as compared to the previous sub-periods.
(Table 2.10). This decline coincided with the sharpest
increase (61%) in export unit values in Tanzania's
history, an increase resulting from the massive surge in

world commodity prices in 1974.   -   The decline in export volumes sharply curtailed Tanzania's benefits from the world primary commodity price boom. The outcome was that despite the huge increase in the export prices, exports value index grew only by 9.8% between 1973-74. (Table 2.11).

On the rest of the current account there was considerable improvement. The effect of services and net transfers were positive and made the current account deficit smaller than the trade deficit in 1974. (Table 2.10). And this current account deficit was financed by a massive depletion of foreign exchange reserves and recourse to IMF drawings.

In 1975 imports rose in value terms. Unit value index rose by 3.4% and volume fell marginally by0.2% Food imports continued to be heavy in first two thirds of the year taking off in the latter third as the improved weather in 1975 together with the government's exhortative campaign to "grow more food or die" began to show results. Despite extremely tight controls on all other categories of import volume below the 1974 level, the total import bill increased by 3.2% due to the import price rise. (Table 2.11).

The decline in export in 1975 resulted from
significant falls in unit prices of major export commodities.
Export values fell by 7.7%. The unit value index fell by
13.5% and volume rose by 6.7% (Table 2.11). Out of the
major export crops there was a 12.7% decline in the
price of sisal and the volume index of cotton fell by
27%. (C.E.M. 1981)

As a result of these movements the trade deficit
widened to $ 297.1 mn. in 1975. However, heavy inflow
of grant, assistance food aid and improvement on services
account kept the current account deficit from widening.
The deficit was met through increased disbursement on
project related aid and a massive infusion of programme
assistance including a $ 30 million World Bank programme
loan, further IMF drawing and multilateral assistance
from the Arab Fund for Africa including multilateral
and bilateral grants. (C.E.M., 1981).

In the remaining two years of the sub-period
(1976,77) the effects of the drought were gradually
reversed and the higher price of oil and oil derivatives
were becoming background factor in a new trading
situation. In 1976, the value of imports declined (in

absolute terms and in terms of import to GDP ratio).
The fall was both in volume (7.0%) and value (11.1%)
terms (Table 2.10). This was brought about by the decline
in food grain import from 18.1% in 1975 to 8.1% in 1976 .
The import of manufactured goods (share) remained at the
same level and that of fuels increased (Table 2.12).

The exports on the other hand rose in both unit
value (8.3%) and volume terms (9%). Among the major
exports there was a dramatic improvement in volume and
unit value index of coffee (14 8%) and cotton (38.5%).
Sisal, however, registered a decline both in volume and
value terms. The share of Tanzania's export in total world
imports, however, remained the same. Terms of trade
improved in 1976. (Table 2.10).

These trends continued well into 1977, the
terminal year of this sub-period. Imports rose more than
exports widening the trade deficit. But aid increases
in this 1975-77 period leading to a current account
deficit smaller than the trade deficits. The rise in the
import bills was mainly due to the rise in unit values
rather than volumes. The export volume fell but prices
improved dramatically leading to improvement in terms of
trade. (Coffee prices rose by 92%, cotton by 24% and
sisal by 20%). The foreign exchange reserve position

improved dramatically by 1977 and the crisis mood was
disappearing.

The prices in this period showed increase, especially
in the crisis years 1974-75. The consumer price index
rose by 19.2% and 26.5% respectively. (Table 2.10).
In the remaining two years the rate of increase fell
(6.9%, 11.9%) as compared to the crisis years.

Alternative Hypothesis of BOP Performance

For the Balance of Payment crisis of 1974-75
both external and internal factors were held responsible.
The quadrupling of oil prices in 1973 added to the import
bill. This difficulty was compounded by the drought in
1974 which resulted in a drop in grain production in a
period of rising foodgrain prices. The rise in the
import is captured by the terms of trade effect, which
certainly worsened in 1974-75 period. Other forms of
external shocks which we know from the previous chapters,
are the slowdown in the growth of world trade and rise
in interest rates. In 1974, Tanzania was 'ranked' third
in the list of most severely affected economies. (Greenⱼₕ
'IMF conditionality). There was a halt to increase in
real per capita aid in 1974-75.

The external shocks that Tanzania suffered were estimated by several authors. We list two such studies. Balassa and Mac Carthy (1983) put the external shocks/ GNP ratio for Tanzania at 0.9%. The terms of trade effect was most important.

External stocks	TOT effect	X-volume effect	i rate effect
Tanzania 1974-78 average	101	-6	5

In the Helleiner study (1986) in the 1973-75 period the observed deficit increase was estimated at 2% of GNP. TABLE 2.7 The unfavourable external shock was put at 4.6% of the GNP. One would gather from existing literature that the country was buffeted by unfavourable terms of trade and recessionary external shocks in the 1973-75 period. The trends reversed in 1978 when the economy was hit by favourable shocks.

However several internal problems were also pointed out. Balassa (1983) for instance argues that 'Tanzania experienced internal shocks in the form of economic disruptions resulting from government policies' in this period.

Michael Lofchie (1976) also blames the economic policies of the government for the economic crisis of

1970s. He does not accept the argument that the severe drought continued in 1974. He presents data to support his argument that in 1974 rainfall was well within normally adequate amounts. The cause of the crisis was a series of bad policies - primarily the attempts to establish communal agriculture in the Ujamma villages (1973) and the failure to encourages production of traditional export crops.

A third line of thought suggests that the crisis was primarily brought on by drought. Villagization played some role, but it is hard to quantify the impact. It accepts that there was no effort to increase exports, and in fact export volume fell as resources were shifted from export crops to food crops in response to the problem of food imports. This exacerbated another problem i.e. sluggish exports. Hence role of both external, internal factors is highlighted in the worsening of the Balance of Payments in 1974-75.

In the 1976/77 period the economy was hit by 'favourable shocks' in the form of higher coffee prices. Tanzania's major export and return of good weather. The aid position also improved as a lagged response to the 1974/75 crisis. (Green et el.).

Government Policy Response
and its Impact

The general approach taken was heavily influenced by the goals of socialism and self-reliance, the avowed objective of the Arusha Declaration. Specifically, the government attempted to shield the weaker groups in the society from the costs of stabilization while continuing the development programmes. The authors of the UNDP[9] study have laid out the policy instruments of the stabilization programme.

The policy instruments on the demand side ranged from fiscal and monetary to exchange rate changes. Restrictions on credit increases were imposed but the money supply grew in this period and the government argued that the expansion of the money supply was an effect of the increase in import prices and higher producer prices for food. A moderate curtailment of public investment, particularly of infrastructure projects with long gestation periods was enunciated but the government was not successful in showing the growth of government expenditure, deficit financing and heavy borrowing from banking sectors.

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9 as reported in the article by weaver and Anderson in n.4.

The main instrument, however, was import control.[10] In mid 1974 the government increased import controls on consumer goods (excluding food) and industrial raw materials. As the crisis worsened, import licencing was tightened even more significantly. Gasoline and electricity prices were allowed to rise to reflect increased costs, and food prices were increased. One year wage freeze was imposed after the increase in 1974.

Tanzania devalued its shilling by 11% in October 1975, but the UNDP authors point out that this should be seen as related more to the domestic management operations than to international balance considerations.

On the supply side, the goals of the government were to increase the output and expand export earnings and production of non traditional exports. The major policy instruments used were : increase in producer prices for food crops and redirecting government investment. The government restructured its development budget by redirecting its expenditure to the directly productive sectors such as agriculture, industry and mining.

The government also sought to mobilize external finance. In 1974, Tanzania received commitments of loans

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10   Dell and Lawrence (1980) too list Tanzania among
        the countries which met the 1974-75 crisis by cut
        in the imports.

on soft terms and also multilateral assistance, but
there was a surge in disbursement only in the 1975-77
period. From 1974-75 to 1976-77, Tanzania utilized its
special drawing rights (SDRs), gold tranche, first credit
tranche, oil facility and compensatory financing facility.
Drawings and trust fund credits were about $ 75
million, or 7% of total external resource transfer over
this period (but about 17.5% in 1974-75).

These were all low conditionality facilities
available on demonstration of balance of payment need.
Negotiations over 1975-76 towards a second credit tranche
drawing petered out early in 1977. There were differences
over appropriate Domestic Expansion (DCE) ceilings,
with Tanzania arguing that the proposed IMF trigger level
would abort sustained recovery of real output by
preventing adequate expansion of productive working
sector capital.[11]

To sum up the developments in the 1974-77 period
it can be suggested that overall economic performance
was passing through rough weather and so was the Balance
of Payments. Imports in this period rose in value terms

[11]   Green, R.H., "Political-Economic Adjustment and
        IMF Conditionality : Tanzania, 1974-81", in
        Williamson (ed.), IMF Conditionality, 1983.

as well as volume terms (due to increase in food imports)
Exports volume index however showed poor performance.
And despite tremendous increase in unit value index
in 1974 and 1977 the economy, because of weak supply side,
(reflected in poor export performance) could not cash on
the export price boom.

According to the existing literature the
economy was buffeted by both external and internal problems.
The government policy response ranged from import control,
Monetary and fiscal controls on the demand side and price
incentive to agriculture sector (food crops) on the
supply side. It   resorted to devaluation and tried
to mobilize external finance.

The Balance of Payment situation started showing
improvement in the rest two years of the sub-period but
it is argued that it could have not been possible without
the lagged aid increase (in response to 1974-75 crisis)
and coffee price boom.

CRISIS REVISITS : BALANCE OF PAYMENTS IN
TANZANIA -- 1978-84

A Brief Overview of Overall Economic Performance

In this period the economy was pushed further into crisis and successive years of Balance of Payments problem. The economy was beset by major problems of falling production in agriculture and industry. Per capita GDP fell by more than 10% over 1980-82. The worrisome trend was the decline in output of the productive sector. Over 1978-82 output in agriculture fell by 2.8% and in manufacturing by 16.6%. On the other hand output in services continued to grow at 5.8%. Trends in National Accounts with other data on falling exports and crop procurement indicate a continued trend of the shift of output away from the monetary to the informal economy.[12]

Agriculture continued to dominate the economy, accounting for 50% of GDP and 80% of export earnings. But after 1978 the per capita agricultural production did not keep pace with the population growth. Out of the food crops, marketed output of maize increased but that of rice

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12   Figures have been taken from Country Economic Memorandum, 1984.

and wheat fell. The performance of export crops has been poor. Out put of cashews, cotton and sisal has declined steadily over the decade of 70's. Coffee and tobacco output have stagnated, but there has been some growth in tea and pyrethrum production.

The manufacturing output fell from 10% to 5% of GDP over 1979-82 period. Consumer goods industries dominate the structure of production and a considerable degree of import substitution has been achieved in a number of industries, but the industrial sector is still dependent heavily on imported inputs.

Balance of Payments Trends

During 1978, liberalisation of imports was attempted on a broad front in line with the 1977-78 and 1978-79 foreign exchange plans. The plans were aiming at reducing the earlier compression of imports, thus stimulating continued growth to allow restoration of real personal consumption and to create the capacity for export expansion. The impact on balance of payments was drastic.

Trade account deficits were especially large in 1978 and 1980 and so were the current account deficits

Table 2.15

	1978	1979	1980	1981	1982	1983	1984
Trade account in mn US $ (a+b)	-516.5	-415.0	-581.5	-372.2	-539.1	-333.5	- 38.7
Merchandise exports (FOB) mn US $ (a)	476.0	545.7	507.7	689.1	412.9	318.7	372.9
Merchandise imports (FOB) mn US $ (b)	-992.5	-960.7	-1089.1	-1061.3	-951.0	712.2	-758.6
Current account deficit	-473.3	-346.5	-433.7	-171.9	-380.9	-196.0	-214.5
Deficit/GDP (in %)	- 11.3	- 7.8	- 8.5	- 2.9	- 6.1	- 3.9	- 3.8
Share of major exports in total exports (in %)	50.9	47.9	41.6	47.1	47.9	55.2	53.8
Imports/GDP (in %)	27.3	25.0	24.47	19.8	18.03	12.9	15.2
Fiscal Deficit/GDP (in %)	- 6.0	- 11.4	- 9.6	- 7.5	- 9.5	- 6.4	- 5.2
Foreign exchange reserves in mn US $	89	63.3	20.8	16.5	4.4	19.2	27.6
Non -Gold Reserve to Import Ratio (in weeks of imports)	8.0	3.7	2.6	1.0	.5	.7	1.4
Money supply changes (in %)	13.5	39.2	30.6	22.4	4.3	14.3	8.5

Table 2.15 continues...

	1978	1979	1980	1981	1982	1983	1984
CPI Changes (in %)	11.3	13.8	30.3	25.6	27.1	27.1	35.3
Terms of Trade	109.2	114.7	100.0	-	-	-	-
Share of exports in total imports (world)	.4	.03	.03	.03	.02	.02	-

Source: Same as Table 2.1.

Table 2.16

% Change	1978	1979	1980	1981	1982	1983	1984
Exports							
Value	-6.0	4.4	2.8	11.1	-21.0	-17.0	-8.8
Volume	- 7.0	5.0	-12.9				
Unit Value	1.4	-.6	18.0				
Imports							
Value	53.8	-3.4	13.8	-6.5	-3.8	-29.1	-15.3
Volume	25.6	-13.3	-2.0				
Unit Value	22.4	11.3	16.2				

% Change in Total Exports

	1978	1979	1980
Exports			
Food, beverage, tobacco	63.5	58.3	55.9
Raw materials excluding fuels	21.6	19.2	23.5
Fuels	2.3	3.3	4.9
Manufactured goods	12.5	19.1	15.6
Imports			
Food, beverage, tobacco	5.7	3.5	12.1
Raw materials excluding fuels	3.8	3.1	2.7
Fuels	11.1	13.8	21.0
Manufactured goods	79.4	79.5	64.2

Source: Same as Table 2.1.
Note : Data sources used did not contain figures
         for period beyond the 1980.

in absolute terms and as a percentage of GDP. The
current account deficit however declined in the latter
part of this sub-period. (Table 2.15).

Imports registered a large increase in volume
terms (25.6%) in 1978, however, in 1979 and 1980 volume
of imports fell (Table 2.16) -- The unit prices retained
the upward trend. Fuel imports registered maximum
increases due to price increase (share rose from 13.8%
in 1979 to 21% in 1980). Manufacturing goods imports
share which were 79.4% in 1978 fell to 64.2% in 1980.
The country imported all its oil and capital goods
requirement. In addition it had to import substantial
quantities of food grain as a result of drought in
1980-81. In this period, food imports amounted to 10%
of the total imports. In 1979 there was a second round
of oil price increases, In Tanzania there were successive
droughts. All the above factors are said to have
contributed in the rise of import bills in this period.
Since 1978 there has been cut down on certain categories
of imports especially on manufactured goods and chemicals.

Exports volume declined in 1978 and 1980 mainly
due to decline in volume of major exports, cotton, sisal,

coffee. This trend continued till 1984. However unit
value index which fell in 1980-82 period rose subsequently. The
Share of Tanzania's exports in total world imports also
fell in this period (Table 2.15 and 2.16).

Although Tanzania's export structure is somewhat
more diversified than before(seven commodities -- coffee,
cotton, cloves, sisal, fibre and cordag and twine),
cashews (nut & kunels), tea and tobacco -- still accounted
for more than two thirds of the total export earnings in
1980. Export of these seven commodities fell. Cloves,
sisal and cashews recorded the sharpest falls while
coffee and cotton made the largest contributions to the
overall decline in export volumes. The only major
commodities to rise were tea and tobacco. (CEM, 1984).

The disappointing performances of Tanzania's
major primary exports reflects the generally declining
production of cash crops from the mid-60's and especially
since 1973, production of cotton, sisal and cashewnuts
has fallen over this period. While coffee production,
has fluctuated without any increase in the trend. Only
production of tea and tobacco has risen substantially
over the past decades.

The effect of aid was to reduce the current

account deficit but since 1978 the volume of aid has stagnated in nominal value. According to Paul Collier (1988, p.23) in the 1970's Tanzania has been among the highest recipients of aid per capita in the world. But aid flows which rose rapidly in the 1970's fell rapidly in the 1980's. He argues that the aid boom was largely endogenous to Tanzanian policies, which first induced an upsurge in receipts and then induced donar discouragement.

Two political stance adopted by President Nyerere probably account for Tanzania's successful increase in its market share during the 1970's. His effective leadership of the Frontline states made the country inter nationally influential and attracted aid. His domestic policy shift, particularly the post-Arusha Declaration commitment to poverty alleviation, self reliance and socialism appealed to the Scandivian countries and led to a surfiet in aid. Both these phenomena were intrinsically trans itory. After the Zimbabwe settlement President Nyerere became less influential internationally and during the 1980's Scandinavism countries became more cautious about their aid policies. Also the severe deterioration in the economy of the early 1980's caused a disillusion in the donar community.

To finance the increased current account deficit after the second oil shock, Tanzania increased its reliance

on supplier's credit financing, drew down reserves and began to accumulate external payment arrears. Despite the support from doners and cut backs in the volume of imports by 32% between 1977-82 Tanzania has exhausted its reserves and has accumulated arrears on import payments. (CEM, 1984).

The arrears on its medium and long term debt, the build up of supplier's credit obligation, the need to make repurchases to the IMF and the fact that many loans incurred in the early 1970's began to fall due, contributed to an increase in debt service payments from $ 50 mn. in 1979 to $ 150 million in 1982 and an increase in the debt service ratio from 10% to 20% over this period. If repurchases from the IMF are included, the debt service ratio rises to 25% in 1982. Arrears on MLT debt were estimated at $ 55 million in 1983. (CEM, 1984).

The reserve position was quite comfortable at the end of 1977. Gross reserves stood at over $ 300 million or five months of imports; by the end of 1978 they had fallen to less than two months of imports. Since then the reserve position has deteriorated further - at the end of 1983 gross reserves stood at $ 19.2 million or five days of imports.

Prices since 1979 accelerated to around 28% per annum as measured by the National Consumer Price index But the actual estimates of inflation may be underestimated because of a thriving informal sector in the economy. (CEM, 1984).

Alternative Hypothesis of Sources
Balance of Payment Problems

Both external and domestic factors were held responsible for the Balance of Payments problem in Tanzania for this period. The external shocks include four years of drought, the rise in the price of energy, the break up of the East African Community (EAC) -- which meant that Tanzania had to build and pay for whole new structure of civil aviation, locomotive repair shops, an earth satellite for the telecommunication system and a central service for posts and telegraphs; the costs of the Ugandan war, the collapse in commodity prices and the rise in the price of essential imports. (CEM, 1984). Estimate for the external shocks and domestic policy responses are given in the following Table. (2.17)

Among the domestic factors the 1978 liberalization of imports were held responsible for the 1978 deficit increase which led to foreign exchange reserves falling to about $ 89 million. For the decline in agricultural exports

Table 2.17

DECOMPOSITION OF SOURCES OF EXTERNAL SHOCK
AND DOMESTIC POLICY RESPONSE IN TANZANIA 1978-82

	1973-75	1973-78	1978-81
Observed Deficit Increase	2.0	4.0	-3.0
External Shocks:			
Total	4.6	-3.6	8.9
Terms of Trade	3.4	-3.4	8.8
Interest Rate	-0.1	-0.1	0.2
World Trade	1.3	-0.1	-0.1
Other external variables	-3.7	-3.7	1.0
Domestic Policy Action			
Total	1.2	11.6	-12.7
Domestic Spending			
Consumption	-0.2	2.2	-2.6
Investment	-0.9	0.2	0.4
Export Ratio	-2.6	12.7	-5.4
Import Ratio	-2.1	-3.6	-5.2
Residual	0.0	-0.2	-0.2

Source: G.K.Helleiner, World Development, 1986.

structural and incentive problems in the sector were held responsible. Fiscal trends deteriorated in this period mainly due to the Ugandan war of 1978/79. Trends in the budget closely reflect the deterioration in the external account with which they are interrelated.

Policy Response

Attempts were made to resolve the crisis. First through the National Economic Survival Programme (NESP) (1981-82), then through the structural Adjustment Programme (1982-85).

The government formulated NESP in 1981 aimed at reviving exports and increasing industrial output from existing capacities. However, at the end of the period most targets of NESP were not achieved. If anything most variables (e.g. exports, industrial output) moved in the opposite direction to the one projected.

The Structural Adjustment Programme (1982-85) was formulated by a team of foreign and local experts and it addressed the issues of restructuring economic activity and rehabilitation of the economy. As a result of SAP the following major actions were taken :

(i)   The agricultural policy was formulated, discussed and adopted in 1983. This resulted in greater attention to agriculture in terms of increased allocation, increased

producer prices, introduction of cooperative and marketing
boards in place of crop authorities and prompt payments
to farmers at the time of crop procurement.

(ii)   The fast growing public administration and expendi-
ture were addressed in comprehensive studies carried out
by the Presidential Commissions, one on the parastatal
sector and another on government expenditure. The results
of these studies led to the rationalization of several
parastatal and disbanding of others and to restructuring
of government ministries and cutting various expenditures
by the government.

(iii)   Export incentive schemes were designed with a view
to increasing exports. The rebate scheme, export retention
scheme, export credit guarantee, concessional interest
rates for production of exports, etc.

(iv)   Devaluation of the shilling (12 in 1982 to 17 in
1985 shilling to US $), decontrol prices of several items
as administering of prices was creating difficulties.

The measures outlined above mainly addressed to
the supply side.[13]

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13   Samuel Wangwe in Kjell, J. Havnevic (ed.),

"IMF and World Bank in Africa", 1987.

On the demand side, the data for Tanzania reveal
a pattern identical to that of other low-income sub-
Saharan economies with the burden of Adjustment falling
heavily, On import, The 1982 level of imports was not
sufficient for the normal functioning of the economy
(70% of what it was in 1970).

The demand pressure generated via the fiscal
deficit is mainly attributed to the growth in expenditures
in the form of transfers to cover the operating losses
of the parastatals. As the government was successful in
containing the growth in the wage bill by holding down
the growth of public sector employment and freezing
wages and salaries. High development expenditures are
also not the cause of high deficit increase as they
declined in this period. Money supply also increased in
this period.

As far as relation with IMF is concerned, the
period 1977-78 was marked not only by relatively relaxed
relations but also by IMF (and World Bank) advice to relax
foreign exchange budgeting (import allocations by category
and major user). This advice was adopted in 1977 as the
beverage boom began to recede, and the relaxation was
maintained through much of 1978 although the external

balance turned sharply negative. The period of 1974-76 had been marked by severe import compression (perhaps 30-40%) in relation to GDP in real terms). Some import relaxation was needed - and some was begun in 1976 in respect to industrial and agriculture import and spares. But the 1977 advise was for import levels that could not possibly have been sustained unless the beverage price boom was viewed the new norm, Across the board liberalization filtered away substantial sums on non priority consumer goods imports.

In early 1979 an interim program was agreed, involving use of the balance of the fund credit tranche, compensatory facility drawing, and trust fund resources Devaluation was recommended. Negotiations over a programme consisting of devaluation nominal wage freeze, abolition of price management, higher interest rates and relaxation of import controls broke down in 1980.

Further negotiation in 1981 over an extended facility reached a deadlock. The IMF policy package was a standard one with devaluation, increase in interest rates, wage freeze dismantling of price control, domestic credit ceilings and reduction in real government recurrent expenditure.

The Tanzanian side argued that devaluation and
interest rate adjustment were irrelevant to the current
account balance in real terms, as import reduction was
undesirable and barriers to increasing exports, at least
in the short and medium runs. It doubled the fiscal
gain from devaluation because its analysis suggested
rapid cancellation by inflation and a potential built
in spiral effect.[14] These issues will be further
discussed in detail in the light of the findings of
this study later on.

Thus at the end of this period the economy
faced crisis in the external sector which as suggested by
the existing literature could have been because of external
and domestic factors as hypothesized in the existing
literature.

The economy tried to meet the crisis by supply
side and demand side measures and had bitter relation with
the IMF. The decline in aid and severe import control, as
suggested in the literature were two worrisome trends.

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14   Green R. in Williamson (ed.), "IMF Conditionality",
        1983, pp.357-60.

ANALYSIS OF EXTERNAL AND INTERNAL CAUSES :
1973-1984

The present chapter attempts at an analysis of external and internal causes in the 1973-84 period. The external sector was fairly problem free in the 1961-73 period. Problems on the external account emerged only since 1970. This was discussed in the previous chapter. Alternative hypothesis of the causes of BOP worsening in 1968-73 period were also elaborated. But the 1961-73 period only serves as a back-drop. And it throws some light on the long term, underlying trends in the economy. In the 1973-84 period the Balance of Payments difficulty of the country grew and the present chapter restricts the analysis to this period only. This period is also of greater interest because external factors emerged compounding the Balance of Payments difficulty in the country.

To analyse the causes, first a decomposition model is used to reveal the movements in both external and domestic explanatory factors and how they had affected the current account position in this period.[1]

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[1] The decomposition model has been adapted from G.K. Helleiner, "Balance of Payments Experience and Growth" Prospects of Developing Countries : A Synthesis, World Development, 1986, pp.877-908.

In the methodology employed in this study external
factors are categorized as terms of trade deterioration,
interest rate shocks and retardation of world trade
growth. All are measured as percentages of actual GNP.
A further determinant of the current account position is
the burden of accumulated debt, the impact on the current
account of the increase in external borrowing since the
last accounting period, this too is expressed as a
percentage of GNP (and forms a part of the 'other external
variables').

Domestic policy responses are divided into
changes in 'domestic spending' and changes in trade
ratios — The former are made up of the consequences of
reduction in gross investment and in aggregate
consumption, and the latter of Changes in export ratios (national export
shares in world markets) and those in the import ratios
(import coefficient of domestic spending)—and are
expressed as a percentage of actual GNP. Allowing for
interaction terms and errors, the sum of the measures
of external shocks, other external variables and domestic
policy response should add up to the actual changes in
the ratio of the current account deficit to GNP.

The Decomposition of the Deficit on Current Account*

The current account deficit (including unrequited transfer) at time t, in domestic currency, is initially expressed as the difference between imports of goods and non-factor services (NFS), M, plus net factor services to abroad, V, and exports of goods and NFS, E, plus net unrequited transfers from abroad T :

$$D(t) = M(t) + V(t) - E(t) - T(t) \qquad (1)$$

Imports and exports are then expressed as the product of price and volume indices (the latter in constant 1980 domestic currency prices):

$$M(t) = Pm(t), J(t) \qquad (2)$$

$$E(t) = Px(t), X(t) \qquad (3)$$

Data are not generally available for a decomposition of import coefficients. Hence, an overall coefficient (j) is assumed to relate the import volume to real domestic absorption (A), which is divided into real consumption plus real gross domestic capital formation :

$$J(t) = j(t), A(t) \qquad (4)$$

$$A(t) = C(t) + I(t) \qquad (5)$$

L.A.Vita and E.Bacha, World Development, 1986, pp.902-93.

An overall export coefficient relates the export volume to the real value of world trade (W):

$$X(t) = x(t) \cdot W(t) \tag{6}$$

Net factor services to abroad are divided into net interest to abroad (V_i), other net investment income to abroad (Vd), and net worker's remittances from abroad (R). Net interest in domestic currency is then expressed as the product of the current dollar interest rate (percent per year) (r) multiplied by the net stock of foreign debt at the end of the previous year (F) with the latter expressed in domestic currency by use of the current year average domestic currency/dollar exchange rate:

$$V(t) = Vi(t) + Vd(t) - R(t) \tag{7}$$

$$Vi(t) = r(t) \ F(t-1) \tag{8}$$

If (2) - (8) are substituted in (1) and the result divided by GNP in current domestic prices (division by potential GNP not being possible owing to lack of appropriate data), the e results :

$$D(t)/Y(t) = j(t) \ pm(t) \ \underline{/}\ C(t)/Z(t) + I(t)/Z(t)\underline{/}$$
$$+ r(t) \ F(t-1)/Y(t) + Vd \ (t)/Y(t)$$
$$- R(t)/Y(t) - x(t) \cdot px(t) \cdot W(t)/Z(t)$$
$$- T(t)/Y \ (t) \tag{9}$$

where national income in current prices is equal to
the product of real national income and the implicit
deflator of GNP :

$$Y(t) = Py(t) . Z(t) \qquad (10)$$

and where

$$pm(t) = Pm(t)/Py(t) \qquad (11)$$

$$px(t) = Px(t)/Py(t) \qquad (12)$$

The final formula is obtained taking first differences in
equation (9)

$$d(D(t)/Y(t)) = j(s) . (C(s))/Z(s) . dpm(t)$$

$$+ j(s) . I(s)/Z(s) . dpm (t)$$

$$- x(s) \frac{(X(s))}{Z(s)} . dpx(t) + \frac{F(s-1)}{Y(s)} . dr(t)$$

$$- x(s) px(s) \frac{d(W(t))}{Z(t)} + r(s) \frac{d(F(t-1))}{Y(t)}$$

$$+ \frac{d(Vd(t))}{Y(t)} - \frac{d(T(t))}{Y(t)} - \frac{d(T(t))}{Y(t)}$$

$$+ j(s) . pm(s) . d(\frac{C(t)}{Z(t)}) + j(s) pm(s) . d(\frac{I(t)}{Z(t)})$$

$$+ pm(s) . \frac{(A(s))}{Z(s)} . dj(t) - Px(s) . \frac{(W(s))}{Z(s)} . dx(t)$$

$$+ \text{interaction terms}$$

where the symbol d before a variable indicates the change
in the value of this variable between each year in the 1973-78
(or 78-84) period and the 1973 (or (1978)) base year, and

where the symbol   s   indicates the year for the weights of
the decomposition terms. Equation (13) was calculated
three times,   s   being respectively the current year the base
year and a simple average of the two. The results reported
above are those employing the average of the current year
and the base year.

With the changes of signs appropriate to their
demomination, the terms in (13) are identified in worksheet
by the following expressions :

Variation in the current account deficit ratio to GNP
between final year and base year (1973 or 1978) = terms of
trade deterioration + interest rate shocks + retardation of
world trade growth + buroen of debt accumulation + change in
airect investment income - change in worker's remittances -
change in unrequited transfers + consumption contraction
+ investment reduction + import replacement - export
penetration + interaction effects and adding up errors.

In the Table 3.1 and 3.2 the burden of debt accumulation
and changes in direct investment income, worker's remittances
and unrequited transfers were consolidated as "other external
variables".

Symbols and Data -

The data for the variables entering equations (1-10)

came from country pages or World Bank, World Tables and IMF financial statistics. They are as follows :

M - Imports of goods and NFS at current domestic currency prices (DCP).

V - Factor payments to abroad (net) at DCP. (Taken from World Tables directly).

E - Exports of goods and NFS at DCP.

T - Net current transfers from abroad at DCP.

D - Current account deficit including transfers at DCP. Calculated according to equation (1).

J - Imports of goods and NFS at 1980 DCP.

X - Exports of goods and NFS at 1980 DCP.

Pm= Domestic current price index of imports with 1980 = 1.0.calculated according to equation (2).

Px- Domestic currency price index of exports with 1980 = 1.0.calculated according to equation (3).

j - Import content of domestic absorption at 1980 DCP calculated according to equation (4).

C - sum of government and private consumption at 1980 DCP.

I - Gross capital Formation at 1980 DCP.

A - Gross Domestic absorption at 1980 DCP. Calculated according to equation (5).

W - World exports of goods and services expressed in ___. 80 DCP.

Taken from IMF-IFS Annual Yearbook 1986 in billions of current dollars and changed into 1980 dollars by using US GNP deflator (1980 = 100) and in%DCP by the use of the conversion factor (dollar/shilling exchange rate)for 1980).

x - Market share in world exports at 1980 DCP. Calculated according to equation (6).

Vi- Net interest payments to abroad in DCR, taken directly from World Bank World Tables.

R - Net worker's remittances from abroad at DCP (World Tables).

Vd- Net direct investment income to abroad at DCP. This was calculated as the residual in equation (7).

(γ)-Dollar rate of interest. Calculated implicitly as the ratio between interest payments in year (t) and debt outstanding - disbursed at the end of year t-1, (World Tables).

F - Net foreign debt at the end of year.

$(t-1)$ expressed in domestic currency by use of the average domestic currency/dollar exchange rate in year t. Calculated implicitly using equation (8).

Y -GNP at DCP.

Z -GNP at 1980 DCP.

Py-Implicit GDP deflator $(= \dfrac{Y(t)}{Z(t)})$

Results of the decomposition exercise are reported in Table 3.1 and 3.2.

Table -31

DECOMPOSITION OF SOURCES OF EXTERNAL SHOCK AND DOMESTIC
POLICY RESPONSE IN TANZANIA (BASE YEAR = 1973)
(As percentage of actual GNP)

Explanatory Factors	1974	1975	1976	1977	1978
Total of all external* factors	.74	.82	-7.25	-10.19	-9.33
Terms of trade deterioration	7.42	5.95	1.86	.5	- .08
Interest rate shocks	-.06	-.11	-,15	-.29	-.37
Retardation of world trade growth	-6.62	-5.02	-8.96	-10.4	-8.87
Burden of accumulated ‡ debt and other external variables like changes in direct investment income workers remittance and transfer payment	-1.96	-3.84	-2.0	-3.18	-3.55
Domestic Policy Action†	13.13	6.42	6.37	13.08	18.74
Domestic Spending ‖ — Gross Investment	1.0	.05	.35	1.39	1.04
Domestic Spending — Consumption	.96	.79	-,34	-.34	1.79
Trade Ratios §					
Export ratio ‖	14.05	9.79	13.96	20.49	18.65
Import ratio ∼	-2,88	-4.21	-7.6	-8.46	-2.74
Total of all explanatory variables	11.9	3.42	-2.8	- .3	5.86
Adding up error and interaction terms	-5.4	- .99	-3.2	-6.0	- .73
Observed deficit increase	6.5	2.43	-6⌀	-6.3	5.13

Table 3.2

DECOMPOSITION OF SOURCES OF EXTERNAL SHOCK AND DOMESTIC POLICY
RESPONSE IN TANZANIA AS PERCENTAGE OF ACTUAL GNP
(Base Year-1978)

Explanatory Factors	1979	1980	1981	1982	1983	1984
Total of external shocks	1.55	-13.95	-15.81	-15.48	-15.08	-17.79
Terms of Trade deterioration	3.87	-10.87	-13.83	-14.58	-12.22	-10.69
Interest rate shocks	.2	.28	.12	.13	.04	-.05
Retardation of World trade growth	-2.52	-3.36	-2.10	-1.03	-2.9	-7.05
Burden of accumulated debt and other external variables like changes in direct investment income, worker's remittance and transfer payments	-.28	2.44	4.67	3.18	3.49	3.67
Domestic Policy Action	-3.91	11.15	5.15	2.372	1.08	8.82
Domestic spending						
Gross Investment	.38	-.57	-.18	-.068	-.67	-1.0
Consumption	-1.48	2.28	.75	.59	.40	1.6

Table 3.2 continues...

Explanatory Factors	1979	1980	1981	1982	1983	1984
Trade Ratios						
Export ratios	2.70	4.0	.3	2.28	5.75	11.65
Import Ratios	-5.51	5.44	4.28	-.43	-4.4	-3.43
Adding up Errors and Interaction Terms	.22	1.12	2.06	5.5	4.25	2.42
Total of All Explanatory Factors	-2.64	-.34	-5.99	-9.92	-10.51	-5.31
Observed Deficit Increase	-2.42	.78	-3.93	-4.42	-6.26	-2.89

Notes to Table 3.1 and 3.2

- ✗ A positive sign denotes an adverse external shock, such as a terms-of-trade deterioration, an interest rate increase, or a deceleration of world trade. A negative sign denotes a favorable external shock.

- ≠ A positive sign denotes an unfavorable movement of other external variables, such as a net accumulation of foreign indebtedness between the beginning and the end of the period. A negative sign denotes a favorable movement of other external variables.

- † A positive sign denotes a deficit-increasing policy action. A negative sign denotes a deficit-reducing policy action.

- ‖ A positive sign denotes an expansion of domestic spending, which increases the deficit. A negative sign denotes a contraction of domestic spending, which reduces the deficit.

- { A positive sign denotes a movement of the trade ratios which increases the deficit. A negative sign denotes that the trade ratios moved to reduce the deficit.

- ‖ A positive sign denotes a reduction of the exports to world trade ratios. A negative sign denotes an increase of the export ratio.

- ⌐ A positive sign denotes an increase of the import content of domestic spending. A negative sign denotes a reduction of the import ratio.

note: above signs hold for TABLE 3.2 too

1973-78 Period

The first group external shocks is subdivided into terms of trade deterioration, interest rate shocks, and retardation of world trade growth. The terms of trade deterioration takes into account both changes in export and changes in import prices. The terms of trade deterioration takes into account both changes in export and changes in import prices. The terms of trade deterioration as a percentage of actual GNP was 7.42 and 5.95 per cent respectively. Terms of trade became less unfavourable in 1976 and 1977 and subsequently became a favourable shock. The effect of export price change was negligible because of low share of Tanzanian exports in world exports.

Change in interest rates also had a favourable impact on current account position in this sub-period as is evident from the table. The effect, however, was small.

As far as the retardation of world trade term is concerned the ratio of Tanzania's exports to actual GNP is expressed as a product of the ratio of country's exports to world exports, multiplied by the ratio of world exports to actual GNP. (All variables in constant prices, 1980,DCp). Thus the variation in the ratio of Tanzania's exports to actual GNP can be written as the sum of two components, one

related to changes in the ratio of Tanzania's exports to
world exports and the other to changes in the ratio of world
exports to Tanzania's actual GNP. It is the latter which is
designated as the retardation of world trade growth effect
in Table 1. (The former appears as export deepening among
the domestic policy actions in the table). From the table
it is evident that growth of world trade was a favourable
factor for Tanzania throughout the period (1974-78) as
compared to the base period.

The second group of factors consist of only one
component - other external variables which comprise of
burden of accumulated debt, changes in direct investment
income, worker's remittance and unrequited transfers, which
also were favourable for Tanzania's current account. Major
component of this was high unrequited transfer that the
country was receiving in this period. Tanzania is not a big
debtor nation hence debt burden does not pose problem. The
burden of accumulated debt   measures the deterioration
in the services account explained by an increase in the
(end of past year) debt to actual GNP ratio. This effect
is calculated on the assumption of an unchanged interest
rates, as the effect of the latter are captured by the

interest rate shocks in the first group of factors. The
burden of accumulated debt was of small magnitude and
was largely offset by increase in net unrequited transfer
- the other component of 'other external variables'.

If other external variables are taken into account
we see that in this sub-period Tanzania enjoyed favourable
shocks. The major unfavourable external shock was terms
of trade deterioration which led to rise in import prices
of Tanzania's major imports. But this trend also reversed
and became favourable by 1978 according to Table 3.1.

The total domestic policy actions were unfavourable
to the current account, as compared to the 1973 base year.
As far as domestic spending is concerned, in this period,
from Table 3.1 we can see that Tanzania did not cut down on
investment, which is essential for long term development in
an economy which is dependent on imports in directly
productive sectors like agriculture and industry.

Domestic consumption cut however took place in 1976-
78 period. This could be because of cut in foodgrain
imports (effect of 1974 draught was reversed) and some
inessential consumption goods due to restrictive policies
of the government mentioned in the previous chapter.

As far as trade ratios are concerned, export ratios
$(X(t)/W(t))$ were unfavourable through out due to insufficient
expansion of Tanzania's exports in the 70's as compared to
world export growth. This was also mentioned in the
previous chapter. Tanzania's exports as a percentage of
total world imports declined or remained the same in this
period. (Chapter two). Since the share of manufactured
export is very little in total exports the explanation for
poor export performance must be sought in the performance
of agriculture and primary products which form the bulk of
exports.

The import ratios however moved in a favourable way
for the current account (Table 3.1). Tanzania was listed in
some other studies (for example Dell and Lawrence, 1980)
as a country where severe import controls were resorted to
improve the current account position. In terms of table 3.1
the import ratio measures import replacement by a reduction
of the import coefficient in the production of domestic
output. The sum of the effects of external shocks, accumulated
debt burden, and domestic policy action is equal to the
observed variation in the ratio of the current account
deficit to actual GNP after allowance for interaction
effects and adding up errors (Table 3.1.).

The 1978-84 Period

The next sub-period analysed is 1978-84 with 1978
as the base year. The results obtained from the decompo-
sition exercise are tabulated in Table 3.2. The observed
deficits declined in this period as compared to 1978
base year for several years, Tanzania experienced favourable
external shocks mainly due to favourable terms of trade,
as compared to the year 1978. World trade growth also
formed a favourable factor for Tanzania's Balance of
Payment in this period. The country experienced unfavourable
interest rate shocks but its magnitude was not very high.
This was coupled with the unfavourable movements in the
'other external variables'. The major component of this
variable was transfer payment which declined as compared
to the 1978 base year. (Not reported separately here).

The unfavourable impact of domestic policy action
was reduced in this period as compared to the previous
sub-period. Unlike the previous sub-period gross invest-
ment declined and consumption rose in this period.
Tradability ratios showed reduction in unfavourable
movement in export ratio in this period. Import ratios
were adverse in 1980 and 1981 but declined and became
favourable later on. It should be pointed out that the

results reported above are different - both in magnitude
and in the direction of movement of the explanatory factors
- from the Helleiner study which employs this model. The
results of the Helleiner study were reported in chapter two.
The results reported in their study was for changes between
base year 1973 (1978) and final years 1975, 1978, (1981)
for Tanzania. In the present study changes in deficit
ratios and explanatory variables were calculated between
each year in 1973-78 (1978-84) period and the 1973 (1978) base.
The external debt of Tanzania too increased in this period.
This has already been discussed in detail in chapter II.
The results of the decomposition conform to those trends.

Other variables, which highlight some important
trends, fall in the realm of domestic policy. As far as
the domestic spending actions are concerned. In the 1973-
78 period the domestic consumption declined but investment
increased. The investment increase contributes to the
worsening in current account but in an economy like Tanzania
which depends on the imports for development, this trend
is not undesirable from the viewpoint of long term develop-
ment.

The trends in consumption and investment spendings,
however, reversed in the 1978-84 period. This reveals the

fact that the country resorted to investment cuts rather than consumption cuts for the improvement of the current account position. So called 'adjustment' according to Helleiner (1986, p.901), that restores external balance by abandoning ultimate objectives, is not so much adjustment as retrenchment. The compression of investment spending is harmful for the long term economic development of the country.

Several authors claim that the country was unable to improve its export performance in the 1973-78 period. This is captured by the unfavourable export ratios in our decomposition model. However, in the 1978-84 period there was a reduction in the magnitude of this unfavourable trend. Import ratios moved in a favourable direction in the 1973-84 period reflecting the severe import controls that the economy was maintaining in this period.

The above mentioned trends have been analysed in the Tanzanian context elsewhere and the decomposition exercise conforms to those observations.

Few limitations of the above exercise however can also be pointed out. The above factors were expressed

as a percentage of Real GNP ratios than potential GNP.
Helleiner (1986, pp.885-86) points out that an economy
which depends on the import of certain essentials, due to
foreign exchange constraint investment and output may fall
below the potential implicit in the existing stock of factors
of production and other inputs. The methodology employed
in this study which uses actual and not the potential GNP -
does not allow for the possibility of under utilization of
capacity because of foreign exchange scarcity. The author
however further points out that in the analysis of the
impact of recent shocks and policy responses the distinction
between actual and potential GNP is not crucial.

The decomposition exercise only reveals movements in
explanatory factors thought to have been important in
determining the current account balance. The underlying trends
are, however, not revealed. For instance this framework shows
that the export performance deteriorated in Tanzania but no
light is thrown on the factors responsible for it.

A further attempt is made, to identify the underlying
factors and trends responsible for the current account position.
Causal factors suggested by alternative hypotheses, both
regarding the third world countries and the Tanzanian
context form the basis for this.

The analysis in chapter two and the decomposition exercise is descriptive and aggregative in nature. The purpose of the regression analysis is to examine empirically the influences of external and domestic factors on the evolution or the current account deficits in Tanzania.

For the purpose of this exercise the Khan and Knight (1983) model was used to test the relative importance of domestic and external factors. This simple model introduces five domestic and external factors independently as the principal explanatory variables and has the following general form.

CA/X = f (TOT, DYIC, RRI, RER, FP/Y, T).

where

       CA   = Current account balance (excluding
              official transfers).
       X   = nominal exports or goods
       TOT = Terms of Trade
       DYIC = Growth of real GNP in industrial countries.
       RRI = Foreign real interest rate.
       RER = Real effective exchange rate index.
       FP   = fiscal position (revenue minus expenditure).
       Y   = Nominal G.D.P.
       T   = Linear time trend.

One would expect an improvement in the terms of trade or an increase in the growth rates of industrial countries

to result in an improvement in the current account, while a rise in the foreign real interest rate or an appreciation in the real effective exchange rate would lead to worsen it. (The export variable (X) is used only to scale the current account balance to make it comparable across countries). The time trend variable is assumed to capture the effects of other factors, both external and domestic, on the current account. The following specific form of the equation was utilized.

$$(CA/X)_t = a_1 \log TOT_t + a_2 DYIC_t + a_3 RRI_t +$$
$$a_4 \log RER_t + a_5 (FP/Y)_6 + a_6 T$$

Basic data in Tanzania's case, were obtained from IMF, International Financial Statistics (various issues), and World Bank, World Tables 1988. The variables CA and X are in current U.S. dollars; TOT is the ratio of the export price index to the import price index, (1980 = 100) and was obtained from the World Bank, World Tables. RRI is six-monthly LIBOR rate.

RER is the index of the number of units of domestic currency per unit of foreign currency multiplied by the ratio of a foreign price index (WPI in the U.S.) to the domestic price index (CPI in Tanzania). DYIC is growth rate of real

GDP in industrial country. FP/Y is the ratio of

government revenues minus expenditures to nominal GDP.
LT IS LINEAR TIME TREND.

[In the Khan and Knight study, for each country

the variables CA and X are in current U.S. dollars;

TOT is the ratio of the unit value of export

to the unit value of imports, both

expressed in terms of the U.S. dollars, RRI is the

three-month Eurodollar deposit rate adjusted for

changes in the individual country's U.S. dollar export

price index, RER is calculated using 1977 import

weights and the relevant consumer price indices, and

FP/Y is the ratio of government revenues minus expendi-

tures to nominal GDP. Data was obtained from Inter-

national Financial Statistics (various issues).]

Equation of the following form was tested

for the purpose of this study: (Table 3.3)

$$(CA/X)_t = b_1 \log TOT_t + b_2 DYIC_t + b_3 RRI_t +$$

$$b_4 \log RER_t + b_5 (FP/Y)_t + b_6 LT$$

Table 3.3

TANZANIA : RESULTS FOR CURRENT ACCOUNT BALANCE (1973-84)

FP	Log(RER)	Log(TOT)	DYIC	RRI	LT	R^2	$\overline{R}^2$	SEE	D.W.
6.176	251.882	-173.371	6.289	-2.518	8.749	.35	-.44	43.36	2.22
(0.78)	(0.59)	(-0.54)	(0.54)	(-0.37)	(0.453)				

Note: Dependent variable is current account to X ratio. T-values are
presented in parenthesis below the coefficient, R^{-2} is the adjusted
coefficient of determination, and SEE is the standard error of
estimated equation.

The above equation (nearest in form to the Khan and Knight model) did not yield significant results in Tanzania's case. So an attempt was made to test equations which were based on the alternative hypothesis specific to the Tanzanian economy. From the analysis in the previous chapter, which was based on existing literature, the following factors were chosen and their significance in the evolution of current account balance was tested. These range from external factors to domestic demand side and supply side factors.

External Factors

Tanzania is a predominantly primary producing and exporting country. So the terms of trade movements and growth rate in industrial countries are expected to have a strong positive relationship with the current account balance (X-M). It was not a major debtor, so the movements in real interest rates are assumed to be of little significance to the current account balance. The country was a recipient of concessional finance from unilateral and multilateral sources. And along with export earnings, it was a major determinant of its import capacity. The changes in the magnitude of the concessional finance can therefore have a strong impact on the current account. The weather related phenomenon like droughts

were also claimed to have exerted an adverse impact on
the current account balance. Other minor external shocks
to the economy were the EAC breakdown in 1979 and the
Ugandan war in 1978. The above factors were mentioned
in chapter two. Here some are analysed separately in
greater detail, as they try to capture the causal factors
discussed in the existing literature.

Terms of Trade

The vulnerability of Tanzania to fluctuations in
the world market prices can be seen in the structure of
its imports and exports. Throughout the period under
consideration, a few non-fuel primary commodities dominated
the export structure of Tanzania. (Tab.2.10-8). Manufactured
                                              2.15
goods accounted for a very low share in its exports.
Quite obviously, declines (rise) in primary commodity
prices will undermine (improve)   prospects for generation
of foreign exchange for a country like Tanzania.

Tanzania imported a few primary commodities in
this period. Major import categories were machinery
and transport equipment and other manufactured goods, and
fuels. The fuel price shocks in 1973 and 1979 and
its indirect effect on other prices were argued to have
had an adverse impact on the current account balance.

The movements in the export and import prices can be captured by the terms of trade between non-fuel primary products and fuel. This index captures the price movements which were relevant for a primary goods exporter and net fuel importer like Tanzania.

Growth Rate in Industrial Countries

Due to the existing export distributions, growth rate in industrial countries also exert an impact on the current account balance. World recession reduces the demand and prices of its exports. By analogous reasoning a recovery in the world economy will have the opposite impact. This kind of effect is important also because of the market distribution of Tanzania's exports. Majority of Tanzania's exports go to the industrial countries.

Together with terms of trade growth rate in industrial countries can be hypothesized to have exerted a strong impact on the current account balance of Tanzania.

Concessional Finance

After exports, the major contribution to Tanzania's import capability is from concessional finance. Almost all the borrowing was carried out by the public sector and was related to the development programme The main sources of government borrowing have been multilateral institutions, especially the world bank; OECD government and China and the bulk of the borrowing has been on concessionary terms. As late as in 1982, the average terms of commitments were maturities of 31 years and interest at 4% per annum. (CEM, 1984).

Net transfers have been strong since 1977 averaging $ 130 million annually and grants have been around $ 90 million per annum. The burden was further eased when a number of donors cancelled all or part of the principal payments due in response to an agreement at UNCTAD in Geneva on debt relief to the poorest countries. The situation changed markedly after 1979. To offset the decline in aid flows -- discussed in chapter two -- from official government sources, Tanzania for the first time incurred loans from suppliers credits and commercial banks. These loans had maturities of 7-10 years including one year's grace and interest rate of 9%. (CEM, 1984)

It also began to accumulate arrears on its medium and long term debt. The export earnings are insufficient to support import requirements. The inadequacy of concessional finance in filling up this gap will imply that the economy will be compelled to place control on the imports. This,as we know from chapter one,is an undesirable method of improving the current account. The movements in this external variable will,therefore,exert a strong impact on the current account in the Tanzanian case.

Of particular interest is the adequacy of loans and grants in providing a cover to the imports. The ratio of loans and grants to imports will exert a favourable impact on the current account when loans and grants increase in r ation to the imports. A decline in this ratio will be unfavourable for the current account position by analogous reasoning.

Domestic Factors

Apart from external factors, domestic factors - both from the supply side and demand side - are also said to have played a very important role in determining the current account balance. From the demand side, three variables have been picked up. They are Fiscal Position, Real Exchange Rates and Import Control Measures.

Fiscal Position

As we know from chapter one fiscal expansion can lead to current account worsening. In Tanzania since the Arusha Declaration and especially since the onset of the second five year plan in 1970 the role of the public sector has been increasing.

The period since 1976/77 saw a very high budget deficit due to government borrowing to finance the war with Uganda in 1978. Since then the fiscal situation has remained critical. The trends in the budget are partly a reflection of the underlying weakness in the economy but they also reflect a preference on the part of the government to use it as a policy instrument. In order to increase incentives to producers of export crops, government abolished taxes on exports. To maintain revenues the government resorted to increased sales tax rates on commodities

such as beer, tobacco, soft drinks and sugar. Also income
taxes were kept high on the other hand, the government
increased budgetary transfers to export crop parastats
instead of adjusting the exchange rates. Recurrent expendi-
tures were moderated largely by restricting wage increases.
The total recurrent expenditure, however, have continued to
rise, due to inflation. Consequently, the government's
efforts to restrain total expenditure have fallen heavily
on the development budget.[2]

Real Exchange Rates

For most of the 1970's the Tanzanian shilling retained
a stable relationship with the U.S. dollar ranging between
7.5 to 8.2 T sh/US $. In January 1979 the shilling was
devalued by 10% against the SDR. Further devaluations took
place in March 1982 and June 1983 of 10% and 20% respectively.
Between 1970 and 1978 Tanzania's real effective exchange
rate was relatively stable vis-a-vis its major trading
partners, according to IMF staff estimates. Since 1979
higher inflation in Tanzania has caused the real effective
exchange rate to appreciate by 70-80%.[3]

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2   Tanzania, Country Economic Memorandum, 1984.

3   Reported in Country Economic Memorandum on Tanzania.1984

It has been pointed out that the government has tried to realign the internal incentives structure (for the producers) without significantly changing the nominal exchange rates. (World Development Report). Another line of thought suggests that since the country operated both import controls and selective indirect taxation as part of overall planning, devaluation was not necessary either to limit imports or to reduce demand.

Import Control Measures

Over the past decade, adjustment to the disequilibrium in the balance of payment has largely taken the form of a severe cut back in import volumes. The volume of imports increased by 15% between 1970 and 1974, fell back by 17% between 1974 and 1977 and rose again briefly in the following year. However, since 1978 the volume of import has steadily declined. In 1982 the volume of imports was 32% below its 1978 level.[4] Since the share of oil imports could not be further reduced and the share of capital goods imports was determined by aid flows, the cut back on import fell heavily on imports of manufactured goods and chemicals. This

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4   As reported in CEM, 1984.

suggests that the share of manufactured goods in total

imports can capture the impact of import control measures

on the current account deficit.

Supply Side Variables

The country's rigid production structure and the

low overall supply elasticity in agriculture is often

said to reveal its supply side weakness. Weak production

structure can adversely affect the Balance of Payments.

Tanzania is a primary producing nation with a high share

of agricultural sector both in total output and in exports.

Domestic policy actions affecting agricultural output

especially of export crops can have an impact on the Balance

of Payment situation.

Two such factors have been mentioned in chapter two.

They are relative price movements between non food crops

and food crops, and the share of investment on agriculture,

In a response to the 1974 crisis which necessitated large

foodgrain imports, (Table 2·13). the government raised

the producer price for the food crops. This worsened the

relative price between export crops and the food crops.

The farmers moved out of export crops, into food crops. The

output of some export crops, notably cashews, cotton and
pyrethrum fell. Coffee production also stagnated. The
effect of this variable can also exert some influence on
the current account by affecting the production of export
crops.[5]

The government in response to the balance of payment
crisis of 1974/75 raised the share of directly productive
sectors—such as agriculture and industry—/to improve the
in total investment
output. This can also affect the Balance of Payments
positively by reducing dependence on imports and increase
in the supply of the exportables.

Lastly behaviour in some of the major exports can
also affect the current account. Tanzania's exports are
concentrated in few primary commodities like coffee, cotton,
sisal, tea and tobacco. The movements in price and volume
indexes of the major crops can affect the current account.
This impact can be captured by the behaviour of the share
of major exports in total exports of the country. Coffee
and cotton are two of Tanzania's major exports and we can
test their significance for the evolution of the current

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5   The increase in food crop price will lead to fall in
     food imports, and fall in export crop (if producers move
     into food crops) if the latter effect is stronger it
     will lead to worsening of the current account.

account balance.

Emperical Estimates of Factors Affecting
Current Account Balance, 1973-84

In this section a more systematic emperical examination is made of the respective influences of domestic and external factors discussed. Relevant published data are available for 1973-84[6]. A simple model of the current account is formulated and estimated that introduces the external and domestic factors independently as the principal explanatory variables, of interest for the purpose of this study is the role of external factors and domestic demand side and supply side factors in the evolution of the current account deficit.

For this (1) equation with external variables only (2) equation with domestic demand side variables and domestic supply side variables and lastly (4) equation with both external and domestic variables was tested.

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6   Data have been taken, for the purpose of this exercise
      from : IMF, International Financial Statistics, 1988
      Yearbook; World Bank, World Tables 1988; Country
      Economic Memorandum for Tanzania, the World Bank,1984.

External factors such as terms of trade, growth rate in industrial countries and availability of concessional finance and rise in interest rates, together form the set of factors emerging from both goods and capital markets which could have exerted a significant impact on the current account balance $(X-M)$ of Tanzania. Negative influences could have been exerted by rise in real interest rates but the impact is hypothesized to be minor.

The following three variants of the current account equation consisting of external variables were tested:

$$CAG = C + a_1 DYIC + a_2 \log (RRI) + a_3 \log(LGM) \quad \ldots \quad (1)$$

$$CAG = C + a_1 DYIC + a_4 TOT_2 + a_3 \log (LGM) \quad \ldots (2)$$

$$CAG = C + a_4 TOT_2 + a_3 \log (LGM) \quad \ldots (3)$$

Where

CAG^7 = current account balance (excluding official transfers) to GDP ratio.

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[7] The dependent variable in the Khan and Knight (1983) Model was CA/X, where exports were used only to scale the current account balance to make it comparable across countries. To avoid problems associated with exchange rate conversions, it was considered preferable not to use domestic income to scale the dependent variable.

DYIC = Growth rate in industrial countries.

TOT_2 = Ratio of non-fuel primary goods price to fuel price.

(1980 = 100)

RRI = Foreign interest rates (six monthly LIBOR rates).

LGM = Share of loans and grants with imports

(Basic data were obtained from IMF, International Financial Yearbook and World Bank Tables.)

Results obtained are tabulated in Table 3.4.

All four variables have the expected signs in Table 3.4. Variations in the foreign interest rates appears to have added to the worsening of the current account but not significantly (Equation 1). The growth rate in industrial countries also has the postulated relationship with the current account but the most significant impact seems to have been those of the terms of trade (as defined here) and the concessional finance (LGM). Both have the expected sign in equation (2) and are significant at the 1 percent level.

In equation (2) all the variables have the expected signs. A deterioration in the terms of trade (as defined here) does indeed result in a worsening of the ratio of the current account to exports, as does the decline in the growth rate in industrial countries in the 1970's. The

Table 3.4

TANZANIA : RESULTS FOR CURRENT ACCOUNT BALANCES (1973-84)

Equation	DYIC	Log(RRI)	TOT_2	Log(LGM)	R^2	$\bar{R}^2$	SEE	D.W.
(2)	0.624 (1.412)		1.386 (1.973)	10.52 (5.213)	.83	.77	2.057	2.8
(1)	1.165 (2.658)	-0.396 (-0.18)		7.875 (4.296)	.75	.66	2.5	2.18
(3)			2.028 (3.592)	11.574 (5.85)	.79	.74	2.16	2.5

Note : Dependent variable is current account to GDP ratio. T-values are presented in parenthesis below the coefficient, R^{-2} is the adjusted coefficient of determination, and SEE is the standard error of estimated equation.

effect of the latter variable is perhaps not as strong
as one might have expected; this probably reflects the
fact that Tanzania was partially successful in offsetting
the direct effects of the slow down in industrial
countries by curtailing imports. In addition since the
indirect effect of a change in industrial-country growth
performance on Tanzania is already captured in the
estimate of a_4, the estimate of a_1 probably does not
represent the total impact exerted by variations in
industrial-country growth rate. Results of equation(3)
show the significant impact of two most important
variables in the Tanzanian case. Together growth rate
in the industrial countries, terms of trade (as defined
here) and the ratio of concessional finance to imports
are the three most important external factors affecting
the current account.

As far as the domestic factors are concerned, it
is hypothesized that the Fiscal position and real exchange
rate (an increase means depreciation of the domestic
currency by our definition) will exert a positive impact
on the current account deficit. Share of manufacturing
goods in total import variable however will exert a
negative impact on the current account position.

The variables affecting domestic supply - non-food
crop price to food crop price ratio, and investment share

alloted to agricultural sector are hypothesized to have had a positive impact on the current account position due to a positive impact on the production of exportables. Improvement in the shares of coffee and cotton in total exports is also hypothesized to have improved the current account position.

The results for the regression analysis for domestic demand and supply side variables are tabulated in the Table 3.5.

The results reported are of the equations tested which had the following functional forms -

$$CAG = C + a_8 NF + a_9 \, Log(RER) + a_6 CCIT + a_5 MIT \quad \ldots (4)$$

$$CAG = C + a_5 MIT + a_6 CCIT + a_7 \, AT + a_8 NF \quad \ldots (5)$$

$$CAG = C + a_6 CCIT + a_8 NF + a_7 AT + a_5 MIT + a_{10} FP \quad \ldots (6)$$

where

MIT = Share of manufacture in total import.

NF = Non-food crop price to food crop price ratio.

AT = Share of agricultural sector in total public investment.

RER = Real Exchange rate.

CCIT= Share of coffee and cotton in total exports.

In equation (5) all the variables have the expected signs and the share of coffee and cotton in total exports

Table 3.5

TANZANIA: RESULTS FOR CURRENT ACCOUNT BALANCES (1973-94)

Equation	MIT	CCIT	AT	NF	LogRER	FP	R^2	R^{-2}	SEE	D.W.
(4)	-.341 (-1.88)	·318 (2·51)		.26 (2.23)	17.83 (1.79)		.63	.42	3.25	2.53
(5)	-.188 (-1.56)	.381 (3.06)	·	.78 (2.49)	.144 (2.21)		.75	.59	2.75	2.855
(6)	-.187 (-1.493)	2.705 (2.501)		.254 (2.13)	.164 (2.37)	.321 (.928)	.866	.779	2.91	

Note : Dependent variable is the ratio of the current account to GDP

T-values are presented in parenthesis, below the coefficient, R^2 is the adjusted coefficient of determination and SEE is the standard error of the estimated equation. D.W. is the Durbin-Watson statistic.

appear to have a significant impact on the current account
(T-value is significant at 5% level). The share of
agriculture in total investment also exerts a significant
impact on the current account (at 5% level). The remaining
two variables non-food price to food price ratio and share
of manufacture in total import are also significant at 10%
and 20% level respectively.

Equation (5) too captures the impact of both demand
and supply side. This time the effect of Real Exchange
Rates was estimated. It is significant at 20% level.
The other three variables are significant at 10% level.
In its most general form the equation with domestic
variables is expressed in equation (6).

Here the supply side variables non-food price crop to
food crop price ratio and share of coffee and cotton in
total exports yield results which are significant at 5
per cent level. Share of agriculture sector in total
investment yields results which is significant at 10%
level. The T-values for the fiscal position variable
are not significant. This is contrary to the results
hypothesized.

As is evident from the results the behaviour of
the value of coffee and cotton exports was very important

for the evolution of the current account balance. The movement in the value of coffee and cotton exports is the outcome both of volume and price changes. (Hence it reflects the effect of demand side too, via price changes).

The significance of price movement of non-fuel primary products (coffee being one of them) has also been captured in the terms of trade. The volume of coffee and cotton fell in this period. [chapter two]

The volume of the major export crops declined in this period as was discussed in chapter two. Poor weather and inadequate incentive structure were held responsible for this. Institutional factors like villagisation could also have played an important role in the poor performance of the major exports, especially cotton.

Poor incentive structure for the agricultural sector was taken into account by the non-food price to food price ratio and share of investment going into agriculture. This yielded significant results thus supporting hypotheses which stress the importance of inadequate incentive structure in the agricultural sector.

Out of the demand side variables the share of manufacture in total imports variables was important for the evolution of the current account balance.

However, the results have to be interpreted with care.

Manufactured imports consists of both consumer goods and capital goods. If import control fall only on the consumer goods sector (especially inessential consumer goods) then long term development is not hampered. However, it is likely that this variable is also capturing the import controls which fell on capital goods /and were not desirable from the viewpoint of long term growth.

Real exchange rates exerted some influence but this was not very significant. It has been pointed out that real exchange rates appreciated in Tanzania and had an adverse impact on the current account balance, but this impact was not found to be very significant here.

In association with other domestic variables Fiscal position has not yielded significant results, but this is contrary to what we expected. But it has the expected relationship with current account.

Finally equations with both external variables and domestic variables were tested, the results reported are of equations consisting of both external and domestic demand and supply side variables.

Table 3.6

TANZANIA : RESULTS FOR CURRENT ACCOUNT BALANCE (1973-84)

Equation	FP	Log(LGM)	TOT_2	CCIT	MIT	DYIC	Log(RER)	NF	R^2	R^{-2}	SEE	D.W.
7	0.56 (2.40)	11.515 (7.20)	1.42 (2.74)						.87	.83	1.75	7.83
8	.41 (1.42)	10.63 (5.46)	1.544 (2.812)	0.068 (.83)					.89	.82	1.78	2.85
9		8.50 (3.95)	2.285 (4.19)	.192 (2.362)	-.145 (1.25)				.88	.81	1.83	2.89
10	.589 (1.937)	9.687 (4.654)				.692 (1.607)	2.523 (.637)		.84	.75	2.14	2.66
11	.8416 (3.368)	9.593 (4.593)					9.096 (1.747)	0.11 (1.62)	.84	.75	2.13	3.01

Note : Dependent variable is current account to GDP ratio. T-values are presented in parenthesis below the coefficient, R^{-2} is the adjusted coefficient of determination, and SEE is the standard error of estimated equation.

$$CAG = C + a_{10}FP + a_3 \text{ Log (LGM)} + a_4 TOT_2 \qquad \cdots \quad (7)$$

$$CAG = C + a_{10}FP + a_6 CCIT + a_3 \text{ Log (LGM)} + a_4 TOT_2 \cdots \quad (8)$$

$$CAG = C + a_6 CCIT + a_5 MIT + a_4 TOT_2 + a_3 \text{Log (LGM)} \cdots \quad (9)$$

$$CAG = C + a_1 DYIC + a_3 \text{Log (LGM)} + a_{10}FP + a_9 \text{Log (RER)} .. (10)$$

$$CAG = C + a_{10}FP + a_9 \text{ Log (RER)} + a_3 \text{Log (LGM)} + a_8 NF ... (11)$$

All variables entering equation (7-11) have the expected signs (Table 3.6). The above equations reveal the importance of both external and domestic variables. When domestic and external factors are taken into account separately too (equation (3) and (6)), it is difficult to choose between the two equations purely on statistical grounds. This implies the significance of both domestic and external variables.

But when external variables are also taken into account, the explanatory power of the equation certainly increases. The fit of equations (7) - (11) appears to be better than the fit of equations (1) - (3) and (4) - (6). It thus appears that domestic variables alone and external variables alone cannot explain satisfactorily the current account position in Tanzania. Both set of variables were important in determining the current account balance.

It thus supports the Khan and Knight model, which also finds both set of variables as important in determining the current account balance of non-oil developing countries in the 1973-81 period.

But the findings of the present study differ from the Khan and Knight model in a significant way. In their study only domestic demand side variables were included and they explained the current account in terms of the domestic demand side and external variables.

In Tanzania apparently only external and demand side variables were not important in determining the current account balance. This is evident from the results of the equation which is nearest in form to the Khan and Knight model and also from equation (10).

In Tanzania apparently the factors affecting domestic supply also exerted a significant pressure alongwith demand side factors as is evident from equation (8) and (9). The significance of a_6 is reduced probably because the effect of price changes have also been captured by a_4 in equation (8).

Thus it can be concluded on the basis of the present study that in Tanzania both external and domestic

variables played an important role in the evolution of the current account. Domestic factors however also included the factors affecting the supply side along with factors generating demand pressures.

SUMMARY AND CONCLUSIONS

In the 1973-84 period the NODC's experienced a
worsening of the Balance of Payments. Broadly both
domestic and external factors were attributed a signi-
ficant role in this process. In Chapter One a general
framework was formed which serves as the basis for
organizing the trends of the Balance of Payments,
analysis of the causes and its implication for the
policies to be implemented, for Tanzania. During the
1961-68 period the country did not appear to have
suffered from a major BOP problem. In the 1968-73
period, however, disturbing trends emerged. The crisis
was overcome by 1973.

In 1974-75, Tanzania faced a marked deterioration
in its external position, said to have been caused in
part by higher oil prices, but more seriously by
drought-induced food imports (at peak international
prices) and a drastic fall in export volumes. The
government responded by increasing agricultural prices
(particularly for food crops), restricting credit,
increasing taxes, and controlling imports more strictly
and increasing the minimum wage. The shilling was
devalued in 1975. Public investment was curtailed in
1975-76.

The programme was carried out in a spirit of
austerity. Increased aid (on concessional terms) some
use of reserves, and borrowing from the IMF helped
cover the external shortfall in 1974 and 1975. In
1976 and 1977 the current account deficit was reduced
largely as a result of improved export prices, parti-
cularly for coffee.

But by 1978, difficulties resumed. Export
prices and volumes fell, war broke out with Uganda,
the effects of the break up of the fast African
community made themselves felt, and adverse weather
affected food output. Balance of Payments situation
worsened in the 1978-84 period and was characterized
by poor export performance, and curb on imports. Aid
which was bountiful earlier declined in this period and
the country had a bitter relationship with the IMF too
which led to breakdown of negotiations several times.
Structural Adjustment plans were carried out in this
period aiming at the improvement of the productive
and monetized sectors.

Price situation also worsened after 1974/75. It
was however not discussed in detail in the present study.

Here analysis of Balance of Payment trends was the overriding objective.

Thus Chapter two provided with trends in indicators to the Balance of Payments problem and also provided some idea about the kinds of external and domestic constraints the economy was facing in this period.

Detailed source analysis was carried out only in chapter three. For this purpose first an attempt was made to decompose the current account deficit into its principal explanatory variables. This showed the movement in external and domestic variables as compared to a base period.

As far as the external variables are concerned, Tanzania experienced unfavourable terms of trade shock in this period. Interest rates, growth rate in world trade and the other external variables -- which capture the effects of burden of accumulated debt and transfers were a favourable factor in this period. On the basis of these results it can be concluded that the trade sector suffered because of the unfavourable terms of trade (which became favourable in the later period) and that the country received external transfers (it is a

component of the favourable movements in 'other external
variables'). The country was not a major debtor and
interest payments were in fact a favourable shock in this
period revealing the softening of terms of external
finance.

Domestic policy action variables reveal a deter-
ioration in the export performance in each year as
compared to the 1973 base year. Import restriction and
consumption restrictions were also important policy
actions in this period.

In the second period, terms of trade became
favourable as compared to the 1978 base, in each year
except 1979. The worrisome trend in this period,however,
was the unfavourable trend in 'other external variables,'
the external transfers fell and in this period and Tanzania
started accumulating debt also.

As far as domestic variables are concerned the
expprt ratios were less unfavourable in this period,
import controls were maintained, and there was decline in
investment. The economy thus faced external finance
decline in this period and adjusted   by cut in invest-
ments and import controls. It was aided by favourable
factors such as terms of trade improvement and growth

in world trade. Thus the improvement in the deficit ratio is explained by the above mentioned movements in the explanatory variables.

The model decomposes the current account deficit into its principal explanatory variables for each year from 1973-84. But it is unable to discern the underlying factors which could have affected the Balance of Payments trends.

The relative importance of various underlying factors was tested with the help of the Khan and Knight model (1983) which had found both external and domestic variables as important explanatory variables in the evolution of the current account.

A model on similar lines (as near to the Khan and Knight model as possible) was constructed for the Tanzanian economy. This exercise proved inconclusive and therefore an attempt was made to construct equations which abstracted from hypotheses available in the literature. The results show the importance of external variables affecting domestic demand, like fiscal expansion, and variables affecting domestic supply.

The policy implications which emerge out of this analysis can be tentatively put forward now. The current

account balance appears to have been influenced significantly by external variables. Principal among them was the availability of commercial finance, (in relation to the economy's import requirement). This suggests that the country is strongly dependent on concessional financial flows for the viability of the current account. The terms of trade (as defined here) and growth rate in industrial countries also appear to have had a significant impact on the current account.

Domestic demand side variable like the fiscal position has also influenced the Balance of Payment adversely. From Chapter two we know that this deficit cannot be justified as developmental expenditure fell in this period and recurrent expenditure rose.

The expansionary fiscal policy was thus leading to balance of payments problems and hence a curb on non-developmental expenditure is essential in ameliorating the balance of payments.

The study also points out the significance of factors affecting the supply side of the economy. The policy priority should then be to promote agriculture and agricultural exports due to the potentially important role of the agricultural sector in effecting adjustment and checking the drain on current surpluses. The inefficiencies

associated with current policies inflicted troubles in a period when external shocks were very significant. A strong case can be made for the increase in external assistance, both from bilateral and multilateral doners. The IMF's stress on demand side policies as evident from chapter two can hardly help Tanzania in ameliorating the Balance of Payment difficulties.

External assistance and domestic policy reforms can and will be mutually reinforcing in Tanzania's case. The urgent need for policy reform must be tempered by a recognition of what domestic policies alone can achieve in Tanzania in the short run. Role of external assistance in fostering adjustment without excessive cuts in growth cannot be underestimated.

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