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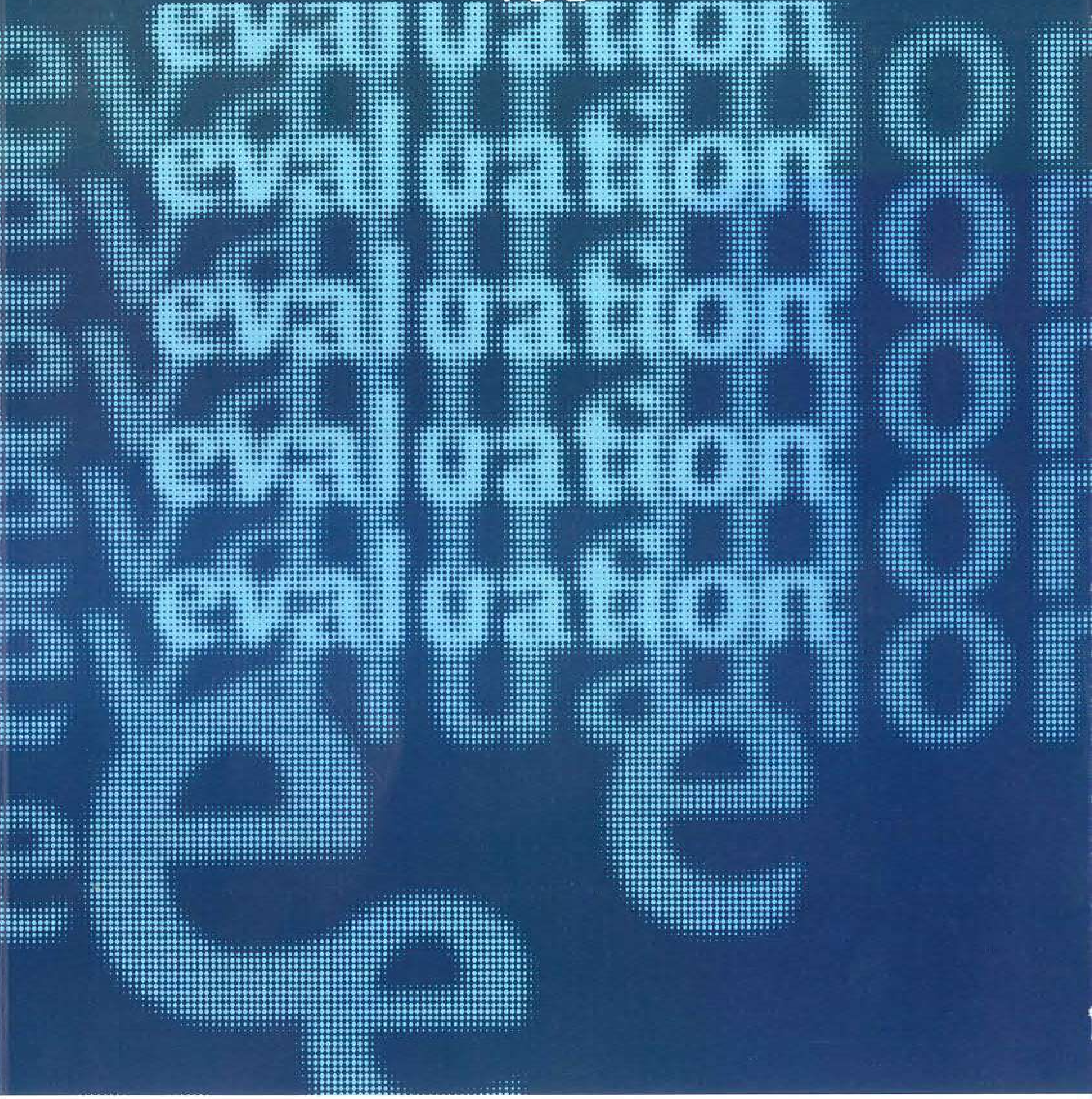

RESULTS OF INTERNATIONAL DEBT RELIEF IN TANZANIA

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POLICY AND OPERATIONS EVALUATION DEPARTMENT

RESULTS OF INTERNATIONAL DEBT RELIEF IN TANZANIA

CASE STUDY FOR THE IOB EVALUATION OF DUTCH DEBT RELIEF

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PREFACE

This report is one of the eight country studies and one of the three field studies for the Evaluation of Debt Relief of the Policy & Operations Evaluation Department (IOB) of the Ministry of Foreign Affairs of The Netherlands. As the results of Dutch contributions to debt relief cannot be distinguished from the effects produced by contributions from other donors and creditors, the eight country studies analyse the results of the combined efforts of all actors.

The field work was carried out between 24 June and 5 July 2001 – with the assistance of Dr Godwin Mjema of the University of Dar es Salaam – by Dr A.J. Danielson and Dr A.G. Dijkstra, who are responsible for the contents of this report. The study is published in the context of the IOB 'Working Documents' series, comprising consultant studies of interest to a wider public.

Rob D. van den Berg
Director Policy and Operations Evaluation Department

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ABBREVIATIONS

BEMO	Appraisal Memorandum (Beoordelings Memorandum)
BoT	Bank of Tanzania
CFAA	Country Financial Accountability Assessment
CG	Consultative Group
CRS	Creditors' Reporting System
DAC	Development Assistance Committee(of the OECD)
DOD	Debt Outstanding
DS	Debt Service
ECA	Export Credit Agency
EDT	Total External Debt
ERP	Economic Recovery Programme (1986)
ESAF	Enhanced Structural Adjustment Facility
ESAP	Economic and Social Action Programme (1989)
FDI	Foreign Direct Investment
FY	Fiscal Year
GDF	Global Development Finance
GDP	Gross Domestic Product
GNFS	Goods and Non-Factor Services
HBS	Household Budget Survey
HRDS	Human Resource Development Survey
HIPC	Heavily Indebted Poor Countries
IDA	International Development Association (soft loan window of World Bank)
IFI	International Financial Institutions
IFS	International Financial Statistics
IMF	International Monetary Fund
IOB	Policy & Operations Evaluation Department (Inspectie Ontwikkelings-samenwerking en Beleidsevaluatie)
LDOD	Long-term Debt Outstanding and Disbursed
MDF	Multilateral Debt Fund
MoF	Ministry of Finance
MTEF	Medium-Term Expenditure Framework
NBC	National Bank of Commerce
NCM	Netherlands Credit Insurance Company
NGO	Non-Governmental Organisation
NPES	National Poverty Eradication Strategy
NPV	Net Present Value
OC	Other Charges
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development

OED	Operations Evaluation Department (of the World Bank)
ORET	Export Transactions Relevant for Development
OS	Development Co-operation (Ontwikkelingssamenwerking)
PA	Programme Aid
PC	Paris Club
PE	Personal Emoluments
PER	Public Expenditure Review
PPG	Public and Publicly Guaranteed
PRBS	Poverty Reduction Budget Support
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
REPOA	Research on Poverty Alleviation
SDR	Special Drawing Rights
TA	Technical Assistance
TAS	Tanzania Assistance Strategy
TSh	Tanzanian Shillings
WDI	World Development Indicators

EXECUTIVE SUMMARY

This report assesses the efficiency, effectiveness and relevance of debt relief given to Tanzania over the years 1990-1999, with special emphasis to Dutch debt relief. The analysis of macroeconomic developments before 1990 in chapter 1 leads to the conclusion that Tanzania had an unsustainable debt. There was a clear liquidity problem since the country was only paying a small percentage of what it owed , and there was also a solvency problem. The country experienced an economic crisis in the early 1980s and although there was some improvement in the late 1980s, the government was only hesitantly carrying out reforms, and economic growth was still fragile.

Most of the debt was to bilateral creditors and concessional, but the share of multilateral debt was growing and was (in the 1970s and 1980s) to an important extent non-concessional. Donors had been uncritical supporters of Tanzania's development strategy in the 1970s and had, until well into the 1980s, given large amounts of loans for financing projects that fitted in that strategy. When the strategy did not prove to work and Tanzania could not repay the loans, one would expect the creditors to take on as much responsibility for the unsustainable debt as the debtor. By 1990, Tanzania needed debt relief in the form of forgiveness, and fresh aid resources in the form of grants.

Reality was different however. Chapter 2 shows that new aid came in large amounts, but that debt relief was limited. Most debt relief given during the 1990s was rescheduling which did not reduce the debt stock – on the contrary, it often increased the stock by capitalising interest. Forgiveness only applied to parts of past and current debt service, not to remaining debt stocks. On the other hand, the amounts involved in relief on bilateral debt according to Paris Club agreements did not generally substitute for other aid to Tanzania, so they were additional.

Most Dutch debt relief financed from the aid budget in the 1990s, NLG 228 million, was in the form of forgiveness of debt service on bilateral export credits. The largest part of this (NLG 121 million) was given in 1997 after the 5th Paris Club meeting, when Naples terms (67% forgiveness) were applied. The second important consisted of the contributions to the Multilateral Debt Fund (MDF), with about NLG 70 million. The third modality was forgiveness of debt service and debt stock of bilateral mixed credits (about NLG 14 million), applied in 1990 and 1991.

The conditions for Paris Club debt relief were that the country had an agreement with the IMF and was on-track. Until about 1995, the reverse was not true: the IMF did not require that debt service to Paris Club creditors would be paid in order for Tanzania to access new loans. In a way, a Paris Club agreement that rescheduled debt service and was accompanied by new grants from bilateral donors, freed the way for new multilateral loans. Multilateral institutions were preferred creditors and their debt was always serviced, with the exception of some small and temporary arrears before 1994. In practice, therefore, Paris Club creditors and donors were paying the debt service to the multilateral institutions even long before the MDF was created.

The efficiency of debt relief

Given the low amounts of forgiveness within total debt relief, annual stock reductions were usually far below 5%. The 1999 nominal debt stock was 22% lower than it would have been without the relief provided during the evaluation period. It must be born in mind, however, that most forgiveness just meant clearing earlier accumulated arrears or rescheduled debt service. Moreover, forgiveness was concentrated in the more recent years, and especially resulted from the 1997 Paris Club agreement and from the 1999 commercial debt buyback.

Most relief also had a limited effect on actual debt service paid (the flow), since Tanzania was not paying on these bilateral debts in the absence of debt relief. Multilateral debt relief given by bilateral donors did free resources, but this type of relief was only given on a substantial scale in 1998 and 1999. The flow effect of this relief was substantial, as these bilateral contributions to the Multilateral Debt Fund (MDF) financed almost half of multilateral debt service due, and almost a third of the total debt service actually paid. It was also mostly additional in the sense that the total aid flow increased at the same time. However, there was some substitution between forms of programme aid, with debt relief substituting for earlier balance of payment support.

The Dutch Paris Club relief and the relief on bilateral mixed credits did not have flow effects since these debts were not serviced by Tanzania. However, they had stock effects. The contributions to the MDF had a clear flow effect: in both 1998 and 1999, the Netherlands financed about 14% of Tanzania's multilateral debt service. Since all this debt relief came from the aid budget, it could not have been additional to regular worldwide Dutch aid, but it may have been partly additional from the viewpoint of the Tanzanian government. In addition to these amounts, Tanzania received about NLG 36 million from the Ministry of Finance as forgiveness on export credits, which clearly was additional to aid.

Tanzania has a mixed record with respect to the implementation of adjustment and reform programmes, with varying levels of commitment and quality of government – donor relations over time. Relations were strained between 1993 and 1996 due to fiscal laxity and evidence of corruption in the tax administration, especially customs. Since 1996, after the Mkapa government took power, government–donor relations are considered to be very good.

With the MDF in 1998, debt relief came for the first time with specific conditions. The donors aimed at protecting public spending in four priority sectors that were selected by the government as being important for poverty reduction, namely primary education, primary health care, water and rural roads. Donors monitored, in particular, whether recurrent spending for 'other charges' (non-wage expenditure) for these sectors was at the budgeted level. At the same time, via the increasingly government-led Public Expenditure Review (PER) process, donors, along with government and representatives of civil society, monitored a broader agenda related to public financial management, transparency, accountability and the quality of actual service delivery.

At a superficial level, figures indicate that the MDF has worked for two out of four defined priority sectors. But figures presented in Quarterly Reports of the Ministry of Finance do not exactly match with what the donors are supposed to monitor, and may even be misleading. And on the broader agenda donors still have a lot to complain about. Tracking studies for the PER show that budgeted amounts often reach district levels very late or not at all. In the areas of financial management and accountability many problems have been found. Corruption is a big issue during CG meetings but so far donors have not decided to stop disbursing debt relief or budget support. Some progress can be observed, however, as these issues are at least recognised, and some of them are considered "good advice" by the government. But it remains to be seen how much real progress will be made.

The effectiveness of debt relief

Given that debt relief hardly reduced the actual debt service burden, except for the last two years of the evaluation period, there can hardly have been a flow effect from debt relief on the balance of payments and on the government accounts. However, insofar as there has been an effect on the flow of resources, this effect cannot be separated from the effect of (other) foreign aid. The flow effect from aid and debt relief together (so mainly from aid) led to higher imports.

For the analysis of government accounts, we looked at the impact of programme aid, in particular, on the recurrent expenditure budget, since project aid generally finances the development budget. In most years, programme aid exceeded debt service, but this was not so in 1994/95 and 1995/96. Before the introduction of the cash budget in 1996, aid had a positive effect in financing part of the budget deficit, thus reducing inflation. The lower programme aid levels reduced real expenditure in the mid-1990s, including social expenditure. In all years, tax revenues as per cent of GDP remained low and it even declined in 1998/99. The combination of more aid, including more freely spendable aid in the form of debt relief in 1998 and 1999, and probably also the conditions attached to the MDF, led to significantly higher social expenditure in those years, especially in health and education. A positive impact on social indicators was, however, not yet visible in the 1990s.

The stock effect of debt relief on economic growth may operate through an increase in investment, especially private investment, and through increased creditworthiness leading to new inflows of private capital. However, the investment ratio declined in the 1990s from about 25 to 15% of GDP. Indicators for creditworthiness show a mixed picture. The ratio debt service paid/debt service due fluctuated but was below 12% over the whole decade. New inflows came about, but official multilateral loans were the largest category and private long-term lending was virtually absent. Foreign direct investment began to take off after 1994 but there was no relationship with debt relief.

Chapter 4 also analyses the effectiveness of debt relief for improving debt sustainability Available indicators based on GDF data such as debt-to-GNP and debt service-to-exports have improved since the mid-1990s. However, by 1999, the debt was still unsustainable. The role of debt relief efforts in this improvement of sustainability has been limited. Improvements mainly came about by rising exports (since 1993, but only if remittances are included) and GNP (since 1995). Prospects for long-term sustainability are bleak. If current trends with respect to export growth, interest rates and trade deficits continue, the external debt will continue to be unsustainable.

The relevance of debt relief

Economic growth was high until 1992 but then the economy stagnated until 1995. Thereafter growth rates of about 4-5 per cent were maintained. Given that there was hardly a flow effect from debt relief until 1998 and no stock effects could be observed, it is difficult to ascribe this growth to debt relief. There may have been a positive flow effect from aid in general, since aid levels were high throughout the decade, although a somewhat lower between 1993 and 1996. Given that the country has been carrying out structural adjustment programmes since 1986, and that aid levels have been high, the results are not impressive. In the "success" period from 1996 onwards, growth proved to be mainly based on construction and on the tiny mining sector, while agriculture lagged behind. Whilst the aid boom between 1986 and 1992 was related to higher growth, there may have been diminishing returns to aid after 1992 – when the "easy" phase of financing imports for increased capacity utilisation was over.

In general, the debt stock or debt sustainability indicators proved to have little influence on private investment or inflows of private capital. Other factors were far more important for private investors. Macroeconomic policies, tax policies and the availability of physical and human infrastructure figure prominently among these factors. Given the importance of government policies for private investment, there is probably an indirect effect of the debt situation on private investment. Debt relief not only frees resources and may influence policies through conditions set, but there may also be an impact on policies from debt stock reductions: for the government, the expected reduction of the debt stock and with it of future debt service due proved to be very important since it would put an end to uncertainty on future payments.

Reliable data on income poverty trends over the decade are not yet available, but non-income poverty seems to have increased. Some social indicators improved, but several others deteriorated. This means that the combination of, on average, positive per capita growth rates between 1986 and 1999, almost continuous structural adjustment programmes and a very high aid inflow has not led to a general improvement of social indicators – a disappointing conclusion. Obviously, the crisis situation in 1985 and the emphasis on economic stabilisation in donor conditions and government policies have both played a role. In the late 1990s, freely spendable programme aid (including debt relief) increased, which meant that there was some real flow effect for the first time. In addition, policy conditions became focused on protecting public spending for priority sectors in poverty reduction. This can be expected to make a difference, but it will take some time to see the effects.

In summary, although debt relief was potentially highly relevant in 1990, the actual amounts of relief provided during the 1990s were limited and had a low efficiency: they did not reduce debt service paid nor the debt stock as they were accompanied by rising debt levels. New disbursements created mainly multilateral debt, which had to be serviced with priority, but also involved some bilateral debt, which was post-cutoff date and therefore also had to be serviced with priority. Bilaterals were to a large extent financing the debt payments to the multilateral institutions. Given that there were several ORET transactions in the late 1990s, the Netherlands also contributed to this rising debt stock and increase in debt service payments. The effectiveness of debt relief through improving debt sustainability and though flow and stock effects proved limited. Given the rather modest efficiency and effectiveness of debt relief, its relevance can also only have been limited.

1 THE BUILDUP OF THE EXTERNAL DEBT, 1970-90

1.1 Introduction

The purpose of this chapter is to provide background information to the debt situation in Tanzania at the beginning of the evaluation period. Following this introduction, we discuss the general relations between creditors and Tanzania in the pre-1990 period in section 1.2. Section 1.3 presents a brief review of how the economy changed at the macro level during this period and section 1.4 presents the development of the external debt and some sustainability indicators. Section 1.5 looks at the resource flows into Tanzania arguing that several factors, including a growing realisation that the country would not be able to service the existing debt, account for the gradual switch from loans to grant aid. Section 1.6, finally, assesses the debt situation in Tanzania at the beginning of the evaluation period.

As most commentators on Tanzania's economy have noted, data are unreliable or sometimes even non-existent. Thus the World Development Indicators – arguably the most widely used source on macroeconomic data in low-income countries – does not even include figures for Tanzania's GDP prior to 1990 (WDI, 2000). This is not due to a lack of GDP data, but to the existence of many different series that are difficult to reconcile. This creates several problems. First, while the Bank of Tanzania's figure (in the year 2000) of GDP at factor cost in current prices was TSh 1,276 billion (BoT, 2000: Table 1.1), the World Development Indicators reports that the figure is TSh 1,132 billion (WDI, 2000), and the International Financial Statistics reports the figure as TSh 1,303 billion (IFS, 2000). Second, the discrepancies between different sources become wider as one goes back further in time, even though discrepancies are smaller in terms of growth rates than in terms of levels (Adam et al., 1994). Third, Tanzanian national accounts have been the subject of repeated revisions. As Bigsten and Danielson (2001, Appendix A) note, the 1997 revision of national accounts (going back to 1985) increased 1985 official GDP by about 65 per cent compared to the old series. Consequently, caution is necessary not only with non-recent data, but also with respect to the time of publication of data. Fourth, informal and non-market activities are substantial in Tanzania. Some of these are included in the national accounts under the heading "Non-Monetary GDP", and it is difficult to know how these have been estimated. In addition, some sources say that informal GDP accounts for a substantial part of economic activity and this is not included in official estimates. Maliyamkono and Bachagwa (1990) estimate this at around 30 per cent of GDP, but Sarris and van der Brink (1993) provide estimates of over 50 per cent. While the latter figure is admitted to be a "ball-park estimate", it nevertheless illustrates the range of estimates available for anyone interested in figuring out the market value of what is produced annually in Tanzania.

Data on debt produce fewer problems, mainly because data are scarce, and the only source that has (or has been willing to share) comprehensive time series is the World Bank (in the Global Development Finance, GDF). However, the GDF data are not sufficiently disaggregated for the purposes of this evaluation, so some data have been collected directly from the Bank of Tanzania's External Debt Department. These are slightly different from those in the GDF, so when possible we show all available series. An additional problem in this respect is that while national accounts are usually expressed in the national currency, external debt data are most often in US dollars. Since Tanzania's official exchange rate was overvalued between 1970 and 1993 (i.e., there was a non-zero black market premium between these years), conversion of national accounts data to US dollars presents a problem. We shall discuss this further where relevant.

1.2 Development strategies and relations with creditors

For six years after Independence in 1961 Tanzania pursued a standard post-colonial development strategy with a clear focus on developing agriculture. This resulted in rapid growth – about 7 per cent per annum for GDP and 7.5 per cent for agriculture. However, dissatisfaction began to mount in the mid 1960s, mainly because the fruits of growth were perceived to be concentrated in the hands of Asians and a few elite Africans (Raikes and Gibbon, 1996: 218-19). During this period, attempts to stimulate foreign direct investment largely failed, and concessional inflows were growing, but small in absolute numbers and limited to a few sources, primarily the U.S. and the U.K.

In 1967, President Nyerere issued the Arusha Declaration, which aimed at self-reliance and equity. Nationalisation increased in pace and the objective was state control of the commanding heights of the economy. The implementation of the Arusha Declaration – it became state policy in 1969 – put a virtual end to foreign direct investments, but concessional lending increased rapidly. Most donors – including the World Bank[1] – strongly supported Nyerere's development strategy "uncritically and enthusiastically" (OED, 2000: 1) and loans and grants were given largely in support of that strategy, without policy conditions.

In the 1970s growth slowed, and the World Bank became less enthusiastic about the policies in Tanzania; a 1974 report on agriculture criticised major aspect of agricultural policy. Despite this World Bank lending to Tanzania continued with few restrictions, increasing to USD 80 million in 1980. Bilateral loans and grants reached a temporary peak in 1979, at USD 540 million dollars (see Table 1–1). Bilateral contributions, however, rebounded somewhat in 1981 and 1982, and started a consistent downward trend only in 1983 – a trend that continued up to 1986/87. It seems that at the time, many commentators saw Tanzania's increasing problems as resulting from a series of unfortunate events – the two oil price hikes, the collapse of the East African Community, falling world market prices for raw materials, the war with Uganda – rather than inappropriate policies, so most financial assistance was given without political strings.[2]

Despite attempts from the government to resurrect the situation through a series of home-grown reform programs, the economic crisis became deeper in the early 1980s. Donors and creditors became increasingly reluctant to continue operations, particularly after the government's 1979 clash with the IMF that resulted in the Resident Representative being declared persona non grata.

In 1985, negotiations with the IMF finally succeeded and an Economic Recovery Plan (ERP) was implemented in 1986. Much was made of the fact that President Nyerere resigned at about the same time as the agreement was being signed, but it is not always mentioned that this was what the constitution required. The flows of loans and grants started to increase again, but this time most donors tied disbursement to the policy conditions in the government's agreement with the IMF. The three-year ERP was replaced in 1989 with an Enhanced Structural Adjustment Facility (ESAF). It is worth spelling out in some detail the policy instruments in these programmes as most multi- and bilateral non-project loans (and grants) were disbursed on the condition that the agreed policies were actually implemented.

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[1] Robert McNamara became President of the IBRD, the IFC and the IDA in April 1969 and personally took great interest in Tanzania: he was a close friend of Nyerere and even attended cabinet meetings (Raikes and Gibbon, 1996: 221).

[2] The exception is a 1979 stand-by credit agreed with the IMF. This was cancelled when the government failed to observe the budget ceilings.

According to Raikes and Gibbon (1996: 224), the 1986 IMF agreement had seven core components:

- Raising agricultural prices to 60-70 per cent of world market prices and reducing the incidence of price control;
- Devaluation of the currency and the gradual move to market-based allocation of foreign exchange;
- Dismantling of tariffs and other barriers to local and foreign trade;
- Reduction of the fiscal deficit by limiting expenditures, a move away from the monetisation of the deficit and restructuring of parastatals;
- Prudent monetary policy in order to cut inflation and increase real interest rates to positive levels;
- Improving revenue collection through a broadening of the tax base and increasing efficiency in collection;
- Liberalisation of consumer goods markets; improved access to agricultural inputs and transport infrastructure.

Most of these have re-appeared in later agreements with the IMF, which indicates that they were implemented only half-heartedly, if at all.

Consequently, in the pre-1990 period, it is possible to distinguish three phases in Tanzania's relations with its creditors; this is also illustrated in Table 1–1. The first phase – pre-crisis – runs from about the time of the Arusha Declaration to around 1980. Foreign aid – in the form of grants and concessional loans – was given largely on the recipient's terms, in support of the domestically formulated development strategy.

Table 1–1 Net ODA and net lending 1970-89 (USD million; 1980 prices)

	Net ODA			Net lending		
	Bilateral	**Multilateral**	**Total**	**Bilateral**	**Multilateral**	**Total**
1970	80	28	108	30	19	49
1971	101	24	125	49	16	65
1972	104	16	120	28	6	34
1973	168	18	186	59	6	65
1974	233	37	270	83	22	105
1975	359	104	463	125	49	174
1976	306	80	386	62	42	104
1977	349	79	428	88	71	159
1978	419	115	534	-111	68	-43
1979	518	144	662	22	88	110
1980	523	127	650	-84	72	-12
1981	438	156	596	39	97	136
1982	414	160	574	48	108	156
1983	354	124	478	43	80	123
1984	324	111	435	36	59	95
1985	285	79	364	21	31	52
1986	386	121	507	-44	65	21
1987	521	118	639	87	68	155
1988	544	160	704	38	81	129
1989	459	149	608	39	81	130

Sources: Adam et al. (1984), Tables 3–1 and 3–3 (data originally from DAC); deflator from IFS (2000).

The second phase – crisis – started in 1979-80, although with the benefit of hindsight one can see signs of it already in the mid 1970s. The war with Uganda, which Tanzania incorrectly assumed to be financed by Western donors, the second oil crisis, the deflationary policies in Europe and the U.S. and falling world market prices of Tanzania's exports all contributed to a drastic reduction in the rate of growth of income and exports, and a dramatic increase of the debt burden. In addition, the recession in Europe may have contributed to an increasing use of non-concessional bilateral export credit as a means of mitigating decreased demand for West European exports (Dijkstra and Hermes, 2001: 9). As noted above, while Tanzania unsuccessfully tried to cope with this situation through a series of home-grown reform programmes, donors increasingly accepted the IMF argument that deeper, faster and wider reforms were necessary.[3,4] This period which lasted up to the implementation of the ERP in 1986, has been called a war of attrition between the government and donors (Adam et al., 1994).

The final phase – reform – started in 1986. When the government accepted the IMF-designed program, the declining trend in external loans and grants was reversed. The major difference between this phase and the pre-1980 phase was that now policy changes were formulated as conditions for the IMF assistance and most donors – both bilateral- and multilateral accepted these as conditions for their own assistance.

1.3 Macroeconomic trends 1970-1990

The main macroeconomic trends follow the phases outlined above. However, as noted in the introduction, reliable data are scarce – particularly for comprehensive time series prior to 1986 – so the selection of indicators in Table 1–2 is based on availability (but cf also Table 1–4). Several comments can be made.

First, per capita income growth is calculated on the assumption that the rate of population growth is relatively constant at 2.8 per cent per annum. It is quite clear from the table that growth of income slows down towards the end of the pre-crisis phase, turns negative for most of the crisis phase and is positive, albeit low, in the first three years of the reform phase.

The gross investment ratio follows a similar pattern, at least to the extent that the ratio is high in the pre-crisis period and dips drastically around 1983. This is mostly due to reduced donor flows (private investments in the early 1980s accounted for a minor share of investments), even though the rapidly falling investment productivity is not reflected in the figures: Danielson and Mjema (1996) calculate that the incremental capital-output was negative throughout the first half of the 1980s, while it was almost 50 in 1986. This reflects negative and then very low capital productivity.

The relations between exports and imports also show a rapid deterioration beginning in the early 1980s. However, it should be noted that there is no significant recovery in that ratio in the reform phase, despite the fact that recovery of industries geared at exports was a prime

[33] The World Bank led the reversal of assistance, mainly to adjust to the changed political climate in the U.S. following the 1980 election of President Reagan. In the aggregate, bilateral assistance turned around at the same time. However, bilaterals sympathetic to Tanzania (inter alia, the Netherlands, Norway and Sweden) continued to provide assistance up to 1982/83.

[4] Domestic opposition increased as well. In 1984 a group of economics lecturers at the University of Dar es Salaam started to hold public meetings in which more market-oriented policies were advocated. Apparently, this did have an impact: some of the members of the group assisted the government in the 1985 negotiations with the IMF.

objective of the IFI-supported reforms. One reason for this is that the reforms stimulated increasing aid inflows, so imports could be increased without a concomitant rise in exports.

Inflation and monetary growth are highly correlated, as one would expect them to be when the rate of monetary expansion substantially exceeds the rate of growth of GDP. This reflects a large and persistent fiscal deficit, caused, among other things, by loss-making parastatals and an inability to substantially increase tax revenues. The external debt (last column) has grown throughout the period (see also below).

Table 1–2 Some macroeconomic indicators, 1970-1989

	Per capita growth[a]	Gross Investment[b]	Exports[c]	Trade gap[d]	Inflation[e]	Monetary growth[a]	External debt[f]
1970	3.0	23	308	n.a.	3	12	188
1971	0.8	27	331	n.a.	5	18	1,164
1972	2.3	24	384	n.a.	8	18	1,312
1973	0.5	23	426	n.a.	10	17	1,582
1974	-0.5	22	476	n.a.	20	23	1,718
1975	2.9	21	419	n.a.	26	24	1,920
1976	2.3	29	637	90	7	25	2,128
1977	-2.7	29	707	80	12	20	2,620
1978	-1.9	34	633	49	7	13	3,075
1979	0.2	34	624	57	13	47	2,858
1980	-0.2	33	677	54	30	27	3,381
1981	-3.7	29	721	61	26	18	3,723
1982	-2.6	26	553	46	29	19	3,791
1983	-5.6	19	438	56	27	18	4,035
1984	0.2	20	426	54	36	4	4,060
1985	1.4	19	460	40	33	30	4,647
1986	3.4	n.a.	276	39	32	28	4,431
1987	2.7	23	353	32	30	32	4,841
1988	1.3	17	390	39	31	33	5,253
1989	-0.6	19	374	40	26	32	5,279

Sources: Bigsten and Danielson (2001), Tables 1.1, 1.2 and 1.3; WDI (2000); IFS (2000)
[a] Percent; [b] Percent of GDP; [c] Millions of current dollars;
[d] Exports of goods and non factor services (GNFS) as percent of GNFS imports;
[e] Percentage change of consumer price index; [f] USD million, current prices

Table 1–3 summarises the macroeconomic data in terms of the phases defined above. Note that while the reform that started in 1986 immediately improved some indicators such as per capita growth, exports were not responsive, and the reforms also failed to produce stabilisation (as indicated by the rates of inflation and monetary growth). As for exports, it is notable that the decline in export proceeds that had started during the crisis phase, continued well into the reform phase – this is due mainly to a fall of world market prices and slow response from producers to liberalisation measures.[5] Coupled with largely aid-financed increases in imports, this contributed to a rapidly growing trade gap.

[5] Real prices of Tanzania's four major export commodities – coffee, sisal, cotton and tea – were calculated using data from ADI (2001). Real prices for coffee and sisal were lower in 1990 than they were ten years before. The price of cotton was roughly the same (but production had decreased for other reasons; Raikes and Gibbon, 1996: 264-65) and only tea – the least important of the four –showed a positive price development in the 1980s.

Table 1–3 Periodisation of macro indicators, annual averages

	1970-1979	1980-1985	1986-1989
Per capita growth (%)	0.7	-1.7	1.7
Gross Investment (% of GDP)	26	24	20
Exports (USD mln)	495	546	348
Export growth (%)	9.5	-4.0	-1.4
Trade gap[a]	69	52	37
Inflation (%)	11	30	29
Monetary growth (%)	21	19	31
External debt (USD mln)	1,856	3,939	4,951

Sources: Same as Table 1.2.
[a] GNFS exports as percent of GNFS imports

Table 1–4 uses data from the International Financial Statistics (IFS) to show the government's affairs during the period under consideration. One observes sharp declines in both revenues and expenditures. The latter is likely to be a consequence of the sharp retrenchment of foreign-financed development expenditure from the early 1980s. Development expenditures claimed over 10 per cent of GDP at the beginning of the 1980s – mainly a reflection of the basic industry strategy and heavy investment in social infrastructure – only to fall to 3.9 per cent of GDP in 1985/86, "a 58 per cent drop in real terms over a five-year period." (World Bank, 1991: 31). Recurrent expenditures were not hurt as badly during this period.

Furthermore, the structure of expenditure changed drastically. As development expenditures declined, debt servicing increased to almost 30 per cent of the budget by 1989. On the revenue side, collections from each major type of tax (import duties, consumption and income taxes) declined. This reflects both a decline in economic activity and the erosion of the main tax bases.

Table 1–4 Government finances, annual averages (per cent of GDP)

	1970-1979	1980-1985	1986-1989
Revenue	18.3	17.5	11.1
Grants received	1.7	1.8	2.0
Total revenue and grants	19.9	19.2	13.1
Expenditure	25.9	28.0	16.9
Lending minus repayment	0.2	0.0	0.0
Total expenditure	26.1	28.1	16.9
Budget balance	-6.2	-8.9	-3.8
Net borrowing: domestic	4.1	6.4	3.1
Net borrowing: foreign	2.1	0.9	0.7

Source: International Financial Statistics on CD-ROM, September 2001.

The consequence was, inter alia, a deteriorating fiscal balance from the early 1980s and onwards. Because of donor fatigue starting in 1980, but particularly since the 1982 crisis of confidence, most of the financing was domestic. Since before 1990 all banks were public and there were only a few domestic financial assets, domestic borrowing for the public sector could only be effected by taking deposits from the private sector. All other domestic financing of excess government expenditure and of parastatal losses in fact added to the money supply and thus to inflation (Collier and Gunning, 1991). The 2000 External Debt Strategy (United Republic of Tanzania, 1999: 29) mentions that annual domestic borrowing was below 5 per cent of total domestic revenue in the late 1980s, which most likely coincided with the amount of demand and savings deposits.

The slow-down of growth, the increasing fiscal deficit and the declining inflows of foreign finance in the first half of the 1980s obviously had consequences for investments. The investment rate improved after the crisis while at the same time – particularly after 1986 – private savings declined drastically. In addition, the first year of IMF-sponsored reforms saw an improvement in the fiscal balance, but this turned out to be temporary and from 1988 public savings were once again negative in the order of two per cent of GDP. Consequently the reliance on foreign finance increased after 1986 and in 1989 net inflow of loans was roughly 50 per cent higher than gross domestic investment. Reliable data for the entire period are not available, but some selected figures on the financing of investment are presented in Table 1–5.

Table 1–5 Macroeconomic balances, selected years (percent of GDP)

	1983	1984	1985	1986	1987	1988	1989
Gross investment	14	15	16	20	23	18	19
Private	8	10	10	12	17	14	15
Public	5	5	6	7	6	5	5
Private savings	10	9	10	11	-2	-4	-1
Public savings	-1	-1	-1	-2	3	-2	-2
Foreign saving[a]	4	5	5	8	23	25	30
Net Official Transfers	-1	-2	-1	-3	1	1	7
memo: Foreign finance[b]	33	35	34	42	95	72	154

Source: World Bank (1991, Vol II: 134) Note: Figures may not add up due to rounding
[a] Balance on current account (with reversed sign) excluding net official transfers
[b] Share of gross domestic investments that is financed by foreign savings (%).

1.4 External debt and debt sustainability 1970-1989

Table 1–6 presents the structure of the debt, averaged over the three periods identified above. There are several things worth noting. First, the share of short-term debt increases rapidly from the first to the second period. The main reason for this is the accumulation of interest arrears on bilateral debt, most of which were rescheduled in the first Paris Club negotiations in 1986; this is the reason for the rapid decline of the short-term share between the second and third periods.

Second, most of Tanzania's debt since the early 1970s has been publicly contracted or publicly guaranteed. Indeed, most of the debt that was not assumed directly by the government was contracted by parastatals with full government support. Third, the share of the debt owed to multilateral institutions has increased consistently during the period. This is a reflection of several developments, including bilateral debt cancellation, a gradual switch, for bilateral donors, from loans to grants, and increasing multilateral activity, particularly by the World Bank, following the implementation of the Economic Recovery Programme in 1986.

Finally, the share of concessional debt in the multilateral debt has increased. This reflects the gradual downgrading of Tanzania to IDA-only terms. However, the share of concessional debt in the total debt stock has decreased for the bilateral debt stock, although it is still high. This probably reflects bilateral debt reschedulings and a tendency for bilateral donors to switch from soft loans to grant aid.

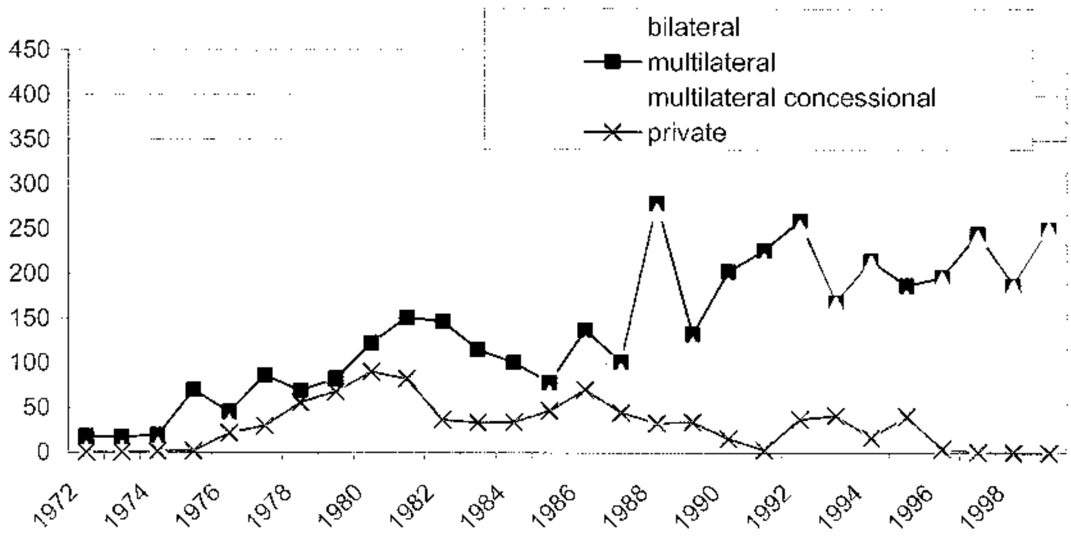
Table 1–6 Structure of debt, annual averages (per cent of DOD, except as indicated)

	1970-1979	1980-1985	1986-1989
Debt structure:			
Total Outstanding Debt (DOD)a	1,856.0	3,939.0	4,951.0
Long-term debt	78.5	32.6	89.9
Short-term debt excl IMF	19.6	64.1	7.8
IMF	1.9	3.3	2.3
Creditor structure:			
Non-guaranteed	3.0	1.6	0.3
Guaranteed (PPG)	97.0	98.4	99.7
Multilateral (% of PPG)	11.0	21.6	31.1
Bilateral (% of PPG)	87.0	70.2	59.4
Private (% of PPG)	2.0	8.3	9.5
Concessional Share (%):			
Total long-term	89.3	77.0	59.0
Multilateral	60.0	63.3	74.5
Bilateral	98.0	91.8	60.5

Source: Global Development Finance 2001 on CD-ROM
a Current USD million

Figure 1–1 also shows that bilateral loan disbursements by far constituted the highest flow of new loan inflows until 1986, and almost all of these are concessional. Multilateral loan disbursements quickly rose during the 1970s, and in particular, between 1974 and 1981. Then annual disbursements decline somewhat, to rise again from 1986 onwards. Until 1974 almost all multilateral lending is non-concessional. Although Tanzania became an IDA-only country in 1989, it continued to receive small amounts of non-concessional lending from other multilateral banks in the 1990s. Private loans were the smallest category among disbursements to the private sector. However, what is more surprising is that there were private disbursements to the public sector. These were probably all non-concessional. The GDF data show that only a tiny proportion of these private disbursements came from commercial banks. The major share must have come from private firms.

Figure 1–1 Disbursements on public (PPG) debt, 1972-1999 by type of creditor (current USD million)1



Source: GDF, 2001.

[1]Although figures are available for 1970 and 1971, these years have been excluded since bilateral disbursements were at the very high level of USD 855 million in 1971.

On the demand side, a reason for the debt buildup was of course that Tanzania was short of investable funds and needed to borrow. However, there is also an important supply side factor. In the 1970s, Tanzania was a very popular country among bilateral and multilateral donors. At the time, almost all aid was given in the form of loans, not grants, so leading to debt. As shown above, donors uncritically supported Tanzania's development strategy in the 1970s. Multilateral lending, probably on projects already conceived of or started, continued in the first half of the 1980s. One of the persons we interviewed quoted a World Bank representative in Tanzania in the 1980s as saying "We were outright immoral in providing all these loans to Tanzania, knowing that the country would be unable to repay."

In Table 1–7 we present estimates of two commonly used debt indicators: the debt-to-GDP ratio and the amount of debt service in relation to proceeds from export of goods and non-factor services. Caution should be exercised in the interpretation of the numbers as GDP data come from the un-revised national accounts, and thus are likely to substantially underestimate total production. In addition, debt servicing data and export data come from two different data sources and the latter is likely to underestimate exports, because of smuggling and overestimate exports because of over-invoicing (but a priori we cannot say anything about the net effect (Mpango, 1996).

Table 1.7 Debt ratios in per cent, 1970-89; annual averages.

	Debt/GDP[a]	Debt Service/ Exports[b]	Interest payments/ Exports[b]	Principal repayments/ Exports[b]
1970-79	97	6.5	3.2	3.2
1980-85	131	20.5	8.1	12.3
1986-89	220	36.0	13.0	22.9

Sources: Debt stocks and debt servicing from GDF (2001); GDP data from Bigsten and Danielson (2001: Appendix A) ; Official exchange rates and export earnings from IFS (2001).

a Total outstanding debt (excluding IMF) as percent of GDP.

b Debt servicing on long-term debt in percent of exports of goods and non-factor services. The sum of interest payments and principal repayment equals debt servicing.

The debt burden increased consistently throughout the period. Analysis of the annual data identifies a turning point between 1982 and 1983: the debt ratio increased from 105 to 139. However, this is not because of an increase in the rate at which new loans were contracted, but rather because of a steep decline in GDP that levels out towards the end of the 1980s. In addition, in the two first Paris Club negotiations (in 1986 and 1988, respectively), Tanzania's debt was mainly rescheduled rather than cancelled which increased the debt burden through recapitalisation of interest.

Table 1–8 shows arrears, averaged over the three periods. These are cumulative, meaning that the stock of arrears is non-decreasing as long as arrears are not repaid or cancelled. The major things to notice from the table are that interest arrears increase six-fold between the first and second period, and decrease even more in the second half of the 1980s. Principal arrears increased only a couple of years later, which may be a result of the debt maturity structure. The reduction in the stock of arrears was probably a result of the Paris Club negotiations in 1986 and 1988 that rescheduled part of the bilateral debt. Consequently, the accumulated interest and principal payments in arrears were no longer registered as arrears but moved to the long-term debt stock. This only meant a postponement of the debt service problem. It should also be noted that the share of debt service due that was actually paid, increased in the later part of the 1980s, probably also as a result of the Paris Club agreements.

Table 1–8 Structure and volume of arrears; annual averages

	1970-1979	1980-1985	1986-1989
Interest arrears, LDOD (USD man.)	375	2,276	250
Interest arrears, official (%)	80	99	65
Principal arrears, LDOD (USD mln.)	111	886	548
Principal arrears, official (%)	86	97	84
Total arrears on LDOD (USD mln.)	486	3,162	798
Total arrears, official (%)	90	98	78
Debt service paid/debt service due (%)	6.8	3.2	12.0

Source: Global Development Finance 2001 on CD-ROM
Note: Arrears are shown in the Global Development Finance on a cumulative basis (GDF, 2001, Vol II: xv). Debt service due is computed by adding stock of arrears to debt service paid (GDF does not contain data on forgiveness or rescheduling before 1989).

1.5 Resource flows

One of the problems associated with a large debt is that it drains resources of the indebted country. In Tanzania, where the bulk of the debt is publicly guaranteed, it drains the resources of the government – resources that otherwise could have been used to increase spending on growth-promoting or poverty-alleviating activities. Consequently, when the debt builds up, one possibility is that an increasing share of the government's resources is used to service that debt. Alternatively, the outflow of resources associated with an external debt may be matched by inflows of new loans, or grants. The analysis of resource flows combines several aspects of the debt issue: the size of the debt, the amount and terms of new loans, and the amount of non debt-creating inflows of foreign exchange.

The standard debt accounting (which is the one used by the World Bank in the Global Development Finance) is to focus the analysis on four core concepts: Net Resource Flows on debt (NRF), which equals disbursement of new loans less repayment of old loans; Net Transfers on debt (NTD), which equals disbursements of new loans less total debt servicing (or, which is the same thing, NRF less interest payment on existing loans); Aggregate Resource Flows (ARF), which equal NRF plus net non debt-creating flows, such as foreign direct investments or aid grants; and Aggregate Net Transfers (ANT) which equals ARF less payment of interest and repatriation of FDI profits.

ANT measures the net inflow of resources into the economy, irrespective of whether these are related to debt or not. In many ways this is the central concept as it reflects the amount of additional resources that are available for a country during the period in question. However, for the purposes of this report, NTD is also relevant as it shows to what extent the country receives more in new loans than it pays in debt service. In addition, NTD is interesting as a highly positive NTD for an extended period of time may reflect an unsustainable situation.

Table 1–9 Resource flows 1970-1989, annual averages (current USD million)

	1970-1979	1980-1985	1986-1989
Loan disbursement (USD mln)	226	248	213
Principal repayment	17	22	27
Net Resource Flows	243	270	240
Other Flows	118	166	200
o/w: FDI, net inflows	0	0	2
Aggregate Resource Flows	361	435	440
Interest payments	-23	-28	-32
Net Transfers on Debt	220	242	208
Aggregate Net Transfers	338	408	408

Source: GDF (2001).

Note: Debt flows relate to total debt, including IMF.

Table 1–10 sets out the central data on foreign exchange resource flows, again averaged over the three periods. It should be clear that the bulk of the item "other flows" consists of aid grants, as both foreign direct investments and other non debt-creating flows (such as portfolio equity flows) were negligible. The most interesting trend is how grants increase in relation to loan disbursement. Analysis of the annual data reveals that the net resource flow exceeded other flows for virtually every year up to 1984 and declined consistently after that while aid flows increased, particularly from 1986. This reflects two facts noted above: first, that Tanzania entered a second "aid boom" after the implementation of reforms in 1986 and second, that bilateral donors gradually substituted grant aid for concessional loans from around 1980.

This, however, did not imply that the Net Resource Flow on debt became negative; as the table shows, it remains roughly constant around USD 250 million a year throughout the period. The reasons for a constant NRF on debt are several, including continuing accumulation of arrears on outstanding debt (Table 1–8), increasingly softer terms for new loans, notably lower interest rates (Table 1–9), and cancellations of bilateral debts (see below). Indeed, one possibility why bilateral donors gradually switched from soft loans to grants may be the growing realisation, at the beginning of the 1980s, that Tanzania would not be able to repay the existing debt, much less service new loans. This would possibly also explain why bilateral donors have consistently accepted default on existing loans while continuing to provide new resources.

The data source used for this evaluation does not provide any information on debt relief prior to 1989. This does not mean that no relief was offered. Tanzania went to the Paris Club twice in the 1980s and negotiated substantial reschedulings of the existing debt. The first Paris Club negotiation resulted in a five-year rescheduling on USD 722.9 million worth of debt and the second negotiation in a cancellation of USD 22.3 million and rescheduling of the remainder (about USD 372.9 million) (United Republic of Tanzania, 1999). In addition, the National Debt Strategy states that "Between 1978 to mid-1997 total debts worth USD 1,044 million were cancelled." (United Republic of Tanzania, 1999: 37).

Even though we are not able to document the flow of debt relief to Tanzania in the period preceding the evaluation period, it could be argued that much of that relief did have a negligible impact; indeed, it may even have decreased the flow of resources available to the country. This was the case if two conditions were satisfied: (i) Tanzania would not have serviced the debt in the absence of relief; and (ii) debt relief came out of the aid budget for the country. Table 1–8 shows that Tanzania was in fact paying very little of the debt service due. And as to the second condition, it is unlikely that debt reschedulings were financed out of aid budgets, but it is possible that debt cancellation was, since cancellation or forgiveness often applied to ODA loans. In those cases, debt relief may have decreased the incoming flow of resources, but forgiveness may still have had a beneficial effect because it prevented the nominal debt stock from increasing further due to accumulating arrears.

1.6 The debt situation in 1990: Conclusion

In 1990, Tanzania had been implementing IMF-endorsed economic reforms for about four years. The Economic Recovery Programme had been replaced by the Economic and Social Action Programme (ESAP) that was scheduled to run from 1989 to 1992. Internal opposition to reforms was still fierce and the thrust of the reform program was crisis management rather than a determined move towards liberalisation (Mans, 1994; Bigsten and Danielson, 2001). Growth of income was still weak, and the economy in general and the export sector in particular showed few signs of response to the measures being taken.

In spite of these hesitant reforms, external lending continued and the external debt continued to grow, both in dollar terms and as share of GDP. The ratio of debt to GDP increased from 122 per cent in 1988 to 161 per cent two years later (Bigsten and Danielson, 2001: Table II.4.1). Several devaluations in the late 1980s coupled with relatively weak export growth increased the debt servicing ratio rapidly – from 21 per cent in 1980 to 33 per cent in 1990.

The growing debt service took an increasing chunk of the public budget – and the problem was exacerbated by the government's inability or unwillingness to increase revenues substantially. Interest payments on foreign and domestic debt increased from 8.7 per cent of total expenditure in FY86 to 15.6 per cent in FY89. Since privatisations hardly occurred in this period, the government also had the burden of financing loss-making parastatals. Consequently most projects aimed at increasing economic growth were financed by donors, and even if many bilateral donors by 1990 had abandoned the policy of giving soft loans, the multilateral institutions' loans were adding to the debt burden (the net resource flow on debt was about USD 250 million in 1990).

The debt situation was clearly unsustainable in the sense that the total debt stock was increasing faster than GDP. In addition, increasing the rate of growth would require not only economic reforms but large-scale investments in sectors traditionally associated with the public sector – in particular rural infrastructure. Since the government could not, for several reasons, mobilise sufficient resources domestically, it had to resort to donor finance, part of which came in the form of loans and much of which was tied to projects. It is difficult to characterise the situation in 1990 as anything but insolvency.

It is important to realise that while gross flows were very large, net flows were much smaller. Instead of taking action that would reduce the debt stock radically, donors preferred to combine reschedulings of debt service with providing new resources to Tanzania. Only a small part of these resources was freely spendable, while the lion's part was tied to projects. The few freely spendable resources that flowed in, flowed out again as debt service. From Tanzania's point of view it would probably have been better to get substantial reductions in the debt stock, so that debt service due could have been reduced. After all, the debt buildup cannot only be ascribed to irresponsible borrowing. Irresponsible lending also played an important role. With a lower debt service, the country could have devoted more resources to its national development.

2 INPUTS: DEBT RELIEF 1990-1999

2.1 Introduction

The previous chapter showed that at the beginning of the 1990s Tanzania was faced with a severe debt situation. The economy was still recovering from the deep crisis of the early 1980s, and the economic reforms had not yet shown an impact; much of what was done by way of reform in the late 1980s was crisis management, rather than reforms proper. The external debt was large and growing – about 150 per cent of GDP in 1989 with bleak prospects for the near future – and debt servicing constituted a major part of both forex use and government expenditure. And even though debt service took almost one-third of export revenues in 1989/90, roughly half of the external debt was not serviced according to contract.

Donors gradually recognised the severity of the situation and the external debt became a major issue among donors during the 1990s, culminating in the creation of the Multilateral Debt Fund (MDF) in 1998 and the reaching of the HIPC Decision Point in 2000. However, long before the creation of the MDF, donors tried to alleviate the debt burden through various forms of relief; the purpose of this chapter is to review and document those as far as the available data allow.

The chapter is organised as follows. Section 2.2 describes amounts and modalities of debt relief as far as these are available in our sources. Section 2.3 outlines objectives and conditions of debt relief and Section 2.4 discusses to what extent debt relief was additional to other forms of aid. Section 2.5 outlines the particularities of Dutch debt relief and Section 2.6 concludes.

2.2 Amounts of debt relief

Debt relief may take many different forms. Tanzania has enjoyed the following four broad modalities during the evaluation period. First is rescheduling according to which payment is deferred until a later time. This is usually accompanied by capitalisation of interest and so does not reduce the net present value of the debt stock. It does reduce the current debt service flow, however, and for this reason it is included in this report. A second form is forgiveness on debt service flows. This may imply outright cancellation of a percentage of debt service due, or rescheduling on softer conditions than stipulated in the original loan contract by increasing maturity, extending the grace period or lowering the rate of interest. Third is forgiveness on the debt stock: debt is prematurely retired. This may occur in the form of forgiveness of outstanding bilateral loans, or debt buybacks of commercial loans. In a debt buyback, the debtor is allowed to purchase the debt at a discount – often with funds from donors, in which case the full amount of the buyback is cancelled. Commercial debt reduction may also be achieved through debt conversion arrangements in which a third party buys outstanding claims at a discount and invests in e.g., equity or bonds in the debtor country. Fourth is multilateral debt relief whereby bilateral donors provide aid funds earmarked for servicing multilateral debt.

Table 2–1 shows amounts of debt rescheduled or prematurely retired for the period 1990-99. There are several things to note. First, the amount of debt relief has fluctuated significantly throughout the years. For some years, the amount of debt forgiven has exceeded the amount actually paid in debt service, but for most of the period the amount forgiven is significantly less than debt service paid. If we add to this the roughly USD 250 million per annum that Tanzania (up to 1995) accumulated in debt arrears, the size of the contractual debt service is in the neighbourhood of USD 600 million per annum, which in the early 1990s exceeded the entire proceeds from exports of goods and non-factor services.

Table 2–1 Debt rescheduling and reduction 1990-1999 (current USD million)

	Rescheduling		Forgiveness		Stock	Debt	Total	Total
	Principal	Interest	Principal	Interest	reduction	service paid	Rescheduled	Forgiven
1990	35	147	102	10	0	179	182	112
1991	5	2	135	37	0	207	7	172
1992	159	189	124	32	0	236	348	156
1993	25	33	193	39	0	211	58	132
1994	6	3	85	16	0	184	9	101
1995	0	0	140	0	0	232	0	140
1996	0	33	29	1	0	271	33	30
1997	33	727	246	92	11	165	760	349
1998	30	122	70	0	0	246	152	70
1999	2	66	26	0	0	194	68	26
Total	295	1,322	1,150	227	11	2,125	1,617	1,288

Source: GDF (2001)

However, Table 2–1 understates the amount of debt relief offered to Tanzania, since it does not include relief by bilaterals on multilateral debt service. According to officials in both the Treasury and the Bank of Tanzania, this type of relief has not been given until 1998, when the Multilateral Debt Fund (MDF) came into operation. However, we know that Sweden has given programme aid in the early 1990s in the form of 5th dimension debt relief (payment of multilateral debt service on behalf of Tanzania). This occurred in FY 1990/91 and 1991/92 and amounted to SEK 118.5 million, at the time some USD 20 million. We also know that the Netherlands began providing relief on multilateral debt service in 1998. Probably, the amount of multilateral debt relief given before 1998 was small: in the early 1990s, most bilateral programme aid was provided as import support, and in the mid-1990s the programme aid amounts from bilateral donors were reduced (Van Donge and White, 1999).

After relations with the IMF had returned to normal and a new ESAF had been signed in 1996, bilateral donors were willing to provide additional debt relief, and Tanzania applied for a new Paris Club round to be held in 1997. However, it also became clearer that multilateral debt increased as a share of total debt,[6] so in order to come to terms with the external debt problem, something would have to be done about the multilateral debt service. In the same year, the Government asked donors to contribute to a debt fund, set up to facilitate timely servicing of Tanzania's multilateral debt. Initially, seven donors — Denmark, Finland, Ireland, the Netherlands, Norway, Sweden, Switzerland— provided support amounting to almost USD 70 million per annum (Table 2–2).

In practice, donors disbursed foreign exchange to an account at the Bank of Tanzania (BoT). The government withdrew funds as needed, i.e., as multilateral debts fell due. As dialogue and co-operation were central to the MDF, it was agreed to follow its development through quarterly meetings between the government and participating donors where the former would present recent macroeconomic developments, the structure of multilateral debt servicing, and the status of the MDF account. Donors, on

[6] Multilateral debt increased from about 30 per cent of the total debt stock in 1989 to over 40 per cent in 1997 (GDF, 2001).

their part, were to present pledges and to explain possible differences between commitments and disbursements.

The documents produced by the government for these meetings are the best available source for multilateral debt relief since 1998,[7] so for the last part of the evaluation period it is possible to get a rather accurate picture of the total amount of debt relief. Table 2–2. presents these MDF figures as well as debt relief from Paris Club negotiations according to Bank of Tanzania (BoT) data, other BoT data on debt conversion schemes and debt buybacks and information on the relief given in the HIPC context.

Table 2–2 Debt relief 1990-2000 (USD million)

	Paris Club					Total	
	forgiveness	Rescheduling	MDF	Other	HIPC	rescheduled	forgiven
1990	19	199				199	19
1991						0	0
1992	183	458				458	183
1993				182[b]		0	182
1994						0	0
1995						0	0
1996						0	0
1997	861	885				885	861
1998			67			0	67
1999			55	253[c]		0	308
2000	226	26	91		224[d]	26	541
Total	**1,289**	**1,568**	**213**	**435**	**224**	**1,568**	**2,161**

Sources: Reports from MDF quarterly meetings; United Republic of Tanzania (1999); Paris Club data from External debt department, Bank of Tanzania.
Notes: Data on the relief negotiated in the Paris Club in 1997 differ significantly between the GoT (1999: 37) and data from the Bank of Tanzania collected in June, 2001. We have chosen to use the latter for the simple reason that they are more recent. Year for Paris Club rescheduling is year of commitment, so the actual relief may flow over several years. Note also that debt relief data from the DAC CRS (Creditor Reporting System) database differ considerably from the data here (cf. Table 2–4) but that the information is not sufficient to disentangle the aggregations in the CRS.
a Includes disbursements into the Poverty Reduction Budget Support facility (PRBS), the successor to the MDF.
b Resulting from the Debt Conversion Programme that ran from 1990 to 1993 (United Republic of Tanzania, 1999: 38).
c The Debt Buyback Scheme, originally scheduled for 1994 but suspended due to non-performance on the ESAF. According to the National Debt Strategy the DBS was scheduled to be completed in 1999 with funds from IDA, Switzerland and Germany.
d Includes estimated interim debt relief under the enhanced HIPC Initiative from April 2000 to June 2001.

The data indicate that debt forgiveness and relief on multilateral debt has become more important (in volume terms) in recent years. This is probably related to the intensified debate in the later half of the 1990s on debt and debt relief, as manifested in the Jubilee 2000 movement, and the emergence of the HIPC initiative. It is also clear that the totals of Table 2–2, even if we would exclude the year 2000, are slightly higher than those of Table 2–1.

[7] One assumption here, of course, is that all donors that provided multilateral debt relief did so within the MDF framework so that the total amount of debt relief can be found by simply adding the sum paid into the MDF account to the debt relief provided within the Paris Club. There are details in the MDF documentation which are not entirely clear – thus a credit item in early 2000 is an IDA refund which we have not been able to explain – but in general the sums are accurate (and have also been checked by donors themselves in the quarterly meetings).

2.3 Objectives and conditions of debt relief

This section reviews the objectives of, and conditions for debt relief: first for debt relief through Paris Club Agreements, then for bilateral relief on multilateral debts, and finally for the HIPC initiative.

2.3.1 Paris Club debt relief

The main objective for debt relief given through the Paris Club agreements usually is to improve the sustainability of debt and debt service. By relieving the current debt service flow and at the same time providing new aid money, it was hoped that Tanzania would be able to grow out of the debt and pay future debt service normally. The standard condition for Paris Club agreements be that there was an agreement with the IMF. An IMF agreement include macroeconomic conditions relating to macroeconomic stabilisation and structural benchmarks regarding institutional reforms. When such a structural adjustment programme was off-track, as between 1993 and 1995, there was also no new Paris Club agreement (Table 2–3).

Table 2.3 Relationship between IMF agreements and relief on bilateral debt

	IMF Agreement	Compliance	Debt relief
1986	Economic Recovery Program	Partial	1986: PC I 1988: PC II
1989	ESAF 1	Partial	1990: PC III
1991	ESAF 2	Suspended in 1993; staff- monitored programmes '93-'96	1992: PC IV
1996	ESAF 3	Yes	1997: PC V 1998: MDF
1999	ESAF 4/PRGF	Yes	2000: PC VI 2000: HIPC Decision Point

2.3.2 Relief on multilateral debt and the MDF

Relief on multilateral debt by bilateral donors was decided on in the context of aid policies. The overarching objective of development aid is – for a majority of donors – poverty reduction (cf. Lensink and White 1999: Table 2–1 for a summary of aid objectives). Consequently, the objective of this type of debt relief (relief on multilateral debt service) is poverty reduction, too. However, the mechanism from the disbursement of aid to the achievement of the objective may differ between donors and – more importantly – over time. Thus, for instance, while in the early 1990s Sweden emphasised the lack of foreign exchange as a rationale for import support and debt relief to Tanzania, the main rationale towards the later half of the 1990s was the generation of countervalue funds to be used by the government to help alleviate poverty.

This is a change of attitude that most donors have in common and it is basically a result of the change of foreign exchange regime in Tanzania. After a few years of gradual liberalisation (details are in Doriye et al., 1998), the currency started to float in 1993 and most restrictions on forex trading were at that time effectively removed. This means that for all practical purposes it was no longer meaningful to think of Tanzania's growth as being hampered by a lack of foreign exchange. Consequently, the inflow of foreign exchange could no longer be considered the most important aspect of this type of debt relief, and the other flow that it generates –freeing resources on the government – came into focus. In addition, the macroeconomic situation improved markedly from 1995 onwards: inflation fell, the fiscal gap was closed and growth resumed, albeit slowly. This, too, contributed to changing the donors' attention to achieving poverty reduction in a more direct way through influencing the budget allocation.

Bilateral donors to the MDF made their contributions conditional on the existence of an IMF agreement, but attached other conditions as well to this form of non-project support. These conditions included for example, increased democratisation, improvement of the role of women, and the curbing of corruption. Often these conditions are not part of the ESAF/PRGF agreement, so non-compliance of these mean that the bilateral flow of non-project aid may be frozen despite the country being declared on-track by the multilaterals. The reverse may also occur however: bilateral donors continuing their non-project aid despite the country being off-track (Chapter 3).

Furthermore, a specific condition for the MDF was that the government would protect spending to "priority sectors". Which sectors should be declared as priority sectors and the amounts budgeted for them was decided by Tanzania and approved by Parliament (Government of Tanzania & Donors, 2000). Priority sectors according to the National Poverty Eradication Strategy, which was later transformed into the Interim Poverty Reduction Strategy Paper, included agriculture, roads, water, education and health (IDA, 2000). However, with the start of the MDF, it was decided to focus attention on education, health, water and roads. The Ministry of Finance provided participating donors with quarterly reports on actual spending by category. Donors monitored, in particular, whether the priority sectors received full funding as allocated in the budget.

Throughout much of the 1990s the government budget was based on highly optimistic forecasts of tax revenue and foreign aid. As these projections often did not materialise, actual allocations for several sectors fell short of what was budgeted. The idea of the MDF was to protect the priority sectors from such shortfalls. According to the MDF Technical Note, donors participating in the MDF reserved the right to select which sectors to focus on (i.e., not all priority sectors were monitored by all donors).

It is important in this connection to say something about the cash budget. It was introduced in 1996 and it implied that Government no longer could spend more in, say, September than what it earned – in revenue and inflows of aid – in August. Expenditure items are prioritised with debt service – external and domestic – as the first priority. Second is salaries in all sectors. Third is non-salary items ("other charges", OC) for priority sectors and fourth is OC for non-priority sectors. Development expenditures are excluded from the cash budget as most of these are financed from project aid, although the counterpart funds sometimes come from the recurrent budget.[8]

Other charges include all recurrent expenditures except salaries. This means that if the government receives in any given month less revenue – in taxes or aid – than projected, the residual – in reality other charges in non-priority sectors – will suffer. This generally happens, since projections on revenues and grants are always too optimistic. This is the major rationale for the MDF condition that allocations to priority sectors should be protected. Since salaries have a higher priority under the cash budget than OC, donors monitor primarily OC allocations to priority sectors.

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[8] The government is nominally required to contribute part of the funding for projects that are mostly donor-financed (counterpart funds). The extent to which this is actually the case is unknown. Interviews at the Treasury revealed that there is no hard and fast rule as to which budget that should finance counterpart funds. The interviews also revealed that the rate of project implementation has gone down since the implementation of the cash budget, because of lack of counterpart funds.

When Tanzania reached the HIPC Decision Point in April 2000 and began to receive interim debt relief from the multilaterals themselves, the remaining multilateral debt service was no longer sufficient to absorb the funds in the MDF. Since the MDF had worked to everybody's satisfaction, it was decided to continue with this setup but to provide budget support instead, and the name of the MDF was changed into Poverty Reduction Budget Support (PRBS) facility. With the PRBS, involvement of the UK increased and the EU also joined. Donors increasingly began to focus on wider governance issues regarding public expenditure, in particular issues of financial management, accountability and actual service delivery. For example, they pushed for more interaction with Parliament and for improving public accountability in general. Several donors remarked that they were willing to channel more resources as budget support but they wanted to be sure that the money is used well. Some donors commissioned a Country Financial Accountability Assessment (CFAA) in 2000.

2.3.3 The HIPC initiative

Tanzania did not attempt to qualify for the original HIPC initiative launched in 1996. The country could not present a good "track record" at that time, as it had just resumed relations with the IMF. Conditions for the enhanced HIPC initiative of 1999 included continuation of macro stability according to benchmarks laid down in the ESAF/PRGF agreement, and the preparation – in a participatory way –of a Poverty Reduction Strategy Paper (PRSP). This PRSP had to be endorsed by the Boards of the IMF and the World Bank. Tanzania passed the Decision Point for the Enhanced HIPC Initiative in April 2000 on the basis of an Interim PRSP, which was later expanded into a full PRSP.

The objective of multilateral debt relief in the context of HIPC is that the money freed will be used for poverty reduction. In this sense, there is some complementarity with the MDF/PRBS framework. While the Ministry of Finance reports to the donors participating in the MDF/PRBS, the Vice Presidency is involved in writing and co-ordinating the work on drafting the PRSP and the progress reports on the strategy. The office of the Vice Presidency also co-ordinates the participation of civil society in elaborating the PRSP. The progress reports obviously contain partly the same information as the quarterly reports for the PRBS. But whilst PRBS focuses on a comparison of actual spending with budgeted spending, for the PRSP the budgets themselves also matter: the resources "freed" by HIPC debt relief should lead to additional expenditure for the priority sectors.

Bilateral donors look upon the PRSP as the most important policy document that also guides the monitoring of the PRBS. They see the PRBS as a way to go beyond the establishment of budget priorities and in this sense it is complementary to the PRSP process. However, several bilateral donors see the danger that PRSP and PRBS together burden the government with additional reporting requirements. They would like to see one integrated system of monitoring and assessment of budget support, in which the World Bank would also participate. Some bilateral donors argue that the PRBS donors as a group provide more budget support than the Bank, so that the Bank would have to integrate its monitoring with the PRBS. This does not seem very realistic, since the World Bank claims that it uses its aid money to push for and to ease the implementation of specific structural reforms.[9] A high official of the Ministry of Finance was not worried about the additional reporting burden for PRSP and PRBS. In his view, the same information could be given for both processes. He saw the requirement to achieve increased transparency on budget accounting and reporting as 'good advice', not as a condition. This seems to be in line with what Harrison termed the 'post-conditionality regime', in which donor conditions have been internalised by local politicians (Harrison, 2001; see also Chapter 3).

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[9] Interview with World Bank representative.

2.3.4 Conclusion

In sum, conditions for debt relief and for budget support have become more extensive over time. While the donor community still attached great importance to macroeconomic policies and structural reforms, poverty reduction via the allocation of government expenditure also became important. In the MDF/PRBS, donors monitor the actual allocation of spending and compare it with budgeted spending. The IFIs monitor whether resources freed by HIPC relief lead to additional allocations to priority sectors. In addition, they monitor the extent of participation in the preparation of the PRSP.

In a way, the PRSP conditionality implies a return to an "old" form of conditionality in which donors attempt to set conditions for the allocation of funding – although, in principle, Tanzania sets the priorities for this spending. The conditionality in the MDF/PRBS is of a slightly different nature. Donors accept and understand that aid money is fungible and they avoid micro-management of resource flows. The condition is not that all countervalue funds of debt relief, or budget support funds, be allocated to priority sectors, but only that the government make sure that these sectors receive the full 100 per cent of the budgeted allocations. At the same time, donors attempt to influence budget execution in a broader sense, including transparency, accountability and the quality of actual service delivery. In Chapter 3 we review whether these conditions result in the desired government behaviour.

2.4 Additionality of debt relief

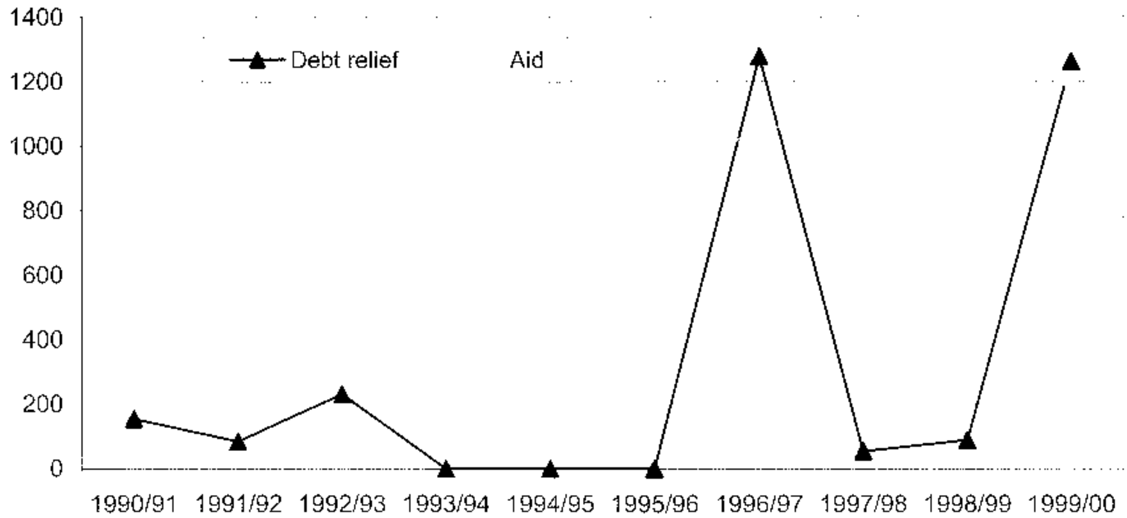
It is important to examine whether debt relief is additional to other aid flows to Tanzania. In order to do this, one would need to know the counterfactual: how much aid would Tanzania have received in the absence of debt relief. This will be different for different donors and creditors. Some debt relief is completely independent of aid, for example debt write-offs by private creditors or by creditors who do not provide aid (or no longer did during the 1990s). In other cases, debt relief granted to Tanzania may have been given at the expense of aid to other countries, but then it is still "additional" from the point of view of Tanzania. It may also be the case that debt relief has substituted for other aid flows to Tanzania, for example if debt forgiveness has substituted for aid in general, or if debt relief from bilateral donors on multilateral debt service has substituted for other forms of programme aid, for instance budget support or balance of payments support. However, it is difficult to assess this fully since it is impossible to know the amounts of aid that donors would have given to Tanzania in the absence of debt relief (even for the Netherlands this cannot be established, see below).

From the viewpoint of Tanzania it is not necessary to make such detailed assessments of the counterfactual. The most relevant issue to the Tanzanian government is to examine what actually happened to aid flows in the years that there was debt relief, or that debt relief was higher than in other years. In order to do this, we need figures of debt relief and aid flows from the same source. These can be derived from IMF balance of payments data (see Table 3–1 below). Debt relief in these figures most likely includes Paris Club relief and probably also the debt conversion schemes of the early 1990s. Aid is the sum of government transfers on the current account and loan inflows on the capital account.[10] Figure 2–1 indicates that debt relief has probably been additional to other aid in Tanzania. There was a gradual decline in total aid between 1992 and 1995, but debt relief was also zero between 1993 and 1995. The aid reduction does not seem linked to an increase in debt relief, but rather to the strained relationships between the government of Tanzania

[10] Assuming that all loans to the public sector were concessional and that loans to the private sector were negligible in this period – so there is a slight overestimation of aid.

and the donors in that period. In some recent years, debt relief from the Paris Club and through the HIPC initiative (1999/2000) has been very large, but this has not been accompanied by lower aid flows.

Figure 2–1 Debt relief and aid (USD million)



Source: Elaboration of data from Table 3–1

Table 2–4 Composition of programme aid (USD million and per cent)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Amounts												
Structural adjustment	20	9	28	55	6	18	16	0	21	136	0	78
Balance of payment	103	90	124	74	21	0	33	43	8	4	0	0
Budget	0	0	0	0	0	0	0	15	0	0	0	35
Debt relief	13	23	7	9	340	11	42	17	87	224	92	162
Total	136	122	159	138	367	29	91	75	116	364	92	275
Shares, in %:												
Structural adjustment	15	7	18	40	2	62	18	0	18	37	0	28
Balance of payment	76	74	78	54	6	0	36	57	7	1	0	0
Budget	0	0	0	0	0	0	0	20	0	0	0	13
Debt relief	10	19	4	7	93	38	46	23	75	62	100	59
Total	100	100	100	100	100	100	100	100	100	100	100	100

Source: OECD/DAC, Creditor Reporting System

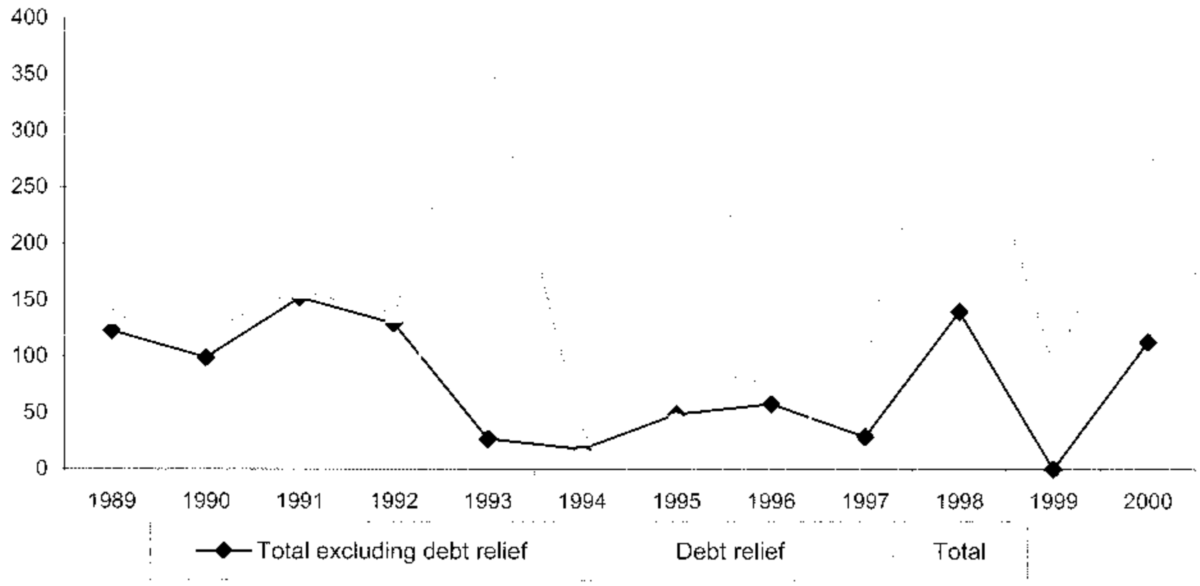
Note: Classification is according to the CRS system. "Structural Adjustment" is code 51010; "Balance of Payment" is the sum of codes 53010 (Balance of payment support), and 53030 and 53040 (Import support for capital goods and commodities, respectively): "Budget" is code 53020 (Budget support); and "Debt Relief" is the sum of codes 60010 (Action relating to debt), 60020 (Debt forgiveness), 60030 (Relief of multilateral debt), 60040 (Rescheduling and refinancing) and 60063 (Debt buyback). The reservations expressed earlier in this chapter regarding the completeness of the data in the DAC CRS database apply here as well, including the remark made in the note to Table 2–2 that the DAC CRS data are not consistent with those from other sources.

[a] Preliminary

Although aid in general does not seems to have been reduced in the presence of programme aid, it is possible that debt relief has substituted for other forms of programme aid, such as balance of payments support or budget support. Available data from the DACs CRS database are presented in Table 2–4. This shows that the share of debt relief in total programme aid has increased during the 1990s. The peak in 1993 corresponds to the fourth Paris Club agreement (concluded in 1992) in which almost USD 200 million worth of debt service was written off during the 30 months' consolidation period and the remainder was rescheduled over 23 years. The next peak, in 1998 corresponds to the 1997 Paris Club agreement whereby the net present value of the debt was reduced by 67 per cent under Naples terms (about half was cancelled and the remainder rescheduled). Even without these peaks, however, debt relief as a share of programme aid has increased consistently.

If we look at the total amount of programme aid disbursed during the period, including part of Paris Club debt relief, it is clear that there are peaks in 1993 and 1998 as well. However, programme aid net of debt relief shows virtually no trend at all (Figure 2–2). In fact, the only "trend" (although not significantly different from zero) that one can identify is negative, mainly due to decreasing balance of payment support. The one exception to this is the peak in 1998 when a relatively large amount was disbursed as support to structural adjustment (code 51010). This is likely to correspond to the release of funds from the IMF: in August that year SDR 35.7 million was disbursed under the PRGF, and the World Bank also disbursed funds under the Structural Adjustment Credit.

Figure 2–2 Programme aid to Tanzania: total, debt relief, and total excluding debt relief (USD million)



Source: Table 2–4

Since the share of debt relief in total programme aid has increased throughout the 1990s and as programme aid net of debt relief has slightly fallen over the decade (with the exception of 1998), the conclusion is that there has been some substitution from other forms of programme aid, notably balance of payment support, to debt relief. Consequently, the net impact on the availability of freely spendable resources of debt relief is smaller that what the data suggests[11], since its effects have been partly neutralised by a decline in disbursements of other forms of programme aid. However, balance of payment support to Tanzania in the 1990s was sometimes still tied to procurement of particular commodities

[11] If and to the extent that debt relief frees resources at all, which is discussed in next chapter.

or from particular countries, so for Tanzania debt relief or untied budget support has probably been more valuable than balance of payment support.

In sum, debt relief to Tanzania has largely been additional to other aid flows, but there has been some substitution between balance of payments support and bilateral debt relief on multilateral debt.

2.5 Amounts and conditions of Dutch debt relief

During the evaluation period, fifteen debt relief disbursements were made. Some of these disbursements followed from commitments made already during the 1980s. In total, there have been 10 commitments. Table 2–5 (at the end of this section) lists these debt relief operations in historical order.

Over the period 1990-99, the total amount of debt relief granted was NLG 240 million (or about USD 125 million). This amount makes Tanzania the second largest recipient of Dutch debt relief after Nicaragua. As Table 2–5 shows, debt relief given concerned bilateral export credits, the bilateral aid loan part of mixed credits[12] and, in the last two years of the evaluation period, relief on multilateral debt service. Forgiveness in the context of Paris Club agreements on bilateral export credits constitutes by far the largest category. The Netherlands had already forgiven all bilateral loans in 1978 (Memo no. MZ-092/90, 11 April 1990). Comparing the amounts in Table 2–5 to the total amount of debt relief as reported in Table 2–2, it is clear that the Netherlands is a relatively large donor when it comes to multilateral debt relief: almost 40 per cent of the contributions to the MDF in 1999 came from the Netherlands.[13] The contributions to the Paris Club, on the other hand, are less than 10 per cent of the total relief, reflecting the fact that the Netherlands was never one of Tanzania's major creditors.

In the Paris Club II meeting of December 1988, The Netherlands had chosen for the application of 'Option C' of the Toronto terms. This was one of the more concessional options, since it meant a 3.5 percentage point reduction of the interest payments due. The option was chosen by the Netherlands delegation, headed by the Ministry of Finance on behalf of the Netherlands Credit Insurance Company (NCM), on the instigation of Development Co-operation (Ontwikkelingssamenwerking or OS). Development Co-operation then had to pay for it. The agreement included that each time Tanzania paid its debt service on pre-cutoff date (pre 1986) debt to the NCM, Tanzania would pay 4.75 % and OS would pay the remaining 3.5% interest. As Table 2–5 shows, Development Co-operation made disbursements in keeping with this agreement in 1990, 1991 and 1994. The 1994 transfer from OS to the NCM was accompanied by a letter explaining the "considerable delay", caused by complications as a result of consecutive Paris Club agreements, and the fact that internal audit requirements of the Ministry had become more strict. At the same time, however, according to a letter from the Dutch Ministry of Finance (MoF) to OS of 6 October 1998, Tanzania did not pay any of its obligations between 1991 and 1996.

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12 Mixed credits are export credits in which (usually the major) part of the loan is non-concessional and the other part is concessional and provided by development co-operation. The debt relief concerned the bilateral aid part.

13 It should be noted, however, that the UK has since then emerged as a dominant donor to the PRBS – the successor of the MDF.

Table 2.5. Dutch debt relief to Tanzania

Commit-ment	Date	Amount NLG mln	Type of debt	Type of relief	Objectives	Rationales	ODA[1]
1	1990	2.0	Bilateral export credit	Paris Club II, Toronto, Option C: interest reduction of 3.5 point	relief of debt burden	LIC, good macroeconomic policy	yes
	1991	0.3	Bilateral export credit	id	id	id	yes
	1994	1.8	Bilateral export credit	id	id	id	yes
	1998	12.8	Bilateral export credit	id	id	id	yes
2	1990	1.6	Bilateral export credit	Paris Club III Toronto Option A (20% of NLG 8.2)	relief of debt burden		yes
3	1990	1.1	Bilateral aid part of 'mixed credits'	Forgiveness on debt service on loans 1980-82	-	LDC, quality of macroeconomic policy	22%
4	1991	1.1	Bilateral aid part of 'mixed credits'	Forgiveness on debt service on loans 1980-82	-	LDC, quality macroeconomic policy	21%
5	1991	12.2	Bilateral aid part of 'mixed credits'	Forgiveness stock of loans 1980-82	-	difficult external financial situation	no
6	1997	121.4	Bilateral export credit	PC V, Naples terms (67%), included arrears on PC 1-3 agreements	support macroeconomic policy; relief of debt burden	implementation reforms and IMF programme, severity of debt	yes
	1998	6.0	Bilateral export credit	id.			yes
	1999	3.6	Bilateral export credit	id.			yes
7	July 1998	17.5	Multilateral debt	Reimbursement of already paid debt service to IMF	support macroeconomic policy; relief of debt burden	severity of debt; poverty situation quality of policy	yes
8	Oct 1998	12.5	Multilateral debt	Payment and reimbursement of debt service to IBRD/IDA	support adjustment policy through relief debt burden	severity of debt; quality social and macro-economic policy, poverty, continuity Dutch policy	yes
9	Oct 1999	30.0	Multilateral debt	contribution to MDF	support macroeconomic and social policy through relief debt burden	quality socio-economic policy, IFI programmes, severity of debt, poverty,	yes
10	Nov 1999	10.0	Multilateral debt	additional contribution to MDF; sectoral aid could not be given	support macroeconomic and social policy, ownership and donor co-ordination via MDF	severity of debt, HIPC	yes

[1]We follow the classification of ODA/non ODA of the Dutch registration: forgiveness of interest payments is defined as ODA, while forgiveness of principals (due or not due) is not. Since the DAC registers forgiveness of principals due as gross ODA (requiring an offsetting entry for repayment for the same amount), ODA performance of the donor is higher with forgiveness than in the case of repayment. In fact, forgiveness on ODA loans leads to higher net-ODA than if loans would be repaid. If we assume that principals due would not have been paid in the absence of debt relief, the classification in the table is correct.

In 1998, OS agreed to another arrangement for the application of Option C. In the 1997 Paris Club V agreement it was agreed to include the arrears on debt consolidated in Paris Club II. Thirty-three per cent was to be rescheduled again over a period of 23 years with 5.3% interest, the remainder (67%) was forgiven. The forgiveness part was charged to the OS budget, on the other part OS would have to continue to pay the interest subsidy of 3.5 percentage points. However, since this was considered very labour intensive for the Dutch agencies, it was agreed that OS would pay to NCM the full amount due immediately. No calculations were made to take the consolidation into account, and in fact the MoF offered a discount of about 20% in case OS would pay the full sum rightaway. This resulted in an amount of NLG 12.8 million of debt relief in 1998. This money therefore was in fact an internal transfer within the government of the Netherlands; however, as it reduced the net present value of Tanzania's debt, it was recorded as ODA.

In March 1990, the third Paris Club meeting was held. Until then, Tanzania had not paid its obligations under the Paris Club II agreement. At first therefore, the Netherlands was not willing to offer Toronto Option C again. The Paris Club III agreement included interest due as a result of Paris Club I and II. According to the agreed minute of that meeting, the Netherlands in fact had chosen to apply Option B, meaning that debt service due in 1990 was to be paid between 2004 and 2015, and debt service due before 1990 (arrears) between 2003 and 2014. The interest on the rescheduled amounts was to be determined in bilateral agreements.

In order to compensate for this non-concessional Option B, OS proposed to forgive a small part of Dutch debt included in the Paris Club agreements, namely the debt service payments due in 1988 and 1989 on the concessional part of the mixed credits provided in the period 1980-1982 (Memo no. MZ-092/90, 11 April 1990). As special reason for forgiving on these mixed credits it is mentioned that Tanzania no longer qualifies for this type of aid.

A letter from OS to MoF of 11 May 1990 argues that one of the reasons to stick to the non-concessional Option B for Tanzania is the fact that "the international discussion on debt relief still continues and that no breakthrough can be expected". In the meantime, however, and following a British initiative, the Dutch government made more far reaching proposals (than the Toronto terms) on debt relief for low-income countries in international fora. This became known as the proposal Kok-Pronk. In view of this initiative, OS considered it inconsistent to choose the non-concessional option. In a Memo (DMP/MZ, 30 October 1990) it proposed to apply Option A, meaning 33% forgiveness on eligible debt service flows.14 For the five countries that had Paris Club agreements in 1990, OS proposed to apply this option as a kind of ad hoc solution in the expectation of more comprehensive international progress on forgiveness. Given the difficult situation of the Dutch Treasury at the time, OS proposed to contribute to this deal by using NLG 12 mln from Andes funds and 'other rest funds'. An agreement was reached with the Ministry of Finance, implying that OS paid about 50% of the amount to be forgiven to these five countries, the Ministry of Finance contributing the other 50%. The actual percentage of the OS contribution varies in each case. Three of the five countries (Bolivia, Mali and Togo) were paying their debt service regularly, while the other two (Guyana and Tanzania) were not. OS argued that forgiveness only helps to relieve an actual debt burden for those countries that are paying. In the case of Tanzania (and Guyana), OS just pays for enhancing the credibility of the Dutch initiative Kok/Pronk, and the deal does not provide additional resources to Tanzania (DMP/MZ, 30 October 1990). For that reason, OS paid only 20% of the total amount forgiven with the remainder coming from the budget of the

[14] In the same Memo, it says that "the Netherlands has so far applied option b for Tanzania" – which is obviously incorrect.

Ministry of Finance. This 20% corresponds to the amount of NLG 2 million in Table 2.5, while data supplied by the Ministry of Finance (not reported in the table) show that this Ministry forgave NLG 6 million.

In 1991 two other amounts were committed and disbursed. First, the debt service due in 1990 on the mixed credits was forgiven, and then the full stock of those credits.

In January 1992 the Paris Club IV meeting was held. According to the agreed minutes, the Dutch participated in that meeting. It was another flow rescheduling on debt service due until June 1994, on enhanced Toronto terms, meaning 50% forgiveness on eligible debt service payments, including those rescheduled in Paris Club I. The Netherlands and several other creditors chose Option A. The amounts rescheduled in Paris Club II had to be paid from 1998 onwards in five years, and the amounts rescheduled in Paris Club III in 1992 and 1993. A OS report of that meeting says that the Dutch part of the amount to be consolidated amounts to NLG 88 million. In this period, forgiveness on export credits as agreed in the Paris Club was fully paid by the Ministry of Finance, so no further debt relief expenditure can be found in the OS documentation. According to the data provided by the Ministry of Finance, forgiveness amounted to NLG 30 million (not in Table 2–5).

The Paris Club V agreement concluded in February 1997 was another flow rescheduling and this time on Naples terms, meaning 67% forgiveness, in principle. Debt service due in 1997, 1998 and 1999 was eligible. The 67% forgiveness only held for debt service due in 1997 on amounts rescheduled in Paris Club I. For amounts rescheduled in Paris Club II and III, 50% forgiveness was granted. The remainder was rescheduled and was to be paid between 2004 and 2021.15 If Tanzania remained on track with the IMF programme and met its payment obligations to Paris Club creditors, the same 50% forgiveness would be given on debt service due in 1998 and 1999. Amounts rescheduled in Paris Club IV were excluded, as were interest payments due under Paris Club III (Report of Paris Club meeting, 7 February 1997). This happened after a major restructuring of Dutch foreign policy, one of the consequences being that from then on, all forgiveness on export credits would be charged to the aid budget. In 1997 this amounted to NLG 121.4 million (Table 2–5), and smaller amounts followed in 1998 and 1999.

In October 1997, the Dutch ministers of Finance and for Development Co-operation visited Tanzania. They announced that the Netherlands would "resume" macroeconomic support in 1998, in fact for the Tanzanian FY 1997/98. The term "resume" probably refers to the fact that after considerable amounts of balance of payments support granted during 1994-1996, no macroeconomic support had been given in 1997 as a result of the large amount of OS money involved in the Paris Club debt relief operation.

The amount actually granted (NLG 30 million) followed from the "macroexercitie"16 and was determined in April 1998. However, in Tanzanian FY 1997/98 the MDF was not yet in operation. Part of the Dutch contribution to multilateral debt relief was therefore transferred to the IMF in June 1998, so just within Tanzania's FY. The government of Tanzania had informed Dutch OS that there were several debt service payments due to

[15] For the amounts rescheduled in Paris Club I, late interest rate of 8.25% p.a. on debt service in arrears was established; for the amounts rescheduled in Paris Club II and III, late interest of 5.75% p.a.

16The macro exercitie was an annual operation in which the amounts to be granted in macroeconomic support were determined on the basis of several criteria. The most important included the quality of social economic policy, the quality of governance, the poverty situation (meaning, whether the country is a low-income country), the debt situation and the country's access to private capital, the continuity of Dutch policy, and the net ODA position (the latter must be positive).

the IMF on 30 June. The BEMO of 3 April 1998 therefore says that the money would be transferred to the IMF so that Tanzania would not need to pay those obligations. The date of 30 June proved to be incorrect, as detected at the office of the Dutch IMF Executive Director: Tanzania had already paid on its obligations to the IMF on 5 and 14 June. For this reason, the IMF reimbursed the Tanzanian government for those debt service payments, and the small remainder of the Dutch grant was kept as partial pre-payment of an amount due by August 22 (letter IMF July 7).

In October, when the Dutch government wanted to transfer the remainder of the money determined in the "macro exercitie", the MDF was still not operational. Therefore, this amount was deposited into a trust fund in the World Bank for partial reimbursement and payment of Tanzanian debt service to the Bank. However, while the IMF reimbursed the money almost immediately, the World Bank did not. On 25 November 1999 a staff member of the Dutch embassy complained that still no reimbursement has taken place. According to the Bank, this was due to miscommunication: the Tanzanian authorities had not given the appropriate instructions for this reimbursement.

In FY 1998/99 the MDF had become operational. Yet, the Dutch were late in making their contribution directly to the MDF. The staff member of the Embassy wrote in 28 May 1999 that "The Hague" was still considering the indirect way of transferring to the multilateral institutions. The Netherlands had always been in favour of the MDF so this behaviour was not well understood by the Tanzanian government nor by the other donors. On 11 June the approval from the Hague finally came. The amount approved in the "macroexercitie" of NLG 30 million would be transferred to the MDF.

In the same year, a further NLG 10 million was contributed to the MDF. This followed from a request from the Embassy in Tanzania to re-allocate an amount that could not be disbursed for a project. Approval occurred in the context of an end-of-year additional macro economic spending operation to disburse any unspent funds from the overall aid budget.

The Netherlands did not participate in the commercial debt buyback operation that was implemented in 1999. This buyback was co-ordinated by the World Bank (IDAs Debt Relief Facility, also called 6th dimension) to which Germany and Switzerland also contributed. There were two major reasons for the Netherlands' non-participation.17 First, most of the private debt was owed to German and Swiss banks and institutions – and hardly any to Dutch parties. Secondly, the Netherlands was already a large contributor to the MDF, while the Germans and the Swiss were not.

2.5.1 Objectives and rationales

As Table 2–5 shows, the objective for most debt relief operations was to provide relief for the debt burden. Supporting Tanzania's macroeconomic policy has been mentioned since 1997. For the last disbursement of November 1999, supporting ownership and donor co-ordination is also mentioned as an objective. The forgiveness on the concessional components of the mixed credits does not carry any explicit objectives.

Turning to rationales, they have become more elaborated in the course of the 1990s. In the early years, it was sufficient to argue that the country was poor and had sound macroeconomic policies. The difficulty for Tanzania of honouring external payment obligations is mentioned only once (in 1991), while the quality of policy, and progress in reform implementation appears regularly. Judging from that, then, the Dutch debt relief has been given more as a reward for policies already implemented than as an incentive to

[17] Interview with staff member of Embassy.

help implement new reforms. The severity of the debt situation is mentioned only from 1997 onwards.

An OS Memo of 20 November 1997, in preparation for the Consultative Group meeting of December of that year, argues that the about NLG 40 million that had been granted to Tanzania as balance of payments support in the mid-1990s should now be given as debt relief on multilateral debt service. The reasons include that Tanzania is a "possibly stressed HIPC", and that it has a "lack of liquidity". In 1998, when this debt relief was actually given, an important rationale was that it would free resources for the government to be spent on the social sectors. This was repeated in the appraisal memorandum of 25 November 1999 accompanying the contribution to the MDF in that year.

The 1991 forgiveness of the debt service on mixed credits extended in 1980-1982 (which were later in the same year cancelled altogether) was co-motivated by the fact that Tanzania was no longer eligible for these credits. The documentation does not reveal the reason for this non-eligibility. Reasons that come to mind include that the country had become too poor, or had lost its creditworthiness because of severe payment problems. If one of these reasons held, they would certainly still apply during the later 1990s. However, in the second half of the 1990s Tanzania received several new loans from the Netherlands on the basis of a Dutch programme that can be considered the successor to the Mixed Credit programme, namely the ORET programme (OntwikkelingsRelevante Export Transacties, or Export Transactions Relevant for Development).

While in the mixed credit programme one part of the loan – for purchasing a good or service from a Dutch firm – was private and non-concessional (but usually guaranteed by NCM, the Dutch government's ECA) and the other part was concessional, in ORET the ODA part is a grant. Dutch Embassy staff involved in the implementation of ORET informed the evaluation team that "with HIPC", Tanzania could no longer contract non-concessional loans and this appeared to prevent Tanzania from benefiting from ORET. In co-operation with GoT a solution was found. The Tanzanian government would not take out a loan, but would pay the non-grant part of the transaction in cash, with the amount spread-out over two budget years. This same solution was mentioned spontaneously as a good thing by a high official of the Ministry of Finance. Given that this was something new, the other ORET cases of the late 1990s apparently did involve non-concessional loans. These are, by definition, post-cutoff date loans which must be serviced by Tanzania in order to qualify for HIPC, and so add immediately to the debt service burden of the government.

Apart from the general doubts one can have about a programme like ORET, such as what the benefits are for the recipient country, and whether it does not distort competition on both sides, in the context of this evaluation some further questions can be raised as to these policies. First, it seems odd that the Netherlands, and in particular the OS department, continued to support non-concessional loans to Tanzania by means of the ORET programme, while at the same time providing debt relief and knowing that Tanzania has severe payment problems. And secondly, it is surprising that the Netherlands is so enthusiastic about these transactions that it even agrees with a "solution" that involves additional immediate spending from the government budget – spending which probably does not benefit the "priority sectors".

2.5.2 The additionality of Dutch debt relief

The overwhelming majority of amounts spent on debt relief according to table 2–5 originate from the budget of OS. Most debt relief therefore substitutes other aid, but part of this "other aid" might otherwise have gone to other aid recipients and therefore may still have been additional for Tanzania. The only debt relief that is surely additional are the amounts financed by the Ministry of Finance. This involves the 80% of the NLG 8.2 million granted in 1990 in the context of Paris Club III as Option A, the forgiveness following from Paris Club IV.

In most cases, debt relief money came from KBE 777, which is an account for macroeoconomic support/debt relief. Decisions on the spending of this budget are taken on a worldwide basis. However, it is reasonable to assume that Tanzania, as a large recipient of Dutch development aid, would have received at least some share of this budget anyway. It is therefore not sure that this debt relief was additional from the Tanzanian point of view.

For the forgiveness on the mixed credits the budget category is not given in the documentation. A letter from the Africa region department within OS reports that the forgiveness of the stock of the concessional part of the mixed credits (which does not count as ODA) explains the reduction of the aid budget to Tanzania of that year. Given that it was a debt relief operation for obligations that were not being paid, the actual flow relief from this was probably nil so that in fact the net ODA flow to Tanzania diminished as a result of this debt relief. It did, however, prevent some arrears from being built up further, and so may have helped improve creditworthiness in later years.

Finally, the money involved in the Paris Club V forgiveness came from the budget category 933, which is called an export credit institution/NCM forgiveness account. This account was probably established after the 1996 agreement between the MoF and OS about OS paying all forgiveness granted on export credits from then on. Nevertheless, since the Netherlands gave macroeconomic support in the form of balance of payments support during 1994-1996, and then "resumed" this support in 1998, it seems that the fact that such a large amount had to be paid for this Paris Club forgiveness prevented other macroeconomic support to Tanzania in that year. Debt forgiveness thus substituted here for new flows to Tanzania implying a loss of about NLG 30 million in 1997.

2.6 Conclusions

The main purpose of this chapter was to document and review debt relief in Tanzania, with special attention paid to amounts, objectives and conditions, and to the question of the extent to which debt relief could be considered additional to other forms of aid.

The data show an increase in the amount of debt relief received during the 1990s. The trend is not particularly pronounced – partly because Paris Club relief has been recorded in full to the year of the agreement, even though reschedulings have been spread over several years. But even if we had been able to correctly allocate the benefits of reschedulings to the proper years, the upward trend would persist because the amounts forgiven and rescheduled in the Paris Club increased in the 1990s. In addition, the creation of the Multilateral Debt Fund in 1998 contributed to an increase in the amount of debt relief disbursed.

The objective of debt relief is the same as that for (all) aid and for most donors: reduction of poverty. This does not appear to have changed in the 1990s. What has changed, however, is the rationale. Prior to 1993, many donors emphasised the capacity to import (or, more generally, the availability of forex) as the main motivation for debt relief. Following the liberalisation of Tanzania's foreign exchange markets in 1993, attention turned to the fiscal side: how the countervalue funds were spent by the government. This trend culminates in the MDF/PRBS in which the protection of the budgeted amounts in social sectors was an explicit policy condition.

With respect to the issue of additionality, we conclude that debt relief was not accompanied by lower aid flows to Tanzania, so that it was probably additional from the Tanzanian point of view. This can be explained from the facts that part of debt relief originates from countries that no longer provide aid, and that another part is financed from other (non-aid) budgets. In addition, debt relief to Tanzania probably reduced aid to other countries with lower debts, as, for example, concluded by Birdsall et al. (2001). However, we also observe that debt relief on multilateral debt partly substituted for other forms of programme aid, notably balance of payment support.

Tanzania was a large recipient of Dutch debt relief. This included debt relief on bilateral aid loans (in particular the concessional component of mixed credits), on export credits and on multilateral debt. Although the amounts involved in export credits were large in the Dutch context, especially the 1997 one, the Netherlands was a relatively small player in the Paris Club. With respect to multilateral debt relief, however, the Netherlands was the largest donor.

The analysis of Dutch debt relief confirms the conclusions on additionality. Most Dutch debt relief to Tanzania is financed from aid budgets, so substituted for other aid flows. It is likely that at least part of this was aid that would otherwise have benefited other countries. There is clear evidence that multilateral debt relief substituted for the earlier balance of payment support.

Questions can be raised as to the consistency of Dutch debt policies to Tanzania. While it was clear that Tanzania had payment difficulties and received Dutch relief on all kinds of debts (bilateral aid loans, bilateral export credits and multilateral), the country "benefited" from several ORET transactions during the 1990s. Dutch development co-operation facilitated these new non-concessional loans by contributing grant money.

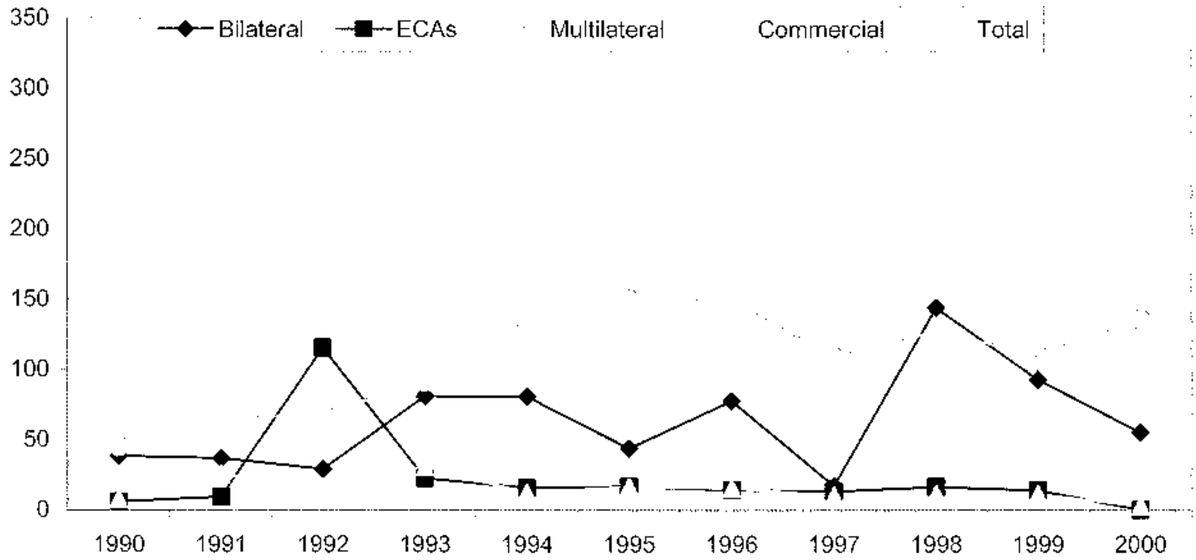
3 THE EFFICIENCY OF DEBT RELIEF

This chapter aims to assess the efficiency of debt relief. It therefore compares the inputs with the outputs. The inputs in terms of quantities of debt relief given may have two types of outputs. They may have reduced the flow of debt service paid, and/or the stock of outstanding debt. A third possible output relates to the conditions set for debt relief. These conditions may or may not have been carried out by the government of the recipient country. These three possible outputs are discussed in sections 3.1 to 3.3. To the extent that debt relief has an influence on resource flows, there is no difference with the influence of (other) aid. The final two sections assess the influence of debt relief and aid on the balance of payments and the government accounts, respectively. These can be considered intermediate outcomes of debt relief.

3.1 The size of the flow reduction

The first question is whether debt relief led to a reduction of *paid* debt service. It matters, therefore, how much debt service is actually paid and what amount of debt service would have been paid in the absence of debt relief. Unfortunately this varies by type of debt relief and type of creditor, so it must be analysed for different kinds of debt relief and creditors separately. In particular, debt relief on past debt service due (arrears) is less likely to lead to reductions in actual debt service flows than relief on current debt service due. But even for current debt service it must be investigated whether this debt service would otherwise have been paid. A complicating factor is that relief by a creditor on debt service owed to himself lowers the debt service paid in the statistics, while relief on debt service owed to another creditor does not usually lead to lower figures for debt service paid. The latter holds, in particular, for bilateral take-overs of multilateral debt service.

Figure 3–1 Debt service paid; total, and by type of creditor (USD million)



Source: Elaboration of data from Bank of Tanzania.

From the External Debt Department of the Bank of Tanzania we obtained annual figures for debt service paid, also by type of creditor (Figure 3–1). Total actually paid debt service has risen over the decade from about USD 100 million in 1990 to about USD 200 million in 2000. Most of the increase during the 1990s took place between 1990 and 1992, reflecting a slow rise in multilateral debt service and a peak in ECA debt service in 1992. Possibly, this peak reflects the terms of the early Paris Club agreements. On the other hand, in 1997 and in 2000 there was a clear drop in debt service payments due to lower service on bilateral aid debts in particular. For this debt service on bilateral aid loans, the peak in 1998 is even more conspicuous than the decline in 1997. This is probably the effect of the 1997 Paris Club agreement: although forgiveness was raised to 67% in that agreement, earlier arrears had to be paid. In 2000 a 90% forgiveness in debt service payments has been agreed, and this seems to have had a clear downward influence on bilateral debt service payments.

Table 3–1 Balance of payments of Tanzania (USD million)

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
Exports	394	414	411	486	593	696	794	613	541	541
Imports	-1381	-1444	-1472	-1591	-1510	-1370	-1388	-1445	-1593	-1631
Trade Balance	**-988**	**-1030**	**-1060**	**-1105**	**-917**	**-674**	**-594**	**-832**	**-1052**	**-1090**
Services (net)	-238	-494	-518	-436	-148	-287	-274	-353	-308	-239
Receipts	141	141	206	369	511	472	520	565	570	672
Payments	-379	-635	-723	-805	-659	-759	-793	-918	-877	-911
Interest	-191	-194	-178	-154	-139	-144	-141	-185	-139	-88
Other services					-519	-616	-652	-733	-738	-823
Private transfers	408	456	463	465	18	20	26	30	32	34
Unrecorded exports		296	312	192						
Government transfers	549	809	759	634	525	581	690	669	722	737
Project					475	524	567	580	595	606
Programme					50	58	123	89	126	130
Current Account	**-269**	**-259**	**-356**	**-442**	**-522**	**-360**	**-152**	**-486**	**-606**	**-559**
Loan inflows	211	188	174	211	272	320	360	422	415	469
Project					180	215	293	314	329	349
Programme					51	68	35	74	49	82
Other					41	38	31	34	37	39
Amortisation	-151	-143	-356	-361	-322	-354	-317	-275	-274	-223
FDI	10	15	62	63	104	134	150	165	179	183
Other capital and E & O	19	-68	-15	344	246	91	-22	41	255	159
Capital Account	**90**	**-7**	**-136**	**257**	**299**	**191**	**171**	**354**	**574**	**588**
OVERALL BALANCE	**-180**	**-266**	**-492**	**-186**	**-223**	**-169**	**19**	**-133**	**-32**	**30**
Financing:										
Change in net foreign assets ('-' = increase)	-86	-133	118	-107	-46	-81	-272	-1	-68	-129
BoT	-116	-117	131	10	33	25	-208	-30	-66	-114
Gross reserves	-86	-176	90	-12	51	15	-220	-61	-102	-177
Use of Fund credit	-31	59	41	-10	-16	-22	49	13	12	50
Other		0	0	32	-3	32	-36	19	25	13
Commercial banks	30	-16	-14	-117	-79	-105	-64	29	-2	-15
Arrears	89	285	138	293	269	250	-1025	79	10	-1163
Debt relief	154	84	230	0	0		1278	54	89	1263
Counterpart to monetisation of gold	23	31	6	0	0					

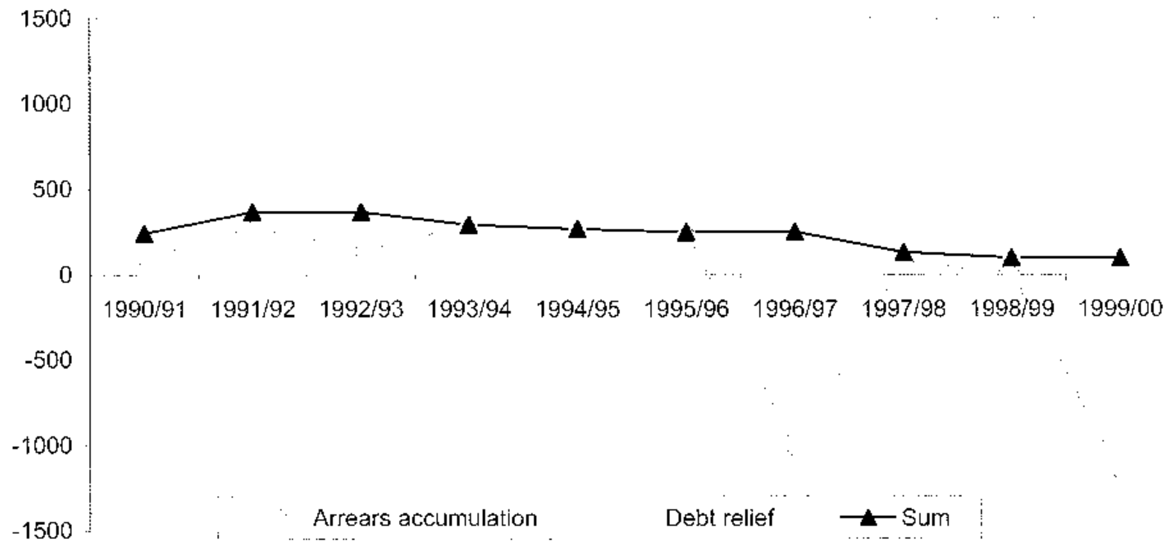
Source: IMF, Statistical Annexes 1996, 2000.

Some other trends in actual paid debt service can be observed. Multilateral debt service has increased during the first half of the 1990s and then stabilised. Since 1993 however, this debt service is the largest category (with some little deviation in 1997). This is consistent with its share in the total debt stock (Figure 3–3). However, in most years the multilateral share in debt service paid is higher than its share in the debt stock (Figure 3–4). This is probably not because of a lower concessionality of these debts, but because most multilateral creditors are preferred creditors. Debt service on commercial debt and on ECA debt (after 1992) has always been low.

The fact that debt relief given during the 1990s has not been accompanied by a reduction in actual debt service, does not necessarily imply that debt relief had no flow effect. Debt service paid could have been even larger without debt relief. For this reason, it is important to analyse whether debt service would have been paid in the absence of debt relief.

We begin by analysing the amounts of debt relief according to balance of payments figures (Table 3–1). This debt relief is recorded under financing, and represents mostly Paris Club bilateral debt relief.[18] It appears that there is a close inverse relationship between this debt relief and arrears accumulation (Figure 3–2). In the years with a Paris Club agreement (1990, 1992, 1997) arrears accumulation is low or negative. Especially in 1996-1997 and in 1999-2000 large negative arrears accumulation (i.e. payment) can be observed, while debt relief figures were high. This means that this debt relief probably served largely to forgive or reschedule accumulated arrears, and much less to alleviate the current debt service burden. We can conclude that most Paris Club bilateral debt relief did not lead to a reduction of the actual debt service flow. Over the 1990s, the sum of arrears accumulation and debt relief shows a downward trend, implying that Tanzania has accumulated less arrears in more recent years.

Figure 3–2 Arrears accumulation and debt relief (USD million)

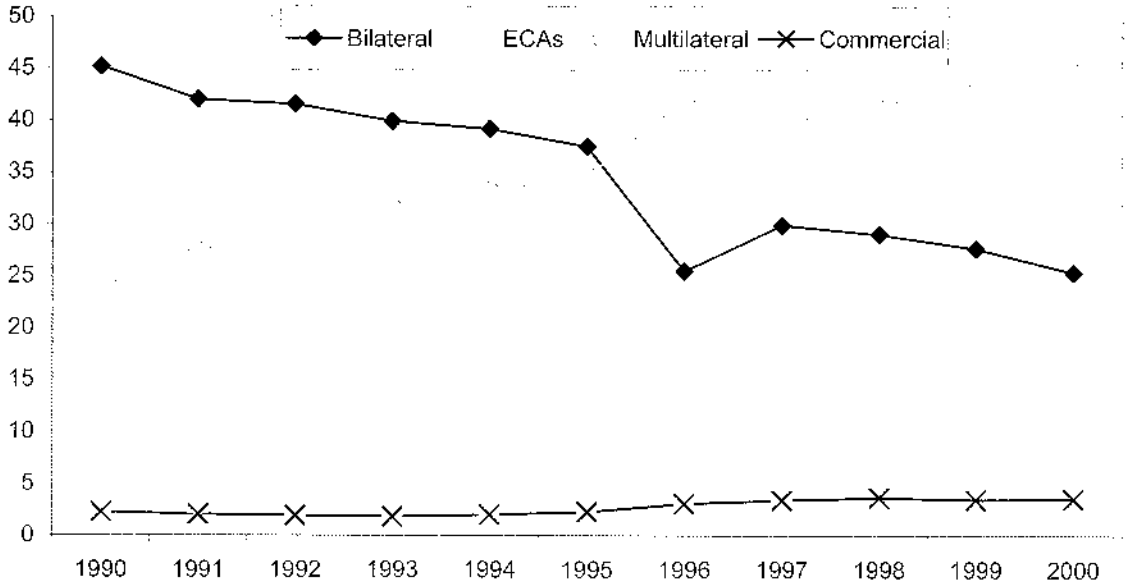


Source: Table 3–1.

[18] It does not include the (smaller) amounts involved in relief on multilateral debt service. Possibly, it does include the relief given in the context of the debt conversion programme of the early 1990s.

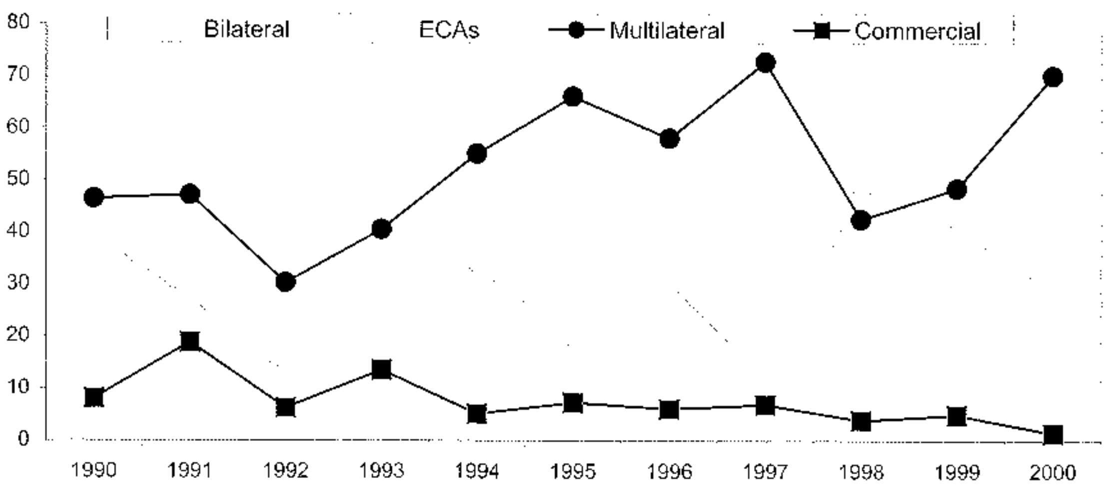
According to the External Debt Strategy of the Government of Tanzania, current arrears on multilateral debt service are only temporary as they are cleared within 60 days after the due dates (United Republic of Tanzania, 1999: 39). The same document also reveals that Tanzania's debt service obligations to Paris Club creditors increased "significantly" in 1994, due to the expiration of earlier Paris Club agreements. However, this appears to have been solved by again building up arrears to these creditors, as actual bilateral debt service did not increase in that year (Figure 3–1).

Figure 3–3 Composition of debt stock by type of creditor (per cent)



Source: Elaboration of data from Bank of Tanzania.

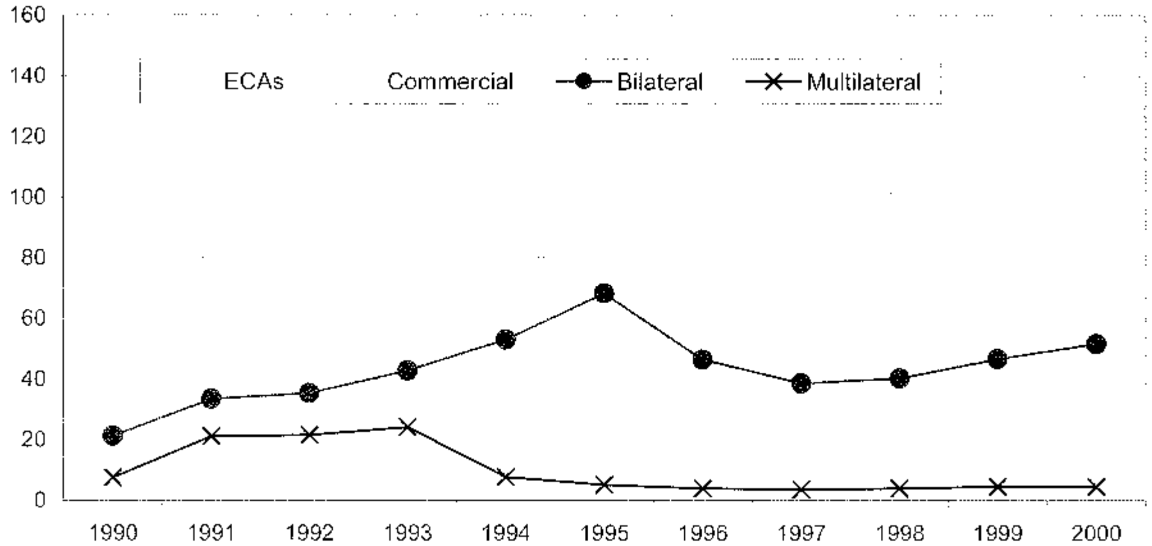
Figure 3–4 Composition of debt service paid by type of creditor (per cent)



Source: Elaboration of data from Bank of Tanzania.

This different treatment of the various types of creditors is also evident from the arrears-to-total debt stock ration for the different creditors (Figure 3–5). Arrears on multilateral debt have been virtually zero since 1994, while bilateral arrears continued to increase. At the other extreme, almost the full commercial and ECA debt stock consisted of arrears. In the latter case, arrears even exceeded the total debt stock in since 1998.[19]

Figure 3–5 Arrears relative to total debt outstanding by type of creditor (per cent)



Source: Bank of Tanzania.

The Paris Club V agreement of 1997 rescheduled and forgave on debts consolidated in Paris Club I-III, with a forgiveness percentage of 67%.[20] Debts rescheduled in the Paris Club IV agreement of 1992 were not included in Paris Club V, so that they had to be paid fully, in principle. According to staff of the Bank of Tanzania (BoT), the country started paying after Paris Club IV in 1992. However, a high official of the Ministry of Finance replied to the question why Tanzania started paying arrears with Paris Club creditors, that this was necessary in order to get a new IMF agreement. Since the IMF agreement was concluded in 1996, it must have been around 1995 that the country began to pay, and this is consistent with rising ECA and bilateral arrears until 1995-1996 (Figure 3–5). Payment of Paris Club creditors has also become a condition for HIPC relief, so the country now has an interest in servicing these debts. In the early 1990s, pressure for paying Paris Club creditors was apparently much weaker: bilateral creditors themselves accepted non-payment, as did the IMF, and in this period some bilateral creditors (Sweden and perhaps others as well) even granted debt relief to Tanzania for paying multilateral debt service.

The conclusion so far can be that most Paris Club debt relief received during the 1990s (and which was by far the largest share of debt relief) did not free resources and thus did not reduce Tanzania's actual debt service burden. It seems that other creditors, apart from the multilaterals, were not paid either during the 1990s. Tanzania owns a large stock of debt to non-Paris club bilateral creditors, including Algeria, China, Iran, and Libya. In total, debt owed to these creditors constituted 30% of total bilateral debt and 14% of all debt in

[19] The higher arrears are due to penalties charged on arrears and to the long time this debt has been outstanding (explanation given by staff member of BoT).
[20] It must be borne in mind, however, that a penalty interest rate was charged on the amounts earlier consolidated and in arrears (Dutch Ministry of Finance Report, 14 November 1997).

nominal terms by June, 1999 (IDA & IMF, 2000). BoT staff informed the evaluation team that debt service to these bilateral creditors is generally not paid. The IMF and the Paris Club donors expect these countries to give debt relief on similar terms as the Paris Club creditors. Since they don't, the non-payment of these creditors is accepted by the Paris Club creditors and the IMF, and does not have consequences for new loans and grants from Paris Club donors and multilateral institutions, nor for access to HIPC relief. Some of the non-Paris Club creditors want to give debt reductions through debt-for-equity swaps or other means by which Tanzania pays in Tanzanian shillings instead of in dollars. This was still mentioned as an option in the External Debt Strategy (United Republic of Tanzania, 1999), but the Government of Tanzania does not want this anymore.[21] In recent years the government of Tanzania has made two exceptions to this rule of non-payment of non-Paris Club bilateral debt service. Debt service to Kuwait and Saudi Arabia was paid, because these countries provided new concessional loans.

The debt owed to Russia is a special case of bilateral debt. Until 1997, Russia was not a member of the Paris Club, and debt service was not being paid. When Russia became a Paris Club member difficult negotiations started on the exchange rate at which the ruble debt had to be converted into dollars, and then on the amount of debt service that had to be paid. In 1999 an agreement was reached which implied that the old exchange rate was maintained but a 80% discount was applied to the debt stock. Russia then gave 90% flow relief in keeping with the Cologne terms, and will also give 90% stock relief when Tanzania reaches the HIPC Completion Point.[22] In consequence, however, Tanzania pays more debt service to Russia than it did before Russia was a member of the Paris Club. In this case, debt relief led to more debt service, not less.

Debt service obligations on commercial debts have generally been paid since 1993, when the private sector and commercial banks got access to foreign exchange through the interbank foreign exchange market. Before 1993, the private sector only disposed of shillings. They paid their foreign obligations to a shilling account at the Bank of Tanzania, but BoT did not have the forex to pay the foreign creditors.[23] Large arrears were built up in this way. Figure 3–5 shows that these arrears declined after 1993. However, since 1997 the ratio of arrears to total commercial debt has increased again.

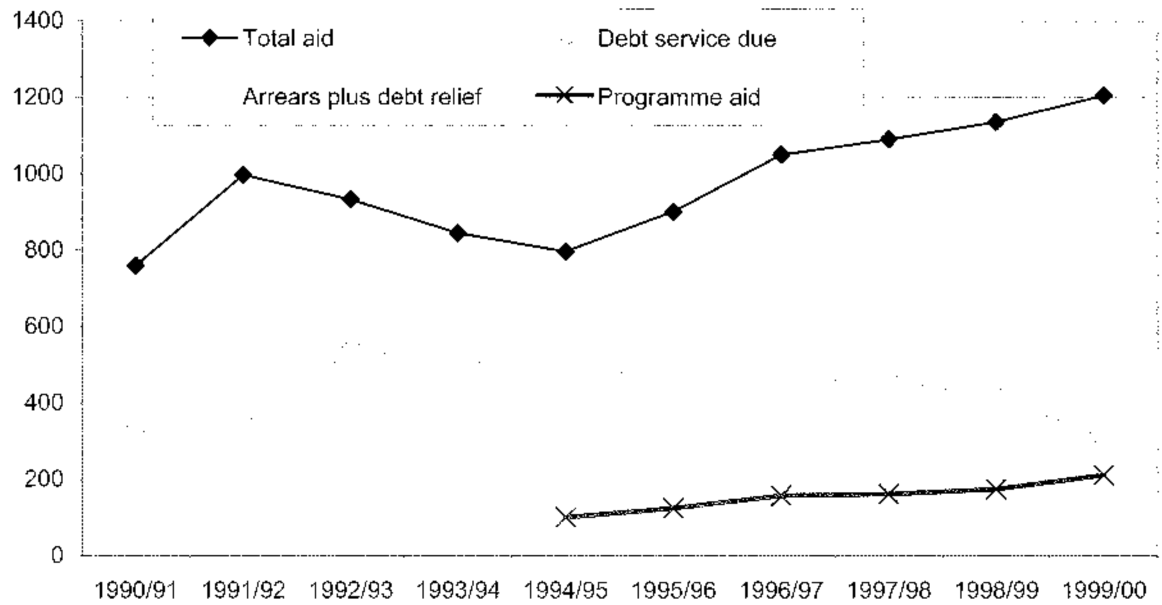
In general, relief on multilateral debt service (not included in debt relief figures according to IMF balance of payments data) effectively reduced the debt service burden (the flow) since this debt service is usually paid. However, debt relief by bilateral donors on multilateral debt service (5th dimension) given in the early 1990s perhaps did not always have this flow effect, as Tanzania maintained arrears with the multilateral institutions in those years. But in any case, that relief prevented more costly arrears from being built up. Since 1994, relief on multilateral debt service had a direct flow effect, since all multilateral debt was serviced. This type of debt relief did not reduce the figures for multilateral debt service paid (in the statistics), but did relieve its burden.

The effect of multilateral debt relief on the possibility of financing the actual debt service burden cannot be separated from the effect of other forms of freely spendable programme aid. While programme aid in the 1980s and early 1990s was mainly balance of payment support and a substantial part of it was tied import support that could not be used for debt service, in the course of the 1990s it became budget support and debt relief. Figures on programme aid in the balance of payments are only available from 1994/1995 onwards,

[21] Interview with BoT staff.
[22] Interview with BoT staff member.
[23] Interview with BoT staff member.

and we can assume that all this has been freely spendable. Programme aid grants have clearly increased (Table 3–1), and this figure includes debt relief on multilateral debt.[24]

Figure 3–6 Debt service due and financing (USD million)



Source: Elaboration of data from Table 3–1.

Figure 3–6 shows how the total debt service due – as it is recorded in the balance of payments figures of Table 3–1 – has been dealt with. Part of it has been "financed", in an accounting sense, by accumulating arrears and by receiving debt rescheduling and forgiveness under Paris Club agreements (this is the "sum" line of Figure 3–1). Another part has been financed from programme aid (see figures from 1994/95 onwards). The programme aid figures include both loans and grants. It is clear, however, that in most years an amount of debt service due remained that had to be paid from other government revenues. Although total aid (top line in Figure 3–6) has always exceeded debt service due, a large share of this was probably tied aid – to projects or to imports – and could not be used for debt service.[25]

So far, we established that total debt service due could be met to a large extent by 1) accumulating arrears and from Paris Club debt relief, and 2) from programme aid loans and grants. In addition, we saw that there are large differences between types of creditors in the extent to which these creditors are paid, with multilateral creditors clearly having been favoured over all others. A more detailed conclusion on inter-creditor distribution can be drawn if we look at the origin of freely spendable loans and grants. Over the second part of the 1990s, programme aid grants have increased much more than programme aid loans (Table 3–1). Since most loans are disbursed by the multilateral institutions, while all grants originate from bilateral donors, this means that bilateral donors have been an

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24 In the earlier years, multilateral debt relief has probably been included in the "transfers to government" in the current account of the balance of payments.

25 Unless we assume that tied aid was fully fungible, i.e., destined for projects or imports that the government or the private sector would have implemented anyway with its own money in the absence of aid. But this is unlikely.

important source for financing multilateral debt service. Between 1995 and 2000, multilateral debt service averaged USD 130 million while average total debt service amounted to USD 220 million (Figure 3–1). From the figures of Table 3–1, it is clear that programme aid loans were by no means sufficient to finance multilateral debt service. There have been transfer from bilateral creditors to multilateral creditors, and this inter-creditor transfer has increased during the 1990s.

In sum, Paris Club debt relief, the largest share of total debt relief, hardly had a flow effect in the sense of freeing resources. But we showed in Chapter 2 that it was not accompanied by (other) aid flows to Tanzania. Relief on multilateral debt service as given in recent years by bilateral donors did have a flow effect, but, according to the analysis in Chapter 2, partly substituted for earlier balance of payment support. The overall effect of debt relief on reducing actual debt service paid was therefore limited.

3.2 The stock effect

To what extent did debt relief efforts lead to a reduction of the debt stock? As we saw before, the extent of forgiveness relative to rescheduling gradually increased in Paris Club agreements. Reschedulings do not lead to stock reductions at all; instead, the Net Present Value (NPV) of the debt stock is maintained while nominal debt stocks increase. Debt forgiveness in Paris Club agreements has so far only referred to debt service flows. However, insofar as arrears on past debt service obligations were forgiven, this led to some reduction of debt stocks. Figure 3–2 shows that there is a close relationship between arrears decumulation and debt relief, implying that most Paris Club debt forgiveness indeed led to an "ex post" reduction in the debt stock. This has reduced expected future debt payments since interest payments on these arrears were no longer building up. The effect of Paris Club debt relief during the 1990s is evident from the overall reduction of the nominal bilateral debt stock: bilateral debt declined from USD 3,780 million in 1990 to USD 2,286 million in 2000 (data from Bank of Tanzania).

Relief on multilateral debt given by bilateral donors, first in the form of 5th dimension operations and later via the Multilateral Debt Fund (MDF), never led to a reduction in debt stocks. It only implied relief of debt service flows.

The 1999 relief on commercial debt (6th dimension), which was a debt buyback at 12 cents for each dollar, financed by IDA and the governments of Germany and Switzerland, implied forgiveness on arrears on both principal and interest, totalling USD 623 million in 1999 (IDA, 1999). This relief will reduce expected future debt payment obligations, since the buildup of interest penalties on these arrears comes to an end.

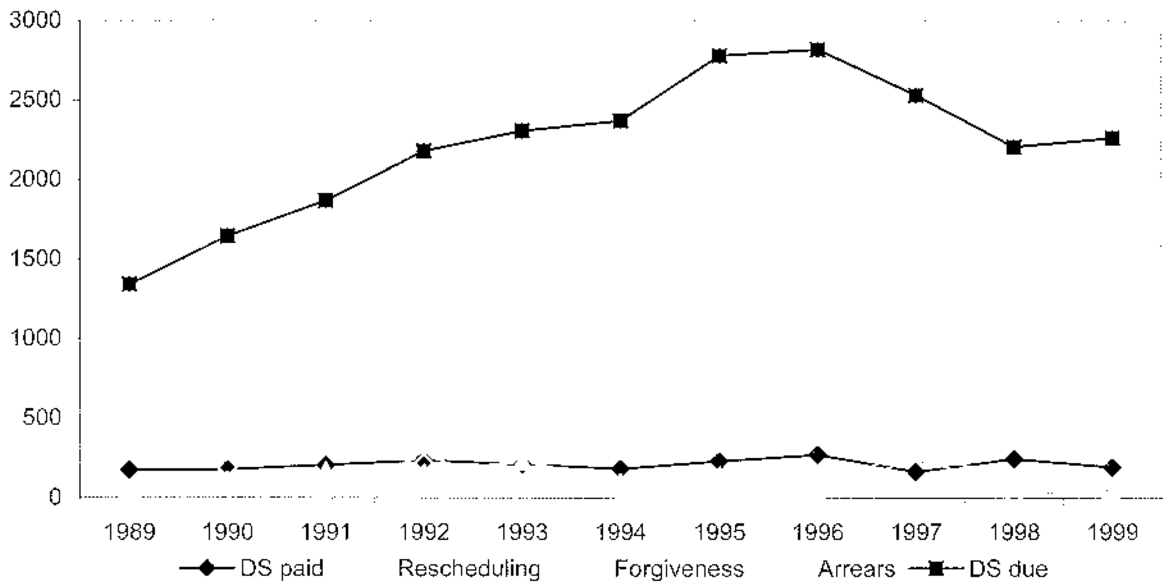
Table 3–2 Forgiveness relative to outstanding long-term debt (USD million and per cent)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Total
Forgiveness	55	113	172	157	232	102	140	41	339	70	26	1445
Total long-term debt	5279	5793	5802	5862	5820	6140	6247	6127	6056	6465	6628	6628[1]
Forgiveness, in %	1.0	1.9	3.0	2.7	4.0	1.7	2.2	0.7	5.6	1.1	0.4	21.8[2]

Source: World Bank, GDF 2001, CD-Rom.
[1]Long-term debt outstanding in 1999.
[2]Total forgiveness relative to debt outstanding in 1999.

Total debt forgiveness over the years 1989-1999 has amounted to USD 1,445 million (GDF figures) or 21.8% of the nominal debt stock in 1999 (Table 3–2). In 1997, debt forgiveness represented 5.6% of the debt outstanding in that year, but in other years relative forgiveness was much lower. It seems that the 1997 forgiveness effectively began to reduce Tanzania's debt service due as computed from the GDF figures (Figure 3–7).[26] But apart from that particular year, the actual reduction in the debt stock as a result of debt relief has been limited.

Figure 3–7 Debt service (DS) due[1] and its composition (USD million)



Source: Elaboration of data from GDF, 2001.
[1]Debt service (DS) due is computed by the sum of annual DS paid, annual rescheduling, annual forgiveness, and accumulated arrears.

With Tanzania reaching the HIPC Completion point in November 2001, two important stock effects will follow. First, Paris Club creditors agreed on a 90% reduction of their eligible ECA debt stocks – that is, debts from before the cutoff date of 30 June 1986 –, so the NPV of these stocks will be reduced as well. In addition, all pre-cutoff aid debts of Paris Club creditors will be cancelled (by those donors who have not done so already). Secondly, although the relief on multilateral debt in the context of the HIPC initiative implies relief on (future) debt service flows only, at the Completion Point this relief will be locked-in for 20 years: Tanzania will receive reductions in annual debt service flows such that the NPV of (currently existing) multilateral debt will be reduced by 54% (IDA & IMF, 2000). In total, Tanzania will receive a reduction in the NPV of its multilateral debt of USD 2,026 million (World Bank, 2001).

According to a BoT staff member, the reduction of the Paris Club debt stocks is very important for Tanzania. Until now, the payment of debt service has depended on annual negotiations. "A certain debt burden is expected from us", the staff member said. But what this certain debt burden is, has been established so far by the creditors/donors on an annual basis. As long as the large stock remains, creditors may suddenly force the country to pay a higher percentage of debt service due, for example if the country's economic performance improves. Actual debt service paid may therefore fluctuate widely, and the government does not have much influence over its amount. In the view of this

[26] Debt service due is computed as debt service paid + stock of (principal and interest) arrears + (principal and interest) rescheduling + (principal and interest) forgiveness, see also O'Connell & Soludo (2001).

BoT staff member, the importance of reaching the HIPC Completion Point was in achieving this stock reduction, and through that, obtaining certainty on future payments.

3.3 The implementation of the conditions

3.3.1 Compliance before 1998

Conditionality attached to debt relief before the MDF (1998) was to a large extent related to the macroeconomic and reform conditions set by IMF and World Bank. In 1986, the Tanzanian government was willing to reach an agreement with the IFIs. However, commitment to reforms was limited. The government's aim was to reduce conditions to the minimum necessary to obtain approval for a new IMF facility (OED, 2000). "Just a handful of ministers" was really in favour of reforms (Bigsten et al., 1999: 30). Nevertheless, a beginning was made with macroeconomic stabilisation, and with trade and exchange rate liberalisation. In 1989, the agreed reform package was expanded to include banking reforms and reforms of the parastatal sector and the civil service. Progress in these areas was slow, however.

After 1992, the relationship with the donors deteriorated. Fiscal benchmarks were not met and the implementation of structural reforms stagnated. From mid-1992 onwards, Tanzania did no longer receive IMF funds under the 1991 ESAF agreement. The country remained off-track until 1995, but bilateral donors sometimes made their own judgement of the situation and many continued to disburse programme aid. However, when a November 1994 report found increasing fiscal laxity and indications of major corruption, particularly in customs, most bilateral donors froze programme aid disbursements. A shadow-programme[27] was then designed under the Joint Follow-Up Committee (JFC), which consisted of representatives of major donors and Ministries. As soon as this had been successfully completed, some bilateral donors – including the Netherlands – resumed programme aid disbursements, while others waited for the new ESAF agreement.

In 1995 a new government came to power after multi-party elections. A cash budget was introduced, and this restored macroeconomic stabilisation. More progress was also made with reduction of the public sector and civil service reform, and with privatisation (Van Donge and White, 1999). Immediately upon taking office, the government installed a high-level committee to investigate corruption in the country. This led to the 900-page Warioba report, which described the problem very well. However, very little action against corruption has been taken since then (Bigsten et al., 1999: 39).

Both Bigsten et al. (1999) and Van Donge and White (1999) describe donor - government relations since 1995 as warm and much improved as compared to the period 1992-1995. The Helleiner report[28] and the follow-up meetings seem to have played an important role in improving the co-operation between donors and government (Bigsten et al., 1999: 20-22). However, this does not always mean that reforms have been implemented as agreed. Compliance with reforms has been much better with respect to fiscal and monetary stabilisation than with respect to structural reforms. Progress was slow in civil service reform and in privatisation. In 1998 the privatisation of the National Bank of Commerce (NBC) almost led to a break with the World Bank (Van Donge and White, 1999). In the end, the government seems to have conceded the issue. One – now independent –

[27] A shadow-programme is an agreement with the IMF without funding.

[28] A Committee chaired by Professor Gerry Helleiner was installed with the aim to restore relations between donors and government. Its report made several recommendations on, among other things, channelling more donor funds through the budget, improving donor co-ordination, and improving country ownership of policies (Bigsten et al., 1999).

person interviewed for this evaluation proved to have been involved on the government side in the negotiations on the privatisation of the NBC. He told the evaluation team that there had been considerable pressure from the IFIs on the government's negotiators to carry out the privatisation. "You feel like a small boy", he said, and, "you say yes to get the money".

In general, institutional reforms are more difficult to implement than stabilisation and liberalisation measures (Nelson, 1996). The reasons include that there is less expert agreement on the contents of reforms, that several government levels are involved, that there is more domestic exposure to criticism and that it is much more difficult to measure progress. Ddumba-Ssentamu et al. (1999) found that some additional reasons held for Uganda. First, these institutional reforms, such as civil service reforms, decentralisation and privatisation often harmed vested interests, while this was much less the case for macroeconomic stabilisation. And second, donors were less likely to apply the threat of withdrawal of aid funds, since macroeconomic policies were good and the country had a high growth rate.

These two reasons may have held for Tanzania, too. The Tanzanian growth rate has been fairly high since 1995, and donors and government have a mutual interest in maintaining the image of a well performing country. The vested interests argument also seems to hold. The introduction of a cash budget was a relatively easy measure that quickly showed results in the form of lower inflation. However, parastatal reform and especially banking reform did affect vested interests. Parastatals with losses were always financed from the government budget. When that became impossible due to the cash budget, the state banks could still play this role by providing loans to these enterprises (Bigsten et al., 1999: 39). Although many parastatals had been privatised, the new owners most likely had close ties to the political elite. That is why reforms and privatisation of the banks were difficult issues. In this area, particular interests of powerful persons were involved. Control over banks' lending policies was one of the few areas in which local politicians or officers still had some discretion vis-a-vis the donors.

3.3.2 More recent compliance with general conditionality

The high growth rate and the commonality of interests between donors and government are among the reasons why Tanzania is one of the few Sub-Saharan countries characterised as a "post-conditionality regime" by Harrison (2001). In such a regime conditionality is less coercive since policies promoted by the IFIs have become internalised with domestic policy makers. Donors and government are mutually dependent on each other: donors need a country where structural adjustment policies appear to have worked well and will not easily withdraw aid money; and the government is dependent on aid and will make its own plans with an eye to the "orthodoxy" as defined by the donors. But the power balance is still unequal, and donors have a large impact on domestic policies. Donors have regular meetings amongst themselves on policies for the different sectors, to which the ministries' Permanent Secretaries are invited (Harrison, 2001).

In Harrison's view, this post-conditionality regime brings its own contradictions. One is that donors are less keen to criticise the country on human rights issues or corruption than countries that are not seen as successful adjusters. This means that in countries like Tanzania corruption can easily continue or even increase as a result of the high aid flow. Second, the picture of a successful implementer of reforms is partly maintained by "institutional imaginings" (Harrison, 2001: 673). In Tanzania, for example, an Ethics Secretariat was created to fight corruption but it was severely understaffed and was ineffective in improving the conduct of politicians and public officials.

During the field work for this evaluation we found that corruption is a major problem in Tanzania and that it is occurring at all levels. It harms production because it increases transaction costs, both for established firms and for small farmers and microenterprises. It also has direct consequences for priority spending in the context of the MDF and the PRSP, since leakages have been found in the transfer of resources from central ministries to district authorities. Tanzanians from outside the government are concerned about corruption, and also about the possibility that higher levels of budget support allow for more illegal diversion of funds.[29] Donor representatives, for their part, maintain that the government is not doing enough to fight corruption and to punish the persons involved. Some donors discovered fraud in the execution of aid projects. They stopped disbursing but then found it very hard to convince the government to take actions against the people found guilty.

Corruption is a major issue brought up by donors during Consultative Group (CG) meetings. Several interviewees told us that almost all donors complained about corruption during the last CG meeting. In his response, the President got irritated while saying that the government is working on it. Then all donors remained quiet. So far donors have not stopped budget support for this reason. In this sense, the post-conditionality regime seems to be confirmed: donors have too much interest in maintaining the image of a good performer. One representative of a bilateral donor spoke of a "game": "as long as we are not too outspoken on corruption" we are allowed to spend more, while colleagues in other countries where problems have been brought into the open, cannot disburse.

3.3.3 Implementation of conditions for the HIPC initiative

In order to access (enhanced) HIPC debt relief, Tanzania had to be on-track with IMF and World Bank programmes, and to elaborate a PRSP in a participatory manner. The country first designed an Interim PRSP (I-PRSP), which was endorsed by the Boards in April 2000 and led to the achievement of the HIPC Decision Point. This I-PRSP in fact replaced the National Poverty Eradication Strategy (NPES) of 1997. The NPES had already been prepared in a participatory way. Therefore, no new consultations were held for the Interim PRSP. As these documents to some extent overlap, the necessity of spending some USD 0.3 million to replace an already existing – and according to some, more comprehensive (Mbelle, 2001) – document may be questioned. The I-PRSP did develop a framework for organising the consultations for the full PRSP.[30]

In order to qualify for the HIPC Completion Point, Tanzania had to comply with several structural reforms and had to improve on its poverty reduction strategy by elaborating a full PRSP. A full PRSP would have to be prepared in a participatory way and would include an elaborated poverty monitoring plan and better analysis of the financial consequences of designed policies. In addition, Tanzania had to write a progress report on the execution of the PRSP. In total, the Interim PRSP identified 30 Completion Point conditions (United Republic of Tanzania, 2000a).

In accordance with the earlier developed framework for consultations for the full PRSP, seven "zonal workshops" were held in May 2000 covering all of mainland Tanzania. In each workshop, four randomly selected villagers per district participated, as well as five representatives from (different) NGOs. In addition, there were representatives of district and town governments (United Republic of Tanzania, 2000b). In response to the priorities brought up in these workshops, the new spending priorities in the full PRSP became

[29] Given the cash budget, sudden increases in revenues due to, for example, proceeds from privatisation or budget support, create opportunities for discretionary spending.
[30] This was the same framework as established for the development of the Tanzania Assistance Strategy of the World Bank, see IDA (2000).

primary education, primary health care, agriculture research and extension, rural roads, water, the judiciary, and HIV/AIDS.

The full PRSP was endorsed by the boards of the IFIs in November 2000. However, the staff of these two institutions made detailed comments to the text of the document that would have to be corrected in the first PRSP Progress Report (IDA, 2000a). For example, the government should integrate the priorities of the PRSP with the Public Expenditure Review (PER) and Medium-Term Expenditure Framework (MTEF) processes and indicate more detailed prioritisation and costing of fiscal expenditures. In addition, more detailed strategies for agriculture and education should be elaborated and more work should be done on the poverty monitoring framework. During our field visit in June 2001, the Office of the Vice-Presidency was working hard on the first PRSP Progress Report. For the preparation of the progress report, working groups had been installed in which the government worked together with NGOs, academics and donor representatives. An officer involved in writing the PRSP Progress Reports frankly told the evaluation team "We want poverty reduction, but the first reason why we write these Progress Reports is that we need the money".

The most difficult of the – more general – completion point conditions proved to be the privatisation of the public water company, DAWASA.[31] The World Bank and the government did not agree on the seriousness of the efforts made by the latter. By November 2001, however, the Boards endorsed the progress report on the PRSP and the participatory process, and the Completion Point was reached (IMF, 2001).

The elaboration of a PRSP was a condition for accessing HIPC debt relief. For this reason, the donor opinion on the contents of the PRSP was of course far more important to the government than that of local NGOs or poor Tanzanians. The fact that technical assistance from the IFIs was employed for the preparation of the PRSP (IDA, 2000b) is another indicator that certain contents of the PRSP had to be guaranteed.

Opinions differ on actual participation and local ownership of the PRSP. The official view is of course that the government owns the process and that there has been real participation. The government had already elaborated the National Poverty Eradication Strategy and this had also been done with broad participation, so it was clearly in line with the government's own priorities. Independent local stakeholders we interviewed argued that PRSP is just a continuation of the old conditionality, but we also heard the view that the poverty focus now imposed by donors is a good thing. NGOs complained that, although they were invited to workshops, they did not receive the documents in time to prepare properly. There was too much time pressure, and some representatives also maintain that the government is not really interested in hearing the views of poor people. This contrasts, in their views, with the dominant role donors play and have played in the preparation of the PRSP, in its monitoring and also in other important fora such as the PER. A positive development is that the government (with support from DfID) had the PRSP translate into a nicely illustrated booklet in simple and direct language (Catalyst & Masoud, 2001). This may enhance grassroots involvement in future consultations. However, some donor representatives express the opinion that the President and high level officers are serious about combating poverty, but that commitment is often lacking at lower levels.

One of the evaluation team members participated in a meeting on the draft PRSP Progress Report to which donors and local stakeholders such as NGOs, academics, and local governments were invited, and could confirm that the meeting was open and that

31 Interview with IMF representative.

everybody could talk freely. The majority of those attending were Tanzanians, but donors were relatively active. The general tone was positive, but remarks were made on many different and sometimes conflicting issues. For example, some persons argued that the PRSP objectives were good but that implementation was now crucial, while others maintained that targets were far too ambitious, especially in education. People asked for more attention for certain issues, like agricultural policies, gender mainstreaming or the costing of the environmental policies. However, it is clear that comments made by important donors had greater impact than comments from local individuals or groups. IMF and World Bank representatives, for example, had a separate meeting with the Vice President's Office the day after the open meeting, in which detailed comments were given.

All in all, the PRSP progress seems to confirm the observation by Harrison (2001) that the government outlines strategies with an eye to the international orthodoxy. Although it is technically true that the NPES was already elaborated before it formally became a condition for the enhanced HIPC initiative, 'donor speak' obviously already went in that direction. Governments of highly indebted countries that wanted to be sure to continue receiving programme aid in general and debt relief in particular, had to make sure that they appeared serious about poverty alleviation.

3.3.4 Compliance with the MDF/PRBS conditions

As described in Chapter 2, the conditions for the MDF/PRBS involve the protection of spending for priority sectors, and increasingly also the improvement of transparency and accountability of budget execution and of actual public service delivery. Priority sectors include education, health, water and (rural) roads; as long as actual allocations to priority sectors are at least 100 per cent of budgeted allocations, the objective has been met. The monitoring of the MDF has been done partly by material presented at quarterly meetings with donors, and partly through the tracking studies initiated under the Public Expenditure Review exercise.

The Ministry of Finance provides the donors with Quarterly Reports that have become more extensive in the course of time – for example, the more recent reports include more macroeconomic data and information on the progress made in the execution of the PRSP. However, these reports do not allow an easy appreciation of spending for priority sectors. Recurrent expenditure (which is the relevant category) is broken down by 'administration', 'defence & security', 'social sectors', 'economic sectors', and 'productive sectors'. This means that no separate assessment can be made for education, health, water and (rural) roads. For central government recurrent expenditure, spending figures are available for the Health and Education ministries, for the Ministry of Water and for the Road Fund, but these figures exclude the flows going to local authorities. The latter are particularly important for primary education and primary health care, and also for water. This means that the Quarterly Reports – which form the basis for the quarterly meetings with donor representatives – do not provide the exact information needed to monitor the MDF/PRBS.[32]

From available figures in current shillings it can be concluded that the protection of social sector expenditure was not better than that of other sectors in FY 1998/99, but that it improved in FY 1999/00. In the social sectors, actual spending was 119% of budgeted spending in 1999/00, while the figures for the other sectors range from 70 to 99 per cent.[33] A joint donor-government team that reviewed the MDF observed that releases to the Road

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[32] Strangely enough, a high officer of the Ministry of Finance informed us that detailed expenditure figures for primary education and primary health care are available in the budget department of the Ministry, but they do not appear in the Quarterly Reports.

[33] Summary table constructed by Mr F. van Rijn of Dutch Embassy on the basis of MoF Quarterly Reports.

Fund were below the approved budgets in 1998/99 and 1999/00 (Government of Tanzania & Donors, 2000: 3). For the social sectors, we computed actual versus budgeted spending in constant shillings (Table 3–3). With the exception of occasional blips, allocations – both to personal emoluments and other charges – prove to have been above what was budgeted. However, figures are more fluctuating for other charges than for salaries, pointing to some weaknesses in the protection of this expenditure. Nevertheless, at a very general level the MDF/PRBS seems to have worked for the social sectors, although in the first year (1998/99), social sectors were not protected more than other sectors.

Table 3–3 Allocations to social sectors in % of budgeted amounts (Tsh million, Dec '94 prices)

	Per cent of budgeted amounts		Actual allocations, Tsh million	
Year-Quarter	**PE**	**OC**	**PE**	**OC**
1098-IV	97	156	5 205	4 943
1999-I	98	132	4 779	3 664
1999-II	101	102	4 974	2 838
1999-III	133	101	6 824	3 864
1999-IV	133	61	6 759	2 277
2000-I	132	116	6 145	3 993
2000-II	132	122	6 192	4 248
2000-III	104	99	6 751	5 195
2000-IV	109	104	7 011	5 298
2001-I	108	109	6 849	5 557

Source: Reports prepared for the quarterly MDF/PRBS meetings; CPI deflator from BOT (2001): Table 7.
Note: PE = Personal Emoluments; OC = Other Charges.

Increasingly however, the MDF/PRBS is also meant to support a broader donor agenda of improved financial management, more transparency in budget flows, more accountability, less corruption, and better service delivery. In this area, the Public Expenditure Review (PER) process is important.

The Public Expenditure Review process has developed into one of the most important fora for policy discussions in Tanzania. In addition, several donor representatives say that it has become a government-driven exercise. The PER secretariat is at the World Bank Dar es Salaam offices, but meetings are chaired by government representatives, and much of the work undertaken by the PER working groups is initiated by the government. In these working groups that meet every two weeks, representatives of the private sector, NGOs, academics, religious organisations and donors participate. Donors appear to be particularly active, however.

The PER has two major purposes. First, it defines the resource 'envelope' and analyses alternative ways of using this in conjunction with government priorities. The result is fed into the Medium-Term Expenditure Framework (MTEF), that has replaced the old five-year plans and whose purpose is to secure financing for medium term objectives. In this respect, the PER commission studies various matters relating to public finance. Second, the PER follows up how the budget has been implemented. The main instrument for this is tracking studies, in which one tries to follow funds from the moment they have been disbursed from the Ministry of Finance until they hit the ground, in primary schools or local dispensaries. The results from these – very costly but also very valuable – studies are used to inform policymakers and also feed into the next year's PER.

Although the PER is an important development, actual progress in budget transparency, accountability and improved delivery of public services is still limited. First, the monitoring of actual versus budgeted spending in the context of the cash budget may be even harmful for this broader agenda. The cash budget gives an incentive for budget holders to increase the amounts budgeted for salaries at the cost of those for other charges. This is because the amounts budgeted for PE will always become available, while those for other charges will not (OED, 2000: 22). Underbudgeting for other charges may be reinforced by the focusing of donors on comparisons between budgeted and actual spending for other charges: it is much easier to fulfil this target with lower budgets. We did not find evidence for this response, but an officer of the Ministry of Education informed the evaluation team that people have never put serious efforts into budgeting other charges, since they never obtained what was budgeted. They will have to learn to prepare budgets in a more serious way. One can wonder, therefore, how much the figures as presented, for example, in Table 3–3 can really tell us.

Second, much remains to be done in securing that actual expenditure as registered at the MoF, reaches the ground. Primary education and primary health care are the responsibility of local authorities. Tracking studies for the PER have shown that transfers to districts are slow and late, and that transfers from districts to the sectoral accounts from which actual salaries and other charges are paid, are slow or missing.

Third, budget transparency and accountability are still weak. The draft Country Financial and Accountability Assessment (CFAA) of April 2001 observed several weaknesses regarding government financial management and accountability. These were due to, among other things, low pay leading to lack of appropriate personnel and of motivation, and a lack of an accountability culture. Although a comprehensive software system, Platinum, is now installed at the central level, introduction at district level is still not completed. In addition, according to several observers this system can only improve the application of the cash budget. It will not lead to more "value for money". A major issue is therefore to increase the actual flows of money to primary schools and health posts.

Our elaboration of data from the public expenditure reviews shows that even in the social sectors the amounts spent are still not impressive, particularly not in real terms per end-user. OC per student in real terms was lower in 1999 than in 1998, despite higher disbursements into the MDF in 1999. Table 3–4 shows also that real expenditure for all three types of education has decreased between 1996 and 1997, and again between 1998 and 1999. In 1998 there was an increase, which may have been due to the beginning of the MDF. In primary education, the real decline in other charges (OC) is smaller than that in personal emoluments (PE), which is in accordance with what the donors wish to see. Nevertheless, the increase in number of students between those years seems to erode the real effects of the protection of OC spending. The fall in real spending has been larger in secondary education and in teacher education. In this sense, the government seems to have given priority to primary education, which probably coincides with the donors' priorities.

An officer of the Ministry of Education maintained that the MDF had made no difference in 1998/99, but that more money had become available for education in 1999/00 and again in 2000/01. However, in 1999/00 the increased resources for salaries had to be spent on a "backlog" of teachers who had to be promoted. Part of the additional funds for other charges had to be spent on the "internal debt". This is probably the debt to the pension funds: part of the resources for other charges is meant for the teachers' pension fund, but local authorities have often used this money for other things. Nevertheless, the Ministry of Education officer is of the opinion that there was some increase in the amount of money available for education in 1999/00, and that this has allowed the abolishment of registration fees for primary education in 2000. This led to an increase of 300,000 enrolled pupils.[34] In 2001, the higher education budget as a result of the HIPC savings allowed for the abolishment of tuition fees, too. According to the government, this was among the government's priorities already for some time, but there had been no money for it before. The Ministry expects a further 1.5 million children to enrol in primary schools as a result of this measure. With the support of a World Bank loan it intends to build some 13,000 new classrooms. At the same time, it intends to increase (i.e. deteriorate) the teacher student ratio from 1:39 to 1:45. What this all means for the quality of teaching in practice remains to be seen. According to independent observers, teachers often come to instruct a class during two hours a day; they are only willing to teach more if parents pay additional fees. This would nullify the effect of the abolishment of registration and tuition fees.

Table 3–4 The Education Budget 1996-99 (Tsh million and per cent, Dec '94 prices)

	1996	1997	1998	1999
Primary education				
Total budget (TSh mln)	49,792	45,678	43,094	38,827
Personal emoluments (TSh mln)	48,181	44,392	41,418	36,274
Other charges (TSh mln)	1,610	1,285	1,676	1,542
Personal emoluments (% of budget)	97	97	96	96
Other charges per student (TSh)	416	327	414	370
Secondary education				
Total budget (TSh mln)	5,772	4,865	5,563	4,291
Personal,emoluments,(TSh,mln)	4,234	4,004	3,241	2,802
Other,charges,(TSh,mln)	1,537	860	2,378	1,488
Personal emoluments (% of budget)	73	82	58	65
Other charges per student (TSh)	16,699	8,838	19,925	12,005
Teacher education				
Total budget(TSh mln)	1,445	1,391	1,676	1,202
Personal emoluments (TSh mln)	1,023	1,068	982	845
Other charges (TSh mln)	422	323	694	357
Personal emoluments (% of budget)	71	77	59	70
Other charges per student (TSh)	25,742	24,287	21,474	33,972

Source: Calculated from Public Expenditure Review, 1999; Price index from BOT (2000), Table 1.19.

In sum, it is difficult to assess the real influence of donors on policies for priority sectors through the MDF/PRBS. Figures presented to donors in the quarterly meetings may not be accurate and may even be misleading. The information resulting from the Public Expenditure Reviews and other reports such as the CFAA is of much better quality, but the resulting picture is not very bright. In the area of education, there appears to be at least one positive effect of increased availability of funds since about 1999, and that is the abolishment of registration and tuition fees for primary education, leading to higher enrolment rates

[34] Interview with officer of Ministry of Education.

3.4 Conclusions

This chapter has assessed the efficiency of debt relief provided to Tanzania in the 1990s. The following outputs of debt relief have been examined: an increase in the flow of resources, a reduction in the debt stock and the implementation by the Tanzanian government of the conditions attached to debt relief.

We can draw several conclusions. First, the flow effect from debt relief has been limited during most of the decade. Most debt relief in this period has been provided by the Paris Club creditors, and most of that consisted of rescheduling of debt service due. In practice the flow effect form these reschedulings proved to be almost zero, since without them arrears were built up. The same holds for the commercial debt buyback of 1999: most of this concerned old arrears that the country was not paying. Tanzania received relief on multilateral debt in 1998 and 1999 (and probably some in the early 1990s – but these figures are lacking). This relief had a direct flow effect since multilateral debt was fully serviced. In these two years, bilaterals financed about USD60 million of the roughly USD130 million in annual debt service to the multilaterals. So there has been a considerable relief of the debt service flow in these two years.

Second, there have been important inter-creditor transfers, in particular, from bilateral (Paris Club) creditors to multilateral creditors. Whilst an agreement with the IMF has always been a condition for a Paris Club agreement, the reverse only seems to have held since about 1995. From then on, Tanzania began to pay debt service due to Paris Club creditors regularly – but by then debt service due had become lower as a result of increasing forgiveness. In practice therefore, the amount of debt service paid to bilateral debtors has always been low as compared to the accompanying debt stock. In addition, many of these bilateral creditors have provided fresh programme aid resources to Tanzania in the form of grants. Fresh programme loans from the multilaterals were not sufficient to finance debt service to these institutions, so programme aid grants from bilaterals were used to pay multilateral debt service. In practice, therefore, bilateral donors and creditors have allowed debt service to the multilaterals to be paid and have freed the way for new loans from these institutions, while they themselves have accepted arrears and have rescheduled and forgiven their debts. Thus, multilaterals were bailed out by bilaterals.

Third, the effect of debt relief on debt stocks has also been limited. Most debt relief was in the form of rescheduling and did not reduce debt stocks. Overall, debt forgiveness amounted to only 22% of the actual stock of long-term debt in 1999.

Fourth, the picture with respect to the influence of donors on government policies is mixed. Specific conditions for debt relief were only set with the creation of the Multilateral Debt Fund in 1998. At a superficial level, figures indicate that the MDF has worked for two out of four defined priority sectors. But figures are not accurate and may even be misleading. Donors have a lot to complain about in the broader agenda regarding public sector performance and governance. Some progress can be observed, however, as these issues are at least recognised also by government, and are dealt with in the Public Expenditure Review process. But it remains to be seen how much real progress will be made. In a way, Tanzania is indeed a "post conditionality regime" (Harrison, 2001) in which donors are not likely to use the stick of aid withdrawal. There is too much at stake for them in maintaining the image of Tanzania as "good performer". The government, although highly dependent on donors, can get away with "institutional imaginings" rather than real changes, especially in areas where advances are difficult to measure: governance issues and civil service reform. Since these areas are crucial for the real effects of poverty reduction measures, the success of the current conditionality for the HIPC initiative can be questioned.

Insofar as Dutch debt relief concerned relief on bilateral export credits and on bilateral aid loans, it did not lead to the freeing of resources. But the Dutch were a large contributor to the MDF, and this debt relief did free resources for the Tanzanian government. With respect to export credits, the Netherlands followed the Paris Club and so the stock effect of this debt relief was limited. The Dutch were, however, relatively early in forgiving the stocks of bilateral aid loans (this occurred before the evaluation period) and the concessional components of the mixed credits (in the early 1990s). This has contributed to a faster reduction of the debt stock. There were no specific Dutch conditions to debt relief, so no particular effects of these can be established.

4 THE EFFECTIVENESS OF DEBT RELIEF

The aim of this chapter is to assess the effectiveness of debt relief, and it therefore compares outputs with outcomes. First, we examine whether debt relief led to an improvement in the debt sustainability indicators, such as the debt-to-export ratio and the debt service-to-export ratio (section 4.1). Then an analysis is made of the effects of the reduction in debt service flow (the flow effect) and the reduction in debt stocks (the stock effects) as a result of debt relief (4.2 and 4.3). Chapter 3 has shown that debt relief hardly freed resources during the 1990s, but that there was some freeing of resources towards the end of the 1990s. However, to the extent that there are flow effects from debt relief they cannot be separated from the flow effects of foreign aid. These two are therefore taken together in the analysis of the flow effects in section 4.2. The possible stock effects of the (limited) reduction in the debt stock on investment and on international creditworthiness are examined in section 4.3. In section 4.4 the long-run debt sustainability of Tanzania is examined. Section 4.5 concludes.

4.1 Debt sustainability

Over the 1990s, the different indicators of debt sustainability have improved. This holds, in particular, for the debt service-to-exports ratio (an indicator for liquidity). The ratio of debt service due-to-exports began to decline after 1993, and the debt service paid-to-exports ratio has decreased since 1992 even more strongly. However, these positive trends are much more the result of increasing exports since 1992 than of lower debt service figures (Table 4–1).

Table 4–1 Debt service (DS) sustainability indicators (USD million and per cent)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
DS due	1645	1869	2180	2308	2372	2781	2821	2534	2208	2264
DS paid	179	207	236	211	184	232	271	165	246	194
DS paid - MDF	179	207	236	211	184	232	271	165	179	139
Exports	544	513	584	787	969	1297	1422	1254	1180	1251
GNP	4072	4771	4414	4094	4357	5131	6378	7583	8534	8725
Ratios (%):										
DS due/exports	302	364	373	293	245	214	198	202	187	181
DS paid/exports	33	40	40	27	19	18	19	13	21	15
DS paid*/exports	33	40	40	27	19	18	19	13	15	11
DS paid/DS due	11	11	11	9	8	8	10	7	11	9
DS paid*/DS due	11	11	11	9	8	8	10	7	8	6
DS due/GNP	40	39	49	56	54	54	44	33	26	26
DS paid/GNP	4	4	5	5	4	5	4	2	3	2
DS paid*/GNP	4	4	5	5	4	5	4	2	2	2

*Debt service paid minus contributions to MDF. Source: see Chapter 2.
Source: Elaboration of data from GDF, 2001.

Figures for debt service paid (according to these GDF data) have been fluctuating around a constant trend during the 1990s, showing that creditors seem to require a certain, more or less fixed, amount of debt service every year. But since export income rose strongly between 1992 and 1995, the debt-service-paid-to-export ratio has declined considerably during the decade. In fact, actual debt service paid has fluctuated around 20% of exports since 1994. If we take the debt relief from bilaterals for servicing multilateral debt into account, average debt service in 1998 and 1999 was only 13% of exports.

With respect to this apparent increase in exports, a qualification is necessary. The figures in Table 4–1 reflect exports of goods and services, including remittances. If we only were to include exports of goods, the figure would be much less favourable. Table 3–1 (first line) shows that the value of goods exports has barely increased over the 1990s. If we compare debt service with exports of goods only, the indicator does not show an improvement over the 1990s.

Despite the debt forgiveness granted in the 1990s, amounting to some 22% of the 1999 debt stock (Table 3–2), Tanzania's nominal debt stock has continued to increase. This holds for both total debt (EDT, including short-term debt and IMF) and for long-term debt (LDOD) (Table 4–2). New disbursements plus the capitalisation of arrears have clearly outweighed the amounts of forgiveness. Nevertheless, the debt-GNP ratio, an indicator of solvency, also began to decrease as of 1995. This reflects an increase in nominal GNP, and is not due to a reduction in the debt stock.

Table 4–2 Debt sustainability indicators

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Debt stock (EDT)	5850	6451	6558	6678	6791	7235	7406	7362	7129	7633	7967
Debt stock (LDOD)	5279	5793	5802	5862	5820	6140	6247	6127	6056	6465	6628
GNP	4241	4072	4771	4414	4094	4357	5131	6378	7583	8534	8725
Ratios (%): Debt (EDT)/GNP	138	158	137	151	166	166	144	115	94	89	91
Debt (LDOD)/GNP	124	142	122	133	142	141	122	96	80	76	76
Debt (EDT)/Exports	1088	1185	1278	1143	863	747	571	518	568	647	637
Debt (LDOD)/Exports	982	1064	1131	1003	740	634	482	431	483	548	530
NPV of debt/Exports[1]											397

Source: Elaboration of GDF, 2001.
[1]By end June 1999. Source: IDA & IMF (2000).

Although several debt sustainability indicators improved during the 1990s, the debt outstanding in 1999 was still at an unsustainable level. The debt-to-export ratio was far above the benchmark for HIPC, which in itself has been reduced from 200-250 per cent of the Net Present Value (NPV) of exports under HIPC 1 (1996-1998) to 150% of NPV of exports under HIPC 2. In net present value terms, Tanzania's debt was at 397% of exports by June 1999 (Table 4–2). The unsustainability of the debt is also evident from the large stock of arrears and the very low ratio of debt service paid-to-debt service due (Table 4–1). If Tanzania were to pay all its commitments, this would take almost 200% of exports and 26% of GNP.

All in all, debt sustainability, and in particular solvency, has improved during the 1990s but in 1999 the debt was still unsustainable. The role of debt relief efforts in this improvement of sustainability has been limited – much smaller than the influence of rising exports and GNP. In addition, export have only increased if we include services, and within services, remittances. Otherwise, there would be no positive development in the debt-to-export-ratio. Liquidity indicators, similarly, only show an improvement if we include remittances in the figures for exports. The still large arrears and the low ratio of debt service paid-to-debt service due also point to very low liquidity levels.

4.2 The flow effect of debt relief

Chapter 3 showed that debt relief hardly reduced the actual debt service burden. So the flow effect of debt relief on, for example, the balance of payments and the government accounts can only be limited. A positive flow effect would be reflected in higher imports, and in lower public deficits or higher public expenditure on items that contribute to economic growth and poverty reduction, for example, social and physical infrastructure. There is, however, a possible positive flow effect from multilateral debt relief, since this debt relief freed resources. In fact, there is no difference between the effect of multilateral debt relief (including 5th dimension and MDF) and other types of freely spendable aid, such as budget support and balance of payments support. They all free resources for the government and for the balance of payments. And if we assume fungibility of aid, there is no difference between the flow effect of debt relief and the flow effect of aid in general. In this section, we therefore first examine the possible effect of aid and debt relief on imports, and then on the government accounts. If debt relief and aid have led to an increase in social spending, this may have had positive effects on social indicators, for example in health and education. Social indicators are therefore examined in the last paragraph of this section.

4.2.1 Effect on balance of payments

The question is now whether the flow effect of debt relief led to increased imports of goods and services, and thereby possibly contributed to economic growth. We concluded above that there was hardly any flow effect from 'debt relief' in the balance of payments table (3–1), which includes Paris Club debt relief and possibly also the debt conversion scheme of the early 1990s. This relief mainly served to clear arrears. This is also evident from Table 4–3, which shows the different sources and uses of forex in percent of the total sources and uses. Years with high 'debt relief' also have high arrears decumulation.

As there is no difference between the flow effect of debt relief (insofar as it frees resources) and of aid, we now examine the impact of aid in general on the import capacity. Earlier studies have shown that the first aid boom, until 1982, was associated with a high investment rate but not with high imports (Doriye et al., 1998). Savings were not displaced, but exports were. Most aid was project aid, directly leading to high investment. Despite the official strategy of self reliance and appropriate technology, most investment was capital and import intensive.[35] However, these investments also boosted local employment and led to an upward pressure on domestic food prices. Since the state set official prices at low levels, parallel markets for food crops came into existence. In the meantime, the exchange rate was fixed and imports were rationed. All these factors led to low and non-stimulating prices for export crops. The import volume other than for foreign-financed investment goods was low, thereby hampering capacity utilisation and growth.

In the second aid boom, from 1986 to 1992, it was the other way round: imports increased and investment as share of GDP decreased (Doriye et al., 1998). In this period, aid reduced inflation by financing the public deficit, and allowed high capacity utilisation through import support (Van Donge & White, 1999). According to Van Donge and White, imports would have been much lower throughout the 1990s (figures up to 1997) in the absence of aid.

[35] **See James (1996) for evidence on this capital and import intensity, and for an interesting public choice explanation of this phenomenon.**

Table 4–3 Sources and uses of forex (per cent of total)

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
Sources:										
Exports of goods and services	27	24	25	30	44	46	47	45	39	42
Aid	38	42	38	29	31	35	38	41	40	42
of which PA					4	5	6	6	6	7
Private transfers	20	19	19	16	1	1	1	1	1	1
FDI	1	1	3	2	4	5	5	6	6	6
Other capital + errors and omissions	1	-3	-1	12	10	4	-1	2	9	5
Arrears accumulation	4	12	6	10	11	10	-37	3	0	-40
Debt relief	8	4	9	0	0	0	46	2	3	44
Monetisation of gold	1	1	0	0	0	0	0	0	0	0
Total	100	100	100	100	100	100	100	100	100	100
Uses:										
Imports of goods and services	79	80	83	78	80	77	74	83	83	85
Debt service (due)	17	14	22	18	18	19	17	17	15	11
Increase in reserves	4	6	-5	4	2	3	10	0	2	4
Total	100	100	100	100	100	100	100	100	100	100

Elaboration of Table 3–1.

Using more or less the same methodology, we can assess what the level of imports would have been in the absence of aid and debt relief, over the period 1990-1999. We postulate four different scenarios. In scenarios 1 and 2 we assume there is no aid and no debt relief. In scenarios 3 and 4 there is only no aid. We already established that debt relief as registered in balance of payments figures is mainly Paris Club debt relief, and that this hardly had an effect on the actual flow of resources. Probably therefore, there will be little difference between scenarios 1 and 2 on the one hand, and scenarios 3 and 4 on the other.

Debt relief and also aid can be expected to influence the extent to which debt service due is actually paid. In scenarios 2 and 4, we assume that debt service is paid as actual, meaning that arrears are accumulated as actual. Since it is unlikely that in the absence of debt relief, arrears would have been paid, we assume that no arrears decumulation would have taken place in the absence of (Paris Club) debt relief. In scenarios 1 and 3 we assume that debt service is about 50% lower than it actually was, reflected in a corresponding increase in arrears accumulation.

We are interested in the effect of debt relief and aid on imports, but apart from leading to higher imports or higher actual debt service (which is covered by scenarios 1 and 3), debt relief and aid may also lead to extra increases in reserves, lower exports (because of an overvalued exchange rate) or "second round effects", such as higher FDI as a result of higher growth rates. On the one hand, it is perhaps reasonable to assume that there would have been less FDI in the absence of aid and debt relief (another source). On the other, we can assume that part of the aid and debt relief received has been used to increase reserves (a use), so that reserve accumulation would have been lower in the absence of aid and debt relief. In order to not complicate the analysis, we assume that these two effects cancel each other out and we just take the same numbers for all other sources and uses of forex. This implies that we abstract from possible effects on exports through the exchange rate. In sum, we assume that all other flows on the balance of payments remain the same.

See Annex B for detailed calculations for the four scenarios. Table 3–6 shows counterfactual imports as percent of actual imports of goods and services in the four scenarios. Given our conclusion above that Paris Club debt relief does not have a flow effect, scenarios 3 and 4 are probably most relevant for our analysis. In fact, if we assume that in the absence of Paris Club debt relief, debt service would have been reduced by the same amount, scenarios 1 and 2 are exactly equal to scenarios 3 and 4 since the amount of Paris Club relief foregone would simply be added to arrears accumulation.

Table 4–4 Counterfactual imports as % of actual imports of goods and services in four scenarios

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
1	53	50	53	67	66	60	36	53	54	47
2	42	43	42	62	61	55	36	47	47	47
3	58	52	59	67	66	60	53	54	56	55
4	48	47	41	61	56	52	55	44	48	50
Memo item:										
Actual imports	1569	1885	2017	2242	2029	1986	2040	2177	2331	2454

Scenarios:
1. No aid, no debt relief; debt service 100 mln lower, 50% of debt relief added to arrears, no arrears decumulation
2. No aid, no debt relief; debt service as actual but no decumulation of arrears
3. No aid; debt service 100 mln lower than actual
4. No aid; debt service and arrears accumulation as actual
Source: Annex B.

Imports would have been about 50% of actual, on average, in all cases. If no aid is combined with debt servicing as actual (scenario 4, which is by no means full servicing!), imports would be between 41 and 61% of actual. If actual debt service would be reduced by USD 100 million, being more or less half of actual debt service (over 1990-1999 actual debt service averaged USD 212 million), imports would be slightly higher, namely between 52 and 67% of actual. This relatively small difference between the effect on imports of a scenario with debt service as actual and one with 50% reduction of debt service, again points to the relative unimportance of actual debt service. Foreign aid is a far more important variable for determining import capacity than the amount of actual debt service paid. Table 4–4 also shows that counterfactual imports are a bit higher in the years in which actual aid was lower (1993/94 through 1995/96).

4.2.2 Effect on government accounts

To the extent that there is a flow effect from debt relief, it will also increase spendable income of the government. Again there is no difference between the flow effect from debt relief and that from other freely spendable aid. In the government accounts, programme aid and project aid is registered separately, under both grants and loans (Table 4–5). After 1993, most programme aid has been freely spendable. The reason is that the forex market became liberalised in 1993 and that the most important donors – Japan excepted – moved away from import support to general balance of payment support with little or no strings attached on the use of forex (Van Donge and White, 1999). In particular, forex was no longer earmarked for allocation to parastatals, so the collection of countervalue became less of a problem. Consequently, after 1993 what mattered for government's affairs was the amount of programme aid.

Since 1993, the relative share of programme aid within the total aid flow diminished: both programme aid grants and loans as a percentage of GDP were at a lower level from 1993/94 onwards (Table 4–5). This does not necessarily mean that the government disposed of lower amounts of freely spendable aid resources, since before 1993/94 a large part of programme aid was in fact tied import support. It is perhaps safe to assume that the total of freely spendable aid resources has remained more or less constant over the years.

It is interesting to compare this amount of programme aid with the amount of (total, so including domestic) debt service paid from the budget (Figure 4–1). Debt service on foreign debts, including amortisation and interest payments, has always taken around 15% per cent of recurrent expenditure since 1992/93. It was higher in 1991/92. It is tempting to assume that the reduction in debt service was due to the 1992 Paris Club agreement, but balance of payments data above showed that higher debt relief was accompanied by lower arrears accumulation, so in the end there was no net flow effect of this debt relief. The share of programme aid in recurrent expenditure was higher than that of debt service in most years. Until 1993/94 it was much higher, around 40 per cent, but as explained above a large part of it was still tied import support. In the years of strained government-donor relations (1994/95 and 1995/96) programme aid was lower than debt service, so the government had to use tax revenues for paying the debt in those years.

When the amount of freely spendable programme aid was higher than external debt service, this aid may have led to a decrease in domestic revenue effort, an improvement in the fiscal position (the balance), or an increase in government expenditures. Which one is best depends on the macroeconomic situation: if there is very high inflation, caused by excessive money creation to finance the budget deficit, using programme aid for closing the fiscal gap may be the best way (in the medium to long run) to reduce poverty; if the fiscal position is reasonable and tax rates not excessive, using debt relief for increased expenditure may be the best way to reduce poverty.

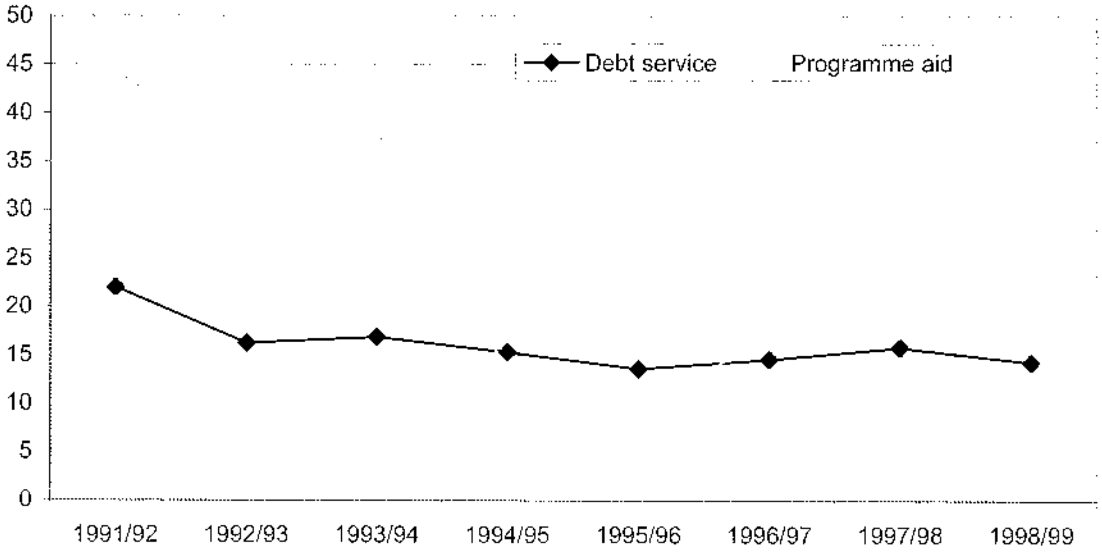
Revenues have fallen between 1991/92 and 1992/93, while expenditure increased between those years (Table 4–5). The fall in revenues was due to a reduction in tax rates in 1992, and the establishment of generous exemptions for foreign investors as from 1990 (OED, 2000). From 1993/94 onwards, revenues have been more or less stable, and they decreased in 1998/99. However, in a growing economy and with the establishment of the Tax Revenue Authority in 1996, we would have expected a higher revenue collection in the later 1990s. In this respect, there may have been some "fiscal response" to an increasing aid flow, in the sense of decreasing revenue efforts.

Table 4–5. Government operations (per cent of GDP)

	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99
Total revenues	14.1	10.6	12.0	12.5	13.2	13.5	12.2	11.3
Tax revenues	12.5	9.5	11.0	11.3	11.3	12.1	11.1	10.1
Non-tax revenues	1.6	1.1	1.1	1.2	1.9	1.4	1.0	1.2
Total expenditure & net lending	15.9	19.7	17.8	18.3	17.6	15.1	15.2	14.7
Recurrent expenditure	13.2	15.5	14.1	15.1	14.0	12.5	11.2	10.8
Wages and salaries	3.1	3.7	3.9	4.2	4.6	4.7	4.3	3.6
Interest payments	1.9	2.5	2.6	3.4	3.3	2.6	2.3	1.6
Domestic	0.9	1.5	1.6	2.2	2.3	1.7	1.0	0.6
Foreign	1.1	1.1	1.0	1.2	1.0	0.9	1.3	0.9
Other goods and services	8.2	9.2	7.7	7.5	6.1	5.1	4.6	5.6
Net lending								-0.1
Development expenditure	2.7	4.2	3.7	3.2	3.6	2.6	3.9	4.1
Domestic financed	0.0	1.5	0.0	0.0	0.0	0.0	0.5	0.3
Foreign financed	2.7	2.7	3.7	3.2	3.6	2.6	3.4	3.7
Overall balance before grants	-1.7	-9.1	-5.8	-5.9	-4.4	-1.6	-2.9	-3.4
Grants	2.7	3.8	3.8	2.0	2.2	3.6	3.1	3.9
Programme	2.3	1.9	2.2	0.8	1.0	1.8	0.8	1.2
Project	0.4	1.9	1.6	1.2	1.2	1.8	2.3	2.7
Overall balance after grants	0.9	-5.3	-2.0	-3.9	-2.2	2.0	0.2	0.5
Statistical discrepancy	-0.2	0.4	-3.0	-1.1	-0.8	-0.2	0.0	-0.2
Overall balance	0.8	-4.9	-4.9	-5.0	-3.0	1.9	0.2	0.3
Bank recapitalisation								1.1
Augmented overall balance	0.8	-4.9	-4.9	-5.0	-3.0	1.9	0.2	-0.8
Financing	-0.8	4.9	4.9	5.0	3.0	-1.9	-0.2	0.8
Foreign (net)	1.8	1.9	2.4	0.9	-1.2	-0.5	1.0	0.4
Foreign loans	4.2	4.0	4.3	2.4	0.2	0.8	2.0	1.6
Programme loans	3.6	3.2	3.2	1.2	0.0	0.5	1.3	0.6
Development loans	0.6	0.8	1.1	1.3	0.1	0.3	0.8	1.0
Amortisation	-2.4	-2.1	-2.0	-1.6	-1.4	-1.3	-1.1	-1.2
Domestic (net)	-2.6	3.0	2.0	3.3	3.3	-0.7	-0.4	-0.2
Bank	-3.0	2.8	0.7	2.1	2.7	-0.4	-0.9	0.0
Non-bank	0.3	0.2	1.3	1.2	0.6	-0.3	0.5	-0.2

Source: (IMF, 2000).

Figure 4–1 Share of total debt service and programme aid in recurrent expenditure (per cent)



Source: Table 4–5.

The overall balance after grants deteriorated in 1992/93 to 5.3% of GDP. In the years 1993/94-1995/96, both total expenditure and the balance after grants diminished, but the deficit was still high. In combination with a reduction of foreign financing between 1994-1996, this led to domestic financing of about 3 per cent of GDP between 1992/93 and 1995/96. It was only after the introduction of the cash budget and the increase in grants in 1996/97 that the deficit after grants fell to below 1 per cent and that net domestic financing became negative. Without (programme) aid, the deficits in the period up to 1995/96 would have been larger and would probably have led to higher inflation and/or higher domestic interest rates, leading to lower growth.

These trends are also evident in Table 4–6, which presents information on the composition of expenditure. It shows several interesting features. First, total expenditures (in real terms) decreased between 1993/94 and 1996/97. This is likely to be an effect of the fiscal crisis which resulted in the slow-down of aid disbursements described earlier, while external debt service remained at the same level. From 1996/97 onwards, however, total expenditures have increased at over ten percent per annum, despite the introduction of the cash budget at the beginning of that period. This is likely to reflect increased aid disbursements following the election of President Mkapa in late 1995 and the restoration of relations between government and donors.

Second, social sector expenditure decreased when aid levels were lower, and there was a large fall in 1995/96 when programme aid was lower than debt service payments (Figure 4–1). This low level of social sector spending continued in 1996/97, but as of 1997/98 the social sectors in general, and education in particular, have been particular targets for increasing expenditure: the share of education, for instance, increases from 13 per cent of total budget outlays in 1996/97 to 25 per cent in 1999/00. This corresponds to an annual rate of growth (in constant Shillings) of almost 50 per cent. The data presented earlier (Table 3–4) on non-salary outlay per student cast some doubt on the validity of these figures. However, the data in Tables 3–4 and 4–6 may be compatible if (a) there are significant leakages of funds on the way from the Treasury to the schools and (b) the number of pupils actually in schools have increased substantially over this period. Both have probably occurred.

Table 4–6 Government expenditures (TSh billion, 1995 prices and per cent of total budget)

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
TSh bln (1995 prices)										
Total budget	452	540	446	576	524	514	413	520	577	602
Recurrent	396	417	370	445	401	363	389	432	431	447
Social sectors	66	81	75	91	93	77	53	88	122	148
Education	30	37	35	43	40	39	28	51	73	82
Health	22	27	28	32	38	32	15	19	38	39
Other	13	17	11	16	16	6	10	18	11	27
As % of total budget										
Recurrent	88	77	83	77	77	71	94	83	75	74
Development	12	23	17	23	23	29	6	17	25	26
Social	14	15	17	16	18	15	13	17	21	25
Education	7	7	8	7	8	8	7	10	13	14
Health	5	5	6	6	7	6	4	4	7	7
Other social	3	3	2	3	3	1	2	3	2	4
Public debt	26	30	28	23	20	24	n.a.	n.a.	18	17

Sources: World Bank, Country Economic Memorandum, 2001, Vol. 2; deflator from IFS (2000).

Finally, the composition of social expenditures has shifted significantly in favour of education. Expenditures on education accounted for about 45 per cent of social sector expenditures in the early 1990s and over 55 per cent in the late 1990s. Expenditures on health, on the other hand, have fallen from one-third of total budget outlays in the early 1990s to a little over one-quarter in the late 1990s. The extent to which this reflects a conscious move by the government or donor pressure is difficult to say: both government and many donors have expressed – throughout the 1990s and particularly in the latter half – concern over the state of education in Tanzania and the need for increased spending in that sector. In health, relative expenditure declined in 1996/97 and 1997/98, but then returned to the levels maintained before those years.

Between FY97 and FY98, total expenditures in real terms increased by 26 per cent. During this period, recurrent expenditures increased by 11 per cent, but social expenditures increased by 66 per cent, and expenditures on education almost doubled – from TSh 28 billion in FY 97 to TSh 51 billion in FY 98. One of the explanations for this probably is the formation of the MDF in 1998. But it also signals a shift in government priorities over the 1990s, whereby social sectors in general – and education in particular – have assumed a higher priority in government expenditures, much – one would assume – to the liking of many donors.

4.2.3 Effect on social indicators

It has been explained above that the 1992 fiscal crisis and its consequences, and the reduction in programme aid between 1994 and 1996 led to severe reductions in social spending, with a low point in 1996/97. This trend was reversed in 1997/98 and it was shown that the conditions attached to debt relief from 1997 onwards probably had some success in changing government priorities for the social sectors, and in particular, education. At the same time, real spending levels per student still proved to be declining until 1998/99. It was only in 1998/99 that budget allocations to education increased, and only in 2000 and 2001 the registration and tuition fees for primary education were abolished. All in all, it can be expected that social indicators will still be mainly influenced by the fall in spending before 1997/98.

The data in Table 4–7 do not suggest that the past fifteen years have seen great improvements in the well-being of the population (we extend the data back to 1985 to see if any trend has been reversed during the 1990s). It is of course possible that the indicators would have been even more gloomy in the absence of aid and debt relief, but the possibility that these two only had a limited impact on social indicators should not be discarded. Indeed, some of the indicators – such as percentage of births attended by health staff or primary school enrolment – have deteriorated in the 1990s.

Some of the indicators have improved. In particular, infant and under-five mortality rates have decreased significantly. It should also be noted that the most recent estimate of child mortality is from 1998 – the same year in which allocations to the health sector increased dramatically (Table 4–6), so the positive trend might be expected to continue.

Table 4–7 Social indicators

	1985	1990	MRE
Low-birthweight babies (% of births)	12	17	14
Births attended by health staff (% of total)	74	60	38
Mortality rate, infant (per 1.000 live births)	102	99	85
Mortality rate, under-5 (per 1.000 live births)	166	154	136
Illiteracy rate, adult total (% of people aged 15 and above)	43	36	28
Illiteracy rate, adult female (% of females aged 15 and above)	57	49	37
School enrolment, primary (% net)	56	51	48
Primary education enrolment, % female	50	50	50
Persistence to grade 5, total (% of cohort)	86	79	81

Source: World Development Indicators 2000 on CD-ROM, Washington DC: World Bank
Note: MRE = most recent estimate, usually 1997 or 1998.

Illiteracy appears to be on the decline, both totally and for women, even though far more women than men are still illiterate. Again, this is a situation that might be reversed, both because of the relatively recent increase in expenditures on education, and because half of all primary school pupils are girls.

The preliminary results of the 2000/01 Household Budget Survey (HBS), which can be compared with the earlier 1991/92 HBS, suggest that access to education has deteriorated if we look at the whole decade (TAKWIMU, 2000). Almost one-third of all adults has received no education at all and this share has increased since 1991/92. The situation is particularly serious in urban areas outside Dar es Salaam. There is a similar pattern in literacy. Although around 57 per cent of all children aged 7-13 attend primary school, the proportion of children and young adults that report having received no education at all has increased from 1991/92. In addition, children enter school later: only one-third of all 7-year olds attend primary school.

A positive conclusion from this may be that primary school enrolment seems to have increased between 1997 (Table 4–7) and 2000/01: from 48% to 57%. This may be a first result of the increase in the education budget as of 1997/98. It can be expected that the abolishment of registration and tuition fees for primary education, in 2000 and 2001, will have further positive effects on access to education.

4.3 The stock effect of debt relief

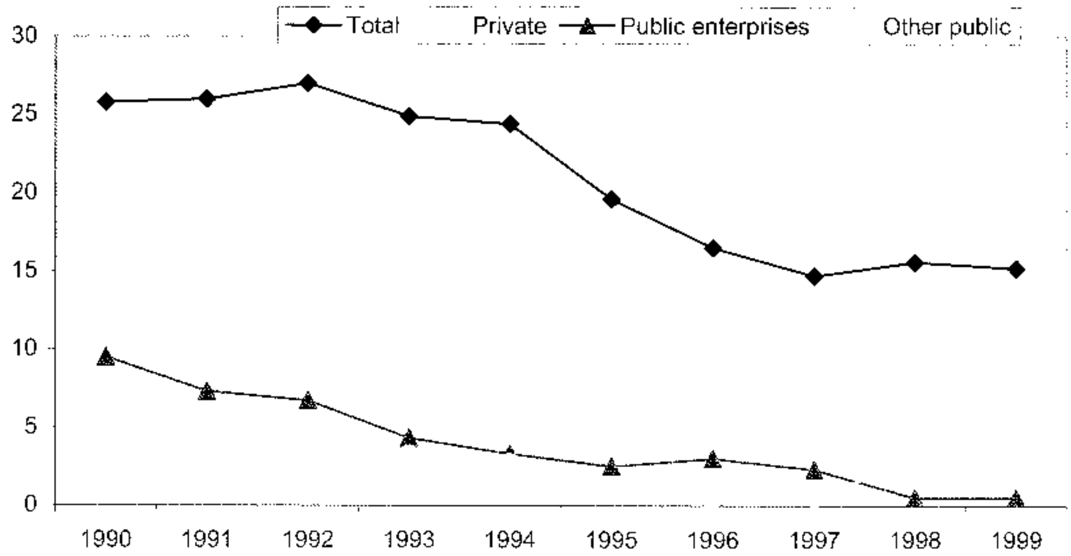
A reduction in the NPV of the stock of the debt reduces expected future debt service payments. This may have several beneficial effects, which together are the stock effects of debt relief. First, it will increase incentives for private investment since the tax on future profits is reduced. Private investment can also be enhanced indirectly, by increasing the government's incentives for good policies. Secondly, it will increase creditworthiness of the country for foreign lenders and investors. We saw in Chapter 3 that nominal forgiveness over the 1990s amounted to about 22% of the 1999 debt stock. At the same time, and as shown in Table 4–2, the total nominal debt stock increased in the decade due to new disbursements. Stock effects on private investment and on international creditworthiness are therefore not very likely. In the following, we first present the data on investment and on different indicators of creditworthiness. We then examine the factors of influence on creditworthiness and on investment, and finally we assess the role of debt stock reductions on the trends in these indicators.

4.3.1 Investment

While the share of investment in GDP had been over 30% in the 1980s, by 1990 it had become 26%. Since then, however, investment has declined further. One important reason for this decline is the fall of investment in public enterprises, from 10% of GDP in 1990 to almost zero in 1999 (Figure 4–2). This is clearly related to the closing and selling process in which state enterprises have been involved. Parastatal managers are not likely to invest if they do not know what is going to happen with the enterprise. Other public investment was at a much lower level during the 1990s, and it shows some fluctuations. In particular, a close correlation with aid flows seems evident.

After the privatisation process of the parastatals, it could be expected that private investment would take off. However, private investment first increased from 15% of GDP in 1990 to 18% of GDP in 1994, i.e., before the privatisation process got off the ground, but then declined to 12% in 1999. These investment figures of 15% of GDP and private investment of only 12% of GDP are a cause for concern, especially given the high aid levels. However, also in this case the data may not be fully reliable. The fall in the investment rate from a high of over 30% to a low of 15% percent may be partly due to the way the figures are constructed. Investment may have been overestimated in the 1980s due to the overvaluation of the exchange rate: since investment goods were often registered in dollars and GDP figures were in Shillings, the share was too high. On the other hand, in the mid-1990s a revision of the national accounts took place leading to higher shilling figures for GDP. This has affected investment shares negatively. Nevertheless, investment does not seem to be very high in recent years.

Figure 4–2 Investment 1990-1999 (per cent of GDP)



Source: IMF, 2000, p. 9

4.3.2 Creditworthiness

There are several empirical indicators for international creditworthiness. A first one is related to the legal and practical possibilities for foreigners to invest in Tanzania and to repatriate profits from their investment. In this respect, 1993 marks a turning point. Before 1993, Tanzanian firms did not have access to forex themselves. In order to service foreign debts, they had to deposit Shillings in the Bank of Tanzania, but the BoT never changed these Shillings into dollars, meaning that servicing foreign loans or repatriating profits from Foreign Direct Investment (FDI) was in practice impossible. After the liberalisation of the forex market in 1993 new loans to Tanzanian firms could be serviced. This has probably facilitated trade credits but may also have had a favourable impact on other foreign loans and on FDI. However, restrictions still apply to a particular type of capital flows: portfolio investment in Tanzania by foreigners or Tanzanian residents abroad is not allowed.

A second indicator for creditworthiness is the relation between debt service paid and debt service due. A country with a lower and more sustainable debt stock can be expected to be able and willing to pay a larger share of its debt service obligations. Ideally, reducing the debt to a sustainable level would imply that a country is able to pay all its commitments without compromising economic growth. In Tanzania, debt forgiveness granted in the 1990s has clearly not yet resulted in an increase in this ratio. In 1989, Tanzania paid 13% of its debt service due and in 1999, 9% (see Table 4–1 again). If anything, creditworthiness has decreased in this period.

A third indicator for creditworthiness are the inflows of new financial flows and of FDI. Table 4–8 gives an overview. As could be expected, multilateral disbursements are the largest category within new loan inflows, and most of these are concessional. However, it is striking that there are still non-concessional official loans, both bilateral and multilateral. Most bilateral donors, however, have switched to grants instead of concessional loans.

According to a senior officer of the Bank of Tanzania, the non-payment of Paris Club creditors in the past was costly to the private sector. The private sector did not have access to short-term export credits or had to pay high interest rates. However, the figures (Table 4–8) show that export credits have been extended in all years in large amounts. But it is possible that their interest rate was higher as long as Tanzania did not pay on its

Paris Club commitments; data on the lending terms of export credits are not available. Export credits were particularly high in the early 1990s. There may be a relationship with the Paris Club agreements of 1990 and 1992. In recent years, the amount of export credits seems to have fallen.

Table 4–8 New capital inflows to Tanzania (USD million)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Private debt	0	0	0	0	0	0	1	2	0	0	0
Public debt	229	298	280	388	238	259	257	207	253	216	258
Bilateral concessional	36	50	41	88	21	18	28	7	6	10	8
Bilateral other	26	30	9	4	8	8	1	0	1	18	0
Multilateral concessional	120	187	214	251	166	211	173	193	240	184	249
Multilateral other	13	16	13	8	2	4	15	3	5	3	1
Commercial	0	0	0	1	0	1	1	1	0	0	0
Other private	34	16	3	37	41	16	40	3	0	0	0
Foreign direct investment	6	0	0	12	20	50	120	150	158	172	183
Memorandum items :											
Grants, excl. TA	536	677	705	697	786	564	451	430	431	649	574
Export credits (short-term)	767	1278	1142	1237	1191	799	911	907	1034	867	760

Source: GDF, 2001.

New long-term loans to the private sector have been virtually zero over the decade, indicating continued low creditworthiness for Tanzania. Private loans to the public sector have also been at a low level, and were zero in the most recent years. This would appear to be an adverse effect of debt relief efforts, but a more likely explanation is an increased awareness of the need to avoid borrowing on commercial terms. From 1986 onwards, the government had an "understanding with the IMF" that it would borrow up to a maximum of USD 50 million a year on non-concessional terms (United Republic of Tanzania, 1999: 59). Since the 1996 ESAF agreement, the government intends to borrow on commercial terms in "emergency cases only". Given the zero figures in the last three columns of Table 4–8, it seems that the government has been increasingly able to effectively eliminate foreign private non-concessional borrowing.

Table 4–8 also shows that FDI has increased over the years. These numbers are roughly equal to the numbers shown in the balance of payments table (Table 3–1), indicating that FDI increased from USD 10 million in 1990/91 to USD 183 million in 1999/00.

Sectors that have attracted large amounts of FDI include mining and tourism. Investment in tourism was in fact still limited to several new hotels in Dar es Salaam. But an interview with one of the managers of these hotels revealed that some of these investors have extensive plans for further investment in Tanzania, and also in the interior of the country. Tanzania seems to be particularly popular with South African investors. They are more aware of the possibilities than other foreign investors, and are also less influenced by the too generalised views on the riskiness of Africa that are dominant in most OECD countries (see also Bhinda et al., 1999).

On the benefits of mining for the Tanzanian economy opinions vary. Some argue that investors in this sector are serious and that they help developing a region by constructing roads and providing potable water and primary schools. Others maintain that spill-over effects are limited, and that investors mainly benefit from the generous tax regime. Stories abound about these companies avoiding even the limited taxes they have to pay. For example, one academic remarked to the evaluation team that a mining company sends a large part of its output as "test containers" to the South African mother company, thus avoiding royalty payments.

Part of FDI is of course related to the privatisation process and is no greenfield investment. This holds for FDI in manufacturing and in public utilities such as energy and telecommunications. But several persons interviewed told us that generally, foreign buyers of parastatals also start up new investment in their newly acquired companies. The beer brewery, for example, that has been bought by a South African company, has expanded its production from 4 million boxes in 1994 to 18 million in 2000. The former state telecommunication company was also investing.

4.3.3 Factors influencing creditworthiness and investment

From available written sources and from our interviews, there are several factors of influence on both private investment in general and foreign investment in particular. On the positive side, many interviewees note the climate of optimism that stimulates investment. They refer to the higher growth rates, the political stability, and the increasing seriousness of the government in listening to the private sector and in fighting red tape and corruption. More in particular, tax laws have become more favourable to the private sector in recent years. For example, land taxes have been reduced, as have import duties on capital goods and raw materials, while duties on imported agricultural inputs have been abolished. Generous five-year tax holidays are in place for foreign investors.

Several persons mentioned as very positive the fact that the President has regular full-day meetings with representatives of the private sector, in which all ministers are present. In these meetings the private sector can bring up all problems experienced in attempting to invest and to produce, and the government commits itself to find solutions. Tax policies are elaborated in a special committee in which representatives of the private sector participate.[36] Representatives of the private sector are very positive about these interactions with the government. One interviewee remarked that the government in the past only listened to donors and that donors used to tell the government not to listen to the private sector.[37] Government officers at lower levels are also perceived as having a more favourable attitude toward the private sector than they used to have.

However, there is also a divergent opinion on this receptiveness of the government to private sector needs. USAID has a long experience with supporting the private sector and has composed several documents on specific needs of and bottlenecks for the private sector, such as the Investor Road Map. In the view of USAID, the government does too little with the recommendations, nor does it ever ask USAID for advice on these matters.[38] Although our interviewees observe some improvements, corruption is still widespread and is still a factor hampering production and investment.

Sectors that currently attract investment are mining, tourism, and telecommunications. There are already two competitors for the former state telecommunication company on the mobile network. On the fixed network, the former parastatal keeps a monopoly position for four years. This sector seems to be expanding rapidly. A manager of a foreign-owned hotel is of the view that tourism also has great potential in Tanzania. Since the reduction, early 2001, of the land tax, investment in agriculture also seems to be a possibility. Our

[36] Interview with TRA officer and with representatives of private sector.
[37] Interview with senior officer of CTI.
[38] Interview with USAID officer.

interviewees were less optimistic on manufacturing investment. The main constraints are in the area of infrastructure. There are serious shortages of energy, leading to many power breaks. In addition, roads are lacking and telecommunication facilities are also still deficient. Prices of utilities are also significantly higher than in neighbouring countries.

Another constraint for investment, mentioned by academics and representatives of the private sector alike, is related to finance. Domestic bank interest rates are high (at 22%) – too high for many firms active in production as opposed to trading or fast-yielding activities. And it is almost impossible for manufacturing enterprises or enterprises in general to get long-term credits from the domestic banking system. Foreign long-term loans to the private sector are still non-existent, as we saw above. An urban bank that provides small loans to small enterprises or enterprising individuals is confronted with an enormous excess demand, despite high interest rates (30%). This bank, Akiba Commercial Bank, set up on the initiative of Tanzanian businessmen but with donor funds, is clearly responding to a crucial need. However, dealing with small clients means high set-up and transaction costs which prevents other banks from getting into this business.

4.3.4 Role of debt stock reductions

The role of the debt stock and debt relief in promoting or hampering private investment seems to have been limited. Private sector representatives say that it is important that the government uses the resources freed by debt relief well, that is, in keeping with the needs of the private sector – which includes infrastructure but also education. There was no mention of the debt stock being a threat to the private sector in the sense of leading to higher future taxes. Whether the debts of the government were forgiven or paid was seen as an issue between the government and its donors/creditors, without direct impact on the private sector. However, government policies, whether or not agreed with donors, were considered very important for the promotion of private production and investment.

Given this importance of government policies, the debt stock may have an indirect effect on private production and investment. According to a senior officer in the Bank of Tanzania, a reduction in the debt stock is very important for the government.[39] He referred, in particular, to the upcoming 90% debt stock reduction of Paris Club debt. As also explained in Chapter 3, without this stock reduction, it remains uncertain what amount of debt service the creditors will be expecting from Tanzania. Paris Club creditors have given flow relief since 1986, but the extent of flow relief depends, first, on the general agreements in the G7, and second, on the particular multilateral and bilateral negotiations with Tanzania. This means that there is the possibility that Paris Club creditors will require a higher level of debt service than Tanzania has been paying in the past years. For example, some successful export years and thus better debt indicators may lead to higher debt service payments, thus taking away the benefit of good performance. Since Tanzania is very dependent on Paris Club creditors for aid receipts, it is obvious that this is a real threat. This official thus confirms the debt overhang hypothesis (Krugman, 1988; Sachs, 1989), according to which high future debt payments lead to high taxes on good performance and thus lower the incentives for carrying out reforms. This points to an important potential stock effect from the reduction of the net present value of the debt. However, during the 1990s the stock reductions have been too small to generate such an effect.

4.4 Long-term debt sustainability

In the long run, a debt can be sustainable and can be accompanied by a continued trade deficit if the growth of exports is higher than the average interest rate (Gillis et al., 1996: 414). Table 4–9 shows that the trade deficit (M-X)/X has been decreasing in the 1990s but in the two last years it has increased again. If we subtract grants from that deficit (second

[39] Interview with senior official in BoT.

row), we get a better measure for the annual increases in the foreign debt. There is not a clear trend in the 1990s. There was a peak in 1992 and since then the deficit has become lower, but it has been rising in the last two years. During the 1990s, interest rates of new loans have been far below the average growth rate of exports (measured as 5-year moving averages).[40]

Table 4–9 Assessing long-term sustainability (indicators in per cent)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Average
(M-X)/X [1]	206	236	227	179	103	76	60	70	114	113	138
(M-X-A)/ X [2]	81	98	108	79	45	41	29	35	59	67	64
Growth of X [3]	4.5	2.8	7.9	9.2	12.5	19.0	22.6	16.5	8.4	5.3	8.6[6]
Interest [4]	1.1	1.2	1.0	1.8	1.2	1.7	1.3	1.0	1.3	1.0	1.3
D/X [5]	2391	5988	1561	1070	396	238	138	229	829	1567	877

Source: GDF, 2001
[1] M = Imports of goods and services, X = Exports of goods and services
[2] A = Grants excluding technical co-operation
[3] Growth rate of exports, based on five-year moving averages
[4] Average interest rate of new loans
[5] Long-term calculated Debt-to-exports ratio.
[6] Average annual growth rate over the ten-year period.

If we assume the trends with respect to export growth, adjusted (for grants) trade deficit a, and interest rates to continue over the next decade, we can compute the resulting long-term debt-to-export ratio, as follows: $D/X = a/(gE - i)$. The last figure on the last row of Table 4–9 shows that this debt-to-export ratio (based on averages over the 1990s) would clearly be unsustainable. This is due to the large adjusted trade deficit that brings about large amounts of new loans every year.

Similarly, a debt can be sustainable in the long run and be accompanied by a savings deficit if the growth rate of GNP is higher than the interest rate. The savings deficit (I-S)/Y has always been high but has decreased over the 1990s (Table 4.10). This is mainly due to the decrease in investment, although savings have increased a bit, too. If we subtract inflows of grants form this deficit, there is a similar trend as for the external deficit: decreasing, but increasing again in the two latest years. Between 1991 and 1994, interest rates of new commitments were still above the growth rate of GNP (three-year moving averages), implying that debt became more unsustainable in that period. But after 1994, GNP growth has been higher than the interest rates of new commitments. New lending in the latter period has been at favourable terms and has not made the debt more unsustainable.

However, if we compute the long-term debt-to-GNP on the basis of average values over the 1990s, by calculating $D/Y = ((I-S-A)/Y) / (gY - i)$, where gY is the growth rate of GNP, this ratio is clearly unsustainable at 455%.[41] This means the domestic savings deficit is also far too large to make the debt sustainable. In sum, even if the debt, for example through the HIPC initiative is made temporarily sustainable, debts will soon become unsustainable again if current trends with respect to growth of exports, GNP, interest rates and trade and savings deficit continue.

[40] During the 1980s, the reverse held.
[41] In the years where the interest rate is higher than the growth rate of GNP, the long-term debt-to-exports ratio cannot meaningfully be computed. (It would result in a [negative figure])

Table 4–10 Assessing long-term sustainability (2) (indicators in per cent)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	Average
I/Y[1]	27	28	26	26	20	17	15	17	17	21
S/Y[2]	3	0	-5	2	2	4	5	2	2	2
(I-S)/Y	24	28	31	24	18	12	10	14	15	20
(I-S-A)/Y[3]	15	16	19	13	9	7	6	8	7	8
Growth of Y[4]	-1,0	1,3	0,2	-3,0	5,1	15,8	20,1	18,3	10,9	3,15
Interest rate[6]	1,2	1,0	1,8	1,2	1,7	1,3	1,0	1,3	1,0	1,3
D/Y[6]		3715			268	38	23	39	83	455

Source: Elaboration of data from GDF 2001, and from WDI, 2001 (for investment and savings data).
[1] I = Gross capital formation in current USD, Y is GNP in current USD
[2] S = Gross domestic savings in current USD
[3] A = Grants excluding technical co-operation in current USD
[4] Growth rate of GNP, based on three year moving averages.
[5] Growth of GNP, average over the nine years.
[6] Average interest rate of new loans
[7] Computed long-run debt-to-GNP ratio.

4.5 Conclusions

This chapter has assessed the effectiveness of debt relief. The most important conclusions are:

Debt sustainability ratios have improved over the decade, especially the solvency indicators (debt-to-GNP and debt-to-exports). However, this must be mainly attributed to increases in GNP and in exports, and not to the debt stock reduction. Furthermore, exports have only risen if remittances are included and in spite of this partial improvement, the debt was still not sustainable in 1999. Liquidity indicators hardly improved over the decade.

Although there was hardly any influence of debt relief on the flow of resources, the influence of aid, including programme aid and therefore including multilateral debt relief, was considerable. With some plausible assumptions, we conclude that imports would have reduced by about 50% in the absence of aid and debt relief during the 1990s. This would certainly have had effects on economic growth. The absence of aid affects imports much more than an absence of debt relief or a reduction of the amount of debt service paid.

The impact of aid on the government accounts was substantial in size but perhaps not always positive. Here, programme aid is the relevant category since project aid mainly finances the development budget. Before the introduction of the cash budget in 1996, programme aid financed part of the budget deficit and so led to lower inflation and a lower domestic interest rate. After 1996, aid financed a higher level of expenditure. However, between 1994 and 1996, programme aid was lower than debt service, so that the government had to pay part of debt service from its own revenues. In these years, deficits were high and real expenditure declined. Recurrent expenditure for the social sectors also declined further in those years, from the already low levels of the early 1990s – to recover only in 1998/99. Tax revenues have always been low and there may have been some negative fiscal response. In the final years of the decade, social expenditure, particularly for health and education, increased significantly. A positive impact on social indicators was not yet visible in the 1990s.

The small reduction in the debt stock did not have an effect on private investment or on creditworthiness. Investment levels are still low in Tanzania, as both public and private investment decreased over the decade. Legal conditions for access to private capital inflows have improved with the liberalisation of the forex market, making interest payments and profit repatriation at least technically possible. Private long-term borrowing is still absent, but foreign direct investment has increased. No relationship with a declining debt stock could be observed, however. A further, future reduction in the debt stock and in debt service payments may have a positive effect on private investment though increasing security of future debt payments, an through increased public investment in social and physical infrastructure.

The prospects for long-term sustainability of Tanzania's debt are bleak. Even if the debt burden were reduced to sustainable levels through the HIPC initiative, it would soon become unsustainable again if current trends with respect to export growth, interest rate and trade deficit continue.

5 THE RELEVANCE OF DEBT RELIEF: IMPACT ON GROWTH AND POVERTY REDUCTION

This chapter examines whether there has been an effect of debt relief on economic growth and poverty reduction, through the flow and stock effects of debt relief and through the effect of the conditions attached to debt relief. Given that there was hardly any flow effect of debt relief during most of the 1990s and that there were no stock effects on investment either, the impact of debt relief on economic growth (and poverty reduction) can also only be limited. The impact of foreign aid (that has been included in the analysis of the flow effect, since these two cannot be separated) can be expected to be more substantial.

The next section focuses on growth. We first present the macroeconomic trends and then assess the factors that have exerted most influence on those macroeconomic developments, and discuss the possible role of debt relief and foreign aid. In the final section, some remarks are made on a possible impact on poverty reduction.

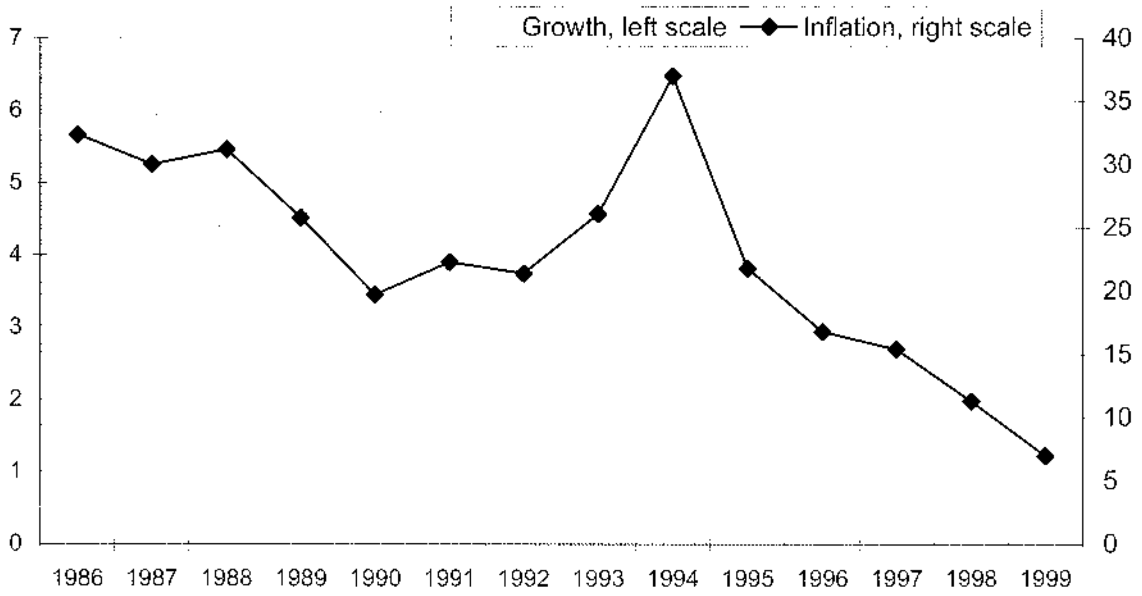
5.1 Economic growth

The 1980s had been a period of low growth and stagnant exports. However, towards the end of that decade some improvement set in. Despite the 1986 Economic Recovery Program supported by IMF and World Bank, a consistent reform policy was still far away (Chapter 1). Nevertheless, between 1986 and 1992 there were some positive policy developments such as the gradual introduction of positive interest rates, a gradual decrease in the budget deficit and a reduction of the black market premium (Van Donge & White, 1999). At the same time, however, loss-making parastatals still had full access to credit and they also benefited directly from foreign aid. That aid was often in the form of specific raw materials, investment goods or other supplies for these parastatals, for which they either paid in shillings at the official exchange rate, or they did not pay at all (given that there were severe problems with collecting the countervalue funds). In 1992/93 government revenues fell and expenditure increased. The improvements achieved in earlier years with respect to fiscal and monetary policy were lost. This led to a larger budget deficit, to an upsurge in inflation and to the country being off-track with the IMF programme.

Economic growth rates have been positive since 1986, but the rates have not been very high (Figure 5–1). Given population growth of about 2.8% per year, per capita income growth has barely been positive over the period. Growth rates were above population growth between 1986 and 1991, then stagnated from 1992-1994, and then rose above population growth again since 1994.

The aid boom was probably one of the most important factors behind the relatively high growth between 1986-92. The impact of economic reforms was limited since a consistent reform policy was still absent. Nevertheless, the gradual liberalisation of agricultural marketing and prices in the 1980s seems to have had a positive effect on some agricultural crops, in particular, on cotton production and later also on tea and tobacco (Van Donge and White, 1999). Coffee production was relatively stable in this period, but its export value declined due to a plummeting of the world market price (World Bank, 1994: 76). However, regional trends in agricultural output of both export and food crops have been very diverse, both in the pre-reform and in the reform period. This makes it difficult to relate agricultural output to macroeconomic policies (Van Donge, 1994).

Figure 5–1 Growth and inflation 1986-1999 (per cent)



Source: IMF, 1992 and 2000.

There does not appear to have been a positive impact of the continuous devaluations since 1986. On the one hand, this seems to be due to the high inflation which reduced the real effects of devaluations. In fact, the shilling appreciated between 1989 and 1991 and again from 1993-1997 (Bigsten & Danielson, 1999). The real appreciation probably also reduced the effect of the liberalisation of the foreign exchange market which was completed in 1994. On the other hand, growth in agricultural production requires much more than favourable prices and exchange rates. In coffee, for example, investments in new trees are required on a large scale. With the liberalised financial sector it is unlikely that credit for small farmers will become available.

Several factors may account for the lower growth rate between 1991 and 1994. First, there was a deterioration of the terms of trade between 1990 and 1993 (Table 5–1). Although export volumes increased, prices were lower in this period and import prices rose. This period coincided with a global recession. Secondly, the increase in the fiscal deficit in 1992/93 and the rising inflation also affected growth. Thirdly, this was a period in which the reform process stagnated and relations with donors became strained. Although aid flows only marginally diminished, the deteriorating relations with the donor community may have caused uncertainty among private producers and may have led to lower production and investment. And finally, the marginal impact of aid probably diminished. A substantial share of aid was still given in the form of import support. At first, this aid helped to increase the rate of capacity utilisation of manufacturing industry and thereby led to high growth rates. Once a high capacity utilisation was achieved, further growth became more difficult.

Table 5–1 **Indices of volume, value and unit value of exports and imports and of terms of trade, 1980 = 100[1]**

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Exports:													
Volume	92	93	108	108	112	118	127	124	155	120	120	126	116
Value	94	104	111	112	84	86	87	106	125	110	110	97	97
Unit value	74	80	76	73	75	73	75	86	81	84	84	77	84
Imports:													
Volume	75	78	84	84	79	80	86	81	72	83	83	92	94
Value	94	104	111	112	117	120	130	123	112	118	118	130	133
Unit value	126	132	132	141	148	151	155	152	156	143	143	142	143
Terms of trade	59	60	57	52	51	48	45	56	51	59	59	54	58

Sources: IMF (1996) and elaboration of figures from IMF (2000).
[1]Data from 1992/93 onwards are for fiscal years. In order to get a full series up to 1999, and since most exports take place in the first half of a calendar year, it has been assumed that exports of 1993 correspond to those of 1992/1993.

As argued before, by allowing much higher imports aid has facilitated capacity utilisation and new investment in the late 1980s and early 1990s, especially in manufacturing industry and in sectors such as energy and telecommunication. To a large extent, aid still benefited the parastatals in this period. Although aid helped these firms to resume production after they had been starved of resources in the crisis years, diminishing returns were probably at work. In the early 1990s countervalue payments were hardly made by these firms, which meant that these companies got access to imported raw materials and machinery as a gift. This aid money helped to reduce the broader public deficit and thus inflation, but it did not enhance an efficient use of resources. In addition, in the course of the 1990s the closing and privatisation of these parastatals was taken on more seriously. If they were closed, the earlier aid-financed investments were lost. But even in cases of successful privatisation, earlier aid-financed investment sometimes became useless. In the former state telecommunication company, donors such as Japan, the EU and the World Bank had financed and provided equipment in the 1990s. But this led to different types of equipment and the systems cannot be connected with each other – an essential requirement for an efficient telecommunication company. The new manager of this privatised company told the evaluation team that he needed to divest the earlier obtained equipment, and invest again.

Another reason why the marginal impact of aid has diminished over time is the requirement (for project aid) that the government of Tanzania contributes also from its own funds, the so-called counterpart funds. In the late 1960s it was already found that project aid could lead to distortions in the receiving economy if it did not provide the resources, not only for the full project costs, but also for the necessary complementary investment (Pronk, 2001: 617). In this respect, a shift from project aid to debt relief would be a favourable development. However, the figures seem to indicate that the share of project aid in both loans and grants to the government increased in the 1990s (Table 4–5). When the cash budget was introduced in 1995/96, it probably became even more difficult for the government to combine the donors' requirements for counterpart funds with its own medium-term spending priorities. This may have posed difficulties for fiscal management and may have led to distortions in the allocation, leading to lower growth rates.

The impact of aid and reforms on the reduction of inflation is more clear-cut. Inflation gradually came down between 1986 and 1992 as a result of improved fiscal management and of the possibility of foreign financing of the deficit. However, in 1992/93 fiscal laxity returned. Expenditure rose and revenues decreased (Table 4–5). The budget deficit after grants mounted to a high of 5.3% of GDP and the government again resorted to inflationary financing. As a result, inflation began to rise again, reaching a peak of 37% in 1994 (Figure 5–1).

In 1995/96 the new government introduced a cash budget and from then on, inflation finally came under control, reaching a one-digit level for the first time in 1999. While the government balance before grants remained negative, the balance after grants has been positive since 1996/97 (Table 4–5). From 1995 onwards, the government also became more serious in implementing other reforms, such as financial reforms, trade liberalisation and parastatal reform. In addition, a civil service reform was prepared. Aid flowed in again on a massive scale. Growth rates have been at around 4 or 5% again since 1995. However, one can wonder what the basis of this growth is.

Chapter 4 showed that investments are still limited, and that both public and private investment seem to have fallen over the decade (insofar as figures are reliable). With respect to sectoral contributions to growth, the primary sector (agriculture, forestry, fishing and hunting) still accounts for about half of GDP (IMF, 2000). This share has remained about constant over the 1990s, implying that growth rates have been about the same as those of total GDP. In recent years, the growth rate of the primary sector (1.5, 2.3 and 4.2 per cent over the years 1997-1999) even lags behind the average growth rate. Most other sectors also experienced stability in their shares in GDP over the 1990s, for example, manufacturing, financial services, and electricity and water.

There are three exceptions. Mining has had continuous high growth rates over the 1990s but started from a very low base of 0.9% of GDP. The shares of public administration and construction have been reduced over the 1990s, from 6.0 to 4.3% and from 4.8 to 3.3%, respectively. In construction, low growth rates between 1991 and 1995 have given way to much higher ones at the end of the decade. Between 1996 and 1999, construction has grown at an annual rate of around 10%. Apart from mining, another sector that is often mentioned as having great potential is tourism. The sector 'trade, hotels and restaurants' was stagnant between 1992 and 1994 but then started to grow, reaching a 6% real increase in 1999. This is not yet spectacular, and the sector now represents a lower share in GDP (14.8%) than it did in 1990 (16.3%).

In sum, from looking at these sectoral growth rates only construction seems to be driving growth in the second half of the 1990s, and these activities are often directly related to foreign aid. Apart from this, mining has grown fast but is still a tiny sector, and tourism has almost recovered to previous levels and may have further potential in the future.

More detailed figures on exports may give more insights. The value of goods exports did not increase much over the 1990s (Table 3–1). In 1996 and 1997 some peaks were achieved, but export value fell again in 1998 and 1999. Traditional exports still constitute about half of these exports and coffee is still the most important crop, although in 1999, the value of cashew nuts was for the first time higher than the value of coffee exports (IMF, 2000: 23). The volume of coffee exports has declined between 1993 and 1999, and that of cashew nuts has increased dramatically, from 35.8 thousand metric tons in 1993 to 100 thousands metric tons in 1999. Another growing sector is that of tobacco. Cotton seemed to be a booming sector until 1997, but exports have since then fallen to low levels. Within non-traditional exports, manufacturing used to be the largest category but these exports have also fallen precipitously in 1998 and 1999. Mineral exports have about doubled between 1993 and 1999, which is consistent with the high growth rates of the mining sector.

Exports of services have increased much more than goods exports (Table 3–1). However, net services exports are negative, even if we exclude interest payments. Within services imports and exports, travel has become the largest category since 1993. This is obviously the result of the liberalisation of the access to foreign exchange. While this is a positive development and allows the growth of tourism, figures indicate that since 1996, net travel exports have become negative (IMF, 2000: 29), meaning that more Tanzanians purchase travel abroad than the other way round. This may again point to some wasting of aid money in (luxury) consumption (see also Chapter 3).

All in all, it seems that there was a positive flow effect from aid on the reduction of inflation, at least until 1995 when the cash budget was introduced and the budget deficit no longer caused inflationary pressure. There was also a flow effect from aid on economic growth, but that effect was largest until 1992. Aid flows diminished slightly after 1992, but the growth rate of GDP already declined from 1991 onwards. Although aid continued to facilitate high levels of imports in the 1990s, the marginal returns from aid probably diminished during that period. This is confirmed by the negative balance on trade in services and particularly in travel, the rising share of project aid in total aid with possible negative effects on fiscal management and allocative efficiency, and the fact that a large share of aid has been used for free or cheap supplies for loss-making parastatals – before their privatisation – that were not making the best use from these aid goods.

Debt relief can hardly have played a role in economic growth since flow and stock effects were limited. However, towards the end of the 1990s the increase in multilateral debt relief had some flow effect and may have contributed to higher growth rates in this period. Although growth rates have risen again since 1995, they are not particularly high and are mainly based on a growth of construction. A real take-off of the economy has still not been accomplished, and the primary sector, which is so important for reducing poverty, has lagged behind in recent years.

5.2 The impact on poverty reduction

Chapter 4 already analysed the impact of some increase in social spending towards the end of the decade, and that of the conditions for the MDF, on social indicators, in particular in education and health. The results were disappointing: during the 1990s no positive effects were visible yet on, for example, access to primary education and on literacy rates.

The other possible link between debt relief and poverty reduction is through the impact of debt relief on economic growth. However, we saw above that the impact of debt relief on growth can only have been very limited. Foreign aid did have an impact on both economic growth (positive per capita rates since 1995) and on the fall in inflation since 1995. These two factors may have been beneficial to the poor, and may have led to poverty reduction in the second half of the 1990s. But since growth figures were erratic in the first half of the 1990s it cannot be expected that poverty has decreased greatly during the decade.

However, data problems make it difficult to say even whether poverty has decreased during the period under consideration. The major obstacle is the absence of comparable studies. The 1991 Household Budget Survey and the 1993/34 HRDS (Human Resource Development Survey) are generally regarded as comprehensive (although the 1991 HBS is usually used for projections), but have been followed up only by two partial studies from REPOA (Research on Poverty Alleviation, a Dar es Salaam-based think-tank). A new household budget survey is underway, but has been delayed, and definitive results are not expected until February 2002.

What we know about how poverty has changed in Tanzania in the 1990s is thus based on informed projections from surveys in the early 1990s and preliminary results from the 2000/01 HBS. This is important to keep in mind, both because projections from the surveys of the early 1990s are based on assumptions of fixed elasticities of expenditure and – more or less – constant distribution of income, and because the preliminary results from the 2000/01 HBS are rendered less valuable by seasonal fluctuations: only three months' worth of surveys have so far been compiled and in an economy dependent on rain-fed agriculture, it is likely that incomes in the remaining nine months are different. In addition the survey period in 2000 was a period of unusually low rainfall.

Bearing these caveats in mind, the preliminary analysis of the 2000 HBS suggest the following changes in the poverty profile of Tanzania between 1991/92 and 2000 (TAKWIMU, 2001):

With respect to income poverty:

- About 22 per cent of the population was below the food poverty line in 2000 and some 43 percent below the basic needs poverty line. When the data from the 1991/92 HBS were re-analysed to maximise comparability, it was found that income poverty apparently had increased over the decade, both in rural and urban areas, including Dar es Salaam.
- The increase in income poverty is not due to a worsening of the distribution of income, but to a fall in mean consumption expenditures.
- In fact, the distribution of income – as reflected in the Gini coefficient – appears to have become more equal over the decade. However, this is due to a fall in the share of income accruing to the highest quintile (quintile 1), and an increase in the incomes of quintiles 2 and 3. Little change could be detected for the two poorest quintiles.
- Ownership of many consumer goods has increased.

With respect to non-income poverty:

- The proportion of female-headed households has increased significantly, reaching almost one-quarter of the total number of households in 2000 (up from less than 20 per cent in 1991/92).
- The proportion of family heads that work on the family farm has decreased, as has the proportion of (urban-based) family heads that are employed.
- There has been a corresponding increase in the share of household heads that are either self-employed or inactive.
- Access to safe drinking water has improved in rural areas.
- The relation between poverty and household characteristics was roughly the same in 2000 as in 1991/92. However, since some household characteristics have worsened, poverty has increased.

However, as noted above the analysis of the HBS 2000/01 is based on a limited sample and only three months' of information. It is possible that the analysis of the full sample will change the conclusions. In particular, since household incomes generally display a seasonal pattern, the results on income poverty may prove to be more positive than here reported. Indicators on non-income poverty are likely to be more stable, mainly because they are probably not subject to seasonal fluctuations. The most positive result in this area is the increased access to safe water.

ANNEXES

ANNEX A REFERENCES

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ANNEX B COMPUTATION OF COUNTERFACTUAL IMPORTS

These computations are based on the sources and uses of forex (Table A1 below) as computed from the balance of payments (BOP) figures. There are four scenarios:

1. No aid, no debt relief; debt service USD 100 million lower and half of 'debt relief' is added to arrears; no arrears decumulation
2. No aid, no debt relief; debt service as actual but no decumulation of arrears
3. No aid; debt relief as actual; debt service USD 100 million lower than actual
4. No aid; debt relief as actual; debt service and arrears accumulation as actual

All other flows on the balance of payments are assumed to remain constant (see main text for justification). The methodology is roughly the same as in Van Donge and White (1999). The difference is that we add debt relief in the scenarios. In addition, in order to reduce debt service paid in our scenarios 1 and 3, we do not put a cap on the 'debt service' figures. Debt service in the balance of payments is debt service due. It is impossible to deduce actual debt service from BOP figures. However, from other sources (GDF) we do know the amount of actual debt service paid. In our scenarios 1 and 3 we reduce debt service by USD 100 million, which is about half of the average debt service over 1990-1999 (this average was USD 212 million). We reduced debt service in these scenarios by adding USD 100 million to arrears accumulation, while maintaining debt service (due) at the same level.

Tables B-2 – A-5 present the results.

Table B–1 Sources and uses of forex

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
Sources:										
Exports of goods and services	535	555	617	855	1104	1168	1314	1177	1110	1213
Aid	760	997	932	844	797	902	1050	1091	1136	1206
of which PA					101	125	158	162	175	212
Private transfers	408	456	463	465	18	20	26	30	32	34
FDI	10	15	62	63	104	134	150	165	179	183
Other capital + errors and omissions	19	-68	-15	344	246	91	-22	41	255	159
Arrears accumulation	89	285	138	293	269	250	-1025	79	10	-1163
Debt relief	154	84	230	0	0	0	1278	54	89	1263
Monetesation of gold	23	31	6	0	0	0	0	0	0	0
Total	1997	2355	2434	2864	2537	2565	2770	2638	2812	2894
Uses:										
Imports of goods and services	1569	1885	2017	2242	2029	1986	2040	2177	2331	2454
Debt service (due)	342	337	534	515	462	498	458	460	413	312
Increase in reserves	86	133	-118	107	46	81	272	1	68	129
Total	1997	2355	2434	2864	2537	2565	2770	2638	2812	2894

Source: Elaboration of table 3—1.

Table B–2 Scenario 1

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
Sources:										
Exports of goods and services	535	555	617	855	1104	1168	1314	1177	1110	1213
Aid	0	0	0	0	0	0	0	0	0	0
Private transfers	408	456	463	465	18	20	26	30	32	34
FDI	10	15	62	63	104	134	150	165	179	183
Other capital + errors and omissions	19	-68	-15	344	246	91	-22	41	255	159
Arrears accumulation	266	427	353	393	369	350	0	206	155	0
Debt relief	0	0	0	0	0	0	0	0	0	0
Monetisation of gold	23	31	6	0	0	0	0	0	0	0
Total	1260	1416	1487	2120	1841	1763	1468	1620	1731	1589
Uses:										
Imports of goods and services	833	946	1070	1498	1333	1185	738	1159	1250	1148
Debt service (due)	342	337	534	515	462	498	458	460	413	312
Increase in reserves	86	133	-118	107	46	81	272	1	68	129
Total	1260	1416	1487	2120	1841	1763	1468	1620	1731	1589
Scen imp/actual, in %	53	50	53	67	66	60	36	53	54	47

Table B–3 Scenario 2

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
Sources:										
Exports of goods and services	535	555	617	855	1104	1168	1314	1177	1110	1213
Aid	0	0	0	0	0	0	0	0	0	0
Private transfers	408	456	463	465	18	20	26	30	32	34
FDI	10	15	62	63	104	134	150	165	179	183
Other capital + errors and omissions	19	-68	-15	344	246	91	-22	41	255	159
Arrears accumulation	89	285	138	293	269	250	0	79	10	0
Debt relief	0	0	0	0	0	0	0	0	0	0
Monetisation of gold	23	31	6	0	0	0	0	0	0	0
Total	1083	1274	1271	2020	1741	1663	1468	1493	1586	1589
Uses:										
Imports of goods and services	656	804	855	1398	1233	1085	738	1032	1105	1148
Debt service (due)	342	337	534	515	462	498	458	460	413	312
Increase in reserves	86	133	-118	107	46	81	272	1	68	129
Total	1083	1274	1271	2020	1741	1663	1468	1493	1586	1589
Scen imp/actual, in %	42	43	42	62	61	55	36	47	47	47

Table B–4 Scenario 3

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
Sources:										
Exports of goods and services	535	555	617	855	1104	1168	1314	1177	1110	1213
Aid	0	0	0	0	0	0	0	0	0	0
Private transfers	408	456	463	465	18	20	26	30	32	34
FDI	10	15	62	63	104	134	150	165	179	183
Other capital + errors and omissions	19	-68	-15	344	246	91	-22	41	255	159
Arrears accumulation	189	385	238	393	369	350	-925	179	110	-1063
Debt relief	154	84	230	0	0	0	1278	54	89	1263
Monetisation of gold	23	31	6	0	0	0	0	0	0	0
Total	1337	1458	1602	2120	1841	1763	1820	1647	1775	1788
Uses:										
Imports of goods and services	910	988	1185	1498	1333	1185	1091	1186	1294	1348
Debt service (due)	342	337	534	515	462	498	458	460	413	312
Increase in reserves	86	133	-118	107	46	81	272	1	68	129
Total	1337	1458	1602	2120	1841	1763	1820	1647	1775	1788
Scen imp/actual, in %	58	52	59	67	66	60	53	54	56	55

Table B–5 Scenario 4

	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99	99/00
Sources:										
Exports of goods and services	535	555	617	855	1104	1168	1314	1177	1110	1213
Aid	0	0	0	0	0	0	0	0	0	0
Private transfers	408	456	463	465	18	20	26	30	32	34
FDI	10	15	62	63	104	134	150	165	179	183
Other capital + errors and omissions	19	-68	-15	344	246	91	-22	41	255	159
Arrears accumulation	89	285	138	293	269	250	-1025	79	10	-1163
Debt relief	154	84	230	0	0	0	1278	54	89	1263
Monetisation of gold	23	31	6	0	0	0	0	0	0	0
Total	1237	1358	1502	2020	1741	1663	1720	1547	1675	1688
Uses:										
Imports of goods and services	758	883	829	1367	1141	1027	1124	949	1124	1239
Debt service (due)	342	337	534	515	462	498	458	460	413	312
Increase in reserves	86	133	-118	107	46	81	272	1	68	129
Total	1237	1358	1502	2020	1741	1663	1720	1547	1675	1688
Scen imp/actual, in %	48	47	41	61	56	52	55	44	48	50

ANNEX C LIST OF PERSONS MET

Government of Tanzania

Bank of Tanzania
Mr Peter E.M. Noni, Director of Economic Policy
Later also contact with:
Mr David Killeng'a, External Debt Department of Bank of Tanzania

Ministry of Finance:
Mr Peniel M. Lyimo, Deputy Permanent Secretary
Mr Mwasha, Ag. Commissioner External Policy
Mr Shabih Ali Mohib, Senior economist, Policy analysis department
Mr S.M. Ali Abbas, Senior economist, Policy analysis department

Tanzania Revenue Authority:
Mr Mugisha G. Kamugisha, Director of Research & Policy

Vice President's Office:
Ms Mwasha
Ms Esther Kerariou

Ministry of Education and Culture
Mr Ndeki, Commissioner of Education

National Bureau of Statistics (NBS)
Mr Cletus P.B. Mkai, Director General

Donor community

Royal Netherlands Embassy
Mr Frans van Rijn

Department for International Development (DFID), Tanzania
Ms Caroline Sergeant, Head

European Union, Delegation of the European Commission
Mr Dr Klaus Schmidt, First Counsellor (Economic)

Royal Swedish Embassy
Ms Anne Stodberg

Royal Norwegian Embassy
Ms Tone Tinnes, Second Secretary and Resident Economist

Royal Danish Embassy
Mr Torben Lindqvist, Counsellor (Development)

U.S. Agency for International Development (USAID)
Mr Stafford Baker, Assistant Director

Royal Embassy of Saudi Arabia
Mr Saud Ezaya

International Monetary Fund
Dr Tsidi Tsikata, Resident Representative

World Bank
Mr Philip L. Mpango, macro-economist

UNDP
Mr Oddvar Jakobsen, Deputy Resident Representative
Mr Ernest S. Salia, Assistant Resident Representative (ECON)

Private sector

Confederation of Tanzania Industries (CTI)
Mr Arnold B.S. Kilewo, Chairman (and CEO of Tanzania Brewery Limited)
Mr Thomas M. Kimbunga, Documentation Officer/Librarian

Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA)
Mr Kalanje, Chairman

Akiba Commercial Bank Ltd
Mr John Lyale, acting CEO

Tanzania Telecommunications Co. Ltd (TTCL)
Mr Fred van der Voort, CEO

Royal Palm Hotel
Mr Adrian, CEO

Research Institutes and NGOs

Economic and Social Research Foundation (ESRF)
Professor Samuel M. Wangwe, Executive Director

Research on Poverty Alleviation (REPOA)
Professor Joseph Semboja, Executive Director

Economic Research Bureau (ERB), University of Dar es Salaam
Dr W.E. Maro, Director
Professor Humphrey P.B. Moshi, Associate Research Professor (and former Assistant to Minister of Finance)

Tanzania Gender Networking Programme (TGNP)
Ms Mary Rusimbi, Programme Coordinator

TERMS OF REFERENCE FOR COUNTRY CASE STUDIES

The evaluation of Dutch debt relief policy and expenditures aims to answer the following research questions:

- to what extent were the political and financial interventions (the inputs) efficient in terms of outputs such as debt and debt service reduction (DDSR) and increases in imports an government expenditure?
- to what extent were these inputs and outputs effective in producing desired outcomes such as improvement of debt sustainability, improvement of creditworthiness and investment?
- to what extent were these inputs, outputs and outcomes relevant by contributing to the longer-term impacts of economic growth and, ultimately, poverty reduction?

Country case studies

In the 8 country case studies, the evaluation questions of efficiency, effectiveness and relevance will all be addressed (see attached Table 1: evaluation matrix). In addition, an in-depth analysis is to be made of the nature of the country's debt problem and therefore of the relevance of debt relief as compared to, for example, new loans or grants.

Debt relief is defined as any action that leads to a reduction in the net present value of the debt. The basic assumption for this evaluation is that IF debt relief contributes to economic growth it does so via a reduction of the debt burden. Two effects are possible:

- The reduction of the net present value of the debt stock will increase creditworthiness of the country (according to the debt overhang hypothesis), and thereby lead to more private investment and inflows of private capital. This will enhance economic growth.
- The reduction of the debt flows (actual debt service) will lead to additional imports and government expenditure. Increased imports may include investment goods or intermediate goods leading to increased use of existing capital stock, and government spending may imply higher public investment and/or more social expenditure.

Since the effects of Dutch debt relief cannot be separated from those of debt relief by other actors, the object for the case studies consists of all debt relief received by the country, both from official and commercial sources. Where possible and relevant, special attention will be given to Dutch debt relief. The evaluation period covers 1990-1999, but the analysis of the debt problem has to start earlier, in the 1970s.

The country studies seek answers to five broad questions, each of which is to be dealt with in a separate chapter of the report, with chapters 2 to 5 corresponding to the different levels of the evaluation matrix (inputs, outputs, outcomes and impact), while chapter 1 will provide an introduction and background. In addition to the sources mentioned in the Evaluation matrix, the researcher carrying out the case study is expected to take into account the relevant academic literature on the country as well as pertinent previous evaluations. A minimum selection will be provided by the co-ordinator and her assistant, but the consultation of additional material at the researcher's own initiative will, of course, be welcomed.

1. Debt problem analysis: nature, causes and consequences.

Why had the debt burden become unsustainable by the beginning of the evaluation period, 1990, and what have been the consequences of this unsustainability? Answering these questions involves analytical descriptions of:

1. The build-up of the country's debt, going back to the 1970s, including major creditors, interest rates, degree of concessionality in real terms, that is including any adverse exchange rate effects (see Mistry, 1996: 25-6), etc.
2. Conditionality attached to loans granted before 1990, and degree of compliance (short overview).
3. Trends in GDP, exports, fiscal revenues; causes of slow growth rates: review of important factors such as developments in terms of trade, inflows of foreign aid, loans and FDI, political instability, natural and man-made disasters, adverse policies, etc.
4. Trends in poverty and social indicators before 1990.
5. Debt sustainability indicators: trends in debt/GDP, debt service due/exports versus debt service paid/exports.
6. Public and private shares of external debt, and changes over time; government take-over of private debt.
7. Extent to which the external debt situation was exacerbated by a domestic debt problem.
8. Net transfers on debt before 1990, and how these compared to aid flows (grants, new loans).
9. Debt relief, if any, provided before 1990 and its influence on debt sustainability indicators. Any bail out of private creditors by official creditors/donors (see Demirgüç-Kunt & Huizinga, 1993).
10. The nature of the debt problem in 1990, in particular, whether the country's inability to pay was caused by insufficient liquidity (short-term problem) or a lack of solvability (long-term problem). Any difference between this ex-post assessment result and the common perception of the debt problem at the time.
11. The consequences of the debt problem in 1990, in particular whether it affected growth rates:

- through too high transfers on debt leading to lower imports and lower government expenditure;
- and/or leading to lower growth rates through a heavy debt overhang (high debt stock, so high expected tax on private profits lowering private investment and inflows of private capital).

---

2. Inputs: amounts and modalities of debt relief in the period 1990-1999

What were the inputs into the debt relief process in terms funding, modalities and conditions? Answering this question requires the following data:

1. Overview of amounts and modalities of debt relief: by creditor, by type of debt, by framework for debt relief activities (Paris Club, Multilateral Debt Funds, 5th and 6th dimension, HIPC, etc.), extent of forgiveness, interest subsidy, buy-back, etc.
2. Stated objectives of debt relief.
3. Any conditions attached to the different modalities of debt relief, including assessment of track records (see attached Table 2 for possible contents of conditions and track records)

4. Special attention to Dutch modalities, motives, conditions, and objectives for debt relief.
5. The extent to which debt relief was additional to other inflows (loans or grants); in general, and for Dutch debt relief in particular; according to the HIPC initiative, debt relief should be additional (Andrews et al., 2000: 16) but practice may be different.
6. Amounts and modalities of new loans and grants 1990-99. Dutch loans and grants.

Assessment:
Was the combination of new funding and debt relief modalities consistent with the perceived and the actual nature of the debt problem (as described in 1.10)? Were these inputs suitable for the improvement of debt sustainability (see Cline, 1995: 29 and Hanlon, 2000)?

---

3. Outputs of debt relief: efficiency analysis

To determine how efficient the inputs were in producing the intended outputs the following data are to be collected and analysed:

1. Debt service due during 1990-1999 as compared to debt service actually paid and accumulation versus payment of arrears.
2. The share of (total as well as Dutch) debt relief that effectively relieved the debt burden in that it led to a reduction of actually paid debt service (see Annex 1).
3. The effect of the different modalities of debt relief on actual payment of debt service on the reduced as well as on other debt. Since debt relief usually increases ability and/or willingness to pay other debts, other creditors may benefit. This may to Dutch debt relief. This follows from 2.6, 3.2 and 3.3. Compare to the amounts of new loans and grants received during the period 1990-1999 (see 2.7).
4. Extent to which debt relief benefited the creditor itself or other creditors (bailing be an unintended side-effect and has been established for debt buy-backs (Bulow & Rogoff, 1988), or it may be an intended result: in the context of HIPC agreements, countries may be obliged to start or resume servicing debts that they ignored before.
5. Extent to which debt relief freed resources for the government, with special attention out), with special attention to Dutch debt relief. This follows from 3.2-3.4. Specify whether official or private creditors benefited.
6. Effect of debt relief on the reduction of the nominal debt stock and the net present value (NPV) of debt.
7. Compliance with debt relief conditionality, changes in policies, changes in governance (see Table 2 and Annex 2).
8. To the extent that debt relief was additional and freed resources (3.4): trace its effects in the government accounts (on public investment and social expenditure, in particular) and in the balance of payments (increased imports, if possible broken down by destination: capital goods, intermediate inputs, consumer goods), according to the accounting framework outlined in Annex 3.

Assessment:
How efficient were the chosen modalities of debt relief in reducing the debt burden, in terms of both NPV of debt and actual debt service?

---

4. Outcomes of debt relief: Effectiveness

The effectiveness of debt relief is to be assessed by collecting / analysing the following data:

1. Trends during the evaluation period 1990-1999 in the debt sustainability indicators: debt/GDP, debt service due/exports, NPV of debt/exports. We focus on trends as most relevant issue for this evaluation. However, the absolute values of these indicators will be compared to subjective sustainability criteria (limits) according to the IFIs (from HIPC documents) but also according to other sources, e.g. Hanlon (2000).
2. Extent to which change in sustainability can be attributed to debt relief. Both the numerators and the denominators of these indicators are not only the result of debt relief, but also of new loans and grants during the period and of the concessionality of those loans (see Annex 4). In addition, the trends in GDP and exports (the denominators) depend on many other factors: policies, political stability, weather conditions, international prices, etc. The possible causes for the developments in the debt sustainability indicators will be analysed.
3. Improvement, if any, of social indicators (see Annex 5) as a result of debt relief leading to policy changes and changes in governance (as analysed in 3.6) .
4. Improvement, if any, of social indicators as a result of debt relief freeing government resources for more public investment and social expenditure (3.7).
5. Increase, if any, in private investment as a result of debt relief freeing resources for more public investment: crowding in.
6. Increase, if any, in private investment as a result of debt relief lowering the debt stock, thereby reducing the debt overhang.
7. Improvement, if any, in the creditworthiness of the country leading to new private capital inflows, as a result of a reduction of the debt stock. This implies an analysis of creditworthiness according to ratings, and of figures on private capital inflows (distinguishing between loans, portfolio investment, FDI). It must be born in mind that other factors such as (expected) economic growth, credibility of government policies, and even conditionality attached to debt relief efforts may also have led to improvements in ratings and increases in flows. Debt relief may, on the other hand, have reduced creditworthiness by lowering expectations on future debt service by the country. According to a recent literature review and additional empirical evidence, policy-based lending and the attached conditionality have only limited effect on private flows (Bird & Rowlands, 2000).

   Field studies:
   In the field studies, the trends in social indicators (4.3-4.4) and in private investment and private capital inflows (4.5-4.7) can be analysed and explained more thoroughly by having interviews with government officials, NGOs, donors and representatives of the private sector.

Assessment:
How effective has debt relief been in increasing debt sustainability, stimulating private investment and improving social indicators, both via the attached conditionality and via the stock and flow effects of debt relief?

5. Impact of debt relief: Relevance

Assessment:
Based on the analysis under 1-4, the final impact of the different modalities of debt relief on economic growth and on poverty reduction is to be assessed.

1. Economic growth was already briefly analysed in 4.1 and 4.2 as denominator for one of the debt sustainability indicators, but the analysis can now be broadened, taking into account the other outcomes under 4 (4.3-4.7).

2. For poverty, trends in the usual poverty indicators (P0, per cent of population below poverty line), and P1, the poverty gap (total shortfall of income of the persons below poverty line) will be collected (if available). For the analysis, it is important that poverty reduction may be achieved through economic growth, through an improvement of the income distribution or (in the longer run) through an improvement in social indicators.

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Table 1. Evaluation matrix Debt relief

OBJECTIVES-*MEANS*	INDICATORS	SOURCES	*EVALUATION CRITERIA*
INPUT Debt relief expenditures and modalities; Policy dialogue	Amounts spent, assigned and contributed; Conditions	Documents for Dutch parliament; "Macro-exercises", assessment for debt relief; Global Development Finance; National statistics; WB/IMF country reports.	
Comparison outputs and inputs →			***EFFICIENCY***
OUTPUT Reduction debt and debt service; Increase imports and government expenditure; Policy change and change in governance.	Total debt (nominal and net present value); amortisation; Balance of payments; Government accounts.	Global Development Finance; World Development Indicators; IMF; National statistics; WB/IMF country reports.	
Extent to which inputs via outputs contribute to outcomes →			***EFFECTIVENESS***
OUTCOME Reduction debt burden; Improvement creditworthiness; Investment.	Debt/GDP; Debt service/Exports; International credit ratings; I/GDP; I_p/GDP.	Global Development Finance; World Development Indicators; IMF; National statistics; Moody's; Standard & Poor; WB/IMF country reports.	
Extent to which inputs via outputs and outcomes contribute to impact →			***RELEVANCE***
IMPACT **Economic growth**	Change in GDP	World development Indicators; National statistics.	
Sustainable poverty reduction			

Table 2. Possible aspects of the track record possible policy conditions for debt relief

Area	Policy/target
Macro-economic	Stock of international reserves Government deficit (% GDP) Government expenditure (% GDP) Exchange rate policies (devaluation)
Economic reforms	Tax reforms Public sector reform/civil service reform Composition of expenditure (defense) Privatisation of SOEs, public utility enterprises Liberalisation of goods markets: prices, domestic trade Liberalisation of foreign trade Liberalisation of labour market Financial liberalisation Other sectoral reforms
Political reforms	Elections Multiparty system Human rights observance Independent judiciary Free press
Governance	Transparency of budgeting Transparency of budget execution Accountability, to parliament, local councils, civil society Anti-corruption measures/sanctions Establishment of and respect for Audit Office Decentralisation
Poverty reduction	Social expenditure Social sector reforms Quality of social service delivery PRSP

Annex 1

Effective debt relief

Effective debt relief (DR_e) is debt relief that reduces actual debt service (DS_a)

To be computed from:

$DS_a = DS_d - AA$ (1)

$DR_e = DR - PA$ (2)

Where:

DS = Debt Service
DR = Debt Relief
Subscript a = "actual"
Subscript e = "effective"
AA = Accumulation of Arrears
PA = Payment of Arrears
Subscript d = due

DRe is still an approximation, since debt relief covering debt service due that would never be paid in the same year, is still included. This often the case with Dutch debt relief on Dutch aid loans. If known, it must be subtracted from the figure for DRe.

Annex 2

The effectiveness of conditionality

To the extent that debt relief was accompanied by conditionality on future policies, or by conditions regarding past policies or policy outcomes ("track record") the extent of compliance with these conditions must be assessed (with respect to changes in policies and changes in governance, see Table 2). The track record has become important for Dutch debt relief decisions since 1996. The evaluation must therefore investigate whether and to what extent the conditions mentioned in the "macro exercitie" were fulfilled in the case of the involved country. A second issue is whether changes in country's policies or governance can be observed since 1996 that go in the direction of improving the "conditions" stipulated in the macro exercitie. Evidence for this can be looked for in HIPC documentation on the country, Policy Framework Papers, Implementation Completion Reports of SALs and SECALs of WB.

In field studies, information can also come from interviews. Interviews should also shed light on the issue of whether the fact that the Dutch have used this track record as basis for decision making on debt relief, has to any extent influenced governance and policies (see below).

In the context of the HIPC initiative, the track record has become important since 1998 and involves an assessment of whether conditions stipulated in earlier IFI programs have been complied with satisfactorily. This can be found in HIPC documents on the country, but an independent assessment by the evaluator is also necessary. For example, earlier evaluation research showed that countries were not always treated equally. As of 1999, the HIPC conditions include the setting up of a Poverty Reduction Strategy Paper (PRSP). For the desk studies it is too early to investigate whether the HIPC track record or the requirement of a PRSP have induced a change in the country's policies or governance. In the field studies, donor influence on policies and governance can be examined.

Donor influence (field studies only)

One thing is to establish that countries have complied (or not) with conditions set by the donor; another is to conclude on effective influence of donors. An earlier evaluation concluded that domestic political factors are most important in policy changes but there is also some room for donor influence, especially if we take other dimensions of the "policy dialogue" into account, i.e. other than the formal, directive conditions laid out by the IFIs and directly imposed on the recipient country's government (White, 1999).

This means, first, that we have to take on a broad political economy perspective in explaining why reforms have come about. Donors usually tend to overstate their roles. Second, it means that we have to consider the policy dialogue as a process with four dimensions as discovered in the previous evaluation: the degree of formality, the channel of influence (directly to government, indirectly through IFIs or indirectly through contact with other donors), whether conditionality is directive (policy monologue) or non-directive, and which instrument is used (White, 99: 53-54; see also a useful table of possible channels and degree of formality on p. 37).

Instruments can be debt relief, budget support, project aid or technical assistance. The earlier evaluation has shown that there may be some influence from donors, but that this is usually carried out through less formal means, non-directive approaches and often using other channels.

The study of donor influence consists of two parts: i) examining Dutch influence, and ii) examining the impact of the HIPC conditions, in particular, the requirement that countries elaborate a Poverty Reduction Strategy Paper (PRSP) and do so in a participatory manner. On the first, field studies can first investigate whether the Dutch Embassy has an infuence strategy that takes the different dimensions into account, and on which particular issues it focused. Second, by having interviews with government officials and with other donor representatives, the effectiveness of that influence strategy can be assessed. Since this may lead to subjective and not very exact statements, the approach will be to single out one or two issues (from the Dutch "track record") on which the Dutch had or have a strong opinion – different from the government's opinion – and examine what happened with this "conflict"
For the second aim, the same interviews with donor representatives and government officials can be used to assess the progress in coming to a PRSP. On this topic, interviews with representatives of NGOs and private sector (civil society) will also be necessary. If possible, also for this part a particular issue on which opinions differ will be singled out and followed, in order to improve the judgement on the extent of influence.

The marginal effect of debt relief: the accounting framework

The approach proposed here is similar to the one described for the Sida Evaluation of Programme Aid (see White, 1999: 94-6). It focuses on the marginal impact of debt relief. This is different from the often used "gap approach" which is considered not very helpful (White, 1999: 89-93). It means that we analyse the influence of effective debt relief (free resources) on balance of payments, internal accounts and on government accounts (a subset of the internal accounts), on the basis of accounting identities.

For the external account, the identity is the following:

$M = AID + PCT + DRe - DS + X + OKI + \Delta R + EO$ [42] (3)

If DRe (see Annex 1) increases, one or more of the other items must change. The fact that DRe is positive, implies that the absolute value of DS (debt service) has reduced (as established in 3.1). The impact of DR on other DS has been established in 3.2 and can be used here. Similarly, it has already been established whether DR was additional, i.e. did not lead to a reduction in aid (2.6). From all these, we can compute the net effective debt relief. It will now be examined whether this net DRe leads to higher imports and/or reserves, which are the preferred responses for donors. This depends on the effects on OKI, ΔR, EO (often capital flight), X, and PCT. A reduction in X could be a negative effect of AID and net DRe, for example due to Dutch disease effects. Decreases in PCT, OKI and EO (if capital flight) would also be negative responses to DRe. Increases in PCT and OKI could be positive second round effects of DRe.
A next step is to look at the composition of imports. Does the composition of imports change as a result of net DRe? The preferred outcome would be that imports of capital goods and intermediate goods would increase more than imports of consumer goods. This would point to a higher propensity to invest as opposed to consume.
For the internal account, the identity is the following:

$I = AID + DRe - DS + OKI + \Delta R + EO + S$ [43] (4)

The analysis for AID, DS, OKI, ΔR and EO is the same as above. The marginal effect of net DRe on I depends on what happens to S, domestic savings.

[42] M = Imports
PCT = Private Capital Transfers
DRe = Effective debt relief
DS = Debt service
X = Exports
OKI = Other capital inflows
ΔR = Change in reserves
EO = Errors and Omissions

[43] I = Investment
S = Savings

If savings diminish as a result of the additional free resources (as claimed by Easterly, 1999, for example[44]), this would be a negative effect of debt relief. Ideally, DRe would be accompanied not only by higher I but also by higher S.

The internal account can be broken down further, allowing for separate government income and expenditure. A change in domestic savings is the sum of changes in private saving and changes in government revenues. Investment can be broken down into government expenditure and private investment (see schemes in White 1999: 95).

According to the "fiscal response" literature (White, 1998), the marginal effect of aid (in this case, net effective debt relief) can be to reduce revenues. The analysis of government accounts must therefore begin by looking at what happens to government revenues. A second possible effect that must be examined is the effect on the deficit. If revenues and deficit remain unchanged, the whole effect of net DRe is on increased expenditure, which is the intended effect of donors (resources should be freed for other – social – expenses). The third step is to look at the composition of expenditure. Does the freeing of government resources lead to increased priority for social expenditure or for public investment? The trends in the share of these sectors within total expenditure will be examined.

[44] Easterly (1999) does not distinguish between debt relief and effective debt relief, however; and his model that stresses "perverse incentive effects" also overlooks that the continued lending by HIPC countries is probably as much the result of (lending) supply factors than of demand factors such as a high discount rate.

Annex 4

Debt sustainability

In the long run, debt service can be sustainable if the following holds (Gillis et al., 1996: 414):

$D/X = a/(gE - i)$ (5)

Where D = debt, X = exports, a = the trade gap $(M - X)/X$, M = imports, gE = the growth rate of exports, and i = the average interest rate on debt.

This means that as long as the growth rate of exports is higher than the interest rate, a sustainable debt/exports ratio can be accompanied by a trade gap a (i.e. by increasing debt). A first issue to be examined is therefore whether the growth rate of exports is higher or lower than the average interest rate of the debt stocks over 1990-99 (as computed in 2.7). If it is lower, it can be argued that the country had a solvability problem and not a liquidity problem, and that new loans would not lead to a sustainable debt service.

The next component to analyse is the trend in the trade gap. This trade gap a is constant if the growth rate of imports is equal to the growth rate of exports, but this is not necessary for the analysis. In our study, the trade gap that leads to this increase in debt $a = (M - X)/X$ must be adjusted for the non-loans part of aid (i.e. grants, A) and for net effective debt relief (DRe, see Annex 1), so we will look at what happens to

$$\frac{M-(X+A+DR_e)}{X}$$

If the growth rates of exports is lower than the interest rate, D/E is only sustainable if there is a surplus, so $M-(X+A+DRe) < 0$.

Similarly, the debt/GDP ratio can be sustainable in the long run if (Gillis et al., 1996: 415):

$D/Y = (v - s)/(gY - i)$ (6)

Where Y = GNP, gY = the growth rate of Y, v = I/Y, the investment ratio, and s = S/Y, the savings ratio.
As long as gY is above the interest rate, a sustainable debt/income ratio can be accompanied by a continuing and constant savings gap ($v - s > 0$). This savings gap leading to increased debt must also be adjusted for grants (A) and for net effective debt relief (net DRe) , so we look at:

$v - s - A/Y - DRe/Y$

If gY is below the interest rate, there must be a savings surplus. The evaluation will examine the trends 1990-99 in gY as compared to i, and of v, s, A/Y and DRe/Y

For the government, we can assess sustainability in relation to the tax capacity (Fishlow, 1988: 220-21). In the long run, the debt burden is sustainable if:

$$D/T = \{(G - T)/T\} / (rt - I) \tag{7}$$

Where T = tax income, G = government expenditure, rt = growth rate of taxes.

In this part of the analysis, the sustainability of the debt burden for the government is not only determined by the external public debt, but also by the internal debt. This is a problem for Jamaica, for example. An average interest rate on total public debt will have to be computed. This average interest rate must then be compared with the growth rate of taxes. The latter will probably be related to the growth rate of GDP, but there can also be an independent effect due to, for example, tax reforms. If the interest rate is higher than the growth rate of taxes, the government must have a surplus $(G-T) < 0$ for debt service to be sustainable.

Annex 5

Social indicators

Social indicators to be analysed could be taken from the OECD/DAC indicators for social development (Nos. 4-15 of the 21 Indicators for sustainable poverty reduction). These are:

Indicator	Measure	Source
Children under 5 with underweight	%	WDR (WDI)
Enrolment in primary education (%)	%	WDR (WDI)
Share of people with fourth grade	% of adults	HDR (WDI?)
Alphabetisation	% of adults	HDR (WDI?)
Gender equality in primary enrolment,	F/m, in %	UNFPA or WISTAT
Gender equality in secondary enrolment	F/m, in %	UNFPA or WISTAT
Gender equality in alphabetisation	F/m, in %	HDR
Infant mortality rate	%	HDR
Child mortality rate	%	WDR (WDI)
Maternal mortality rate	%	WDR (WDI)
Deliveries under expert supervision	% of total	UNFPA
Use of contraceptives	% of married women	HDR
HIV ratio	% of adults	UNAIDS

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