HOW TO PREVENT ANOTHER EXTERNAL DEBT CRISIS IN TANZANIA

DEALING WITH INTERNAL DEBT

Management issues

At the end of 1998 Tanzania s external debt stood at US $ 5 billion, larger than Tanzania s estimated GDP. By the end of 2000 the external debt increased to US $ 7.9 billion what is the origin of this huge debt by Tanzania standards?

ii. After independence in 1961, Tanzania s First Five Year Development Plan was drawn up on the expectation of foreign capital inflows. The plan emphasized industrial development largely through private investment supported by government infrastructure, incentives and minority participation. However, foreign capital inflows did not materialize as expected in the plan. The failure to obtain adequate amounts of foreign aid to finance projects in the First Five Year Plan influenced the adoption of the policy of socialism and self-reliance (the Arusha Declaration). Self-reliance was to be the rallying point in the country s development efforts. Self-reliance was aimed to taking the country domestic rather than foreign resources as the basis of development. Departing from the premises of the First Five Year Plan, subsequent development plans were to put emphasis on the development of agriculture and the rural sector, where the country s resources (labour and land) were concentrated. In later discussion of how to implement the policy of socialism and self-reliance influential economists in the country pushed for the adoption of a development strategy that would bring about self-sustaining (internally generated) growth. This self-sustaining growth was to be achieved via a "Basic Industries Development Strategy"

iii. The very nature of the Basic industries Strategy adopted called for massive capital inflows; and hence increased dependence on foreign aid. Tanzania s development was not, contrary to the expectations in the Arusha Declaration, based primarily on domestic resources.

iv. The world economic crisis of 1973/74 (the main features of which were the rise in oil prices, recession in the Western industrialized countries and worsened terms of trade for oil importers) and later on the drop in world agriculture commodity prices of the late 1970s and 1980), together with the basic industries strategy trade altogether greatly increased the demand for capital inflows. Policy failures and the vagaries of weather have also contributed to the demand for foreign assistance, for example in food aid or general import support programmes.

v. Tanzania s Basic Industries Strategy adopted in the 1970s was inward looking. The objective was to establish industries that would meet basic needs (food processing, textiles, clothing, building materials, footwear. ect.) and others which would supply intermediate inputs and capital goods. During the 1970s a number of industries were established via foreign loans. These industries are highly dependent on imported raw material inputs. However, the severe foreign exchange shortage in Tanzania especially beginning with end 1978 has prevented full capacity utilization of established industries.

vi. Tanzania has incurred loans in order to finance various sectors of her economy especially industry, energy, services, transport and communication infrastructures, education, and agriculture among other. One has to appreciate the fact that returns cannot be ready available within the current economic environment. The building up of an economy s productive capacity is a long term process. The payback period is much longer than the period within which the foreign loans are supposed to be repaid back.

vii. Even with the above remarks it should also be pointed out that some of problems emanating from Tanzania s indebtedness are rooted in mistakes by planners and policy makers. In planning horizon no provision was made to ensure that grace periods are long enough, as well as to ensure that the country s debt-service profile is properly aligned with its prospective foreign exchange earning. Not enough provision was made for unforeseen changes in the terms of trade, weather conditions, South Africa s potential and ever present destabilization campaigns against Frontline States of Southern Africa, the failure of domestic policy initiatives, etc.

viii. This report has four parts. Part 1 deals with the evolvement of the debt management system in Tanzania, Part 2 deals with weaknesses in this debt management system; Part 3 deals with some of actions already undertaken or underway in improving the debt management system. Part 4 outlines main areas needing immediate actions.

ix. The main underlying assumption for this research was That even if Tanzania qualifies for a comprehensive debt relief and the World Bank and IMF Heavily indebted poor countries (HIPC) initiative, this does not guarantee that there won t be a recurrence of another debt crisis in the coming years.

x. That improving the internal debt management system is equally important in preventing another debt crisis.

1.0. The current set-up for Government debt management in Tanzania involves key central institutions, namely the Ministry of Finance, Planning Commission (President office), the Attorney General s Parastatal Organisations and private firms which are involved at appropriate stages in the loan cycle. The loan cycle covers activities for project identification,

project appraisal and approval, loan negotiations and contracting, loan disbursement, implementation and monitoring, project evaluation as well as loan repayment. Evidently to perform these functions efficiently the government requires a well functioning institutional arrangement equipped with high quality professional capacity.
The evolvement of the current government debt management system has been shaped and is being shaped from different sources. For example:

xi. In 1988, the Economic and Legal Advisory Services Divisions (ELAS) of the commonwealth Secretariat based in London, prepared a report assessing the adequacy of the legal and institutional framework for external borrowing and provided recommendations to improve the set up, some of which were adopted by the government.

xii. In 1993, a debt data consultant funded by Japanese grants executed by the World Bank, and who worked under the supervision of ELAS, highlighted the weaknesses in the institutional procedures and made proposals which were incorporated in the report titled; "Tanzania external debt Management Strategy" (July 1993).

xiii. In 1994, the Bank of Tanzania (BOT) requested the World Bank and ELAS to review the internal organizational structure and work programme of its External Debt Department (EDD) as well as draw up the terms of reference of the proposed high level debt coordination committee (DCC). The scope of the work also covered the drawing up of policy guidelines in contracting external loans of debt. A review of debt and aid operations were made in the Ministry of Finance given its important role in the area. This work resulted in a report issued in August 1994 titled, "Debt Management in Tanzania Scope for improving the existing Framework."

xiv. Despite the above three critical documents on the country s debt management, the debt problem still remains an obstacle to development progress. The need for new strategies necessitated the establishment of a task force by the government in November 1996. This task force was required to draft a National Debt Reduction Strategy dealing with External and Internal debts. The first part of the report dealing with external has been published for wider circulation.

xv. On top of these government initiatives, the debt management system in Tanzania is also heavily influenced by the country Assistance Strategy paper from the World Bank, the policy framework paper from the IMF which has now been renamed "Poverty Reduction Growth Facility (PRGF) and the Paris Club agreement document.

This historical aspect in dealing with debt management leads to the following observations

- The Government of Tanzania recognizes that there are weaknesses in its debt management system, which has contributed to the prevailing debt burden.
- A solution must be found to the internal debt management problems in order to see the external solution to the debt problem have a long term impact to the development of the country, and a future recurrent of the debt crisis is stopped.
- There must be a problem in the implementation process of the recommendations and actions presented in these reports, especially when you find that some weaknesses have been pointed out in 1988 and in 1993 and in 1994 and 1998 but no concrete action has been taken to deal with many of them.

The weaknesses pointed out in the various reports produced and submitted to the Government can be summarized as follows:

Project Identification, Appraisal and Approval:

Identification of projects is supposed to be done by implementing agencies/beneficiaries that is:

- Parastatal organizations projects falling under the parastatal sub sector.
  - Regional and District authorities for Local and Regional programmes.
  - Sectoral Ministries for projects belonging to this ministries.

After projects are identified the actual appraisal for purposes of establishing the feasibility of the project requires professional reviews and assessments. This work is normally done by consultants and in few cases by public officials. In most cases where external funding is expected, project appraisal is normally done by consultatants. After project appraisal is done and where the implementing agency is convinced that the project is feasible, the relevant sectoral Ministry of Regional Authority is required to submit it to the planning commission for review at national level. The aim of this review is to see to it that the project is of priority in nature and is in accordance with the national policies for economic development. However, because of weaknesses in the institutional framework, in many cases project proposals are taken straight to the Ministry of Finance for submission to external funding institutions. In cases where they are taken to the planning commission, this is done when many commitments are already in place making it difficult to undertake meaningful project appraisals. Within the planning commission and the Ministry of Finance the procedures for processing projects are yet to be streamlined. This is important in order to eliminate delays, approvals by inappropriate officials and the use of short cuts when submitting projects

LOAN NEGOTIATIONS AND CONTRACTING

After a project has been appraised and approved it is submitted by the Ministry of Finance to the would be external lending agency. Following that submission, the Ministry of Finance leads the negotiation process, working closely with the Attorney General s Chambers, Planning commission, the relevant sectoral Ministry and implementing parastatal organization or regional authority. Within the Ministry of Finance, negotiations and where the process is successful, loan agreements are signed by the

Ministry for Finance of his duly appointed representative on behalf of the Government of United Republic of Tanzania. After this stage, the project is included in the budget and taken to Parliament for approval. However, beginning 1997/98 the government projects seeking for external loans will have to be approved by cabinet before signing loan agreements.

The current arrangements have several weaknesses:

i. Loan agreements are signed before assurance that local budgetary requirements will be in place.
ii. Project proposals are taken to Parliament after loan agreements have been signed. This limits considerably the authority of the Parliament in respect of external loan contracting.
iii. The new requirement for cabinet approval before external loan agreements are signed is a positive step in improving the processing of external loans. However, this requirement is not statutory and it also does not allow for contributions from non-Government sources.
iv. The minister of Finance is not obliged to take into account the advice of the Minister responsible for Economic Affairs that is in the Planning Commission before signing such agreements and therefore possibilities for decisions not observing the national economic policies can not be ruled out.
v. Lack of coordination and interlink ages between sectoral Ministries and institutions responsible for debt management.

Loan Disbursement

After loan agreements have been signed, loan disbursement is done in accordance with the action plan of the project and the speed of project implementation. Loan disbursements are also subject to meeting all conditionalities for loan effectiveness and related reform targets. In actual practice, loan disbursements are slowed down by the following factors:-

vi. Lack or delayed availability of local counterpart funds
vii. Delays in fulfilling conditionalities, which are linked to project implementation.
viii. Poor progress in implementation of projects or in awarding of tenders.
ix. Slow preparations and submissions of implementation report.
x. Processing delays by external lending institutions.
xi. Method of disbursement.

Within the Ministry of Finance disbursement transactions are coordinated by the Accountant General beginning 1997/98 fiscal year.

Disbursements are effected in three options, namely Cash, Direct to project (in for of equipment and personnel) and by Reimbursable System whereby the borrowing agency incurs ant thereafter submits claims on costs incurred. Where Cash method is used, disbursements are made to the Government Account in the Bank of Tanzania then released to the relevant Accounting Ministry or Region. Where a Parastatal Organisation is the ultimate beneficiary agency, the relevant Sectoral Ministry would transfer the disbursed funds to the respective parastatal organization. Regarding Reimbursement procedure, the implementing agency submits its claims through the Ministry of Finance and lenders disburse the claimed funds following the cash method procedure. For Direct to project arrangement, disbursements are made directly to the implementing agencies are required to provide the Ministry of Finance information on type and value of disbursements received.

Project Implementation and Monitoring

Supervision of project implementation is the immediate responsibility of the implementing Ministry, Region or Parastatal Organisation. At the National Level the monitoring of project implementation is coordinated by the Planning Commission. Implementation reports as a basis for plan implementation and monitoring. However, recently monitoring of projects have been highly constrained by the acute shortage of development funds and the squeeze in allocations for other charges in the Recurrent Budget.

Project Impact Evaluation:
Project evaluation is supposed to undertaken after project completion and after an appropriate period of implementation. The objective is to evaluate the impact of the project as against immediate objectives and targets as well as against long-term factors like contributions to employment, literacy and environmental protection. This exercise is normally not done by the Government because of lack of resources. If resources were available, the most effective approach would be to commission specialized consultants as independent evaluators. The negative effect of not carrying impact evaluations are that the Government is not made aware of the effects of project externalities and thus not able to effect corrective measures where necessary. Most negative effects of projects are related to environmental destruction, dislocation of societies, use of inappropriate technologies and distraction of cultural and ethical values.

Loan Servicing:
In servicing loans for the Government, the Ministry of Finance is required to budget for all maturities expected in each financial year. Once the budget has been approved by Parliament, the Ministry is required to pay on due date to the

Bank of Tanzania the shillings equivalent of the maturing debts for onward remittance to the creditors. Where the Government loan is on-lent to Zanzibar or to a Parastatal Organisation are required to pay the equivalent local cash cover to the Bank of Tanzania for onward remittance to the creditor.

External loan servicing is associated with following problems:-

- Under-budgeting on the part of the Government because of weak revenue base.
- Non-allocation of requisite cash cover on the part of Ministry of Finance; Zanzibar.
- Lack of cash cover from the Parastatal Organisations because of their poor financial positions.
- Shortage of foreign exchange, especially during the period prior to economic liberalizations programmes.

The outcome of these problems is the build up of external payment arrears and the transfer of parastatal debt obligations to an already over-strained Government budget.

The legal framework

The legal framework for raising local external and loans and grants is enshrined in the Government Loans, Guarantees and Grants Act No. 30 of 1974. The Act, empowers the Minister for Finance to raise loans and grants on behalf of the Government . The Act also stipulates the limits within which the Government can borrow.

The main weakness of the current legal framework are:

xvi. Although the legal framework has been in force since 1974, it has been poorly administered and it is not properly observed as there cases where unauthorized persons have contracted loans without the consent of the Minister for Finance. This partly explains why foreign loans continued to be contracted without respect of the legal limits.

xvii. Although the Act has been contravened by exceeding the stipulated borrowing limits and by unauthorized persons contracting loans without the concert by the Minister of Finance, no legal action has been taken against the offenders.

The Government has already started take certain actions with a purpose of dealing with not only with weaknesses in its debt management system, but also weaknesses in the entire development management systems. The following are areas with deals directly with addressing debt management weaknesses:

Public expenditure review process

The annual public expenditure review (PER) process was introduced in 1997 with four main functions:

xviii. To provide support to the Government budget process, in particular the preparation of the MTEF (Medium-Team Expenditure Framework) and Budget Guidelines;

xix. To analyse the composition of Government spending, its consistency with policy and the effectiveness of programmes;

xx. To support the development of public expenditure management systems;

xxi. To provide a mechanism for external transparency and a forum for coordination with donors regarding policy together with expenditure priorities.

The PER process is guided by a working group, chaired by the Ministry of Finance, Comprising Government representatives, donor agencies, academic and research organizations, the private sector and civil society organizations.

Parastatal Reforms

About % the external debt repayment areas comes from loans to parastatals but guaranteed by the Government. Therefore debt cancellation alone is not enough to deal with any possible future debt crisis unless Parastatals area reformed.

By the end of 1991, there were over 400 parastatals which in total had accumulated losses of more than US $ 100 million over the previous five years alone. It was then that the Government resolved to deal with this problem through privatization. Following this decision the Parastatal Sector Reform Commission (PRSC) was formed in 1992 to stop the Government from additional spending and debt accumulation through parastatal subsidies and loan guarantees. Up to December 2000, 334 privatisations had been completed.

Country Financial Accountability Assessment (CFAA)

Between February and April 2001, the Government of Tanzania through the Ministry of Finance and supported by the U.K Department for International Development and the World Bank conducted a CFAA by using a team of both local and international consultants.

This Country Financial Accountability Assessment (CFAA) is intented to:

xxii. Consider the strength of the financial accountability framework in Tanzania s public and private sectors amidst the continuing institutional and structural reforms being undertaken;

xxiii. Assist the Government s own ongoing efforts to strengthen the financial accountability framework and build capacity to carry out financial accountability functions;

xxiv. Measure the degree of the Government compliance with rules and procedures; and also to identify areas of risk, especially where the country s formal rules, systems, and procedures fall below international benchmarks and to suggest remedial actions and mitigating measures.

Refocusing Development efforts

xxv. In 1998, the National Poverty Eradication Strategy (NPES) was released which sets out governments objectives and targets for reducing absolute private consumption poverty by half by 2010, and eradicating it by 2015.

xxvi. The recent Poverty Reduction Strategy Paper (PRSP) deals with the same themes as the older NPES, but for the medium term. This PRSP is a result of the requirement for getting debt relief under the World Bank/ International Monetary Fund Heavily Indebted Poor Countries (HIPC) Initiative. It is based on wider consultation than the NPES, and has a stronger link to resources, including projections of the resource envelope and resource allocations based on the medium term expenditure framework (MTEF) projections. The PRSP also links targets for outcomes to be achieved by year 2005 to intermediate monitoring indicators.

xxvii. The Tanzania Assistance Strategy (TAS) being prepared provides a development framework for organizing donor assistance around strategic priorities and increasing the share of aid, currently as low as 40% accounted for by the budget.

Debt Sustainability Analysis (DSA)

The first indepth analysis was done in 1999 with a report presented to the WB/IMF Executive boards in September 1999. Another DSA is expected during the second half of year 2001. This exercise helps both to reconcile the debt figures and to assess and analise the country s debt sustainability.

In Service training:

There is an on-going capacity building training on debt management for the Bank of Tanzania and the Ministry of Finance. This is mainly done with MEFMI a debt management institute based in Harare, Zimbabwe.

Despite the fact that many weakness have been pointed out and a number of actions have taken place to deal with them, there are some issues which need immediate action. For example

Reviewing the Government aid, guarantee and loan Act of 1974.

This Act needs a very urgent review. It does not have an enforcement clause which can bite offenders. The loopholes in the Act can be a very good breeding ground for corrupt practices. Also, this Act. talks about Tanganyika, when officially Tanganyika ceased to exist in 1964. This also means the position of Zanzibar in this Act is not very clear.

(iii) Public Accountability

This calls for the effective use of the current officially constituted civil societies like the Parliament in monitoring the borrowing and the use of loans. For example TASOET (Tanzania Social and Economic Trust) and Christian Aid office in London in 1997 and 1998 conducted studies on a number of World Bank funded projects which have failed in Tanzania. For example out of 25 agricultural and rural development projects funded between 1966 and 1985, 13 of them had a negative economic rate of return. This is one example which calls for an internal reform in the debt management, which will be easily monitored by the public, despite the recent improvement in the performance of the current active World Bank portfolio.