

DEBT RELIEF, FOREIGN AID AND PROSPECTS FOR POVERTY REDUCTION IN TANZANIA

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INTRODUCTION

Foreign capital flow in terms of aid and soft loans have contributed significantly towards economic growth in Less Developed Countries (LDCs) since the 1950s (Rahman, 1968). Although there has been considerable debate on the impact of foreign capital flows on domestic savings of recipients, there is some agreement among analysts that the impact of these resources on economic growth is less disputable (Weiskopf, 1972). What appears to be controversial is the impact of foreign resources in the form of debt creating loans particularly because they carry with them a repayment obligation.

The external debt stance of LDCs has concerned analysts and policy makers in debtor and creditor nations in a number of ways. At the on-set of the debt crisis the creditor community represented by various credit lending institutions in North America and Western Europe was worried that the heavily indebted countries would not be able to repay the accumulated interest as well as the principal extended to them. This concern was further intensified in the early 1980s when some Latin American countries (e.g. Mexico, Argentina and Brazil) threatened to declare a unilateral moratorium that would in turn, lead them to stop honouring their outstanding external debt obligations (Griffith-Jones, 1989).

The creditor community was further concerned that the failure of the indebted countries to repay the loans would disrupt the lending and profitability objectives of their financial institutions to an extent that would jeopardise their future operations. Apart from lending and profitability matters the creditor community feared that were the heavily indebted countries allowed to default this would unleash

"band wagon" effect that would encourage other indebted countries to follow suit. Given this background it was critical for the creditor community to pressurise Latin American countries not to default. The pressure exerted managed to persuade Mexico and other Latin American countries to continue to honour their external debt obligations. However, Mexico, like other indebted LDCs was concerned about the magnitude of the debt in the midst of deteriorating terms of trade. Furthermore, the servicing of the debt was constraining the budgetary operations in indebted countries.

Such were the debt issues between debtor and creditor nations in the 1980s. Currently however, the LDC debt problem has acquired new dimensions. Indebtedness co-exists with a myriad of other socio-economic problems the most prominent of which appear to be poverty. The depth and intensity of Highly Indebted Poor Countries (HIPC) in particular has necessitated International Financial Institutions (IFIs) including the World Bank and the International Monetary Fund to devise a focused initiative that would be an exist strategy for indebtedness. The HIPC initiative which became operational in 1996 rests on various principles. The objective is to target overall debt sustainability (as defined later) on a case-by case basis thus providing an exit strategy from the rescheduling process. Indebted countries were expected to get support when they had shown, through track record, ability to put to good use the support provided. The HIPC initiative is in this sense not a new strategy as it builds on and adds value to existing mechanisms in particular those provided under the Paris Club and non-Paris Club arrangements. The new external finance for countries qualifying for this initiatives is supposed to an "appropriately

concessional" terms. Whether the HIPC initiative will adequately address the debt burden of highly indebted countries is mutable.

This paper reviews the foreign aid and external debt stance in Tanzania in the context of the HIPC measures. Working from the country's current foreign and and debt stock the paper analyses whether the implementation of the HIPC initiative will make the debt burden more bearable and finally be the true exist to the debt problem. It is plausible however to commence with a theoretical note, albeit briefly linking a countrys indebtedness to its poverty stance.

FOREIGN AID, EXTERNAL DEBT, ECONOMIC GROWTH AND THE POVERTY NEXUS

Foreign aid can be broadly defined to include grants and soft loans from rich (donor) to poor (recipient) countries. There are different motivations for foreign aid relationships (Mosley, 1985). However, the impact of foreign aid and debt on the economic development of recipients has been made by use of the Harrod - Domor model (Chenery and Strout, 1966). Given certain conditions (including productivity of investment and egalitarian distribution of income) aid can have profound positive impact on growth and poverty in recipient countries. Models analysing the effect of debt service on economic growth and poverty have employed neo-classical growth models in which growth is influenced by factors such as debt service (Degefe, 1991; Kruger, 1994; Iyoha, 1996). These models usually commence with a neo-classical production function where output (Y) depends on Hick's neutral technical change (A). Labour (L). capital (K) and foreign capital (Q). According to this model, imports of foreign capital are assumed to be financed by the current account surplus and net capital inflows. Thus:

$$Y = A(t) f(K,L,Q) \dots\dots\dots (1)$$

Where f is assumed to be twice differentiable. Other variables are as defined earlier. Taking the time derivative and dividing by Y the following shares are obtained:

$$\frac{\Delta Y}{Y} = \frac{\Delta A}{A} + \frac{\Delta \delta f \Delta L}{\delta k Y} + \frac{\Delta \delta f \Delta L}{\delta L Y} + \frac{\Delta \delta f \Delta Q}{\delta y} \dots\dots\dots (2)$$

Letting $gy = \frac{\Delta Y}{Y}$ and $\lambda = \frac{\Delta A}{A}$ we have

$$w_L = \frac{\delta_Y \cdot L}{\delta_L Y} = \text{relative share of labour in output.}$$

$$w_K = \frac{\delta_Y}{\delta_K} \cdot \frac{K}{Y} = \text{relative share of capital in output.}$$

$$w_Q = \frac{\delta_Y}{\delta_Q} \cdot \frac{Q}{Y} = \text{relative share of technical change in output.}$$

Equation 2 can be simplified to:

$$gyx = \lambda + \frac{w_K}{K} + \frac{w_L \Delta L}{L} + \frac{w_Q \Delta Q}{Q} \dots\dots\dots (3)$$

Letting the labour force grow at a constant rate of n and abstracting from depreciation, we may set K = I. Furthermore, let domestic capital stock be roughly proportional to output where the factor of proportionality, F is the incremental capital-output ration (ICOR). Since it is assumed that the indebted country being analysed is an LDCs, the most plausible assumption is that its rate of technical change $\frac{\Delta A}{A}$ is proportionately zero.

Hence equation becomes:

$$gyx = w_L n + w_K \frac{I}{\delta} + w_Q \frac{\Delta Q}{Q} \dots\dots\dots (4)$$

The change (increase) in foreign capital inflow will normally be financed by the export surplus and net capital inflows made up mainly of direct foreign investment and new borrowing. From debt service payments made up of repayments of principal and interest on outstanding debt must be substracted. This results into:

$$\Delta Q = (X-M) + DFI + R_c D_c (I-c) D \dots\dots\dots (5)$$

Where:

- c represents the proportion of debt repaid
- i is the average interest rate on debt
- x is exports
- M is imports

- DFI is direct foreign inflows
- B is new borrowing
- D is outstanding debt stock.

It is further assumed that the export surplus (X-M) is determined mainly by export growth (gx). It is possible to summarise (from equations 4 and 5) the factors determining income growth in an indebted country as follows:

$$gy = (n.\delta.\% .DFI.B.D.DBS.gx) \dots\dots\dots(6)$$

Where $f_1 > 0, f_2 > 0, f_3 > 0, f_4 > 0, f_5 > 0, f_6 < 0, f_7 < 0$ and $f_8 > 0$.

This briefly says that an increase in industrial labour force, (n) investment ratio (δ) direct foreign investment (DFI) new borrowing (B) and export growth (gx) tends to increase the rate of economic growth of an indebted country. The increase in debt stock (D), incremental capital - output ratio (c) and the debt service burden (DSB) will tend to reduce the rate of economic growth.

Following Underwood (1990), it is possible to begin with a general-proposition that if a country is to benefit from external borrowing, its economy must be that an adequate amount or new resources can be available to service its maturing debt obligations. In particular, the growth in income must be sufficient to provide increased consumption and increased debt service. Another way to state this is that debt and debt service will be less burdensome the more rapid the growth of income becomes overtime.

In order to establish an empirically verifiable relation between external debt and growth we begin with the fundamental identity that the increase in debt less the change in international reserves is equal to debt service less interest income owned from international reserve assets plus the import surplus. ie.:

$$(D_t - D_{t-1}) = (R_t - R_{t-1})iD_{t-1} - iR_{t-1} + nM_t - X_t \dots\dots(7)$$

Where R = stock of international reserves. Other variables are as defined earlier.

Equation 7 ignores the capital flight phenomenon which could be quite significant in some African countries including Tanzania

(Nyoni. 1997). Since the interest income on reserves is often small in many African countries, we may set $-iR_{t-1}$ equal to zero. Ignoring changes in reserve stock and simplifying equation 7 we obtain:

$$D_t = M_t - X_t + (1+i)D_{t-1} \dots\dots\dots 8$$

Consider further identity which relates the demand for final products to the uses of income that is:

$$Y = C + I + G + X - M = C + S + T \dots\dots\dots 9$$

- Where C = consumption
- I = investment
- S = Savings
- T = Taxes
- G = Government Expenditure

Other variables are as defined earlier.

Re-arranging and simplifying the identity in equation (9) gives:

$$M - X = (I - S) + (G - T) \dots\dots\dots(10)$$

which gives the import surplus as the sum of the investment-savings gap and the budget deficit (G-T). Combining equations (2) and (4) and, suppressing the time subscript we obtain:

$$D = (I - S) + (G - T) + (1 + i)D_{t-1} \dots\dots\dots(11)$$

Where D_{t-1} is the lagged value of the debt stock.

At this point, it is plausible to introduce the ability of the country to service its debt as this has an effect on the debt burden and by extension, the stock of external debt. The major factors to consider are: the growth rate of income and the degree or exchange rate over-valuation (ER). Given this background we may now specify the determinants of debt stock, subject to empirical verification as follows:

$$D = g(SG.FD.ER.GI.D_t) \dots\dots\dots 12$$

and $g_1 > 0, g_2 > 0, g_3 > 0, g_4 < 0, g_5 > 0$.

This suggests that the higher the investment-saving ratio, the fiscal deficit and the degree of

exchange rate overvaluation the higher will be the stock of debt. However, the higher the growth rate of income (GI) the lower the debt and debt service burden.

This conclusion, as we show in the following sub-section is important for LDCs and Tanzania in particular in designing exit strategies to foreign indebtedness. At this juncture it is plausible to analyse closely the HIPC framework and its relevance to Tanzania.

DEBT RELIEF INITIATIVES AND GRAVITY OF TANZANIA'S EXTERNAL DEBT

The HIPC initiative was proposed by the International Monetary Fund (IMF) and the World Bank in 1996 as "an appropriate basis" for resolving the external debt problems of the heavily indebted poor countries of which Tanzania is a member. To qualify for HIPC, eligible countries must go through several stages. At the first stage the Paris Club, other bilateral and multilateral donors agree to provide flow rescheduling (as per current Naples terms) on a net present value basis. The country concerned establishes a three-year track record of good economic performance. The first stage is then followed-up by a decision point in which assessment is made on whether or not the Paris Club and other interventions have been adequate to enable the country to attain debt sustainability), at completion point. 'The second stage is reached when additional concessional flow rescheduling is still required for its debt to be sustainable. Like in the first stage, a country is required to have a second track record of good performance.

At the completion point the Paris Club and other institutions provide deeper stock-reductions of debt to enable a country to reach a sustainable level of debt. Debt sustainability is defined for HIPC purposes in terms of three indicators (World Bank, 1996):

- a) The ratio of the net present value of debt-to-exports should be within a range of 200-250 percent or below
- b) The debt service to exports is expected to fall within a range of 20-25 percent or below.

- c) Other debt sustainability, indicators including stress on debt service on government budget diversity or the country's export base, reserve coverage and resource base.

Besides the sustainability aspect, the HIPC initiative has other important building blocks including eligibility performance criteria and participation by all relevant creditors (World Bank, 1996).

Only International Development Assistance (IDA) member countries are eligible to the initiative. The criteria for good performance is based on indicators like: progress on key structural reforms, macroeconomic indicators and social welfare.

The HIPC initiative has been well received in most LDCs including Tanzania (Basuga-Nsadhu, 1997). Indeed, in line with good performance track record. Tanzania has prepared the National Poverty Reduction Strategy Paper (PRSP) in consultation with a broad spectrum of stakeholders. The PRSP spells out Tanzania's objectives and strategies for combating poverty with the help of debt relief funds (URT, 2000). The first progress report on the implementation of the PRSP has been produced. This report shows that there are signs that Tanzania is on the right track of implementing the PRSP.

Apart from the PRSP, the government has since 1993, put in place an elaborate External Debt Management Strategy with an objective of (a) restoring orderly relations with all creditors (b) reduce contractual debt service to a manageable level and (c) prevent the build-up of unsustainable level of debt and debt obligations in the future.

The next logical concern emerging from the HIPC, PRSP and the Debt Management Strategy is whether they constitute a necessary and sufficient exit strategy for the country's indebted stance. To reiterate, will the HIPC initiative improve income growth sufficient enough to lessen the debt problem and put the country on a sustained economic growth path.

As an insight into this concern we take a critical look at some debt indicators of the magnitude of the debt problem in Tanzania.

Table I: Some Indicators of External Debt in Tanzania: 1986-2000

| | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|-----------------------------------|------|------|------|------|------|------|------|-------|------|------|------|------|------|------|------|
| Total Debt (% of GNP) | | | 122 | 128 | 161 | 151 | 143 | 156 | 179 | 141 | 114 | 97 | 95 | 98 | 92 |
| Debt Service ratio (% of exports) | 35.2 | 39.2 | 32.0 | 32.9 | 32.9 | 40.3 | 40.4 | 26.16 | 19.0 | 17.9 | 18.9 | 13.0 | 14.3 | 15.2 | 14.5 |
| Concessional debt (% of total) | 52.9 | 49.7 | 53.1 | 54.2 | 53.8 | 54.5 | 57.5 | 59.0 | 60.1 | 59.8 | 60.5 | 70.9 | 71.2 | 72.5 | 69.0 |
| Multilateral Debt (% of total) | 26.2 | 26.8 | 24.9 | 30.9 | 33.0 | 34.4 | 35.6 | 36.7 | 37.7 | 39.1 | 41.0 | 42.1 | 43.1 | 48.3 | 49.8 |
| Arrears (US \$ m) | 531 | 766 | 845 | 1050 | 1215 | 1486 | 1518 | 1815 | 2090 | 2421 | 2532 | 1995 | 1820 | 1885 | 2022 |
| Rescheduled debt (US \$ m) | 657 | 59 | 385 | 77 | 185 | 7 | 348 | 58 | 9 | 0 | 33 | 761 | .. | .. | .. |

Notes: .. Indicates data not available

Source: A. Bigsten and A. Danielson (1001) p. 52 and Global Development Finance. 2001. Washington DC. World Bank

Bank

The magnitude of Tanzania's external debt has been a subject of review for many authors (see Mjema and Kilindo, 2000; Mjema and Kilindo, 2001; Danielson and Mjema, 1995; Danielson and Mjema, 2001) There is some convergence in terms of the critical findings from these studies that: most of the debt is public or public guaranteed with only a small proportion of the total outstanding debt has been serviced. While in the 1970s and 1980s bilateral creditors were important, currently multilateral institutions are also significant in extending loans to Tanzania. There is also consensus among the studies that despite the fact that loan conditions (average interest rate, average grace and maturity periods) were favourable compared to those subjected to other Sub-Saharan Africa recipients, the country's debt burden is still unsustainable (Mjema, 1994). The bench mark for this assessment is the current rate of income growth and export performance.

For example, from 1993 onwards, the debt-to GDP ratio trend is negative due to the fact that GDP growth increased insignificantly in the mid 1990s. Furthermore in 1995 the government introduced a strict cash budget system in which the servicing of external debt was given top priority (Danielson and Mjema, 2000; Bigsten and Danielson, 2001) in government expenditure. There is no doubt that the economic reform measures have managed to arrest the declining GDP growth rate and put the economy into the right footing. Export growth has picked up. The sound macroeconomic environment and political

stability in Tanzania have contributed to the current surge in foreign direct investment. All these measures must have an impact at the grass-root level. There is willingness and commitment on the part of the government to see that the positive effects of the reforms are felt at the lower levels of the society.

IS HIPC THE EXIT STRATEGY FOR TANZANIA'S DEBT PROBLEMS?

In Tanzania as in most highly indebted countries the HIPC initiative has been received well. Indeed, Tanzania qualified for the HIPC eligibility in April 2000 and should have no significant problems at the decision point for its debt to be categorized as sustainable. This somewhat good news invites one to question whether this is the exit strategy for highly indebted countries' debt problems - Tanzania in particular.

Whether the HIPC initiative is sufficient to deal with Tanzania's debt problem will depend on various factors. First, the initiative must have a significant impact on income growth. Thus, it must help the country to revive its economic activities especially sectors like agriculture, agricultural marketing and rural roads which have a high propensity to generate incomes in the rural communities. Furthermore, there will still be new (multilateral and bilateral) loans. The reason for this being that the country does not have sufficient domestically generated resources to enable it to undertake the kind of investments it desires. Besides investment requirements there

are other Socio-economic programmes which cannot be undertaken without foreign loans and aid. Table 2 shows external debt developments in Tanzania in the 1994/95-2000/2001 period.

The external debt trends in Table 2 lead one to suggest that for HIPC to be an exit strategy for the country's indebtedness much will depend on the effective utilization of foreign loans. As Mjema and Kilindo (2000) put it "A lot of debt

analysis has focussed on debt relief and debt rescheduling. Much less attention has been paid to concerns like how best to utilize the loan resources" Most highly indebted countries in Africa (including Tanzania) will have difficulties to address the question: where did all the borrowed funds which have resulted into the current debt problem go? It is ironic to see countries in Africa in the midst of poverty and yet grossly indebted

Table 2: External Debt Developments

Millions of USD

| Item | 1994/95 | 1995/96 | 1996/97 | 1997/98 | 1998/99 | 1999/2000 | 2000/2001** | |
|-----------------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | | | | | | | Sept. | Dec. |
| 1. Overall Total Debt Committed | 8,440.70 | 7,933.00 | 8,100.80 | 7,910.70 | 7,972.90 | 7,595.70 | 7,588.20 | 7,603.20 |
| 2. Disbursed Debt by Creditor category | 6,917.50 | 6,623.30 | 6,600.30 | 6,435.80 | 6,580.30 | 6,538.30 | 6,382.90 | 6,428.20 |
| Bilateral debt | 3,426.26 | 3,216.30 | 3,044.90 | 2,785.79 | 2,791.78 | 2,514.10 | 2,409.90 | 2,383.70 |
| Multilateral debt | 3,022.39 | 2,989.50 | 3,142.50 | 3,179.41 | 3,330.10 | 3,571.50 | 3,529.00 | 3,573.30 |
| Commercial debt | 226.69 | 211.70 | 214.90 | 270.60 | 251.50 | 264.90 | 259.30 | 285.50 |
| Other private creditors | 242.16 | 205.80 | 198.00 | 200.00 | 206.92 | 187.80 | 184.70 | 185.70 |
| 3. Disbursed Debt by Borrower category | 6,917.50 | 6,623.30 | 6,600.30 | 6,435.80 | 6,580.30 | 6,538.30 | 6,382.90 | 6,428.20 |
| Central Government | 6,523.00 | 6,264.80 | 6,233.80 | 6,017.40 | 6,168.20 | 6,092.60 | 5,946.40 | 5,981.60 |
| Public Corporations | 220.50 | 171.50 | 167.00 | 171.80 | 165.10 | 183.20 | 177.40 | 178.90 |
| Private Sector | 174.000 | 187.00 | 199.50 | 246.60 | 247.00 | 262.50 | 259.10 | 267.70 |
| 4. Disbursed Debt by use of funds | 6,917.50 | 6,623.30 | 6,600.30 | 6,435.80 | 6,580.30 | 6,538.30 | 6,382.90 | 6,428.20 |
| Balance of payment support | 1,889.40 | 1,688.94 | 1,524.67 | 1,493.11 | 1,512.20 | 1,648.10 | 1,625.60 | 1,602.90 |
| Transport and Telecommunication | 1,325.10 | 1,291.54 | 1,339.86 | 1,306.47 | 1,337.80 | 1,067.40 | 1,027.20 | 1,064.90 |
| Agriculture | 1,017.30 | 967.00 | 950.44 | 913.88 | 963.80 | 1,040.20 | 1,013.20 | 1,014.10 |
| Energy and Mining | 691.80 | 721.94 | 745.83 | 791.60 | 821.80 | 869.00 | 832.30 | 834.80 |
| Industries | 654.00 | 609.34 | 567.63 | 527.74 | 504.40 | 430.00 | 418.00 | 421.10 |
| Social Welfare and Education | 219.00 | 245.06 | 257.41 | 276.74 | 292.70 | 426.50 | 322.00 | 329.90 |
| Finance and Insurance | 215.10 | 192.08 | 184.81 | 167.33 | 215.50 | 122.80 | 119.40 | 125.70 |
| Tourism | 89.90 | 92.73 | 92.40 | 77.23 | 80.20 | 84.10 | 83.20 | 83.80 |
| Others | 815.90 | 814.67 | 937.24 | 881.70 | 851.90 | 850.20 | 942.00 | 951.00 |
| 5. Total Debt Service (Actual) | 180.10 | 212.00 | 218.70 | 204.60 | 187.90 | 190.89 | 211.20 | 211.50 |
| Principal | 115.60 | 140.10 | 122.60 | 138.00 | 112.20 | 140.53 | 211.20 | 211.50 |
| Interest | 61.70 | 71.80 | 95.50 | 66.40 | 75.60 | 49.56 | 0.00 | 0.00 |
| Others | 2.80 | 0.10 | 0.60 | 0.20 | 0.10 | 0.80 | 0.00 | 0.00 |
| 6. Total Arrears by Creditor Category | 2,636.20 | 2,813.70 | 2,443.20 | 2,357.60 | 2,660.50 | 2,239.0 | 2,176.60 | 2,310.20 |
| Principal | 1,549.90 | 1,682.90 | 1,465.00 | 1,408.80 | 1,571.10 | 1,152.50 | 1,114.90 | 1,178.10 |
| Bilateral | 1,230.50 | 1,367.20 | 1,173.10 | 1,134.10 | 1,235.40 | 810.70 | 762.60 | 800.00 |
| Multilateral | 18.40 | 29.60 | 14.60 | 10.30 | 23.00 | 0.00 | 0.00 | 0.00 |
| Commercial | 120.70 | 100.80 | 83.50 | 91.90 | 132.40 | 185.00 | 189.50 | 211.90 |
| Other Private Creditors | 180.30 | 185.30 | 193.80 | 172.50 | 180.30 | 156.80 | 162.80 | 166.20 |
| Interest | 1,086.30 | 1,130.80 | 978.20 | 948.80 | 1,089.40 | 1,086.5 | 1,061.70 | 1,132.10 |
| Bilateral | 747.70 | 827.50 | 705.00 | 654.30 | 740.00 | 739.5 | 717.80 | 763.10 |
| Multilateral | 6.70 | 29.30 | 4.20 | 6.00 | 8.30 | 0.00 | 0.00 | 0.00 |
| Commercial | 195.50 | 155.20 | 156.20 | 163.90 | 204.30 | 261.1 | 259.00 | 278.60 |
| Other Private Creditors | 136.40 | 118.80 | 112.80 | 124.60 | 136.80 | 85.9 | 84.90 | 90.40 |

Source: Bank of Tanzania. Economic Bulletin (2000)

Notes** Projections

without some sentiments of improper utilization of the loans cropping up.

If the HIPC initiative is to be the exit strategy for the debt problem it should help to change the image from one of "improper" to "proper" utilization of loan resources. We view the emphasis put by IMF and World Bank on eligible countries to utilize the funds on programmes that improve social services (e.g. health, education and water) as positive and appropriate. Similarly, we view Tanzania's efforts to use the debt relief funds in social services as explicitly spelled out in the PRSP as equally positive and right steps in the right direction. What remains to be seen is a proper implementation of the PRSP strategies.

Besides the strategies for utilization of debt resources, Tanzania and other countries in similar situations need to develop a coherent institutional capacity for debt management. Tanzania has made positive progress in this direction. It has enacted laws which empower only the Minister for Finance to contract loans on behalf of the government. No other ministries and government agencies can contract loans on behalf of Tanzania. This measure will help to monitor and co-ordinate the debt strategy.

However, the Ministry of Finance has to put, in place an efficient database for monitoring external debt trends. In the past, criticisms in handling the debt problem was levelled at the fact that all external debt data was almost classified (Lyakurwa, 1984; Mjema, 1994). Nowadays the external debt data is both public and current. This is a credit to the Finance Ministry. What is required now is for the ministry to use the data to prepare

an alternative external debt strategy with a view to convincing the creditor community that the HIPC initiative needs to be supplemented with debt forgiveness for it to be a true exit for the debt problem.

DEBT RELIEF AND POVERTY STANCE IN TANZANIA

In Tanzania, as in many highly indebted poor countries the HIPC initiative has rekindled expectations of policy makers and ordinary citizenry that the debt relief will have a significant impact on poverty. This is especially so when the IMF and other IFIs have insisted and continue to emphasize that any debt relief must be used by the concerned country for poverty reduction programmes especially education, health, water and other related social service delivery capacities.

While this is undeniably good news for most LDCs the expected debt relief from the HIPC initiative needs to be understood in the context of the need for additional borrowing. Much as the HIPC initiative has been accepted and welcome in most highly indebted poor country the initiative *per se* will not eliminate future borrowing needs of these countries. As indicated in Table 4, whereas the Net Present Value (NPV) of old debt will decline from US \$ 1.674 m in 1999/00 to US \$ 1,041.6 in 2005/06, the NPV of new debt will increase from US \$ 202.4 m to US \$ 1.768.7 m in 1999/00 and 2005/06 respectively.

Table 3: Use of External Debt, Funds in Tanzania 1994-1999 (%)

| | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|-------------------|------|------|------|------|------|------|
| BOP support | 27.3 | 25.5 | 23.1 | 23.2 | 23.0 | 18.7 |
| Transport | 19.2 | 19.5 | 20.3 | 20.3 | 20.3 | 21.5 |
| Agriculture | 14.7 | 14.6 | 14.4 | 14.2 | 14.6 | 15.6 |
| Energy and Mining | 10.0 | 10.9 | 11.3 | 12.3 | 12.5 | 13.2 |
| Industries | 9.5 | 9.2 | 8.6 | 8.2 | 7.7 | 7.8 |
| Social welfare | 3.2 | 3.7 | 3.9 | 4.3 | 4.4 | 4.9 |
| Finance | 3.1 | 2.9 | 2.8 | 2.6 | 3.3 | 3.7 |
| Others | 13.0 | 13.7 | 15.6 | 14.9 | 14.2 | 14.6 |

Source: Danielson and Mjema (2001). Table 10

Table 4: Net Present Value of External Debt After Rescheduling Selected Years (USD mn unless otherwise indicated)

| | 1999/00 | 2002/03 | 2005/06 |
|-------------------|---------|---------|---------|
| NPV of total debt | 1,876.9 | 2,616.6 | 3,297.0 |
| NPV of old debt | 1,674.5 | 1,570.0 | 1,510.0 |
| NPV of new debt | 202.4 | 959.0 | 1,768.7 |
| Debt-to export | 165.4 | 174.9 | 154.8 |

Source: IMF/IDA (2000), p. 32

"NPV of debt stock to three-year average of export proceeds. For 1999/00 this includes interim relief and relief to be delivered at completion point. Since the completion point was not reached in 1999/00, it implies that the actual debt-to-export ratio in that year was higher than what is depicted in the table.

Likewise as the projections in Table 4 show Tanzania's debt to export ratio will not change significantly during the period under review. A critical examination of the severity of the situation in Tanzania leads one to cast doubt on the impact the debt relief will have on poverty. Different methods have been used to assess the status of poverty in Tanzania (see for example the 1991/92 Cornell/ERB Survey, the 1995 participatory Poverty Assessment (PPA) and the 1998 REPOA Survey). Data problems notwithstanding there appears to be some consensus that poverty is both pervasive and deep. According to some surveys, 27% of the people were in households with total expenditure that was insufficient to obtain food to meet nutritional requirements, and about 48% of the households were unable to meet their food and non-food basic requirements. The results of various updated estimates for year 2000 suggest that poverty levels may have increased to well over 50% per cent for Mainland Tanzania.

In the following sub-section, we use the Poverty Reduction Strategy Paper (PRSP) to describe the various income and non-income characteristics of poverty.

Income poverty is largely a rural phenomenon. In rural areas incomes are lower and poverty is more widespread and deeper than in the urban centres. Some surveys put the basic needs rural

poverty incidence at over 50% (see for example the 1991/92 HBS).

The poor are concentrated in subsistence agriculture. A REPOA study shows that the incidence for households whose heads work in own farm is 57 per cent. In addition farmers that grow cash crops have higher incomes than those who do not holding factors like farm size and education constant.

Urban poverty is on the increase as indicated by the 1991/92 HBS which shows that the basic-needs poverty incidence for Dar es Salaam is as high as 5.6%. In other urban centres it is as high as 41%. It is noted in the PRSP document that the youth, the old and large households are prone to poverty.

The 1991/92 HBS shows that 44% of the population is below the age of 15 and 4% is above the age of 60 implying a dependency ratio of over 0.9. Other studies show rising poverty incidences as dependency ratios rise. Although female-headed households are not necessarily poorer than male-headed households women are generally perceived to be poorer than men.

It is estimated that 14% of households are female-headed but these are not necessarily poorer than their male headed. However, according to the PPA (1995) survey, women perceive themselves to be poorer than men owing to their vulnerability in the form of the lack of asset ownership (including land and livestock) and limited schooling.

Education plays a role in strengthening human capabilities and in the crusade against poverty. Tanzania made impressive progress towards attaining high literary rates in the 1970s and early 1980s and was able to attain literacy rates as high as 80%. With the onset of the economic crisis in the early 1980s Tanzania could not sustain these rates. While literacy rates have fallen, the school enrolment rates have also considerably declined. There is evidence linking the poor to the less educated. In 1991, 54.3% of rural poor were literate compared to 61 percent of the rural population as a whole.

High mortality rates (especially among infants) and low quality of life are indicators of poverty. The 1999 infant mortality and under-five mortality

rates were lower than those for 1970. The current killer diseases for infants are malaria, anaemia and pneumonia. Recently it has been estimated that the average life expectancy at birth is 48 years, mainly on account of HIV/AIDS.

Malnutrition among children is one of the indicators of poverty levels or social well-being. In 1996, 43% of under 5 children were found to be stunted (low height for age) and 18% were severely stunted. Some surveys show a positive correlation between malnutrition and poverty. Accordingly 43% of stunted children came from families in the first asset quintile and 26% came from families in the fifth asset quintile in 1991. The corresponding figures for 1996 were 46% and 8%.

About 68% of urban population have access to piped water. In rural areas about 45% of population have access to safe sources of water. People with unprotected water sources are more likely to be poorer than those using piped water. In addition only a limited number of the existing waste waters treatment facilities work. Incidences of waterborne diseases (cholera, typhoid) affect mostly low income areas.

It is at this point where the caution made by Ross (1977: 33) is important and worthy quoting at length:

All debt initiatives that I know of, look to reduce debt to a level where it is sustainable for you to fund it in the future. I do not know of any serious proposal out there where creditors have considered where they are going to write off your debt in totality. The HIPC initiative is welcome because it brings multilateral debt into the picture for some reduction. Do not expect that automatically 80 percent of your debt is going to be written off any time soon. Your goals are to get the debt down to a serviceable amount to promote investment and development in your country.

This caution is important in that it warns countries like Tanzania which are likely to get debt relief from the HIPC initiative to utilize the funds in investment undertakings with a higher return of investment than the interest on loan borrowing. In this way the initiative will pave the way to the

solution for debt problem and allow for sustainability, in income growth. The caution appears to be saying that unless Tanzania and other highly indebted countries can utilize the (debt) relief in programmes that will have an impact on the poor, it will not solve the country's poverty and debt problems.

CONCLUSION

The external debt burden in Tanzania is still unsustainable. This is because the magnitude of the debt relative to the country's capacity to service it is still unbearable. A number of initiatives have been put in place to address this problem. The latest strategy that is the HIPC initiative has been well received in Tanzania and in other heavily indebted countries. The expectation among these countries is that it will provide a true exit to the debt problem.

The analysis in this paper shows that it is undeniable that the HIPC initiative will provide some relief to the debt problem in most countries including Tanzania. However, a lasting solution to the debt problem will be found when the HIPC initiative and other debt relief measures help to improve the incomes in such a way that it is possible to service the debt without constraining economic growth.

Whereas the HIPC initiative and aid programmes have provided and will continue to have significant relief to Tanzania, the extent to which these measures will have a "felt dent" on poverty will depend on a host of other factors. These include, the effectiveness and use with which these resources are targeted to the poor the magnitude of the relief and the extent to which the poor are actually involved and are part of these initiatives.

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