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Evaluation of Swedish Development Co-Operation with Tanzania

A Report for the Secretariat for Analysis of Swedish Development Assistance

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FOREWORD

On the basis of a government report on forms of management and co-operation in overseas aid (SOU 1993:1) the Swedish Parliament approved a proposal to carry out country profiles and country studies as an essential tool for the management of aid to individual countries.

Examinations of the overall management of the bilateral aid programmes, in terms of results or the effectiveness of programmes in each country, have seldom been carried out in Sweden. The recipient country is an appropriate level at which to address the question of results because it is the level where bilateral funding allocations are made by the Swedish Parliament, where the strategy for results can be determined, where goals are set and where bilateral agreements are signed for programmes and projects. A country specific strategy would enable Swedish development co-operation agencies to focus on specific and measurable results, country by country.

The Secretariat for Analysis of Swedish Development Assistance (SASDA) has commissioned a number of country-case-studies in order to analyse the results achieved by Swedish aid, taking into account other donors' experience. The objectives are to analyse the effect and effectiveness of Swedish aid in the sense of appropriateness to the objectives set for aid, to analyse its cost-effectiveness, to make recommendations to improve its effectiveness and efficiency in development co-operation in the future, and to make proposals for the methodology to be employed in analysing and following up the effectiveness and efficiency of aid in country studies.

In this report, Professor Arne Bigsten, Department of Economics, University of Gothenburg, together with Dr. Chris Adam, Professor Paul Collier, Dr. Eva Julin and Ass. Professor Steve O'Connell, analyses Swedish development co-operation with Tanzania for the period 1965/66-1991/92, and particularly on its development after 1980.

The opinions and conclusions of the authors of the report are their own.

Stockholm, August 1994.

Ingemar Mundebo
Chairman

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Part 1: BACKGROUND

1. INTRODUCTION

1.1 Purpose

Sweden has been giving aid to Tanzania since the early 1960s, and in most years it has been the most important recipient of bilateral Swedish aid. The total amount of aid disbursed is about 18 billion SEK at 1993 prices. Moreover, Tanzania has been at the focus of the discussion in Sweden, on aid specifically, as well as on development issues generally. It is therefore of particular interest to discuss and summarize the experiences of three decades of development collaboration with Tanzania. Many analyses of specific projects and programmes have been undertaken previously, but no comprehensive review of Swedish aid to Tanzania has been done before.

SASDA has commissioned four country studies on the impact of Swedish aid. The Göteborg-Oxford team is responsible for this one on Tanzania and another one on Zambia, while the reports on Guinea-Bissau and Nicaragua are written by two other teams (Svedberg, Olofsgård, Ekman, 1994, Lundahl, Behar, 1994). SASDA has also commissioned studies of the overall impact of aid to the four countries (White, Voss, 1994) and of other aspects, such as evaluation quality. Each study is rather limited in scope, but the aim is that they jointly shall provide a basis for a discussion of Swedish aid policy. The country studies are not comprehensive enough to be the only basis for Swedish decisions on aid to the respective countries. They cover a wide range of issues, which means that it is impossible to penetrate all issues in depth.

The main purpose of this report on aid to Tanzania is to examine the extent to which Swedish aid has been successful in achieving its stated objectives. A secondary purpose is to investigate the efficiency with which aid has been handled by Swedish aid agencies. Finally, on the basis of our analysis we will discuss implications for future Swedish aid to Tanzania.

1.2 Goals of Swedish Aid

The overall objective of Swedish aid is to improve the standard of living of poor people. More specifically, the Swedish parliament has decided that Swedish aid should contribute to economic growth, economic and social equalization, economic and political autonomy, democratic development of society, a sustainable use of natural resources and environmental protection.[1] Although the main priority has always been poverty eradication, the translation of this into concrete activities has changed over the years, with trends in the development debate and experiences gained (see e.g. Hveem, McNeill, 1994).

The Swedish government has recently decided that the amount of aid allocated to a country is to be based on five criteria: 1) development towards a market economy, 2) democracy, 3) respect for human rights, 4) the efficiency of aid, and 5) a low military share of total government expenditures.

In the 1960's and 1970's Sweden supported Tanzania enthusiastically, since it was felt that the goals of the Tanzanian government were very much in line with those specified for Swedish aid. The Tanzanian government emphasized equitable growth, and Tanzania was one of the strongest proponents of self-reliant development. Politically, Tanzania was far from democratic, but still President Nyerere was a much-respected spokesman for the poor countries of the Third World. At the time, therefore, it seemed reasonable to Swedish governments to supportTanzania. Eventually it became clear that the policies pursued were not successful in realizing the noble aims, however, and donors became increasingly disillusioned. Even Sweden started to loose faith, and from about 1983 Sweden joined the critics of the policies pursued under President Nyerere.

In the latter part of the 1980's, the main objectives of Swedish assistance to Tanzania were economic growth, equity and conservation of the environment. Support of the economic

[1] See e g. UD. Prop 1993/94:100, bilaga 4 s 58. Littera C: Internationellt utvecklingssamarbete.

recovery programme (ERP) introduced in 1986 became top priority.[2] The main activities in the Swedish aid programme were geared to support the ERP, and commodity support was conditioned upon agreements with the IFIs.

It has also always been emphasized by the Swedish government that Swedish aid should be complementary to the efforts of the recipient country. This implies that there is a need for increasing domestic resource mobilization and for strengthening domestic institutional capacity. Full responsibility for the planning and implementation, as well as for the follow-up and reporting of the use of funds, should rest with the recipient, as should the full responsibility for coordinating donor support. SIDA emphasizes that only those projects which are cost effective will get continued support. We will consider to what extent these ambitions have been realized with regard to Tanzania.

1.3 Approach and Scope of the Study

We have been asked to investigate what the effect of Swedish aid has been on Tanzania's overall development. Specifically, it is noted in the terms of reference that the review should focus on growth and distribution. We will therefore concentrate on the goals of growth and equity, while the other goals of Swedish aid will be touched on more briefly. It should be noted that unless there is economic growth, it will not be possible to achieve poverty eradication in the long term.

When one looks at a cross-section of countries and controls for other relevant variables, it is not possible to find any correlation between the amount of aid and growth (Mosley, 1987, p. 139). At the same time, project evaluations show that the majority of projects are successful. This is referred to as the macro-micro paradox. It could mean that the direct effects of aid are positive, but that the indirect effects tend to be negative. This may be so because project money indirectly leaks into less productive activities (fungibility), or because of negative indirect effects on the public and private sector. Of course, aid is primarily allocated to countries that are in a poor state to begin with - often more aid to those in the

[2] See, for example, the agreed minutes from discussions between the two governments in 1988.

worst shape - and this may explain the lack of correlation. For example, during the 1980's Sweden concentrated its aid efforts on Africa, where the worst performing economies are located.

The major problem when analyzing the impact on a specific country is to define the counterfactual, or the norm of comparison. We are not able to derive a well-defined counterfactual. Moreover, Swedish aid is a relatively small component of overall resources, which means that its impact is not easily identified. We therefore abstain from trying to undertake an econometric exercise linking Swedish aid and macroeconomic aggregates. We will confine our analysis to a more general discussion of various effects. We will reason about the impacts of Swedish aid on the basis of the information that we have, and on the basis of our understanding of the workings of the Tanzanian economy and the constraints that it faces.

In our analysis we distinguish between the direct and the indirect effects of aid. The direct effects alter production, incomes or consumption as a direct consequence of the project. The indirect effects are less easily identified. Aid to the public sectors releases resources which can be used for cuts in taxation and borrowing, or for increases in expenditures. The private sector is indirectly affected, for example, via changes in relative prices. A proper identification of these indirect links is not easily done without a general equilibrium model of the economy, which we do not have. Our discussion of these links will therefore be tentative.

Foreign aid should assist countries in their development efforts. The long term aim is that the recipient country should grow from its own resources. For this, domestic resource mobilization is essential. Possible negative indirect impacts of aid on such mobilization will therefore be considered. Domestic savings and tax efforts are two important variables to consider. We are also concerned with the development of exports, which in the longer term is a necessary prerequisite for self-sustained growth.

In our analysis we will first consider the direct effects of aid, that is, we will consider the

effects of projects and programmes at the micro level. Then we will consider the indirect or macroeconomic effects on the economy.

1.4 Outline of the Study

The study is structured as follows: In Chapter 2 we review briefly the factors determining economic growth in Africa and discuss some relevant aspects of the aid relationship. In Chapter 3 we show the overall flows of aid to Tanzania, while Chapter 4 describes Swedish support.

Then follows our discussion of the results achieved. In Chapter 5 we examine the direct effects of aid. We review the major projects and programmes in which Sweden has been involved. This chapter thus summarizes the results of Swedish aid as observed at the micro level. It is based on evaluations and other studies already undertaken. We do not undertake any evaluations of our own, and we do not cover all projects. Still, the coverage should be comprehensive enough to give a fair picture of the problems and achievements of Swedish aid to Tanzania.

In Chapter 6 we discuss various aid management issues. We consider very briefly the administrative costs of Swedish aid, although it is impossible to come up with reasonable estimates of cost-effectiveness without a major research effort. It is obvious, for example, that higher administrative costs may result in better quality of output. Simple ratios, therefore, tell us little. Still, we provide estimates for one year, to give a feel for how large a share of aid goes to administration. We also discuss the quality of appraisals and evaluations. The chapter concludes with some notes on the results of other donors.

Then, given the time and resource constraints we face and, as discussed before, the relatively small Swedish share of total aid, what can we say about the impact of Swedish aid from a macro perspective? We start in Chapter 7 with a macroeconomic overview of Tanzania's record with respect to growth, export performance, investment, savings, and government resource mobilization since 1971. Chapter 8 is devoted to an analysis of aid dependency.

Chapter 9 analyzes of policy conditionality and its impact, while Chapter 10 discusses the design of policy conditionality in the light of the former analysis. Chapter 11 discusses Dutch disease and the choice of projects versus programmes, while Chapter 12 discusses the roots of corruption, its impacts and possible responses. Finally in Chapter 13 we draw policy conclusions from the macroeconomic discussion. The general reader may prefer to skip some parts of Chapters 9-11, which are somewhat technical.

The main task of this investigation was to look at the macroeconomic effects of Swedish aid and, particularly, to consider its impact on growth and income distribution. We have pointed out that it is virtually impossible to provide a sound scientific answer to these questions. Still, in Chapter 14 we summarize what we have learned about the impacts from our micro and macro analyses. We provide a tentative discussion about the possible growth effects and distributional impacts. Particularly on the latter issue, data is scarce and contradictory.

Finally, Chapter 15 presents our policy conclusions and discusses what seem to be the appropriate forms of future Swedish aid to Tanzania. More remains to be said on this difficult issue.

2. GROWTH DETERMINANTS AND THE IMPACTS OF AID

2.1 Introduction

In order to analyze the impact of Swedish aid to Tanzania with particular emphasis on growth and income distribution, we first need to review the factors that determine income growth in African economies[1]. This chapter will do this, and then we will identify some important aspects of the aid relationship itself. In later chapters we will analyze the impact of aid on the growth factors identified here.

2.2 Accumulation and Technological Progress

In any economy, the rate of growth is determined by the accumulation of physical and human capital, the efficiency of resource allocation, and the ability to acquire and apply modern technology. This proposition is consistent with all types of growth theories, the traditional neoclassical model (Solow, 1957) as well as the more recent endogenous growth approach (see survey in Hammond and Rodriguez-Clare, 1993). Models in the latter tradition typically assume that the accumulation of human capital is a crucial determinant of technological progress. Unfortunately, evidence shows that the gap is widening, between technologies as applied in Africa, and those at the international frontier. It thus seems reasonable to hypothesize that poor education is one of the decisive constraints on African productivity increase.

The policy question is how the environment could be changed to facilitate not only the accumulation of production factors and their efficient allocation, but also the introduction of better technologies. The experience of many countries shows that economic policies at the micro level should aim to develop and sustain efficient markets, while macro policy must be geared to guarantee macroeconomic stability. It has become obvious, furthermore, that an efficient economy requires a supporting environment of efficient institutions.

[1] Svedberg, Olofsgård and Ekman (1994) provide a good review of recent work on the determinants of growth in LDC's.

2.3 Economic Policy

There have been large distortions in the incentive structures, in Tanzania and in many other African economies, and consequently resources have been poorly allocated. With recent reductions in distortions the allocation of the meagre resources has probably improved, but the growth impact has been somewhat disappointing. Obviously, much more is required in terms of economic policy to support factor accumulation, efficient allocation of resources, and technical progress, . The structural adjustment programmes have been grappling with this, and there has been some progress.

A necessary but not sufficient condition for growth is investment. A major aim of recent adjustment programmes has been to increase private sector investment, and studies of the adjustment experience of a range of countries suggest that recovery of private investment is the distinguishing feature of a successful programme.

Uncertainty and lack of credibility are important constraints on investment. These factors make investors shy away from irreversible long-term investments, and they stimulate short-term speculative behaviour. When there is uncertainty, firms choose to place their money in liquid assets. Investment expansion thus requires long-term macroeconomic stability, and for this to be credible, debt burdens may have to be reduced. A sound overall macroeconomic environment is thus a basic condition for investment, which is a requirement for growth.

A hotly debated issue with regard to the Asian NIC's is whether selective, non-neutral market interventions played an essential role in their success. The answer given by the "miracle-study" is a qualified "no" (World Bank, 1993). However, one area where experiences of the Asian NIC's suggest that there might be scope for non-neutral policy is with regard to export support. It is essential, though, that interventions be based on economic performance criteria, and that the bureaucracies that handle them are not corrupt. These preconditions seldom exist in African economies.

2.4 Institutions and Transaction Costs

So far we have argued that growth is determined by physical and human capital accumulation, technological progress, and the efficiency of resource allocation, and further that the outcome is influenced by the economic policy pursued. However, the smooth running of the economic system also requires an efficient set of institutions. An efficient economic system requires low transaction costs. The character of institutions is a very important determinant of these transaction costs. In developed countries, agents can rather confidently make explicit or implicit contracts with strangers, and this makes specialization possible. In African economies, one needs to be more careful due to higher uncertainty. This hinders transactions and reduces the scope for specialization. Uncertain ownership conditions incline people to avoid long term contracts and to use little fixed capital.

A central question, then, is why growth-supporting institutions develop. A government which is primarily concerned with its own survival does not necessarily set up ownership rules that are good for economic growth. With special interest politics at centre stage, there is bound to be static inefficiency due to distortions, investors are going to be cautious, and resources are going to be wasted in rent-seeking activities.

2.5 Governance and Politics

Many observers of African economies have noted the pervasive influence of politics on economics. A characteristic feature is that many policy interventions have been discretionary in Africa, while they have been more rule-based and institutionalized in the Asian NIC's. This selectivity of interventions has paved the way for the high level of corruption and rent-seeking in Africa (Bigsten, 1993). Many interventions were well-intended, but the power elite has also used the system to allocate rents as a means of securing their power positions (Bigsten and Moene, 1992).

A notion that appears many times in the analysis of the Asian miracle is "shared growth", that is, the mass of the population must see the benefits if they are going to participate actively. And it is not only the general citizen who must be included, but also the ruling elite must allow competing elites to progress, and must also allow new competitors to come in. The desire for total control has stifled many initiatives in African countries. For shared growth to come about, there is need for a bureaucracy of high quality, which is sufficiently insulated from pressure groups. Such an institutional set-up is not easily created. It is not enough to instill the relevant skills in civil servants. If they are then put into institutions where outside interference determines outcomes, they become frustrated and cynical. To avoid this result, the norms and behaviour in the society at large have to change. An open debate can contribute to such change, and here African economies have taken strides in the right direction in the last few years.

We have just reviewed the basic factors which, we believe, determine the rate of economic growth in African economies. Now we will consider some aspects of the aid relationship itself which need to be kept in mind when analyzing the impact of aid on growth.

2.6 A Choice Between Current and Future Consumption

Aid can be used either for consumption in this period, to thus improve the welfare of the current generation, or it can be invested to generate growth and increased future consumption. A choice is made by the recipient government on the basis of its preferences, but it may be constrained by donor conditionality. The smaller the share of the budget that is financed by aid money, the larger is the scope for the recipient government to allocate its own money in such a way that the impact of conditionality from the donor is neutralized. It is natural that some of the inflow of aid is going to be used to increase the consumption of the current generation. This means that the domestic savings share is going to be smaller than before, even if the sum of domestic and foreign savings and investment is larger. It should also be noted that investment in human capital, in the form of education, is going to be recorded as current public sector consumption.

This seemingly simple choice between present and future consumption is in reality further complicated by a range of factors. For example, economies are exposed to uncertainty, and

incomes may fluctuate due to swings in commodity prices or commodity production or because of international cycles. The recipient may therefore chose to use aid for consumption-smoothing, rather than for investment, when the economy is facing problems. This should be acceptable to the donor also, when there is an emergency situation with, for example, drought and the threat of starvation.

Furthermore, the choice in most countries is not under the full control of a central decision-making body, such as the Ministry of Finance. Much aid is channelled directly to line ministries, local authorities or other organizations. Even when the government channels the money centrally, it may not have full control further down the line in the expenditure process. The final allocation may then be viewed as the end result of a game between these different actors.

2.7 Constraints on Project Choices

Once the choice between current and future consumption has been made, the government has to choose the projects and their locations. This process is heavily influenced by political considerations. Decision makers at all levels have clients that they want to satisfy. The less central control there is, the larger the scope for these considerations in the process. Since the power base of governments is essentially urban, there may be a general bias against rural areas.

It is normally the Ministry of Finance which tries to control expenditures, while the line ministries always have ambitious plans. At the same time, the donors have a long list of projects that they would like to finance. To the extent that they negotiate directly with the line ministries, they are very likely to come to an agreement. And once such an agreement exists, it is difficult for the central authority to turn a project proposal down. Therefore, development budgets are often added up from the spending ministries without due consideration for the recurrent cost implications. In the short term the decisions may make sense, but eventually the recurrent costs will have to be faced. If the budget cannot bear them, the projects will not be viable in the long term.

Donors gradually became more aware of the recurrent-cost problem, and in the 1980's there was a shift towards rehabilitation and maintenance. More money was used for spare parts and repairs, and sectoral programmes were getting increasingly supported. Still, donors have generally been reluctant to finance recurrent costs, and one of the reasons is that it is difficult to end such support. However, to introduce another project when the recurrent costs of the system cannot be met is destructive. It would make more sense to focus on changing the system and/or on providing money for recurrent costs. The use of counterpart funds as budgetary support is one example of such an intervention. At the same time, however, one should guarantee that the recipient shows commitment to new projects by covering a part of the recurrent costs. Moreover, this share should be increasing over time, to pave the way for donor withdrawal. If this condition is imposed by all donors, there will be a natural check on project proliferation.

Mosley (1987, p. 99) concludes that the fragmented environment of decisions will result in an allocation of aid money which deviates wildly from the economic optimum, unless a coordinating agency exists to override the political and bureaucratic imperatives.

2.8 Impacts on Public Institutions

The problem described is naturally compounded when the number of donors is large, and Tanzania has more donors than most other LDC's. Apart from the problems discussed above, we also have the problem of administrative overload. Each donor wants to have a system that supports the efficient management of their projects and makes it possible for them to be accountable to the taxpayers at home[2]. It is also noted that in East Africa "some of the most talented local personnel were tied up greeting, meeting and generally satisfying donor curiosity, whims, regulations and performance criteria. The care and attention given to visiting missions contrasted starkly with the cursory treatment given to the domestic

[2] They all wish "at the very least to apply an economic, technical and financial appraisal to suggested projects before they start, to engage in subsequent negotiations concerning location, technical specification, training of counterpart staff, phasing of financial contributions and very possibly aspects of the policy environment such as product prices , rail rates, subsidies and commercial policy, to monitor progress through projects, involving the setting up of complex statistical reporting systems; and to evaluate the projects at the end of the disbursement and possibly a few years afterwards as well" . (Mosley, 1987, p. 100)

annual budgeting process" (Carruthers, 1983, p 49). In the same way many talented persons are absorbed into the projects of the donors as counterparts or employees, further undermining the competence of the core organization.

Another factor that has been pointed out many times is the technological proliferation that results when many donors are involved in the same sector. There may also be conflicting conditionalities or cross-conditionalities. All these factors contribute to institutional destruction. Coordination in the form of consultative group meetings, and other meetings on the ground, in the recipient country, will be of some help, but so far progress has been rather limited. Donors want to give identifiable aid, but also the recipients want to be able to play the donors off against each other, to retain more decision-making power.

2.9 Summing Up

Growth-determining factors are investment in physical and human capital, efficiency of resource allocation, and technical progress. Changes in these factors do in turn depend on the character of the policy environment (appropriate prices and macroeconomic stability), on institutions and on governance. Thus, variables to consider are the investment rate; accumulation of skills through education; relative prices such as the exchange rate; macroeconomic stability in terms of budget balance, external balance and monetary stability; institutional structures; and the quality of governance. In this study we will investigate the impact of aid on these variables, and in this context we will also discuss how the character of the aid relationship itself affects the growth impact of aid.

Part 2: THE STATISTICAL PICTURE

3. FOREIGN AID TO TANZANIA

3.1 Total Aid Flows

This chapter presents figures on total official development assistance to Tanzania, based on Swedish and international statistical documents, mainly from SIDA and the OECD. We cover bilateral and multilateral flows, and consider aid by sector, by donor, and by grant and loan structure. Data is presented in time series as far back as we are able to find it.

Since independence, Tanzania has received substantial amounts of official development assistance, in the form of grants and loans, both bilateral and multilateral. Between 1960 and 1991, around 9 billion US dollars (current) was disbursed to Tanzania from bilateral donors (see Table 3.1), while it received a total from all sources of almost 13 billion USD between 1970 and 1992. During the 1990s, Tanzania's share of total global assistance has been around 2.5%, and its share of all DAC assistance to Sub-Saharan Africa has been around 8%. Thus, Tanzania is one of the major recipients of assistance.

From the mid-1970's until the early 1980's, we saw a major expansion in aid to Tanzania. This was the first aid boom. During the first half of the 1980's, however, aid declined, as there was disagreement about economic policy between the Government of Tanzania and most of the donors. In particular, relations with the IFI's were bad, but multilateral aid flows to Tanzania remained substantial even so (see Table 3.1). In the second half of the 1980's, there was again a rapid increase in aid to Tanzania. This was due, of course, to the fact that agreement was reached with the IFI's about a structural adjustment programme, which started in 1986. This second aid boom has continued up to the present, although there is now considerable apprehension among donors about the ineffectiveness of the government. Many are also worried about the consequences of the high level of aid dependence, with aid being about 40% of official GDP. Aid flows are therefore more likely to shrink than to increase in the next few years.

Table 3.1: Net ODA to Tanzania in million US dollars by DAC countries (current prices) and the bilateral share of the flow

	1960	1961	1962	1963	1964
Bilateral	5.42	21.6	36.8	20.2	26.1
Multilateral	-0.04	2.39	-0.01	0.59	5.04
Bilateral share	100	90	100	97	84
	1966	**1967**	**1969**	**1970**	**1971**
Bilat.	24.2	17.8	27.9	37.8	50
Multilat.	1.26	5.81	11.4	13.4	12.5
Bilat. share	95	75	71	74	80
	1972	**1973**	**1974**	**1975**	**1976**
Bilat.	53.4	90.7	140	235	212
Multilat.	7.8	9.7	22.3	67.7	55
Bilat. share	87	90	86	78	79
	1977	**1978**	**1979**	**1980**	**1981**
Bilat.	257	332	457	523	484
Multilat.	58	91	127	127	173
Bilat. share	77	78	80	80	74
	1982	**1983**	**1984**	**1985**	**1986**
Bilat.	485	429	409	373	514
Multilat.	188	150	140	104	161
Bilat. share	72	74	74	78	76
	1987	**1988**	**1989**	**1990**	**1991**
Bilat.	719	782	692	844	768
Multilat.	163	230	225	327	313
Bilat. share	81	77	75	72	71

Sources: DAC geographical distribution, various years.

Note: Data for 1965 and 1968 is missing.

In the six first years of the 1960's, Tanzania's major donor was the UK, which alone (and in some years together with the USA) supplied almost all bilateral aid to Tanzania. In the later part of the 1960's, a lot of other donors emerged, and since 1967 Sweden has been the major donor every year, except for 1970 and 1987. The other Nordic countries, Germany, and the Netherlands have also been important donors, with Italy, Japan and Canada emerging as substantial partners in the 1980's (see Appendix 3A).

Table 3.2 illustrates the importance of Swedish support to Tanzania, especially since the 1970's. Starting from scratch in 1962, it increased to around 10 percent in 1967 and averaged over 20 percent in the 1970's. Sweden's share of bilateral ODA declined to around 15 percent in the 1980's, but then increased to about 20 percent again in the first years of the 1990's.

Table 3.2: Sweden's share of bilateral ODA to Tanzania in per cent of total DAC

Year	Share	Year	Share	Year	Share	Year	Share
1962	0.05	1971	21	1978	19	1985	13
1963	0.80	1972	31	1979	20	1986	21
1964	4.09	1973	36	1980	14	1987	11
1966	6.70	1974	25	1981	16	1988	13
1967	9.90	1975	23	1982	15	1989	13
1969	30	1976	24	1983	16	1990	18
1970	18	1977	22	1984	13	1991	19

Sources: DAC geographical distribution

3.2 Grants and Loans

The grant share of aid to Tanzania has always been larger than the loan element. Table 3.3 shows that the bilateral share of grants is larger than the multilateral share, and that the grant element, in both bilateral and multilateral aid, is high The grants element in bilateral aid between 1985 and 1991 varies between 95% an 99%. In multilateral aid the grants element has been somewhat lower, between 82% and 94%. Donors have obviously realized that the debt-burdened and crisis-ridden economy cannot carry more loans.

Table 3.4 shows the amounts of net official lending since 1960. In the 1960's, almost all official lending was bilateral, but in the 1970's, multilateral lending increased in importance, becoming the dominant form of lending in the 1980's. Since traditionally no debt relief has been given on multilateral loans, the debt service situation will soon become problematic.

Table 3.3: Grants element of ODA and bilateral share of grants

	1985	1986	1987	1988	1989	1990	1991
Bilat.	99	99	95	91	98	96	99
Multilat.	94	85	94	86	88	82	83

Sources: DAC geographical distribution, various years

Table 3.4: Net official lending, millions of US dollars

	1960	1961	1962	1963	1964	1966
Bilat.	4.65	17.2	10.3	10.2	15.6	9.1
Multilat.	--	--	--	--	--	--
	1967	**1969**	**1970**	**1971**	**1972**	**1973**
Bilat.	12.9	7.9	14.3	23.7	13.9	32.4
Multilat.	--	7.0	9.4	8.1	2.7	3.0
	1974	**1975**	**1976**	**1977**	**1978**	**1979**
Bilat.	50.3	82.7	42.7	65.4	-88.0	18.8
Multilat.	12.8	31.7	28.6	52.5	54.5	78.1
	1980	**1981**	**1982**	**1983**	**1984**	**1985**
Bilat.	-84.0	43	56	51.8	46.2	27.7
Multilat.	72.2	107	127	97.3	74.6	41.2
	1986	**1987**	**1988**	**1989**	**1990**	**1991**
Bilat.	-58.0	120.5	55.2	57.6	56	-52
Multilat.	86.5	94.0	116.7	121.7	230	220

Sources: DAC geographical distribution, various years

3.3 Aid By Sector

Table 3.5 shows aid flow to Tanzania by purpose. In the 1990's, the most important sector was economic infrastructure, that is, energy, telecommunications, and transportation. Social sector support has received 7-11%, except for a peak in 1990. Programme aid has varied between 9% and 35%. Production sector support has been between 18% and 29%, and technical assistance between 15% and 31%. Small amounts of aid have been allocated to food support. Debt reorganisation has been of minor importance, except for 1989 and 1990. If we compare this total allocation with the Swedish allocation, we note that Swedish support to the social sector has been larger between 1985 and 1991, while support to economic infrastructure has been less (see Table 3.6). However, Swedish assistance to economic infrastructure has increased in recent years up to the same level as in OECD countries. Swedish production sector support has been in line with that of other donors, while the most striking differences is the very large share of multisector/programme aid in Swedish aid to Tanzania.

Table 3.5: Aid by sector in percent, all ODA

	1985	1986	1987	1988	1989	1990	1991
Social sector	10	7	8	9	7	16	11
Economic infrast	21	24	29	9	24	26	37
Prod. sector	29	22	18	24	21	21	25
Techn. coop.	26	18	17	20	31	17	15
Progr. aid	11	26	17	35	10	9	12
Debt reorg.	0	0	8	2	3	10	1
Food aid	3	1	1	1	0	1	0

Sources: DAC Geographical Distribution, various year

Table 3.6: All official development finance, compared to Swedish aid 1985-1991, by main sectors in per cent

	All ODF	SWEDEN
Social sectors	10	19
Economic infrastructure	24	9
Production sector	23	24
Programme assistance	21	42

Source: OECD Geographical Distribution of Financial Flows to Developing Countries, various years, and SIDA, BSD

Appendix 3A: Net ODA to Tanzania by Main Donor, in millions of US dollars

	1970's	1980's	1990-1992	Total	%
Bilateral	**1,865**	**5,419**	**2,416**	**9,700**	74.15
of which:					
Sweden	422	780	386	1,588	12.14
Netherlands	246	607	202	1,055	8.07
Germany	252	533	205	990	7.57
Norway	150	566	271	987	7.55
Denmark	194	475	263	932	7.13
UK	102	441	197	740	5.66
Italy	4	486	210	700	5.35
Japan	51	453	171	675	5.16
Canada	177	300	96	573	4.38
Finland	70	291	127	488	3.73
USA	167	174	101	442	3.38
Multilateral	**476**	**1,632**	**1,159**	**3,267**	**24.98**
of which:					
IDA	175	736	584	1,495	11.40
UN	129	308	156	593	4.43
EC	82	342	195	619	4.76
OPEC	11	97	4	112	0.86
TOTAL	**2,352**	**7,148**	**3,579**	**13,079**	**100**

Sources: OECD, Geographical Distribution of Financial Flows to Developing Countries.

4. SWEDISH DEVELOPMENT ASSISTANCE TO TANZANIA

4.1 Time Series of Swedish Aid to Tanzania

Tanzania was one of the earliest recipients of Swedish aid and, since SIDA's formation in 1965, Tanzania has been one of its main aid recipients. In fact, Tanzania has received more from the Swedish aid budget than any other country: a total of 18,414,977,000 Swedish kronor (in 1993 prices) during the period 1965/66 to 1992/93, of which 17,669 million was channelled through SIDA.

The volume of aid to Tanzania increased rapidly up to 1974/75, and then remained rather constant for a decade. Sweden thus supported Tanzania consistently through the crisis period of the early 1980's, when some other donors reduced their aid because of disenchantment with economic policy. When Tanzania failed to reach an agreement with the IMF during the first half of the 1980s, Tanzania could still rely on Nordic and other sympathetic countries for aid. By tacitly sympathizing when Tanzania rejected the IMF's demands, these donors made it possible to delay economic adjustments at least until 1984. Pressure on Tanzania increased when the Nordics around 1983 also made it clear that they felt that the overvaluation of the currency was a serious problem, and that Tanzania should undertake a comprehensive structural adjustment programme.

During the mid-1980's, Tanzania entered into an Economic Reform Programme supported by the whole spectrum of donors. Swedish disbursements increased, along with those of other donors, during the second half of the 1980's, and reached a peak in 1989/90 at 1,047 million SEK in fixed 1993 prices. This of depended primarily on a large reservation, but the Ministry of Foreign Affairs also disbursed substantial amounts of balance payments support that year. The allocation from SIDA to Tanzania from 1994/95 to 1996/97 is planned by SIDA to be 550 million SEK annually, which is a substantial reduction in fixed price disbursements (see Table 4.1).

Table 4.1: SIDA aid and all Swedish aid to Tanzania (in thousands SEK) in fixed 1993 prices

	SIDA	All Sweden
1965/66	45,454	
1966/67	135,042	
1967/68	75,148	
1968/69	185,236	
1969/70	251,818	
1970/71	277,059	
1971/72	344,621	
1972/73	464,426	
1973/74	591,333	
1974/75	812,291	
1975/76	831,592	
1976/77	900,505	
1977/78	756,028	
1978/79	906,286	
1979/80	853,490	
1980/81	680,063	
1981/82	982,774	
1982/83	782,497	
1983/84	865,145	
1984/85	797,038	
1985/86	692,253	950,064
1986/87	818,980	908,136
1987/88	714,316	833,235
1988/89	710,772	885,867
1989/90	1,025,530	1,047,034
1990/91	772,931	790,078
1991/92	831,140	856,526
1992/93	565,267	606,190
TOTAL	17,669,035	18,414,977

Sources: BSD 1992/93

Disbursements as a percentage of allocated funds vary from a high of 123.8% in 1989/90 to a low of 70.4% in 1992/93 (see Table 4.2). Slow disbursements are normally due to problems and delays in projects, but it is of course rational to hold payments back in that case, rather than trying to reach disbursement targets at all costs. However, taking all years together, virtually all allocated money has been disbursed.

Table 4.2: Percent of country budget disbursed

Year	Percent disbursed	Year	Percent disbursed
1971/72	95.6	1982/83	93.2
1972/73	106.0	1983/84	106.3
1973/74	110.4	1984/85	104.8
1974/75	108.1	1985/86	92.2
1975/76	90.6	1986/87	101.2
1976/77	109.7	1987/88	86.5
1977/78	93.3	1988/89	93.0
1978/79	101.9	1989/90	123.8
1979/80	91.8	1990/91	97.0
1980/81	80.0	1991/92	99.7
1981/82	112.4	1992/93	70.4
		1993/94	60.0
		Total	**99.6**

Sources: BSD various years; figure for 1993/94 from SIDA.

Table 4.3: Reservations, million SEK (current prices)

	1989/90	1990/91	1991/92	1992/93	1993/94
Country Frame	540	550	585	530	445
Reservations	195.2	66.5	83	-	-
Reservations as percent of total	26.0	10.8	12.4	-	-

Sources: SIDA direktionspromemorior

Reservations (unused funds from previous years) vary overtime, but are on average substantial (see Table 4.3). Reservations have been caused by different factors. The one for 1992/93 was mainly due to a delay in payments for bas turbines, while the one for 1993/94 was caused by the freeze on import support payments during an 18 month period.

4.2 Swedish Aid by Authority

Up to 1984/85, almost all Swedish aid to Tanzania, and even now, about 94% of total aid since the start, has been allocated by SIDA. Today other authorities are involved in the distribution of aid, but their role is still very small compared to SIDA. Overall, about 94% of total aid from Sweden to Tanzania since the start has been channelled through SIDA. Table 4.5 shows that between one and two percent of aid has been disbursed by SAREC, but no other authority, except for the Foreign Office (UD), which decides on substantial amounts of balance of payments support[1], comes up to one percent of disbursed aid. It is therefore natural to concentrate this review on SIDA support to Tanzania, although we will also comment briefly on e.g. SAREC support.

[1] When decisions about balance of payments support are taken by the Foreign Office, it normally instructs SIDA to administer the support, that is to enter into agreement with the recipient, to pay out the money and to follow up the agreement.

Table 4.4: Disbursements by authority, in thousands SEK (current prices)

	SIDA	SAREC	UD	BITS	IMPOD	SWEDE FUND	SWEDE CORP
1986/87	555,895	5,480	50,000	0	62	5,141	-
1987/88	519,737	5,993	72,800	5,318	430	1,985	-
1988/89	551,054	13,683	115,600	5,318	139	1,006	-
1989/90	872,145	12,798	0	4,525	0	965	-
1990/91	723,785	13,651	18,500	420	260	1,726	-
1991/92	793,907	16,280	0	4,436	0	0	3,533
1992/93	565,267	17,301	7,310	4,039	-	0	12,273

Source: BSD

Table 4.5: Disbursements by authority in percent of disbursed aid

	SIDA	SAREC	UD	BITS	IMPOD	SWEDE FUND	SWEDE CORP
1986/87	90	0.8	8.0	0	0.01	0.8	-
1987/88	86	1.0	12.0	0.8	0.07	0.3	-
1988/89	80	2.0	17.0	0.7	0.03	0.1	-
1989/90	98	1.3	0	0.5	0	0.1	-
1990/91	95	1.8	2.4	0.1	0.03	0.2	-
1991/92	97	2.0	0	0.5	0	0	0.4
1992/93	93	2.8	1.2	0.7	-	0	2.0

Sources: BSD various years

4.3 Swedish Aid by Channel

Most Swedish aid has been bilateral and on a grant basis. As can bee seen in Table 4.6, the importance of Swedish non-governmental organizations has increased. In the beginning of the 1970's, when distribution of government aid by NGO's started, they distributed less than one per cent of total aid. In the 1980's their share of disbursements increased, and today about 8% of Swedish bilateral aid to Tanzania is disbursed through NGO's. The most important Swedish NGO's in Tanzania have been Christian organizations and volunteers. In 1991/92 73% of NGO assistance was handled by the Pentecostal Movement (PMU) and the Swedish Missionary Council (SMR) (see Table 4.7).

Table 4.6: Disbursements to Tanzania via NGO's

	Thousand SEK	Percent of SIDA disbursement to Tanzania	Percent of Swedish bilateral aid to Tanzania
1972/73	630	0.6	Same as SIDA 1972-84
1973/74	200	0.15	
1974/75	1,839	0.9	
1975/76	3,628	1.6	
1976/77	4,100	1.5	
1977/78	3,726	1.4	
1978/79	4,435	1.3	
1979/80	4,561	1.3	
1980/81	8,843	2.8	
1981/82	14,252	2.9	
1982/83	15,771	3.7	
1983/84	19,043	3.7	
1984/85	19,630	3.8	
1985/86	24,826	5.4	3.9
1986/87	35,154	6.3	5.6
1987/88	36,242	6.9	6.0
1988/89	39,459	7.1	5.7
1989/90	37,990	4.3	4.2
1990/91	49,267	6.8	6.6
1991/92	42,323	5.3	5.1
1992/93	48,937	8.7	8.1

Sources: BSD various years

Table 4.7: Assistance by NGO's 1991/92, in percent of NGO allocations, and in thousands SEK

	Percent of NGO allocations	Thousand SEK
AG	0.1	57
LO/TCO	1.4	578
PMU	43	18,167
SCC	1.5	601
SHIA	5	2,160
SMR	30	12,639
SRK	2	957
SVS	11	4,605
Other NGOs	5.6	2,559
TOTAL		42,323

Sources: BSD

4.4 Swedish Aid by Sector

The agriculture sector accounted for about 20% of aid in the 1980's, while industry accounted for the largest growth in sectoral share since the late 1970's. Table 4.8 shows the high average level of import support, and a relatively low engagement in agriculture. However, rural water supply also makes up a substantial part of the aid flow, and education has received a relatively large share of Swedish aid. Over time there has been a shift away from project assistance, towards programme assistance.

Table 4.8: Disbursements in thousands SEK at current prices to Tanzania by major sectors, 1965-1993 (country frame)

Social Sector: 2,071,318 = 25%
Education: 12% Health: 2% Water/Sanitation: 10%
Economic Infrastructure: 682,460 = 8%
Transport: 1% Communications: 1% Energy: 6%
Production sectors: 2,125,165 = 26%
Agriculture: 10% Industry: 16%
Administration and management: 594,101 = 7%
Banks: 3.5% Central administration: 3.5%
Multi sector: 2,706,807 = 33%
Import support: 31%

Sources: BSD 1992/93

Within the social sector, education and water supply are the dominant areas, and almost 90% of social sector aid is allocated to these two categories. Some health projects have also received substantial amounts of support, but today almost all health support is included in the water and sanitation projects. Economic infrastructure support includes communications, transport and energy sectors. Within the production sector, about 40% of support has been allocated to agriculture and 60% to industry. There has been a large Swedish involvement in forestry, soil conservation and environmental support. In the industry sector, Sweden has supported both large-scale

and small-scale industry projects, as well as training and education. In administration and management support, almost all aid has gone to banks (the Tanzania Investment Bank and the National Bank of Commerce) and to the development of public administration. Since 1989/90, all support is for public administration development. In the multisector category, most support is import support. Since 1965, just 4.5% of multisector support has consisted of other aid, for example, in export promotion. We will describe Swedish involvement in more detail in Chapter 5.

The major share of aid by SIDA has been allocated within the "country frame". Aid allocated outside the country frame was of less importance during the 1970's. However, such disbursements have increased since then, and since 1986 they have always been over 10% of total disbursements. In 1992/93, as much as 34% was handled outside the country frame.

Outside the country frame we find allocations for import support (53% in 1992/93), NGO's (25% in 1992/93), and regional programmes (14% in 1992/93), as well as for democracy and human rights, food and emergency assistance, and environmental programmes. Table 4.11 shows the shares of the most important sectors of non-country frame support since 1986/87. The regional support to southern Africa, SADCC support, includes support to strengthen the cooperation between countries in the region by for example strengthening transport capacity. In Tanzania most of this support has gone to the Tanzania-Zambia railway (TAZARA) and Tanzania Harbour Authority (THA). Sweden has cofinanced a project to develop the port of Dar Es Salaam, and since 1986 Sweden has supported a ten year railway rehabilitation project. Evaluations have shown that there are problems in mainly in management and organization and that commercialization is essential for the viability of the institutions. SIDA has complained about the political unwillingness to support the reforms and the lack of "economic knowledge".

Table 4.9: Sectoral distribution over time, as percent of total disbursements (country frame)

	Social sector	Economic infrastructure	Production sector	Administration/ Management	Multi-sector
1965/66	85	0	15	0	0
1967/68	85	0	4	11	0
1969/70	53	28	14	4	1
1971/72	57	19	20	3	1
1973/74	40	14	31	11	3
1975/76	49	3	19	4	24
1977/78	38	6	20	23	12
1979/80	25	9	30	7	28
1981/82	21	1	28	3	46
1983/84	19	3	30	6	42
1985/86	19	8	28	8	38
1987/88	19	9	22	8	42
1989/90	19	6	27	3	45
1991/92	20	13	21	5	41
1992/93	30	32	13	7	17

Sources: SIDA

Table 4.10: Distribution of total SIDA disbursements (in per cent) within country frame and outside country frame

Year	Within	Outside	Year	Within	Outside
1965/72	100	0	1982/83	96	4
1972/73	99	1	1983/84	96	4
1973/74	99	1	1984/85	95	5
1974/75	99	1	1985/86	93	7
1975/76	99	1	1986/87	86	14
1976/77	99	1	1987/88	85	15
1977/78	99	1	1988/89	88	12
1978/79	97	3	1989/90	68	32
1979/80	91	9	1990/91	74	26
1980/81	97	3	1991/92	73	27
1981/82	95	5	1992/93	66	34

Sources: BSD 1992/93

Table 4.11: Aid distributed outside the country frame, by major sectors, (per cent) 1986-92

	86/87	87/88	88/89	89/90	90/91	91/92	92/93
NGO's	46	46	58	19	26	20	25
Region programmes	48	40	27	40	30	29	13
Import support	0	0	0	34	36	46	53

Sources: SIDA and BSD, various years

4.5 Changing Directions of Swedish Aid

In the first years of assistance in the 1960's, much Swedish support was directed to the development of social sectors, including mainly education and health. Assistance to civil service staff was also given, including salaries as well as overseas travel.

At the beginning of the 1970's, the Tanzanian government suggested that Swedish support should be directed mainly towards education and industry. Steps had already been taken to increase Swedish capacity to support education, and support to industry was now also increased, in line with the basic industries strategy. In the mid-1970's, Sweden started to allocate money to import support, to counter increasing balance of payments problems.

Since the late 1980's, the overriding objectives of Swedish assistance have been economic growth, equity, and conservation of the environment. According to the agreed minutes of 1988, the first priority is to support the economic recovery programme introduced in 1986. The main areas of Swedish aid at this time were industry, education, water supply, forestry, public administration, and commodity support. Swedish assistance, has since the late 1980's, been very much linked to the ERP and to agreements with the IMF. In some areas, for example commodity support, Swedish assistance was actually conditioned on Tanzania's agreements with the IMF. Eventually, SIDA also reduced its large involvement in industry. At the beginning of the 1990's, Swedish assistance was increasingly concentrated on support of balance of payments and the government budget, and the linkage of Swedish aid to further reforms in the economy continued.

SIDA has also been concerned about its own administrative burden, due to the large number of projects and programmes. Thus, one important priority in recent years has been to reduce the number of projects within each sector and also to reduce the number of sectors. To achieve concentration, support to the health sector and vocational training are to be phased out, while the number of public administration support activities has been reduced from 8 to 4 since 1989.

Other important issues in the agreements of recent years are the concerns regarding

"efficiency" and the "role of the recipient". Concerning efficiency, SIDA states that, only those projects which can show cost-effectiveness and efficient utilization of aid funds will be able to get continued support. More emphasis will be put on reporting, auditing, and evaluations. To increase involvement of the recipients and to enhance project sustainability (and to reduce costs), more in-country training and more use of local consultants should be promoted.

Part 3: DIRECT IMPACTS OF SWEDISH AID

5. REVIEW OF MAJOR SWEDISH PROJECTS AND PROGRAMMES

5.1 Introduction

In this chapter we discuss Swedish aid on a sector and project level. We have not done any project evaluations of our own, which means that we base our analyses on existing evaluations and reports from various sources. We have selected projects in the social sector, economic infrastructure, production, administration and management, and research. We start by looking at some projects in water, sanitation, health and education. Then we look at activities in energy and telecommunications, which are areas where SIDA is presently deeply involved. We continue with a discussion of Swedish aid to production. Then we look briefly at administration and management support and support to research via SAREC. A short presentation of import and balance of payments support follows, but further analysis is deferred to the macro analysis in Part 4.

5.2 Social Sector Support

In the Arusha declaration of 1967 on "African socialism", the major goals to be achieved were equity and self-reliance, which meant that efforts to improve primary education and health services were put high on the agenda. Government allocations to education and health in the 1970's were substantial: about 20%, compared to 13% in the beginning of the 1990's (see Table 5.1). Access to primary education and health services increased during the decade.

Allocations to the education and health sectors diminished during the 1980's. Today there is a lack of books and other supplies in the schools, teachers are often unskilled, and school buildings are deteriorating. The same picture of decline emerges for the public health sector. Thus, a serious consequence of the recent economic crisis is that the early improvements in the social sector have been eroded.

Table 5.1: Percentage allocation of government expenditure to health and education 1970-1992

Period	Education	Health
1970-1974	13	7
1975-1979	13	7
1980-1984	11	5
1985-1989	6	5
1990-1992	7	6

Sources: Economic Survey and Budget Speeches

About 25% of total Swedish aid to Tanzania has been allocated within the social sector, mainly to education, health and water. In the early years of assistance, disbursements to this sector were a much larger proportion, around 85%, while it fell to around 20% in the 1980's. In 1992/93 it was about 30%. It should be noted, however, that balance of payments support generates countervalue funds that go into the budget. These funds may be allocated to social services, but it is then not possible to specifically identify the eventual impact of Swedish aid.

Now we will consider some specific Swedish activities in the social sector: rural water supply, health through sanitation and water (HESAWA), health including Tanzania Food and Nutrition Centre (TFNC), and education.

5.2.1 Rural Water Supply

SIDA's engagement in rural water supply started in the 1960's. From 1965 to 1984, the programme represented 48% of Swedish disbursements to rural development and agriculture. In the early 1970's, as much as 80% of the overall resources used for rural water supply in the country were contributed by Sweden. There was a political eagerness in Tanzania to get water projects going, because they fitted the villagisation scheme. Today, the Swedish contribution is much less dominant. By the middle of the 1980's, Sweden's investment in rural water had dropped to about a third of the total. Total disbursements to rural water are shown in Table 5.2.

Table 5.2: Disbursement to rural water supply from SIDA at current prices, in millions of Swedish kronor

66/67	**67/68**	**68/69**	**69/70**	**70/71**	**71/72**	**72/73**
5.9	4.2	7.1	18.2	12.9	24.3	26.0
73/74	**74/75**	**75/76**	**76/77**	**77/78**	**78/79**	**79/80**
32.2	22.0	62.5	39.0	49.0	45.0	32.1
80/81	**81/82**	**82/83**	**83/84**	**84/85**		
12.1	30.4	26.6	34.6	39.2		

Source: SIDA, EA-system

The dominant role of Sweden in the water sector makes it possible to say something about the impact and results of Swedish aid, even though Swedish involvement is hard to separate out specifically. Radetzki (1986) concluded that "the activities finally adopted were technically inappropriate or misconceived, and inadequate consideration was devoted to the responsibility for operations and maintenance that would follow the investments financed by the donors". Apart from financial and administrative inability by the government to provide maintenance and operations costs, the diesel-fueled pumps proved a problem in a country which often could not afford to import diesel fuel. There were also problems with competence building, since personnel often left for other occupations once they were trained. The original plan was for free water for all of the rural population before 1992. But by 1984, only 12% of the rural population had access to reliable drinking water, according to to Radetzki's evaluation report..

As early as the mid-1970's, criticism of the programme had emerged, and slowly SIDA's strategy changed, from supporting a nationwide water programme to recommending a regional rural water development programme, concentrating on rehabilitation of existing water installations and local engagement. However, due to very extended "planning and groping", change was slow. In the cooperation agreement ("Samarbetsavtal") for 1981-84,

SIDA abandoned the position that water was to be a free good. Instead it concluded that finance from local communities could relieve the government of excessive financial burdens, and could also improve local participation.

Considering the substantial amounts of money spent and the long time period involved, one must deem results of the rural water supply programme in Tanzania very disappointing. (An evaluation of Dutch aid to the sector reaches the same conclusion.) As Radetzki (1986) concluded in his evaluation:

- One must specify who is responsible for recurrent costs.
- Advanced technological solutions must be supported with adequate facilities.
- For sustainability, local engagement is essential.
- The programme was overambitious, beyond the scope of the government.
- The donor must be careful not to enthuse the recipient into ventures that are above their financial capacity.

In 1985, Tanzania and SIDA decided to concentrate in three regions, and the so-called HESAWA project started.

5.2.2 HESAWA

The HESAWA programme, health through sanitation and water, started in 1985 as an integrated programme of health education, sanitation and water supply in the Kagera, Mara and Mwanza regions around Lake Victoria.

Table 5.3: Disbursement to HESAWA 1985-93, in current prices, thousand SEK

1985/86	33,250	1989/90	37,984
1986/87	30,844	1990/91	31,365
1987/88	31,597	1991/92	27,817
1988/89	38,520	1992/93	36,000

Sources: SIDA, EA-system and Utvecklingssamarbete med SIDA, 1994/95-1996/97

The basis for this programme is local community engagement, instead of reliance on central government support. Sustainability is to be achieved through the use of simple techniques land local financing, material, and resources. Villages are brought into the programme at their own request, and external assistance is offered initially. Villages are supposed to open HESAWA accounts and establish management committees. Apart from developing infrastructure, the programme aims to develop human resources and capacity. Involvement by women is considered central.

Thus far we can summarize some important achievements of the project: 1) Improved access to water in the three lake regions; 2) Acceptance by the government and villagers for using more appropriate, affordable technologies; 3) Increases in knowledge, skills and capacities at local levels for planning, implementing, operating and maintening water supply improvements; and, to a lesser extent, 4) hygiene and health activities.

The project has been evaluated several times, and the conclusions are very much the same: A rather well-functioning programme with a lot of potential. However, there is criticism of the weak data-base and of the limited preparation for phasing out. These conclusions have been reached in several evaluation reports, as early as 1987 and as late as 1993. The sustainability of the programme after SIDA's withdrawal is still an open question. External involvement continues to be substantial. Many people working in the project seem to believe that assistance has to continue for a long period. What can be done to prepare for phasing out? A cornerstone of the project is local cost recovery, but little has been done (after almost a decade) in terms of fee collection. The ambition now is to collect user fees, and the degree of succes in this will be interesting to follow up. We fear that it will be difficult to implement fees when people have got thoroughly used to getting free water. In the future, fees for water should be introduced directly after installation.

SIDA should also analyze what implications there may be to always using the same consultancy firm, which has been working with the project for over ten years. Does the project gain or loose in efficiency, costs, etc.? What happens to the knowledge and "historical memory" of SIDA?

In this project, as well as in others, the donor has chosen to minimize the involvement of central authorities, and instead to concentrate on cooperation with districts and local institutions. This is in line with the Local Government Act of 1982 and the National Water Policy of decentralization of 1991This reflects obvious problems of corruption and the weak government in Tanzania today, and we do appreciate the problem of allocating money through central government if it does not fulfil even the most basic accountability requirements. The procedures chosen thus do increase the efficiency of assistance in the short run, but we still believe it is very important to analyze what will happen in the future, if donors undercut the central government. The local level obviously need to be strengthened, but the question is what effect a weakening of the links to the centre will have.

5.2.3 Education

Despite being one of the poorest countries in the world, Tanzania managed to achieve very respectable enrolment rates and literacy levels during a long period after independence. However, since the middle of the 1980's the situation has deteriorated, many schools have fallen into decay, enrolment rates have fallen, and drop-out rates have increased.

SIDA has supported the education sector in Tanzania since the 1960s. At current prices this has totalled around 1 billion SEK, or 12% of total disbursements from SIDA to Tanzania.

Table 5.4a: Disbursement to the education sector 1965-93, current prices, thousand SEK

Year	Disbursements
65/66	5,386
66/67	14,021
67/68	5,454
68/69	3,813
69/70	2,807
70/71	4,503
71/72	12,619
72/73	13,973
73/74	17,694
74/75	21,300
75/76	35,078
76/77	25,151
77/78	33,391
78/79	44,025
79/80	38,069
80/81	52,702
81/82	62,280
82/83	70,514
83/84	54,408
84/85	51,501
85/86	39,013
86/87	50,410
87/88	47,297
88/89	51,499
89/90	66,706
90/91	74,065
91/92	65,149
92/93	59,633
TOTAL	1,022,461

Sources: BSD various years

Table 5.4b: Education sector aid to selected projects, current prices in SEK

Project	Years	Amount disbursed
Kibaha,KEC	1965-84	33,765,000
Adult education	1971-76	67,806,000
Vocational training	1985-93	189,834,000
Total Education	**1965-92**	**962,828,000**

Source: SIDA, BSD and EA-system.

Note: Adult education includes general adult education, adult education in Kidatu and the institute IAE.

The major areas of Swedish assistance have been vocational training, adult education, and primary school support, which includes primary schoolbook production and teachers training. Most of the support to adult education was disbursed in the 1970's, while support to vocational training was dominant in the 1980's.

Together with Denmark, Sweden has supported and developed vocational training. Support has mainly been in the form of training and education of teachers, aid to central authorities, and to five schools. The direct support to the schools will be phased out during 1994-96, and in line with the goal of concentration, SIDA will phase out vocational training completed during 1996/97. Support to adult education has already been phased out, since it was considered to be the least efficient form of education support according to several evaluations. One general criticism of Swedish support, which has come up in several different evaluations, is that education and training often have been expensive, and sometimes too advanced. In post-literacy programmes and adult training, many persons in the target groups did not feel that they had the time to attend courses, and they also complained that it was too expensive for them to attend. In the area of schoolbook distribution, there have been large problems with management and organisation. Evaluations, therefore, have recommended that private firms should get involved in production and distribution of books.

Despite the substantial amounts of money put into education by Sweden and other donors plus the government of Tanzania, the average education level remains low. Large improvements took place in the first decades of independence, but the current downward trend in education is very worrying. Problems with low salaries and delayed payments to teachers have decreased the status and the standard of teaching. There is an urgent need for supplies in the sector.

Today even the ability to of maintain the existing resources is in question, let alone initiating any new education projects that might be desirable. Especially alarming is the problem with primary education, which must be considered a top priority for a country such as Tanzania. Aid to education should now focus on the restoration of the primary school system, which is vitally important for economic development in general. A good primary system is also the necessary basis for higher education.[1] The current support is aimed at the supply of teaching materials and the further education of teachers. These programmes support primary education and have a national coverage, which is appropriate in the current educational crisis.

5.2.4 Health

Health sector support was until June 1994 divided in three main categories: support to Tanzania Food and Nutrition Centre (TFNC), support to fight against HIV/AIDS, and support to district health care through the UNICEF programme for Child Survival and Development (CSDP) in Mwanza and Mara. The support to the health sector from July 1994 is concentrated on only TFNC. A final support for the programme against HIV/AIDS will be given until December 1994 and is thereafter terminated. We will confine our discussion to support to TFNC, which is an interesting example of institution building. HIV/AIDS has also received substantial aid in recent years through different organizations, such as the national programme (NACP), the African Medical Research Foundation (AMREF), and Svenska Kyrkans Mission (SKM). Disbursements to the health sector are shown in Table 5.5.

[1]There is somesupport from both SIDA and SAREC to University of Dar Es Salaam.

Table 5.5 Disbursement from SIDA to the health sector, in million SEK

	1965-78	1979-86	1989-93
TFNC		21	20
HIV/AIDS			30.5
Total	53	72	61 (1989-92)

Source: SIDA EA-system, BSD and Resultatredovisning 1993, SIDA.

The Tanzanian Food and Nutrition Centre started in 1974 as a parastatal under the Ministry of Health. The major functions of the centre were: 1) planning and initiation of food and nutrition programmes; 2) reviews and revisions of food and nutrition programmes; 3) training related to food and nutrition; 4) research; and 5) advising the government and the public institutions.

The changing economic and political environment in Tanzania has also changed the environment for institutes such as TFNC. TFNC's claim on the government's total health budget has increased, but these resources are far from enough to maintain operations. As can be seen in Table 5.6, funds from Tanzanian sources, such as the government and internal funds, cover just 28% of the centre's budget. However, the increased allocation from the government's health budget, in a time of serious economic problems and budget cutbacks, shows a willingness from the government to support the centre. But forecast when and if the centre can be totally funded from local sources is difficult. As in many institution-building projects in Tanzania, external funds seem to be needed for a very long period.

Table 5.6: Contribution to the TFNC budget, 1986-92

Tanzanian Government	24%
SIDA	48%
Other donors (mainly UNICEF)	24%
Internal funds	4%

It seems that the centre today is functioning well, and problems that were discovered in evaluations in the 1980's are to a large extent solved. The staff is well educated, and there has been little problem with brain drain. Performance that can be measured shows rather good results. The UN's committee on nutrition, ACC/SCN, reports that malnutrition among children under age five has decreased in regions where TFNC and UNICEF collaborate. Also, investigations made by TFNC show improvements in nutrition standards in regions where work has been done by the Centre.

Sustainability of institutions is primarily linked to the financial capacity of the recipient country. Often, too optimistic estimates are made as to the time required for a project to become self-financed. According to the evaluation report of 1991, 20 years is a short period of time for building a solid institution. Continued support for the next five years is planned. This indicates the long-term aid implications in giving aid to this kind of project.

5.3 Economic Infrastructure Support

Economic infrastructure support has been around 8% of total Swedish disbursements between 1965 and 1992. There was no such aid in the 1960's. It then increased to in average 20% in the first half of the 1970's, decreased to under 10% in the 1980's, and increased again in the first year of the 1990's. For the budget year 1992/93 it was about a third of Swedish disbursements to Tanzania, and it will be a major area for Swedish assistance in coming years. As noted above, substantial regional support has also been given to the port of Dar Es Salaam and TAZARA. The most important areas for Swedish economic infrastructure support today are energy and telecommunication support. We will describe the energy support including Pangani power plant, and telecommunications support.

5.3.1 Energy Support

Sweden has been involved in the energy sector in Tanzania since the beginning of the 1970's, both in capacity-building and in maintenance of power plants, often together with other donors, mainly the Nordic countries and the World Bank. Energy support is still a major

area for SIDA support to Tanzania. 557 million SEK has been allocated for the energy sector to be disbursed between 1984 and 1997. About 299 million SEK of that had been disbursed up to 1993. Between 1985 and 1990, demand for electricity increased by about 10% per year, and between 1992 and 2002 the World Bank estimates demand will continue to increase about 4.5-6% per year. Rapidly rising demand for electricity in recent years has led to power shortages. In a report on power in 1993 the World Bank argues that this will have large negative consequences for economic recovery programmes in Tanzania. The shortage of energy in Tanzania is thus a serious growth constraint.

The major recent project has been the power plant in Mtera, which was supported with 130 million SEK from 1984 to 1994. The plant has been in use from 1988. Large investments have also been made in the power plant at Pangani, further discussed below. In the period from 1992 to 1996, SIDA will also support gas-turbines in the Dar es Salaam region to alleviate the energy shortage caused both by drought and by increased demand. Moreover, 90 million SEK has been allocated to studies, seminars, consultancies and reports, through UNDP/the World Bank (ESMAP) and the Stockholm Environment Institute (SEI), between 1988 and 1995, to increase efficiency and to facilitate awareness of environmental aspects in the energy sector.

5.3.2 Pangani

The shortage of electricity in Tanzania in the beginning of the 1990's led to discussions on how to increase the supply of energy. Among the options considered, the redevelopment of Pangani Falls hydropower potential was found to be the best. Cost-benefit analyses suggest that this project is highly profitable, with rates of return in the range of 20%.

This seems to be a well-functioning project. It has a form of donor coordination and cooperation that we believe should increase in the future. The Norwegian, Swedish and Finnish aid agencies are all contributing to the project but, instead of each of the three donors administering their own assistance themselves, NORAD has responsibility to administer project work and to negotiate with the recipient country, and then to report to the other two donors, SIDA and FINNIDA.

Table 5.7: The preliminary disbursement schedule for Pangani in NOK (millions)

	TOTAL	NORAD	FINNIDA	SIDA
1990/91	148	83	28	57
1992	153	64	50	47
1993	222	87	79	52
1994	190	66	77	34
1995	88	37	29	12
1996	11	5	4	2
1997	8	3	3	1
TOTAL	820	345	270	205

Sources: Insatspromemoria 1991-10-08, SIDA, ANNEX 1, Regeringsbeslut

The Tanzanian Electric Supply Company, TANESCO, has been involved in the work from the beginning, and has been the contractor in the construction of the lines. About ten Nordic consulting companies have assisted with the procurement of materials and with construction management. Thus, technology transfer and training of TANESCO personnel have been a natural part of the construction work. Another important part of this project is water management and environmental protection. Water management of the entire Pangani river basin is being organized as a vital part of the project, and the Pangani Basin Water Office has been created to supervise water use. An important part of water use management is stopping illegal abstractions, the registration of water rights and the introduction of water fees. However, as in the case of HESAWA, the concept of user fees is difficult to implement. Many people working in the project have doubts about the possibility of successfully collecting user fees. Here again, one should implement fees as soon as possible, before people get used to getting the water free of charge.

Besides transmission lines, which are provided by TANESCO, dependence on foreign skills and funding is high. TANESCO finances local costs, while donors provide for international costs. In the 1991 budget, the foreign component was 100 million USD and the local

component from the Government of Tanzania about 3-4 million USD. NORAD contributed 42% of the foreign component, FINNIDA 33% and SIDA about 25%. SIDA has allocated to Pangani 193 million SEK, to be disbursed between 1991 and 1997. Of this, 130 million SEK has already been disbursed (see Table 5.7).

Construction of the power plan seems to have run relatively smoothly. However, sustainability and economic return on the investment will depend on the efficiency of the power company handling it. Therefore Sweden has joined the World Bank in a policy dialogue about commercialization. TANESCO has improved its financial managment since this work started, and it is now working under a performance contract which states the Government's required return from the company. The process of commercialization will, however, take time. It is a much more difficult undertaking than the actual plant construction.

5.3.3 Telecommunications

The telecommunications sector is one of the high-priority areas in the Economic Recovery Programme (ERP). Sweden has contributed to the telecommunications sector since the 1970's. It began with an IDA credit, together with the World Bank, and has increased since then. Now SIDA concentrates on maintenance of existing facilities and on developing and commercialisation of the national telephone company. Disbursement to this company between 1981 and 1992 is shown in Table 5.8.

Table 5.8: Disbursement to the national telephone company, current prices, thousands SEK

81/82	82/83	83/84	84/85	85/86	86/87
1,928	5,7938	6,712	8,034	8,465	10,681
87/88	88/89	89/90	90/91	91/92	92/93
11,465	13,176	11,801	12,094	9,741	

Sources: SIDA, EA-system and Resultatredovisning, 1993.

Support to the telephone company (TTCL, previously TPTC) aimed to reconstruct the company and to make it more effective and professional. Education and development of staff resources at all levels is central. Managerial competence is low and needs to be improved. There are also problems with maintenance. Latelly, there is a concentration of efforts on the development and commercialisation of TTCL. No evaluation of telecommunications support has been done, but in SIDA's presentation of results in 1993, it is concluded that willingness to reform within the telephone company has been low, due to lack of economic incentives. Reforms have been implemented only because of donor pressure. As with Pangani and TANESCO, SIDA has joined the World Bank in a policy dialogu, and here also there seems to be some improvement. The degree of progress in this area is going to be a major determinant of the success of the reform process in Tanzania.

5.4 Production Support

For a period after independence, economic policies remained unchanged, but then with the Arusha declaration of 1967, there was a shift away from the previous liberal economic policies. The agricultural sector was now to be transformed from individual ownership and management to communally-planned farming in a huge villagization programme, creating the so-called Ujamaa villages. The villagization programme was initially voluntary, and these reforms created little disruption in the beginning. The nationalization programme in other sectors was also implemented gradually, and companies were compensated in the nationalization process. However, between 1973 and 1979 the reforms quickened, and in 1975 the Basic Industries Strategy became a key component of the national development strategy. Instead of market forces, reliance on administrations and controls increased. The industrialization strategy also meant large import requirements, at the same time that the export sector was squeezed.The strategy was not viable.

A larger share of Swedish support to production has gone to industry than to agriculture. As we saw in Chapter 4, about 26% of all Swedish aid has been allocated to production, of which 16% went to industry and 10% to agriculture. In the industrial sector, Sweden has supported both large-scale and small-scale industry projects. We will discuss two, the sister

industry project and the Mufindi paper mill. Other Swedish production sector support has gone to forestry, soil conservation and environmental protection, and to the Nordic Cooperative Project.

5.4.1 Mufindi

Southern Paper Mills (SPM) in Mufindi is the best known industrial project in Tanzania which has received financial support from Sweden. The plant was initiated by the World Bank and several other donors. Sweden contributed 200 million SEK to the total initial investment costs of about 240 million USD. In 1983 the World Bank, German KfW and Sweden contributed another 40 million USD (Sweden's share was about 100 million SEK) for running expenses, and in 1990 Sweden contributed another 65 million SEK. Unfortunately, Mufindi is a major economic failure.

Table 5.9: Disbursement to MUFINDI from SIDA

	Thousand SEK
1979/80	7.5
1980/81	34.3
1981/82	53.8
1982/83	49.2
1983/84	66.4
1984/85	28.3
1985/86	14.9
1986/87	19.4
1987/88	14.9
1988/89	7.1
1989/90	4.0
1990/91	24.4

Source: SIDA , Economy division

Since the start in 1986, SPM has run with heavy losses, often around 100 million SEK per year. Initially, external problems such as lack of railway capacity hindered production. However, internal problems such as poor management and bad maintenance have also contributed to the poor results. Production costs are simply too high for the firm to be competitive. Since recommended reconstructions did not improve results, both Germany and the World Bank stopped assistance, followed by Sweden in 1992. Today, Tanzania is trying to privatize the mill, but there does not seem to be any willing buyer.

With the results in hand, it is obvious that Sweden and the other donors should never have supported this large-scale industrial project. The donors failed to appreciate the problems of running such a big firm in the Tanzanian economic environment. Sweden was also slow to cut support to the project. SIDA does not seem have to have done its own analyses of the project, but has relied on the judgements of the other donors involved. In many documents (eg "agreed minutes"), problems are discussed, but SIDA states that it will continue support if agreement can be reached between Tanzania and the other donors.

5.4.2 The Sister Industry Programme

Since the 1970's, Sweden has supported small-scale industrial development through the Tanzanian Small Industry Development Organization (SIDO), 90% of whose budget is supported by SIDA. The major part of the programme has been the Sister Industry Programme (SIP).

The Sister Industry Programme was very different from the large-scale Mufindi project. This programme aimed to establish locally managed, small-scale industries in Tanzania with assistance from Swedish small industries, so-called "sister industries". By technology transfer from small industries in Sweden to sister industries in Tanzania, the programme aimed to build a Tanzanian manufacturing sector. The programme started in 1976 and continued to 1991, but from 1992/93 onwards, no SIDA assistance is directed to the sister companies. However, SwedeCorp still supports some projects within SIDO.Initially SWEDECORP also offered some small support to the sister firms to finance consulting services which previously had been free, on the condition that the firms themselves paid 10% of the cost. No firm was then interested.

The first outline of what was to become the SIP was made in 1976 by a team lead by B. Sandkull, who recommended a sister approach as a tool for technology transfer. Three objectives were considered especially important, namely utilization of local resources and skills, raising technology levels in rural areas, and undertaking production for import substitution.

The first sister industry started under SIDO in Arusha in 1978/79. After ten years of sister industries support, a SIDA evaluation concluded that results were very mixed: Many companies faced large management problems and were in urgent need of reconstruction. Most of the industries were kept alive through import support. SIDA also concluded that, if measures to boost production were not undertaken, there would be a continuation of capital out-flow from the industries into more rewarding activities. Thus, at least one evaluation report pointed out specific problems to be solved if the project were to become more efficient, but little was done. So, when a new evaluation was done in 1991, criticism was massive: "The sister industries are, however, neither small scale or rural nor private sector nor innovative, and the programme cannot possibly be considered a lucky move, at least not for Tanzania". It was also pointed out that around 90% of the 700 million SEK disbursed from the beginning of the project up to 1991 had been for purchases in Sweden. In 1992 SwedeCorp took over the SIDO support and reduced assistance to less than a third the following year. No funds were disbursed directly to sister industries.

5.4.3 Other Production Support

Finally, we just note that substantial support has also been given to forestry, soil conservation, environmental protection, and to the Nordic Cooperative Project, as can be seen in Table 5.10. We have not reviewed these projects, but it was obviously very difficult to get the cooperative project to work in the policy environment which existed in the 1970's and early 1980's.

Table 5.10: Disbursements to the Nordic Cooperative Project, agriculture, forestry, and fishing (thousands SEK)

Year	Total agriculture, forestry and fishing	Of which to the Nordic coop. project
65/66	1,010	0
66/67	223	0
67/68	478	0
68/69	776	0
69/70	5,307	2,868
70/71	3,930	986
71/72	12,223	2,218
72/73	28,361	1,497
73/74	34,766	1,878
74/75	34,052	1,138
75/76	43,326	2,286
76/77	28,345	2,607
77/78	33,580	535
78/79	28,207	599
79/80	42,788	11,431
80/81	30,211	3,427
81/82	32,193	5,247
82/83	42,352	9,442
83/84	29,641	2,856
84/85	52,000	17,003
85/86	34,555	11,479
86/87	49,224	15,000
87/88	22,699	0
88/89	35,005	15,135
89/90	66,064	32,169
90/91	39,320	0
91/92	37,792	0
92/93	40,356	0

Sources: SIDA BSD and EA system

5.5 Administration and Management Support

Since the late 1960's, Sweden has given technical support to administration and management. About 7% of Swedish assistance between 1965 and 1993 has been allocated to this sector. At the beginning of the 1980's, support concentrated on institution building, primarily central administration and banks.

Support has mainly been in the form of cooperation between Swedish and Tanzanian institutions, for example, between the economic departments of the University of Lund in Sweden and the University of Dar es Salaam, between the Swedish Central Bureau of

Statistics (SCB) and its Tanzanian counterpart (Takwimu), and between Bohlins in Sweden and the Tanzania Audit Corporation.

Swedish assistance has included:

- *Support to improve the budget process*

From 1986 to 1993, 14.7 million SEK was disbursed. This has strengthened the capacity of the Ministry of Finance and the Planning Commission to handle the reform process. Education of personnel and introduction of computers in the budget process are major achievements.

- *Central Bureau of Statistics (Takwimu)*

From 1983 to 1993, 51 million SEK was disbursed. The main goal of this assistance has been to improve the capacity of the statistical bureau. The competence of Takwimu has increased, but still it can not function properly without external assistance.

- *Higher education in economics*

From 1980 to 1993, 25.4 million SEK was disbursed. Support has aimed to increase the quality of education in economics at the University of Dar es Salaam. Since the start of financial support, 12 doctoral degrees in Economics have been granted, and dependence on foreign staff members has decreased. It also seems that the department has played an important role in the economic reform process.

- *Tanzania Audit Corporation (TAC)*

Between 1989 and 1993, 14 million SEK was disbursed. Support has aimed to educate personnel and to introduce computers. Quality of audits has improved, and TAC tries to use internationally acceptable methods.

- *Institute of Tax and Administration (ITA)*

From 1985 to 1993, 13.4 million SEK was disbursed, mostly for education of tax and customs personnel.

- *Bank of Tanzania*

From 1988 to 1993, 11.5 million SEK was disbursed. The Export and Transit Trade system has been developed. Improved education of personnel has increased efficiency, and has increased the possibility of managing without external help in the future computerization process.

- *Tanzania Bureau of Standards (TBS)*

From 1979 to 1993, 80 million SEK was disbursed. Among management and administration projects, TBS has received the most Swedish support. (It was initially a project within the industry support.) We will discuss this institute in greater detail below.

From 1993 to 1996, SIDA plans to reduce annual support from 30 million SEK to an average of 18 million SEK, and to reduce areas of support from 11 to 4 (plus planning and evaluations). These changes are in line with the goal of concentration and the reduction of the Swedish country frame for Tanzania. Aid will be concentrated in areas which support the structural adjustment programme (ERP 2), including support to the Budget Management Development Project (13 million SEK), the Government Accounts Development Project (14 million SEK), TAKWIMU (18 million SEK), and doctoral education in economics (6.5 million SEK). Programmes in public administration such as these will hopefully help to improve the government's administrative and accounting systems. Such improvements are obviously crucial if the government is to become accountable and effective. Progress on these fronts will facilitate the integration of de-linked projects and programmes into the normal administrative system, and it should thus also contribute very much to sustainability of projects generally.

5.5.1 Tanzanian Bureau of Standards

The Tanzania Bureau of Standards (TBS) was established in 1975. The Tanzanian government sought technical assistance from the Swedish government, and a bilateral agreement was signed. The Swedish Standards Institute (SIS) was commissioned by SIDA to act as the executing agency, through SIS Service AB. Between 1979 and 1992, 80 million SEK was disbursed, and three five-years agreements have been concluded.

The 1979-83 period included design and construction of the TBS office and laboratories, training of personnel, and delivery of equipment and materials. In the 1984-88 period, more training was carried out. Staff housing was completed, and a materials testing laboratory was constructed and began operation. Training continued between 1989 and 1993, and more

equipment was delivered. A packaging technology centre (PTC) was built.

During the first phase, the standardization work was concentrated on domestic consumer products and onindustrial products for the domestic market. In later years, work was diversified to cover commodities for export. For a long time, the sale of standards has been very low, but recently there have been marketing efforts to increase sales.

TBS offers calibration services in the areas of mass, length, volume, temperature and pressure. TBS also handles tank calibration for all Tanzanian oil dealers. Since 1984, almost 1000 industrial workers have been trained. Technical assistance is also provided by TBS to exporters.

However, after almost 20 years, TBS has a long way to go. It has to work more towards the market, towards paying customers and creating its own funds. Over the years, the proportion of internally created funds has caught up with government subsidies. SIDA grants, however, have always been the dominant support.

PTC was initiated because packaging standards are poor in Tanzania, and increasing the quality of industrial packaging was seen as necessary to increase exports. However, since SIDA has now phased out its support to the institute, no more equipment has been bought, and the packaging technology centre building remains incomplete and empty. The government has now, however, decided to allocate 45 million TZS to finish the PTC plus 100 million topay outstanding credits and current costs. It seems, that TBS, in spite of its problems, is on the whole a technically rather well-functioning institution. But, it remains to be seen if it will be sustainable. The TBS budget cannot be met through self-generated funds in the short-run, and if external funds are not coming in, there is a risk that activities will be closed down or that the quality of work provided by the bureau will decline.

This is a good example of the sustainability problem. There is a risk that this institute is too advanced, has too large running expenses and has capacity too large for the existing Tanzanian market. Most of the equipment installed and spare parts required are not produced in Tanzania, which means that imports are necessary. At the same time, the government does not feel pressure in the short- run if an institution such as this one runs down. TBS therefore tends to get put way down on the list of priorities. A proper analysis of the recurrent cost implications, and of the willingness and ability of the government to take these over later, must be made before such a project starts.

5.6 Import Support

Economic crises in the late 1970's led to adoption of structural adjustment reforms. Already in 1982, some structural adjustment measures were initiated, including liberalization of marketing and distribution. Fiscal and external balance reforms were implemented in 1984. Relations with the IFI's were poor in the late 1970's, but they improved somewhat in the 1980's. An Economic Recovery Program was designed in 1986, together with the World Bank and the IMF. The program involved relaxed state control and abolition of the state monopoly in grain purchasing, price reforms in agriculture, and reduced import controls.

Sweden contributed import support during the economic crises to relieve the foreign exchange shortage. This was done to enhance capacity utilisation and to contribute to the rehabilitation of the existing capital stock. A major concern about commodity import support (CIS) was that it was not used to foster structural change in the industrial sector, but rather simply to preserve that heavily protected sector. Between 1988 and 1992 a large proportion of support (as much as 74% of Swedish CIS) went to parastatals, and only 24% to the private sector. Firms also got the foreign exchange at subsidised rates, since importers paid in local currency at the official rate, which was lower than the parallel market rate. Moreover, many importers did not even pay their cash cover, so that CIS allowed the government to subsidize loss-making enterprises.

Table 5.11: Disbursements to import support/commodity support in thousand SEK

Year	Tied	Untied
72/73		4,000
73/74		3,904
74/75		22,523
75/76		53,665
76/77		63,901
77/78	14,910	11,200
78/79	37,652	31,140
79/80	32,802	50,165
80/81	31,980	34,772
81/82	52,904	107,999
82/83	103,035	49,433
83/84	123,833	31,672
84/85	138,591	26,669
85/86	163,355	68,007
86/87	117,074	99,936
87/88	126,585	131,292
88/89		17,258
89/90		368,064
90/91		255,967

Source: SIDA EA-system

Then the market based Open General License (OGL) system replaced CIS. From the beginning of the 1990's import support was increasingly allocated through the OGL system. OGL was planned to work on a "first come, first served" basis. Foreign exchange was allocated to those companies that could obtain a letter of credit from a bank. In total, about 30% of disbursements between 1965 and 1992 has been allocated to import support. The amounts disbursed are shown in Table 5.11.

According to the most recent agreement, conditions for disbursements of Swedish import support included, among others, that an agreement on financial support should exist between the IMF and Tanzania. Otherwise, Sweden may suspend its grant to Tanzania. In order to ensure cost effectiveness, Tanzania should carry out pre-shipment inspection to verify quality, quantity, and the reasonableness of the price in procurement. For public sector procurement, established procurement procedures in Tanzania shall apply. For private sector procurement, established commercial practices shall apply. Tanzania shall provide Sweden with audit reports, and shall assist Sweden in performing audits, follow-ups and evaluations of the impact of the programme. The current system is thus more strict than before, and the scope for abuse is substantially reduced in the new auction system.

5.7 Research Support via SAREC

SAREC initiated cooperation with Tanzania in the area of research in 1977. Total commitments between 1977/78 and 1993/94 were 125.4 million SEK. Disbursements in 1992/93 were 16.7 million SEK.

Tanzania is a country with a very weak resource base and the support of SAREC has had two main objectives: a) To assist in the creation and strengthening of research capacity, and b) to promote research work of high relevance to the development of the country.

The projects also entail the training of local scientists in modern research techniques, the introduction of Tanzanian researchers to the state-of-the-art in their disciplines, the equipping of research libraries and the interaction between Tanzanian scientists and their foreign counterparts involving transfers of knowledge. SAREC also supports the universities and cooperates directly with a number of research departments in Tanzania in order to strengthen national research capacity. The major areas are agriculture/natural resources and health. The former includes support in the areas of soil, water and vegetation and concentrates on rehabilitation and improvement of degraded environments. Health research is concentrated to HIV/AIDS, schistosomiasis, weaning and reproductive health.

Library support: The University of Dar es Salaam has always been one of the universities in the region, which has put least resources into book acquisition and the library on campus,

only 0.6% of recurrent costs. Many books and other material are also in bad shape and often out of date. SAREC supports this university library as well as other libraries. The periodicals support for various libraries in Tanzania is meant to counteract the isolation caused by the lack of foreign currency. The total SAREC contribution between 1984 and 1991 was 10.5 million SEK.

HIV/AIDS: In one of the other main areas for SAREC support, HIV/AIDS support, 21.1 million SEK was disbursed between 1985 and 1991. This is a collaborative research project between institutions in Sweden and Tanzania and it has thus far resulted in a variety of research papers and training.

COSTEC: SAREC earlier supported Tanzania Commission for Science and Technology, COSTEC, with substantial funds. Between 1976 and 1982 with 8 million SEK. In 1986 , however, the agreement with COSTEC changed and between 1986 and 1991 only some 1.1 million SEK was disbursed for spare parts, travel costs and information was disbursed. Financing of the commission comes from the national budget and several external donors eg. SAREC, NUFFIC, NORAD and UNESCO. Since most donors don't finance administration, the funding of the commission has been difficult.

In general SAREC support to Tanzania has been relatively successful in strengthen the very weak research environment. It is important to support individuals/groups who try to do research, in spite of the adverse conditions, on a long term basis and to support their research environment.

The research support seems to suffer from the same kind of problems that we find in other forms of support. Documentation about projects is very important for evaluations and when decisions about future support are to be taken, but it seems as if the archives are not satisfactory. Often it can be difficult to find the first project plans and proposals and documentation of results.

Evaluations by Widstrand from 1991 recommended concentration of SAREC support to fewer institutions to enable long term support and planning. Periodically evaluations based on common sense, good and well kept archives and knowledge of the subject matter was also considered to be high priority. It would generate better knowledge about the state of the projects and thus make it possible to close down bad projects quicker. Widstrand also mentioned donor coordination as a important area.

Often there is a tendency to overestimate the capacity of the recipient country, both with regard to personnel and financial resources. With few graduate students one cannot carry out large scale research and research training programmes even if the subject or area is of high priority. Sometimes impact of support to supplies such as instruments, books, xerox machines, subscriptions etc. can be more valuable than other kinds of support. It is utmost important for the functioning of the Universities.

5.8 Conclusions

Aid to the social sectors dominated Swedish aid in the early years, while it is now about a third of the total. In the 1970's, Sweden spent very large amounts of aid on water supply, but the results were poor. Since then, there has been a shift of focus to the HESAWA project, which is a local, low technology concept. This works relatively well, but its future sustainability should be analyzed further. Support to education contributed to early improvements in literacy, etc., but standards have been eroded by the general economic decline in the 1980's. Support to health projects has been rather limited, but the Tanzanian Food and Nutrition Centre seems to be a well-run and worthwhile project. Like many other institutions, however, it does not seem viable without foreign support.

Support to economic infrastructure has grown in importance, and these projects seem to be investments with a high rate of return. The main worry is that the organizations that are to run these activities are generally highly inefficient. The development of these institutions is thus top priority, if the resources invested are not to go to waste. SIDA is actively involved in this work, together with the World Bank and others. In addition to the cases of

TANESCO and TTCL mentioned above, the same type of policy dialogue goes on with the Tanzania Harbour Authority and TAZARA. Commercialization is established as a condition for future support, and this is obviously very important for the future viability of these institutions.

Swedish direct support to industry has not fared well. The co-financed Mufindi Paper Mill was a major failure, and the small-scale alternative Sister Industry Programme also did poorly. Because of these experiences, SIDA has essentially withdrawn from direct support to production, and concentrates now in infrastructure which supports productive activities.

A growing share of aid is going to administration and management, which is obviously an area where support is needed. The worry here, of course, is that progress will depend on changes in overall policies, such as civil service reform. One must change institutions and incentives, and also provide individuals with relevant skills. There has been some progress, but it is too early to see what the overall impacts of the aid will be.

Import support has been a major part of aid to Tanzania. It is an efficient way to put money into the economy and the government budget, but its effectiveness will depend on the effectiveness of the recipient. Controls seem to have improved recently, but the government is still highly inefficient. Still, some government services are essential for economic and social development, and this may be the best way of supporting them. Appropriate conditions should be imposed, however.

A central issue is concentration and coordination. Swedish aid should be concentrated on few sectors, few projects to increase efficiency and to facilitate monitoring and auditing. To concentrate in few areas also means that knowledge about these areas increases within the donor organization, which should increase its efficiency. SIDA is currently trying to concentrate Swedish support and to decrease the number of activities within the sectors.

Sweden should further improve coordination with other donors, as well as with Tanzanian authorities. This is not just a Swedish problem. Most donors and Tanzanian authorities discuss the importance of coordination, but in practice very little is done.

Swedish aid policy has in recent years had the ambition to increase the role of the recipient country. In Tanzania, this has been hard, due to the weak capacity of Tanzania both economically and institutionally. Many projects have thus been donor-driven, both with regard to financing, and to personnel. Consequently, many projects in Tanzania have low sustainability. This seems to apply to other donors' projects as well.

There has been an ambition from many donors (see SIDA's study of the roles of different actors in the aid process - "rollutredningen") to delegate the work of the recipient country, and as soon as possible to leave and hand over projects to domestic agents. There are few donors who will agree to paying for spares, development, maintenance and recurrent costs over a longer period. But to be able to hand over projects later, we have to develop plans for phasing out at the very beginning of the project.

Maintenance costs are crucial in many projects. It should be very clear from the beginning who is responsible for maintenance. Donors and the recipient should together analyze and decide how maintenance costs will be covered in the future, before projects are implemented. If donors do not want to pay for recurrent costs, it must be clear that Tanzania can handle the cost. If there is doubt about Tanzania's willingness or ability to pay, one must question whether the project is sustainable. The government can, of course, get its priorities wrong, but donors cannot forever run large parts of the economy, and in the long-run, recipient countries must generate their own resources and reduce aid dependency.

Another difficult question is, what to do when some, perhaps technically advanced project demands donor involvement for a long time before it can become sustainable. If the recipient government cannot afford support during economic crises, projects stand or fall with donor commitment. Shall donors agree to support some projects for a very long time, in hopes that the recipient government will be able to take over in the future?

In general, in the early years of independence, lack of trained manpower was a major

problem for Tanzanian administration and institution-building. This is not an acute problem today, but instead there are problems of poor motivation due to low wages and lack of proper incentive structure for individuals, which lowers chances for sustainable projects. Donors must support changes resulting in a smaller but better paid civil service.

In many programmes international consultancy costs are very high. One could reduce such costs by using local consultants and institutions. There are also high costs associated with travel and training abroad in many programmes. These costs could also be reduced by using local facilities to a larger extent.

SIDA now puts more stringent conditions and demands on Tanzanian authorities. If there are doubts about recording, monitoring, etc., within the projects, SIDA should stop payments and await records. There should be a greater readiness to take even more unpleasant steps, such as ending bad projects.

6. AID MANAGEMENT

6.1 Aid Disbursements by Function

We have been asked to identify what aid disbursements consist of. The request was to divide disbursements into expenses for technical assistance (consultants), SIDA personnel and administration, resource transfer and debt relief. In our classification, based on SIDA's EA-system (which could only give us figures from 1989 onwards), we define technical assistance to consist of costs for experts working on a contract basis; SIDA personnel costs to include salaries, education, travel costs, etc.; and resource transfers to include all transfers of money and goods. We have had to confine this analysis to disbursements through SIDA, and since no debt relief has been given through SIDA, we do not include figures for this.

With reservations for the quality of the statistical data and the classifications made, Table 6.1 shows the shares of SIDA personnel and administration, technical assistance, and resource transfer of disbursements to Tanzania in the four budget years for which data is available, 1989/90 to 1992/93. Table 6.2 shows a further breakdown of 1989/90 aid, both by sector and by function.

Table 6.1: Cost shares of SIDA personnel and administration, technical assistance, and resource transfer in aid to Tanzania 1989-93 in per cent

	1989/90	1990/91	1991/92	1992/93
SIDA personnel and administration	2.7	2.3	1.6	1.6
Technical assistance	26.0	31.8	23.0	28.0
Resoruce transfer	73.0	68.0	76.0	71.0

Sources: SIDA EA system

Table 6.2: Shares of different disbursements categories in important sectors, 1989/90, in per cent

	SIDA personnel	Technical assistance	Admin./ Other	Resource transfer
SAP	0.01	3.4	0	96.5
Industry	0.5	37	0.02	62
Education	15	10	1	73
Admin./ Management	8	78	0.01	13
Water	2.3	73	0.6	23
Forestry	2.9	18	0.8	78
Health	9.2	7.4	1.2	82
B.O.P	0	0	0	100

Sources: SIDA EA-system

Costs for administration and SIDA personnel as measured here are relatively small, but it should be noted that we have not been able to allocate any costs relating to the headquater in Stockholm nor costs relating to the development office in Dar es Salaam. Technical assistance is a large share, about 28% in 1992/93. This category can, of course, be a substitute for SIDA staff. The reduction of SIDA core staff in recent years has led to increased use of consultants. This may be rational in many cases, when specialist staff is needed only short term, or when the type of specialists required cannot be recruited to the organization. However, in some instances SIDA hires consultants to do work that they could have done as SIDA employees, if SIDA had been allowed to increase its staff. The employment limitation imposed by the government to improve "efficiency" may therefore inflate costs instead, since consultants generally are more expensive per unit of time. It may also be the case that extensive use of consultants negatively affects institutional learning, since the experiences of the consultant are less likely to be retained by the organization.

Looking at sector distribution we find, as one would expect, that in financial transfers such as balance of payments support, close to 100% of the total disbursement is in fact resource transfer to the recipient. At the other extreme, we have aid categories containing mostly technical assistance. In aid aimed primarily at human capacity development and institution building, the resource transfer is as low as 13%. These figures, taken by themselves, unfortunately tell us very little about what would be an appropriate cost structure for different types of aid. Even within the categories in the table, one would expect percentages to vary a lot across countries, according to the specific character of the activities undertaken. It is, of course, far from self-evident that projects are "better" if there is less administration or less technical assistance. Therefore, to get beyond these simple ratios and say anything sensible about aid effectiveness, one must do evaluations of specific projects and programmes.

6.2 Appraisals and Evaluations[1]

The issue of project appraisals is a vast one, which we cannot discuss in full here. We will just dwell on some aspects relating to sustainability: When undertaking initial appraisals in countries like Tanzania, it is absolutely essential to consider the future availability of funds to cover recurrent costs. Availability of human resources should also be investigated, although this is less of a problem now than it used to be. More generally, from the very beginning of the project, it is important to consider the project's long-term status, particularly how the donor involvement is to be phased out. So far there has been very little specific discussion in initial plans about this, and if no plans exist for the definite transfer of a project to the recipient country, there is an obvious risk of low recipient ambitions to take over all the costs. This may "force" the donor to continue support, or else see the project collapse. Discussions about phasing out are seldom found in the original plan documents.

During and after projects, the donor also undertakes evaluations. An interesting study by Holm, Lindgren and Olsson (1994) analyzes the quality of evaluations of Swedish aid to Tanzania and

[1] For a more extended discussion of evaluation within SIDA, see Carlsson, Köhlin and Ekbom (1994).

the use SIDA has put them to in its recommendations to the Swedish government.

The study first checks whether there are explicitly stated criteria for the evaluation. Results may be evaluated against the stated goals of the project. One can also consider the sustainability of the project. Secondly, the study looks at the reliability of the conclusions, and whether potential sources of error are explicitly discussed. Thirdly, they consider whether the costs of the project are explicitly discussed, and whether benefits are compared with costs.

The study covers 56 evaluations between 1968 and 1993 but, according to the definition used in the study, only 28 of those can be properly considered true evaluations. The earlier ones often lack clear criteria for evaluation, but later ones are better. Only 31 of the evaluations discuss project goals comprehensively, while only 17 consider whether the project is sustainable without aid.

Most of the evaluations have a qualitative approach, which means that the results are based on interviews and the analysis of documents. Only eight studies have a satisfactory discussion of the validity and reliability of the results, while ten more have a limited discussion. Only eleven studies apply an acknowledged method of evaluation, such as cost-benefit analysis. Only a few of the evaluations show clearly what the total costs of the project are. Cost effectiveness estimates are rare. These deficiencies may be due to inadequate routines for accounting and surveillance. There is little in the evaluations about agency monitoring, that is, about how well SIDA follows upon the development of the projects.

In 16 evaluations there is a relevant discussion of project inputs, while in 15 cases there is an adequate discussion of project outputs. Not one of the evaluations discusses whether the results could have been achieved with less resources, or if the resources could have been used more effectively. This is the most important deficiency.

One general conclusion of the study is that SIDA does generally use the results of evaluations

They seem to be an important basis for decision making at SIDA. In general, it seems that SIDA uses the recommendations as a basis for its proposals to the government ("regeringsskrivelse"). In all six evaluation reports which were analyzed more closely in the HLO-report, recommendations were made which could later be found in proposals made by SIDA to the Swedish government.

There is scope for further improvement of both appraisals and evaluations. Considering the vast sums of money that are handled by SIDA, it would certainly make sense to set aside more resources for analysis. An upgrading of analytical capacity would require that SIDA be allowed to pay competitive salaries.

6.3 A Comparison with the Experiences of Other Donors

Several donors countries are in the process of evaluating their collaboration with Tanzania. So far these studies have not been published, so we are not able to quote directly from them. Still, it is probably fair to say that they generally find the results of the collaboration disappointing.

However, a World Bank study was published in 1990, in which it reviews the projects it has undertaken in Tanzania (World Bank, 1990a). It reviews its projects on the basis of Economic Rate of Return (ERR), achievement of physical targets, capacity utilization, financial viability, and delays in project completion. Its record as reported there is far from good:

- In agriculture, 17 out of 23 were evaluated. Of those, 12 had negative reestimated ERRs, and another 4 had ERRs substantially below the estimates at appraisal.
- In direct lending to industry, reestimated ERRs were available for only two (both textile) of the four projects. The reestimated rates were negative, partly reflecting low capacity utilization of 10% and 28%. Capacity utilization in the other two, leather products and pulp/paper was only 4% and 49% respectively. Thus, massive operational losses were experiences in all the enterprises.
- In infrastructure, the Bank had financed ten projects, and re-estimated ERRs were available

for six. Five had ERRs below the estimates at appraisal. Still, operations in telecommunications, energy and power, and water supply and sanitation were generally successful, though significant delays in completion were experienced.

- In the social sectors, results were mixed. Out of seven education projects, six had been reviewed. Of those, only two were successfully completed. The others had failed to meet physical construction targets, were substantially delayed, and operations were hampered by staff shortages.

In most sectors the highest failure rate did occur in the mid-70s. In several cases, the failure was said to be due to poor and hasty preparation. In other instances, projects were too large and complicated, beyond Tanzania's managerial capabilities. It was also noted that support by the government was often inadequate, and that there was a lack of some types of manpower. The study also suggests that the field staff of the World Bank was not large enough to supervise the projects. Lastly, of course, many of the failures were due to the government policies pursued and to the overall economic situation.

The conclusions that are drawn from this study would also seem relevant today. First it is noted that it is important to understand the country's development strategy and the operational implications of that strategy. It is important to take a realistic view of the recipient's absorptive capacity. One must recognize the critical importance of economic analysis. Moreover, projects should not be too complex. Projects should be designed simply, with only a few components. Finally, the role of institution building is emphasized, as is the need for supervision and donor coordination. Exactly the same recommendations can be made on the basis of Swedish experience.

> If the Arusha experiment had not existed, the western social democrats in the 1970s would have to have invented it.
> -- Bagachwa, Mbelle and Van Arkadie, 1992, p. 6.

7. A MACROECONOMIC OVERVIEW

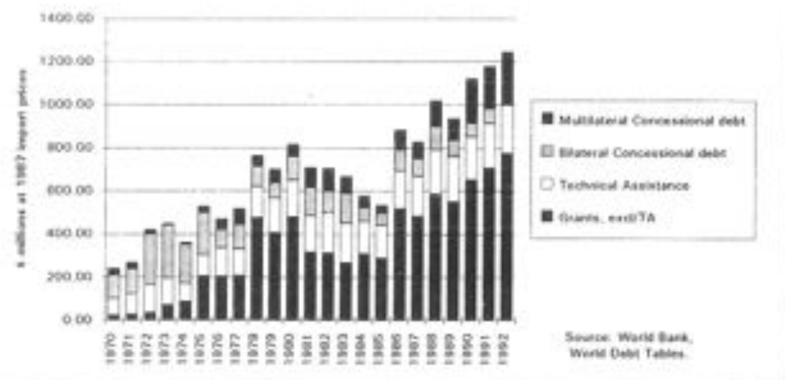
This chapter provides a macroeconomic overview of aid in Tanzania in the period since 1970.[1] Figure 7.1 shows the evolution of aid in Tanzania, measured in imports at 1987 prices. We measure aid using "net transfers on aid", which is the sum of grants and disbursements of concessional loans, minus repayments of principal and interest on concessional loans. Data are from the World Debt Tables; they are quite close in magnitude to the similar concept of "net ODA transfers" reported by the DAC, so we will confine the analysis to the WDT data.[2] Aid in Tanzania has evolved in three very distinct phases in the period since 1970. A broad interpretation of the three phases is that they involve a shift from an essentially cooperative, arms-length relationship between sovereign partners in the 1970s, to a confrontational relationship between 1980 and 1985, and finally in 1986 to a renewed collaboration but one influenced by the recognition of clear conflicts of interest between donor and recipient and by the overwhelming concentration of bargaining power in the hands of the donors.

The three major phases in aid to Tanzania are apparent in Figure 7.1. The first last from the early 1970s to 1980 and is associated with steady increases in net transfers. There are fluctuations around this trend associated with the 1974/75 drought and oil shock, the coffee boom of 1976/77, and the trade liberalization of 1978, but the overriding story is one of steadily increasing engagement by donors. The second phase lasts from 1980 to 1985; it is a phase of donor

[1] The literature on Tanzanian macroeconomic performance is extensive. See Bevan, Collier and Gunning (1989, 1990) for an overview of the period between 1975 and 1985 and Mans (1993) for an overview of the period since 1985. Collier (1990) and White *et al* (1993) focus on the macroeconomic effects of aid.

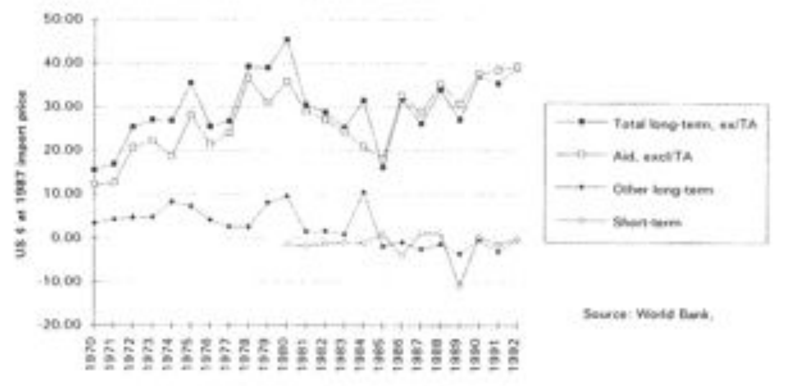
[2] The net transfers measure excludes outright debt forgiveness, which alters contractual obligations but does not produce a net flow of funds.

Figure 7.1 Net Aid Transfers, 1987 Prices



disengagement that might be best characterizedas a 'war of attrition' between the Tanzanian government and its foreign patrons. Foreign aid falls steadily by roughly $30 million per year during this period of economic decline. The reduction is more dramatic in per-capita terms, and excluding technical assistance; by this arguably more relevant measure, the disengagement period drives aid down to the level of the early 1970s (Figure 7.2). The final and current phase began

Figure 7.2 Aid Per Capita Excluding Technical Assistance, 1987 Prices



in 1986 and is associated with the IMF-approved Economic Recovery Program and its successors. During this phase aid has resumed the increasing trend characteristic of the 1970s, both in aggregate and per capita terms.

Holding aside the trends in Figures 7.1 and 7.2, the levels of aid in Tanzania are high by virtually any measure. Net transfers per capita (excluding technical assistance) averaged $11 between 1970 and 1978, $26 between 1979 and 1985, and $35 between 1986 and 1992. In 1992, net transfers were $39 per capita and represented an extraordinary 42 percent of GDP at the official exchange rate. By contrast, aid to other countries in Sub-Saharan Africa averaged roughly $17 per capita in the 1980s; for other low-income countries the figure was below $5 (World Bank, 1994). Figure 7.2 shows that aid has been the overridingly most important source of long-term net external transfers for Tanzania; there are short-lived blips in nonconcessional net transfers borrowing during the first and second oil shocks and in 1984, but the levels are small relative to aid and net non-aid transfers have been negative since 1985. The figure also shows net transfers on short-term debt beginning in 1980. These have been small and negative in most years, with more substantial reductions in 1986 and 1989 associated with the retiring of arrears.

Aid of the magnitude received by Tanzania is clearly of macroeconomic importance, not only for its direct and general equilibrium effects on variables like imports and investment, but also for its influence -- whether passive, as in the 1970s, or active, as in the 1980s and 1990s -- on the policy environment. In what follows we focus on the interaction of aid with economic growth, investment, saving, exchange rate policy, export performance, and government revenue mobilization. The remainder of this chapter provides the overall context by providing an overview of macroeconomic developments in these key areas. Chapters 8-12 then take a more analytical approach to selected issues in the aid debate, focusing particularly on aid dependency, conditionality, dutch disease effects, and the problem of corruption. Chapter 13 concludes this section of the report with a summary of macroeconomic policy implications.

7.1 A Caveat and Classification of Episodes

At the outset we issue a caveat regarding the quality of the macroeconomic data. Careful attempts to assess the size of the unmeasured "second economy" (Maliyamkono and Bagachwa (1990), Sarris and van den Brink (1993), Planning Commission (1993)) conclude that it is extremely large -- generating income equal to at least 30% of official GDP in the late 1980s -- and that the national income accounts are subject to serious bias. Trade statistics are also extremely unreliable given the prevalence of export smuggling and import overinvoicing and weaknesses in customs data collection. Investment data are crude, largely based on import data and local cement production; while the recent national accounts revision represents an important improvement in the investment data, the revision is confined to 1976-85. All of these weaknesses affect estimates of consumption and saving, since these variables are derived as residuals in the national accounts.

Since a large part of economic activity is mis-measured, inferences drawn from official data must be based on general trends rather than on detailed movements from year to year. Even multi-year averages can be misleading, however, if major changes in the policy environment systematically alter the incentives for official and unofficial activity mid-sample. To handle this problem, we divide the period since 1970 into three sub-episodes -- corresponding closely to the three phases in the aid relationship -- within which policy was relatively consistent. The "Pre-Crisis" period runs from the Arusha Declaration in 1967 to the collapse of the coffee boom in 1978. Since our data start from 1970, we date the "Pre-Crisis" period from that year. The "Crisis" period begins with the Uganda War and the second OPEC oil price shock in 1979 and runs until the resignation of President Nyerere in 1985. The "Reform" period begins with the adoption of a major IMF adjustment program in 1986 and runs to the present.[3]

By the early part of the pre-crisis period (1970-78), the Government had consolidated its hold on most aspects of formal economic activity. Banking and large portions of the industrial sector had been nationalized, the bulk of international trade and private retail trade had been confined to state agencies, and market prices had largely been replaced by administered prices. A foreign exchange allocation system had been developed in response to the balance of payments crises of 1970-71

[3] The terminology is from Mans (1993).

and 1974-75, and in 1974 a National Price Commission was established that by the late 1970s was setting controlled prices on some two thousand goods. By the mid-1970s, most of the rural population had been resettled into "Ujamaa" villages in a major -- and ultimately coercive -- strategy to promote cooperative agriculture, and peasant marketing cooperatives had been replaced by monopoly government marketing boards covering both export crops and the main food crops. The Government had formulated a Basic Industries Strategy (BIS) of import-substituting industrialization and began its implementation in a modest way by 1974, only to postpone it indefinitely in the balance of payments crisis that accompanied the first oil shock (1974). The external position improved markedly with the coffee boom in 1976, and the Government resuscitated the BIS in a decision that was to dominate the allocation of foreign exchange and the pattern of domestic investment throughout most of the subsequent crisis period. The end of the pre-crisis period was marked by the breakup of the East African Community in 1977 and the rapid depletion of international reserves following the collapse of the coffee boom in 1978 and an abortive import liberalization that same year.

Collier (1991) emphasizes the lack of unanimity among Tanzania's donors during the 1970s. A sectoral report on agriculture by the World Bank report in 1974 strongly criticized the major features of agricultural policy, and both the World Bank and the IMF wanted movement on the exchange rate. But the major bilateral donors (including SIDA) were highly sympathetic to the Arusha experiment, and the drawing power of President Nyerere was further enhanced by his evident personal integrity and effectiveness, not only domestically but also as leader of the Frontline States. President Nyerere was able to take a hard line with the IFIs[4], and the fundamental policy decisions of the 1970s -- with respect to agriculture, domestic pricing, and the BIS -- were unaffected by dissent among the donors.

The "Crisis" period began in 1979 with a major increase in the fiscal deficit associated with the war in Uganda. During this period the control regime developed over the previous period tightened considerably as the government sought to finance the increased spending and to

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[4] President Nyerere used the issue of national sovereignty as a way of isolating the World Bank. Collier (1991) argues that the appearance in Tanzanian newspapers in 1976 of a letter from World Bank President Robert MacNamara that was critical of ujamaa effectively removed this policy from future debate.

maintain the import-intensive BIS in the face of rapidly declining export proceeds.[5] External arrears developed rapidly and after the end of the Uganda war foreign inflows fell dramatically as the government clashed with the IFIs and bilateral donors over the exchange rate and other aspects of macroeconomic policy. Dialogue with the IMF ended as early as 1978-79, when an IMF agreement including a 15% devaluation was vetoed by President Nyerere.[6] The Government implemented its own "National Economic Survival Programme" in 1981-82, but reforms were minor and met with no success. A second internal effort, the "Structural Adjustment Programme" went further but did not address issues of first-order priority with donors (including exchange rate overvaluation and liberalization of agricultural marketing). By 1983 even donors sympathetic to the overall Tanzanian program were pulling out. The "beginning of the end" of the crisis period occurred in 1984 when the Government implemented made the first major move towards liberalization, adopting an own-funds scheme that allowed importers to obtain licenses without declaring the source of their funds. The exchange rate adjustment was small, however, and a more definitive end came in 1985 with the resignation of President Nyerere and his succession by President Mwinyi.

The "Reform" period began in 1986 with a maxi-devaluation and the initiation of a standby agreement with the IMF and a structrual adjustment programme with the World Bank. The "Economic Recovery Programme" (ERP) presented to donors in that year incuded a broad range of policies aimed at liberalizing internal and external trade, unifying the exchange rate, reviving exports, stimulating domestic saving, and restoring fiscal sustainability. Internal debates about the degree of liberalization were ongoing in Tanzania, however, and the thrust of the ERP was crisis management rather than a definitive move to a market-oriented economy (Mans (1993)). The programme nonetheless addressed the chief short-run concerns of donors and met with substantial support, including renewal of the IMF structural adjustment facility in 1987, 1988 and 1990. In 1989, reforms entered a second phase under the government's "Economic and Social

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[5] Bevan, Collier and Gunning (1990) provide an extensive analysis of macroeconomic developments during the crisis period. Loxley (1988) and Hyden and Karlstroem (1994) provide accounts of the policy dialogue within the Tanzanian Government and between Tanzania, the IMF, and other donors.

[6] President Nyerere again used national sovereignty in an attempt to protect policy autonomy and isolate unsympathetic donors. A phrase that was widely quoted internationally was "When did the IMF become an International Ministry of Finance? When did nations agree to surrender to it their power of decision making?" (Bank of Tanzania, 1991, p 226).

Action Programme" (ESAP). ESAP continued earlier efforts at trade and exchange rate liberalization and macroeconomic stabilization, but widened significantly to include reforms in the banking system, agricultural marketing, the parastatal sector, government administration, and the civil service, together with a targeting of the social sectors which had deteriorated substantially during the crisis period. These reforms were accompanied beginning in 1990 by definitive moves towards adoption of a multi-party political system. The first multi-party presidential election is in 1995.

7.2 Macroeconomic Performance by Episode

7.2.1 Aggregate Growth

Table 7.1 summarizes the sobering economic growth picture provided by the official GDP data. From Independence in 1961 to 1966, growth averaged over 6 percent a year Over the period from 1970 to 1992, real GDP barely kept up with population growth on average. Real GDP per capita was therefore roughly equivalent in the early 1990s to its level in the early 1970s. Against this background, however, the data suggest important changes by episode. The 1970s were a period of stagnation in overall real GDP, though with substantial fluctuations in gross domestic income (which incorporates terms of trade changes) associated with the oil shock in 1973/74 and the coffee boom of 1976/77. The stagnation of the 1970s already represented a decline from the 1966-70 period (not shown), during which real GDP had grown at 4.2 percent. Stagnation turned into decline in the crisis period, and between 1979 and 1985 real GDP fell by 1.5 percent on average. The reform period has seen a definitive turnaround in growth, with real GDP per capita increasing at the modest rate of 1 percent per year.

The national accounts, then, suggest a broad picture of stagnation, then decline, and then rebound, with essentially zero overall growth in income per capita over the entire period. This view is corroborated by survey evidence in Bevan, Collier and Gunning (1989), who show a protracted decline in incomes during the "Nyerere Experiment" and some recovery thereafter. Given the magnitude of aid received by Tanzania, the dismal growth picture poses an obvious question of aid effectiveness. It is clear on the face of it that aid has not had extremely strong payoffs in terms of growth. Constructing a proper counterfactual is extremely difficult, however. What would

have happened if aid had been significantly smaller? Aid has clearly exerted two kinds of influence in Tanzania on the supply of external resources, and the other on policy formation. Disentangling these effects is crucial for assessing both the historical role of aid and its potential effectiveness in the 1990s. We argue below that the effects of aid on the overall policy environment have been at least as important for Tanzania's growth performance as has the resource transfer financed by aid.

Work on the second economy modifies the picture suggested by national accounts data in two respects, but without changing its overall thrust. The first is to suggest that the output decline during the crisis period, and its subsequent recovery, were more pronounced in formal activities than in informal ones and in the urban sector than in the rural sector (Sarris and van den Brink (1993), Bagachwa and Naho (1990)). The second is to suggest a somewhat stronger overall recovery during the recent adjustment period than is suggested by the national accounts (World Bank (1993)). The Cornell/ERB/USAID project suggests that rural incomes fell very little during the collapse of official real GDP, as peasant households readily switched to subsistence activities that were not captured in the official statistics. These same households benefitted less from the officially measured economic rebound that occurred after implimentation of the structural adjustment measures in the mid-1980s. Urban incomes were more affected, both by the crisis and by the subsequent adjustment, and their welfare (as measured by consumption) grew strongly between the budget survey year of 1976/77 (which was the last good year before the crisis) and 1990. The authors argue that most of this growth probably took place after the implementation of adjustment in the mid-1980s.

Table 7.1. Real GDP Growth, 1970-92

	1970-78	1978-85	1986-92
Real GDP growth (factor cost)	3.3	1.5	4.0
Real GDP per capita growth	0.5	-1.6	1.0

Sources: World Bank, World Tables.

7.2.2 Sectoral Growth

Table 7.2 shows growth in officially measured sectoral GDP for the three sub-periods. The sectoral growth rates show a clear shifts in relative performance by episode but relatively little change over the full period in the sectoral structure of output. In the pre-crisis period, growth is led by the public administration sector, with strong contributions from agriculture and manufacturing as well. The picture changes markedly in the crisis period, with a collapse of manufacturing output under import strangulation and a decline in agricultural growth of over two percentage points per year on average; public administration retains its leading role but at a much reduced growth rate of 3.7 percent. The picture in the reform period is the reverse of the pre-

Table 7.2. Sectoral GDP Growth and GDP Shares. 1970-92[a]

	Sectoral growth rates ---------			Shares of GDP		
	1970-78[b]	1979-85[c]	1986-92[c]	1970	1986	1992
Agriculture[d]	4.9	2.7	4.9	43.0	46.7	48.3
Manufacturing	4.9	-3.8	3.7	9.3	7.9	8.3
Electricity and Water	7.1	7.1	2.7	1.2	2.2	1.7
Construction	0.7	-3.7	13.5	4.3	2.8	4.5
Trade, Transport and Communications	3.5	-1.1	4.9	22.3	17.8	18.1
Finance[e]	3.6	3.9	1.3	8.6	9.8	7.6
Public Administration and other services	10.5	3.7	0.3	11.3	12.9	11.5
GDP (factor cost)	5.1	1.4	4.2	100	100	100

Sources: Government of Tanzania, *National Accounts of Tanzania*, September 1981 and August 1993.

Notes: [a] Growth rates are calculated using beginning-of-period and end-of-period observations. GDP shares for 1970, 1978 and 1992 are in parentheses. [b] Data in constant 1966 prices. [c] Data in constant 1976 prices. [d] Includes Mining and Quarrying (0.9% of GDP in both 1978 and 1992). [e] Net of Imputed bank service charges (equal to -2.2% of GDP in 1978 and -4.2% in 1992).

crisis period. Agricultural growth nearly doubles, while the manufacturing sector switches from a decline of 4 percent per annum to an increase in 4 percent. Sharp recoveries also take place in construction and in a category we loosely label "market infrastructure", which includes retail and wholesale trade and transport and communications. The lagging sector is public administration. The changing role of public administration in Table 7.2 captures only part of the public sector/private sector divide in Tanzania. State control of the "commanding heights" of the economy was a central tenet of the Arusha Declaration, and by the late 1970s Tanzania had constructed a parastatal sector of extraordinary scope by international standards.[7] From roughly 40 entities in 1966, the parastatal sector grew to encompass over 400 entities in the late 1980s, covering the entire range of economic activities. As of the late 1980s the parastatal sector as whole contributed nearly 25% of non-agricultural wage employment and generated some 13% of total GDP (Bagachwa (1992)). The manufacturing sector is dominated by parastatals, which account for 60% of sectoral value added. The official data suggest that the share of the parastatal sector in current-price GDP changed very little in the 1980s, although this almost certainly underestimates the shift in activity towards the private sector given the strong growth in the informal sector.

7.2.3 Reform and Response: Exports and the External Sector

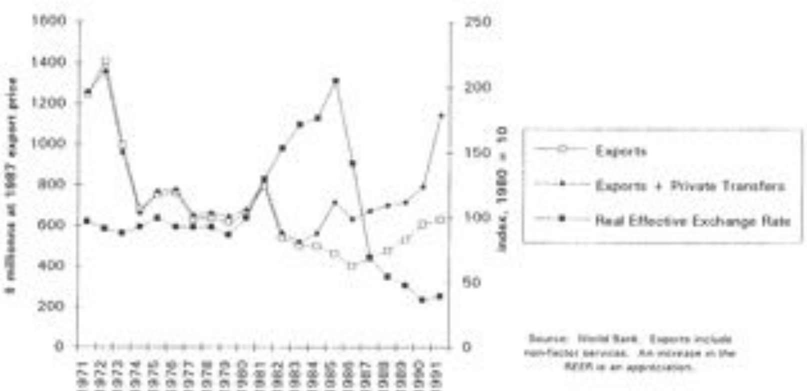
Tanzania's export sector is strongly tilted towards a relatively well diversified set of traditional agricultural exports (coffee and cotton acounting for 14 and 34 percent of total exports on average during the 1980s). Nontraditional exports accounted for an average of 24 percent in the 1980s.[8] Until the early 1980s, the policy environment in Tanzania was hostile to both categories of export. The pro-rural stance of the Arusha declaration meant that explicit taxation of the agricultural sector was relatively mild, but such taxes as existed favored food crops over export crops. More importantly, the rewards to peasant production for export were undercut during the 1970s by (1) government monopolization of marketing, with increasing "marketing margins" driving down producer prices; (2) the enforced relocation of rural producers in the "villagization"

[7] See Bagachwa, Mbelle and van Arkadie, eds. (1992).

[8] We include manufacturing, mining and petroloum in this category.

of the mid-1970s; and (3) the imposition of heavy effective protection in the import-substituting industrial sector, which turned relative prices in favor of urban areas; and (4) the use of trade controls rather than exchange rate adjustment as a means of adjusting to external shocks. Development of the small nontraditional export base was further discouraged by the rapid emergence of the state as an empoyer of first resort for capable Africans -- whose entrepreneurial talents were then developed in a wholly bureaucratic environment -- and the active discouragement of private sector trade in general. Figure 7.3 shows the result, with export volumes declining precipitously in the mid-1970s and failing to recover by the onset of the crisis period.

Figure 7.3 Export Volumes and Real Effective Exchange Rate



Export performance deteriorated markedly in the crisis period, as domestic inflation increased rapidly and the government compressed imports through direct foreign exchange rationing rather than accomodating the inflation through nominal depreciation. While the government began to reverse its producer pricing policies in an attempt at export promotion in the early 1980s, this was rapidly more than offset by increases in marketing inefficiencies and overvaluation. The exchange rate became the centerpiece of a prolonged struggle between President Nyerere and the IMF, with

the more sympathetic donors prolonging the period of overvaluation by continuing to support 'hardliners' in the Tanzanian government. By 1983, however, even the Nordic countries were certain of the need for a substantial devaluation, and the donors as a group (together with pro-reform internal groups) won a decisive victory with the resignation of President Nyerere in 1985. A maxi-devaluation of 55 percent (the IMF had earlier pushed for 100%) was implemented in the following year along with the adoption of a crawling peg. Import liberalization has also been an important feature of the reforms. Figure 7.3 shows a dramatic turn-around in export performance during the reform period, with exports increasing by nearly six percent per year on average, in comparison with a decline of 3.6 percent per year during the crisis period.

Table 7.3: Changes in Exchange Rates, Export Volume, Terms of Trade, and Import Capacity

	1971-78	1979-85	1986-92
Average annual percentage changes:			
Official exchange rate (increase = depreciation)	1.0	13.0	45.1[a]
Real effective exchange rate (increase = appreciation)	-0.9	12.5	-21.0
Parallel foreign exchange premium	2.6	25.1	-38.7
Export volume (goods & services)	-4.9	-3.6	5.8
Exports + private transfers[b]	-4.9	2.4	6.2
Terms of Trade	4.0	-3.0	-2.1
Import capacity:			
Exports	-1.7	-7.3	3.0
Exports + private transfers	-1.9	-1.5	3.1

Notes: [a] 1986-93. [b] Private transfers are measured in units of exports.

Sources: The real effective exchange rate is from the World Bank. The parallel exchange rate against the US dollar is from *World Currency Yearbook*, various years, and Kaufmann and O'Connell (1991). The official exchange rate and balance of payments data are from IMF, *International Financial Statistics Yearbook 1992* and Bank of Tanzania, *Economic and Operations Report* June 1993. Export and import price indexes and terms of trade are from the World Bank.

The export volume data in Figure 7.3 and Table 7.3 refer to officially measured exports and should be interpreted with care, given the likely importance of export smuggling. The Tanzanian shilling has been nonconvertible for capital account purposes since its introduction in 1966, and exporters have been required to remit foreign exchange earnings to the Bank of Tanzania at the official exchange rate. The balance of payments crises of 1970-71 and 1974-75 saw major increases in the black market premium on foreign exchange, and thus provided strong temporary incentives for the smuggling of exports. These incentives became more systematic in the crisis period as tight foreign exchange rationing drove up the domestic prices of imports and increased the demand for foreign exchange to finance import smuggling (Kaufmann and O'Connell (1991)). It is likely therefore that a substantial portion of aggregate exports has been smuggled since at least the early 1980s. The decline in official exports during the crisis period is at least in part a diversion of exports from official to unofficial channels in response to an increasing parallel premium (which doubled roughly every two years on average, rising from 45 percent at the end of 1978 to over 800 percent at the end of 1985). Similarly, some portion of the rebound of officially measured exports after 1986 may reflect the "officialization" of illegal exports rather than a response of aggregate exports.

While smuggled exports are by their nature difficult to measure, a rough order of magnitude during the recent period is suggested by the volume of imports brought in through the "Own Funds" window introduced in mid-1984. This scheme allowed importers to obtain import licenses without declaring the source of their funds. It is likely that reverse capital flight was an important source of own funds early on, but after the first few years of the program, the bulk of own-funded imports has probably been financed by current undeclared exports. Since a large portion of own-funded imports are offset in the balance of payments accounts through a credit item under private unrequited transfers, the sum of officially measured exports and private transfers gives a (very) rough estimate of total exports. By this measure, total exports during the reform period exceed the official amount by some 50 percent. Table 7.3 indicates that the growth rates of the two categories have not been markedly different, after controlling for the jump in transfers in the first two full years of the program. This is puzzling, given that the parallel premium fell markedly throughout the reform period. One explanation for this is own-funded imports were until 1992 subject to much looser pre-shipment inspection than other imports, allowing greater avoidance of customs duties. Since export retention has only recently been substantially liberalized, undeclared exports have remained the major source of these cheaper imports. Additional explanations for the persistence of unrecorded exports in the face of exchange rate unification may

therefore be (1) uncertainties on the part of private traders about the sustainability of exchange rate reforms, and thus a reluctance on their part to expose their own histories of export smuggling by declaring their current activities fully; and (2) deterioration of NBC banking services and thus a continued preference for the financing of trade through parallel channels.

Figure 7.4 Imports and Import Capacity of Exports and Aid

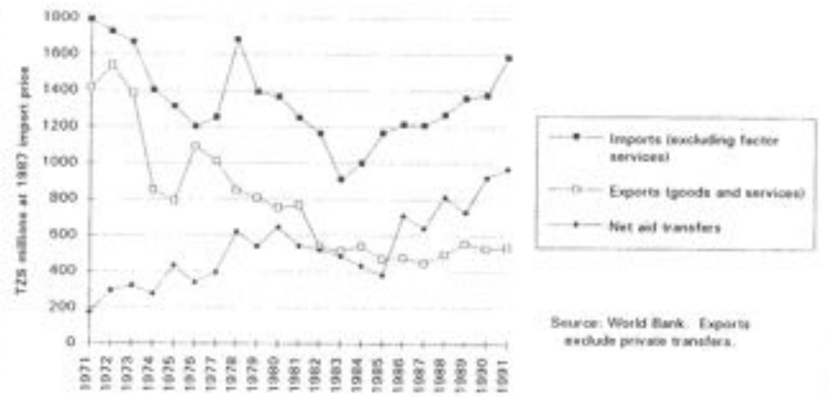


Figure 7.4 shows import volumes and the import capacity represented by exports and aid (measuring import capacity by deflating dollar flows by the import price index). Terms of trade movements were favorable on average in the pre-crisis period (Table 7.3), with the commodity price boom of the early 1970s and the coffee boom of 1976-77 more than offsetting the first OPEC oil price shock in 1973 and 1974. The terms of trade have followed a declining trend since the late 1970s, however, so import capacity grews more slowly than export volume during both the crisis period and the present reform period. The figure brings out a dramatic shift in the relationship between aid and exports over the three periods. During the pre-crisis period, net aid transfers offset the trend decline in import capacity of exports nearly dollar for dollar on average. Flucutations of aid around its rising trend to some degree offset short-run fluctuations in exports as well, particularly the portion attributable to movements in the terms of trade. Aid then fell in the crisis period and exports continued to do so until the short-lived terms of trade improvments of 1984 and 1985; and in the reform period both aid and exports have contributed to rising import

capacity, as increases in aid have been conditional on substantial exchange and trade regime liberalizations that have improved the policy environment for exports.

7.2.4 Investment, Saving, and the Productivity Problem

Table 7.4 shows the structure of expenditure in current prices from the national accounts. The data show a significant shift out of current government spending over the three periods, becoming more pronounced in the reform period. Private consumption rises steadily as a share of GDP, undoubtedly a reflection of the extraordinary increase in the import share during the reform period, a phenomenon we consider further below. The composition of investment shifts definitively in favor of the private sector over the entire period, although the collapse of public investment during the crisis period is offset to some degree during the reforms. Foreign saving has an increasingly dominant role in the financing of domestic investment, with the share of gross domestic saving in GDP declining steadily from 16 to 5.

The data suggest a broad shift of spending to the private sector from the public sector and a shift of saving from domestic to foreign sources. The data are weak, however, and revisions to the national accounts may ultimately imply substantial modifications. Two are worth mentioning here. The first is suggested by the last two columns, which compare the national accounts data (used in columns 1-3) with the recently revised national accounts data in current prices for 1976-85. The revised data suggest a much larger investment share during the 1976-85 period and a correspondingly lower share of private consumption. Estimated gross domestic saving therefore rises by some 5 percent of GDP, suggesting a much stronger domestic contribution to capital formation during these years and a much more adverse picture for private consumption. Unfortunately the revised data for 1976-85 are not comparable with the unrevised national accounts data for 1970-75 or 1986-92, so it is difficult to determine how conclusions about changes across episodes -- particularly pre-reform vs reform -- may ultimately be altered.[9]

The second modification (Mans (1993), Agrawal, *et al* (1993)) is suggested in the memo item for

[9] White *et al* (1993) argue that since the yearly differences between revised and unrevised data become smaller towards 1985, direct comparisons with unrevised data for 1986-92 may not be seriously misleading.

gross domestic saving. Saving and consumption are determined as residuals in the Tanzanian national accounts and are therefore subject to potentially serious bias due to underrecording of exports.[10] In Table 7.4, we include an upper-bound estimate of GDS in which unrecorded exports -- estimated by private unrequited transfers, which capture an important share of own-funded imports, the counterpart to which is widely thought to be smuggled exports -- are added to gross domestic saving. Consumption would of course be correspondingly smaller, so that a much higher portion of external inflows during the transfer period would have been channeled to investment rather than to consumption.[11]

Table 7.4 Expenditure and Saving Shares of GDP (current prices), 1970-92

	1970-78	1979-85	1986-92	NA	NArev
Consumption	84	89	95	87	83
Private	69	75	84	72	67
Public	15	14	11	15	15
Investment	23	20	35	21	26
Private	8	10	21	10	12
Public	16	10	13	11	13
Gross Domestic Saving	16	11	5	13	17
memo:					
upper-bound GDS		15	15		
Foreign Saving	7	9	30	8	9
Imports	29	19	45	21	21
Exports	22	10	16	12	13

Sources: Columns 1-4: for 1976-92, Government of Tanzania, *National Accounts of Tanzania*, August 1993; for 1970-75, World Bank. Column 5: Staglin and Komba, eds, (1992) *Revised National Accounts of Tanzania*.

The data in current prices overstate the reform-period boom in expenditure aggregates

[10] The expenditure-side GDP identity is $Y = C + I + X - M$. As pointed out by Agrawal, *et al* (1993), output is determined on the production side and I, X and M are independently estimated from the expenditure side. Consumption therefore incorporates any underestimate of exports; and since gross domestic saving is $Y - C$, the same holds for saving.

[11] The estimate should be treated as an upper bound for two reasons: first, some portion of own-funded imports, particularly in the early years 1985-87 or so, was probably financed by reverse capital flight. Second, exports that are not captured in the official export data may also not be captured in official production data, although the underestimation is certainly greater on the export side.

Table 7.5. Tanzania: Gross Fixed Capital Formation, 1976-92

	1970-78	1979-85	1986-92	1990-92
Gross Fixed Capital Formation (share of GDP, 1976 mkt prices)	22.1	22.3	26.3	27.5
	1976-78	1979-85	1986-92	1990-92
Shares of GFCF:				
Private Sector	43.3	52.2	60.7	64.2
Parastatal Sector	37.0	26.3	31.1	26.3
Central Government and Not-for-profit sector	19.8	21.5	8.1	9.5
Total	100	100	100	100
	1976-78	1979-85	1986-91	
Shares of GFCF by sector:				
Agriculture and mining	8.6	10.6	3.7	
Manufacturing	27.4	23.5	26.6	
Electricity and Water	6.5	8.3	15.3	
Construction	3.4	8.1	10.0	
Trade	5.3	2.4	1.3	
Transportation	29.4	23.8	36.5	
Finance	6.8	5.9	1.8	
Public Administration	12.6	17.3	4.9	
Total	100	100	100	

Sources: Government of Tanzania, *National Accounts of Tanzania*, August 1993. The 1990 data include what looks like a substantial underestimation of total GFCF, so the totals for 1986-92 and 1990-92 should probably be higher. Capital formation by sector is from *National Accounts of Tanzania* (1992).

highly weighted towards traded goods, given the large real depreciation of the shilling since 1986. Nonetheless, the boom in real investment has been substantial, as indicated in Figure 7.5, which

shows gross fixed capital formation at 1976 prices. The boom associated with the BIS is clearly apparent beginning in 1976; the boom persists following the reductions in external flows starting in 1981, and a short-lived collapse occurs only in 1983. The boom associated with the reform period is significantly larger in real terms, with fixed investment reaching a level nearly 50 percent above the previous boom by 1987, only to increase further in the early 1990s. Relative to GDP the second boom is considerably smaller, given the rapid growth of real GDP during the reform period (Table 7.5).

Figure 7.6 shows the breakdown of real capital formation by type of asset. The boom during the reform period is primarily in equipment investment; within this category, the dominant role is played by transport investment, as opposed to machinery and other equipment. The transport investment boom starts as early as 1984 with the implementation of the own funds scheme, and suggests the existence of a pent-up demand as well as a continuing response to the liberalization of internal trade. Other works (roads, etc) are more closely tied to the aid boom; and investment in buildings only begins to participate in the boom in 1990. The breakdown by sector (in current prices) is in Table 7.5. The most dramatic shifts in the reform period are a decline in the shares taken by agriculture and public adminstration and an increase in the transport sector. The decline in the agricultural share is troubling, given the strong movement of relative prices in favor of this sector and its evident priority in a mainstay of employment and exports.

The investment rates in Table 7.4 are high by international standards -- and more than double the average share of 16 percent for Sub-Saharan Africa as a whole (World Bank (1994), p.38). It is clear that Tanzania's poor growth performance cannot be attributed to low levels of capital formation. The issue is one of quality rather than quantity. Low quality of investment during the pre-crisis and crisis periods is easily explained by the highly distorted macroeconomic environment and, in the crisis period, by the government's dogged pursuit of the BIS in the face of collapsing foreign exchange availability. The latter policy, buttressed by the donors' preference for financing capital expenditures rather than recurrent ones, meant a strangulation of imports of intermediate goods which drove the capacity utilization rate in manufacturing below 30 percent in the early

Figure 7.5 Real Gross Capital Formation

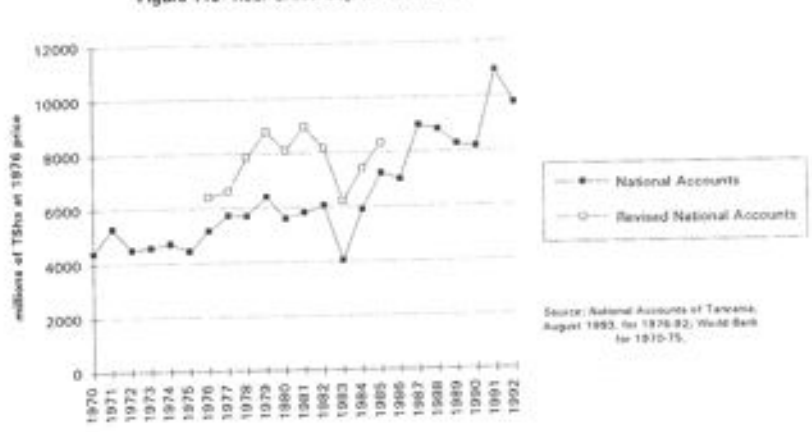
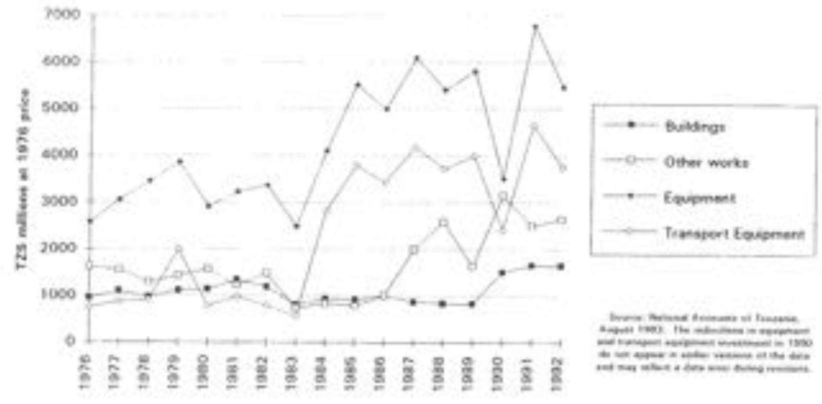


Figure 7.6 Real Capital Formation by Type of Asset



1980s.[12] An investment puzzle remains in the 1990s, however. With extremely high investment in the current aid boom, why has output growth been so modest? The evidence suggests that the productivity of investment has improved, but that it still falls significantly short of levels typical of other adjusting African countries. Using the change in output per unit of investment as a rough measure of investment efficiency, Tanzania's level of efficiency in the 1986-90 period -- 15 percent -- was lower than that of Ghana, Kenya, Malawi, Senegal and Uganda (Agarwal, *et al* (1993), Mans (1993)). Moreover, while efficiency increased markedly in Tanzania between 1981-85 and 1986-90, it increased by more (in levels) over that same period in three of the five comparators. Rough calculations in Gavin (1993) similarly suggest that total factor productivity may not be markedly higher in the post-reform period than pre-reform.

[12] The story is well told in White *et al* (1993).

The first phase of reforms in Tanzania was clearly designed to address the more drastic distortions associated with quota protection and non-market pricing of foreign exchange. A second constraint on investment productivity in Tanzania, however, is the dominance of the public sector in the allocation of credit. Until the banking sector reforms initiated in 1992, the parastatal sector had automatic access to credit from the monopoly commercial banking sector (The National Bank of Commerce is itself a parastatal), which in turn had automatic access from the Bank of Tanzania. The vast bulk of NBC's lending was to the parastatal sector; in 1980 the private sector accounted for less than 8 percent of NBCs outstanding loans. The parastatal sector made enourmous losses through the 1980s (see Eriksson (1993)), representing a major drain not only on the budget but also on credit from the banking sector. The point is simple: without hard budget constraints, relative price changes are not likely to produce major reallocations of resources or major productivity gains. To a large degree, the parastatal sector, and particularly the marketing boards and (quasi-public) cooperative unions during the reform period, were able to pass a major portion of the relative price changes they faced into greater losses that were financed by the budget or banking system.

Parastatal reform was acknowledged as a priority at the highest levels of Tanzanian government as early as 1985 and had important support within the government since at least the early 1980s.[13] Action has come only recently, however, and primarily in the form of (1) a transfer of bad debts from NBC to the government and the adoption of standard commercial practices in its lending; (2) the creation of the Loan Advances and Realizations Trust (LART) to liquidate nonperforming assets; and (3) creation of the Parastatal Sector Reform Commission (PSRC) to oversee the privatization effort. In the meantime, the shift of investment towards the private sector (Table 7.4) has clearly come at the expense of central government rather than the parastatal sector. The parastals suffered a sharp decline in investment share during the crisis period but then increased their share during the reform period as the central government share fell by more than half. While the parastatal share of investment fell back in the early 1990s to the lower level prevailing in the early 1980s, the level is still high and out of proportion to the sector's contribution to GDP. As emphasized by Gavin (1993), Eriksson (1993) and others, the delay in parastatal reform has almost certainly exerted an important drag on growth.

Recent evidence is on balance encouraging about the productivity of investment. NBC loans outstanding to the private sector increased from 7 percent of the total in 1985 to nearly 30 percent in the second half of 1993. The shift in overall investment towards the private sectoris considerably greater than this and suggests that the private sector has considerable access to informal sources of finance (Mans (1993)). Surveys conducted by the World Bank find that firms in the industrial sector that were inefficient in 1985 increased output significantly more between 1985 and 1990 than did the less efficient firms; and a greater efficiency in foreign exchange usage was a hallmark of the expanding firms.[14] Private sector firms also expanded significantly relative to public sector firms. The Government's new investment code (adopted in 1990) makes a substantial departure from past policy by embracing the need to promote private sector investment (both private and foreign).

[13] Bagachwa *et al* (1992) note that the Tanzanian Advisory Group had expressed serious concerns about parastatal performance in 1982 and that President Mwinyi, soon after taking office, spoke publicly of taking an "iron broom" to clean up the parastatals.

[14] Details appear in Mans (1993).

7.2.5 Fiscal Performance

The most dramatic hallmark of the beginning of the crisis period was an increase in the government deficit by roughly 10 percent of GDP in 1979, associated primarily with the war in Uganda. The data in Figure 7.7 suggest that government spending as a share of GDP has followed the general pattern of net aid transfers, rising dramatically over the 1970s with fluctuations associated with the OPEC shock and the coffee boom, falling steadily over the crisis period and then rising steadily again during the reform period. The deficit also follows aid transfers in the pre-crisis and crisis period, since revenues are relatively stable as a share of GDP over the 1970s and early 1980s. Some fall in the revenue share is apparent in the crisis period, however, and then a marked improvement in revenue performance takes place during the reform period.

There is no obvious evidence of a discouraging effect of aid inflows on tax effort in Figure 7.7 (cf. Figure 7.1). The stronger effect, apparent during the crisis period and more dramatically during the reform period, is a direct positive link between aid and revenue generated by the dependence of revenue on the import base. Figure 7.8 makes this point dramatically. What is difficult to determine, of course, is how fiscal decisions reflected in Figure 7.7 would have differed if large aid inflows had not been available for budgetary support, whether explicitly (as counterpart funds) or implicitly (as partially fungible project support). The evidence from the crisis period -- when spending rose more rapidly than external loans and grants but then fell less rapidly when aid fell -- suggests that monetary finance, rather than tax revenue, would have operated as the marginal source of funding.[15]

What is clear is that the current fiscal situation is unsustainable in two key respects. The first is that the quality of government spending in its core areas of responsibility -- such as infrastructure, education, health -- has been seriously undermined during the 1980s and 1990sby reductions in public sector wages and underfunding of intermediate input costs.Retrenchment of 50,000 public sector workers is an aim of the current civil service reforms,and a focusing of government

[15] Gavin (1993) also finds no effect of aid flows on government consumption in Tanzania. This may in part be an artifact of the automatic classification of all project-related spending as development spending, even though an important component of it is recurrent.

spending on core activities is a central feature of the new Rolling Plan and Forward Budget adopted for the first time in the 1993/94 budget. The second is the extraordinarily high degree of aid dependence. The World Bank estimates that in 1993/94, donors will fund more than 80 percent of the development budget and a third of recurrent expenditures. The implied dependence of recurrent spending is even higher, given that a quarter of the development budget covers project-financed recurrent (World Bank (1993)).

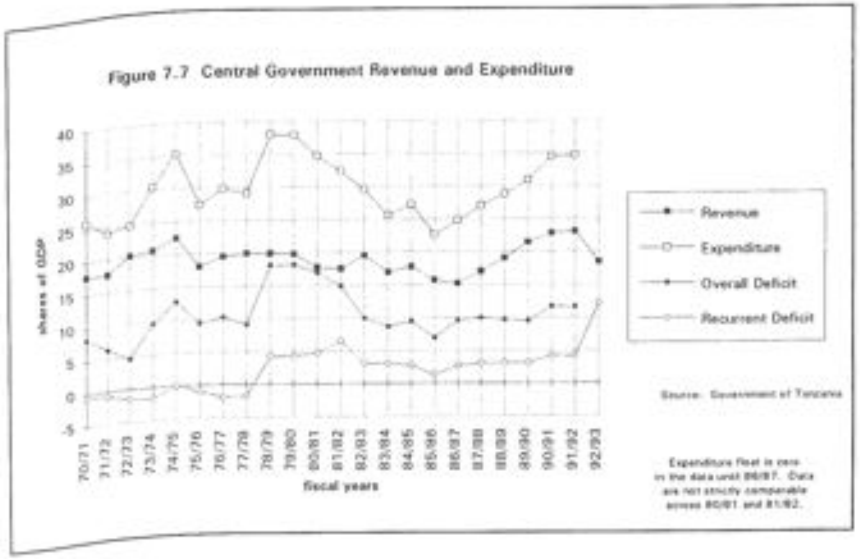


Figure 7.7 Central Government Revenue and Expenditure

Fiscal problems are at the center of the recent failure to meet IMF programme targets and the resulting suspension of the programme. The problem is evident in Figure 7.7, which shows a fall in government revenue by nearly 5 percent of GDP in 1992/93. Three are three reasons for the

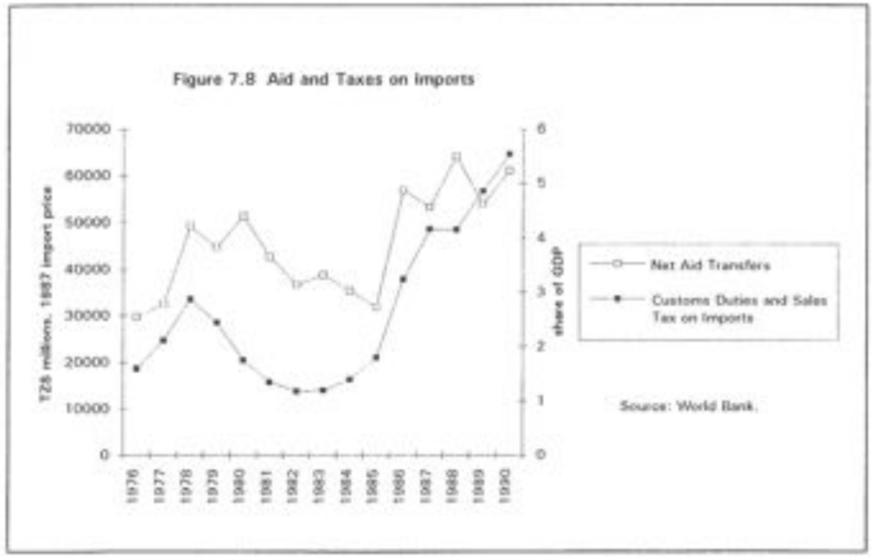


Figure 7.8 Aid and Taxes on Imports

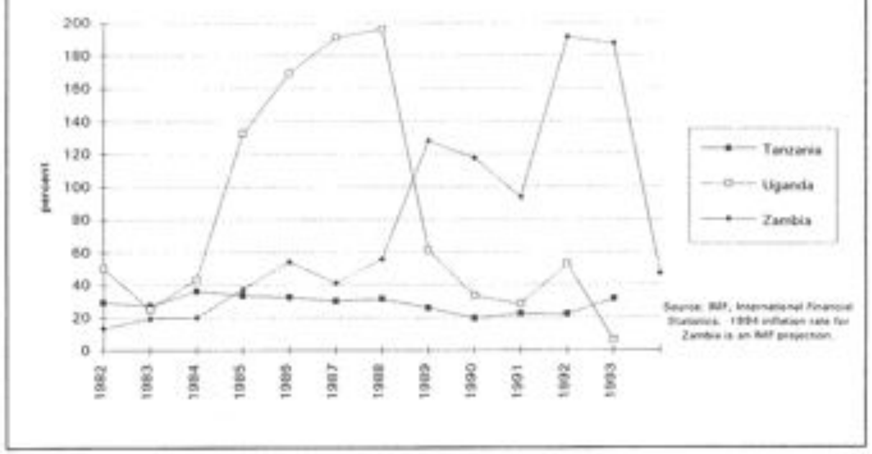
revenue collapse. The first is the package of tariff reforms implemented early in the fiscal year that lowered rates in the interest of increasing compliance. Exemptions were supposed to be tightened as a complementary measure, but this did not occur and exemptions appear, if anything, to have increased. The second is a fall in import capacity associated with withholding of import support as donors awaited the Government's report on arrears in countervalue payments. This reduced the import bill directly and thus the base for customs revenue. The third is a fall in revenue productivity of customs officials. Lack of data makes it impossible to assess the relative importance of these three explanations, but all three have been alleviated to some degree in the current fisal year. Import support flows have largely resumed, the Government has imposed extraordinary revenue measures including an increase in customs duties and sales taxes (including incorporation of excise duty in sales tax base for imports), and customs assessment is now in the hands of two foreign firms. As of March 1994 it appeared as if the modest revenue targets in the shadow program were being more than met.

Clear dangers remain, however, on both the revenue and expenditure sides; among the latter are included a large increase in wage payments to the military and TZS 65 billion in expenditure float from fiscal year 1992/93 -- the result of inadequate control of last-minute spending in light of poor revenue performance.

A key facet of the shadow program is the cash budget, in which monthly spending at the level of ministries and regions is limited to current revenues. The cash budget is undoubtedly draconian and will lead to some degree of inefficiency as legitimate spending is deferred in the face of liquidity problems. Similar schemes have been implemented recently in Uganda and Zambia, where they have been instrumental in bringing down rapid inflation (e.g, Adam (1994)). A key role of the cash budget in these countries, given their histories of monetary instability, has been to bring down private sector expectations about inflation by raising the cost of monetary finance to the government. On the face of it, it is remarkable that such extreme measures have been implemented in Tanzania, since a stabilization problem of this sort does not exist there (Figure 7.9). But liberalization of the exchange rate regime has undoubtedly increased the ease of substitution between shillings and foreign assets in Tanzania, and the government has moved towards a more active targeting of the real exchange rate -- thus forsaking any role of the nominal exchange rate as an "anchor" for private sector expectations about inflation. Both developments increase the potential for a rapid and destabilizing pass-through of fiscal indiscipline into inflation. The cash budget may therefore have a rationale as a preventative measure, rather than as a cure for a pre-existing stabilization problem.

A second, and perhaps more fundamental role of the cash budget in Tanzania is to improve

Figure 7.9 CPI Inflation Rates in Tanzania, Uganda and Zambia



fiscal performance by hardening budget constraints at the level of spending units. This will (1) force prioritization by the ministries and regions -- a process already envisioned in the Rolling Plan and Forward Budget -- (2) focus pressure on the Treasury for improved revenue generation, and (3) heighten the public and intra-governmental outcry against the excessive granting of customs exemptions and other tax privileges by officials at the highest level.

The final aspect of the current fiscal situation is the Treasury bill auction introduced in late 1993. Planning for this was initiated in the early 1990s, at a time when fiscal perfomance looked on a reasonably stable course, as part of an overall strategy of moving from direct to indirect instruments of monetary control. Far from allowing a divorce of monetary and fiscal policy through open market operations, however, the auction has rapidly -- particularly in the face of tight IMF programme (and shadow programme) targets for domestic credit -- become a major and extremely costly source of financing for the government. Real interest rates are high -- roughly 25 percent -- and pose a clear fiscal fiscal danger If interest and principal continue to be rolled over, the interest bill will increase, relative to GDP, at the difference between the nominal interest rate and the growth rate of nominal GDP -- a difference that is currently at least 20 percent. The difference will be even faster if the auction continues to be used for new borrowing above and beyond the rolling over of existing debt. The arithmetic is daunting and implies the rapid emergence of a strong incentive for inflation as a way of reducing the real burden of debt repayments. In the meantime, the high real interest rates contribute to a credit crunch in the formal financial sector and attract foreign inflows which appreciate the real exchange rate. Given the large amount of bills already outstanding -- TZS 50 billion in March, 1993 -- these considerations must be faced squarely if the government is to avoid the emergence of a stabilization problem or the undercutting of its credibility if it chooses to default more directly (e.g., by declaring a moratorium on interest payments, as Nigeria did with its T-bill auction in recent memory).

8. AID, GROWTH AND DEPENDENCY

Aid has complex effects on the macroeconomy and political economy, and donors should obviously be particularly concerned with dysfunctional effects. While it is difficult to speak meaningfully of an aid program that is "optimal" from the donor's viewpoint a program that is at least defensible must have two efficiency features. First, the overall *size* of the program should be appropriate in the sense that the marginal value of aid over the donor's planning horizon is roughly commensurate with its marginal cost in terms of the donor's other objectives (either domestically or with other aid recipients). Second, given the size of the program, its *structure* -- broadly construed to include both the allocation of resources across activities and the way in which aid is delivered and outcomes are monitored -- should be such that the contribution of the overall aid budget to the donor's objectives (which may include any degree of pure altruism) is maximized, or at least obvious opportunities for efficiency gain are exploited. Size and structure are often interlinked -- for example, threats of cuts in program size may play the important structural role of influencing the actions of the recipient government. But there is also a natural hierarchy to the two dimensions, in the sense that structural failures reduce the effectiveness of aid on the margin and increase pressure for a reduction in program size even if there are gains to maintaining or even increasing the size of the program.

Tanzania experienced a major bout of aid fatigue in the early 1980s, and we have emphasized the positive role aid reductions played in bringing about major policy change. The current situation, with the formal IMF program suspended and clear signs of donor disenchantment, raises the possibility that the third phase in the evolution of the aid relationship is about to end. Donor disenchantment is likely to be accompanied by vigorous attempts to tighten conditionality or alter the nature of aid, and possibly also by a breakdown in the consensus among donors that has supported the formulation and coordination of policy advice in the reform phase (though there is no sign of serious conflict within the donor community as yet). There may be significant changes in the relative importance of different donors and in the coordinating role of the World Bank. These occur against the background of a deteriorating position of President Mwinyi over the Zanzibar issue, an upcoming (1995) Presidential election, a crisis in the public sector, and -- as we have emphasized -- clear evidence that the Tanzanian economy is working much better today than it was before the beginning of reforms. In such a situation it will be difficult for donors to proceed constructively without developing a view as to the fundamental nature of the recent policy failures. The next five chapters take a more analytical approach to selected issues in the Tanzanian aid debate. Our aim is not to resolve these issues but to suggest avenues for thinking about them. We begin in this chapter with a discussion of aid dependency.

Aid is primarily motivated by the desire to alleviate poverty. This can legitimately be motivated both by altruism and self-interest: for example, fear of the long term consequences of a large and alienated impoverished population. However, aid gives rise to the disutility of paternalism and dependency. These are more tolerable if the aid relationship is seen as temporary, but this in turn implies that aid should enhance growth. Donors should therefore wish there to be a high savings rate out of aid, but should not be disturbed if this is significantly less than 100%. A rate of 100% would only be justified if the donor attached no weight to the alleviation of current poverty. The World Bank's latest study *Adjustment in Africa* finds an investment elasticity of .6 with respect to net aid transfers across 29 African countries that underwent adjustment programs in the second half of the 1980s. If correct, this would seem to be a reasonable compromise between current poverty alleviation and future growth.

The role of aid in the growth process implies that market forces are inadequate, due for example to big-push externalities. However, since the formulation of these ideas (in the 1950s) the world capital market has expanded enormously, and non-African developing countries have both attracted very large capital inflows and achieved high domestic savings rates. Africa has almost completely missed out on world capital flows and has a low domestic savings rate. This can be interpreted as strengthening the need for aid as long as these failures are not attributable to the aid relationship.

Both public and private financial inflows must take some view as to what to do in the event of poor economic performance. This was a central challenge for donors in Tanzania as export performance deteriorated in the 1970s; it is a central issue now in the face of a perceived slowing of the pace of reform and the clear prospect of continued very high aid requirements. We consider three broad interpretations of poor performance. The first is risk. Since Africa is a high risk environment (for example, due to external shocks), the contractual structure of capital flows should address the issue as to who bears this risk. The negative shocks of the 1980s revealed that

African governments were bearing too much of the risk associated with capital inflows. As a result, contracts could not be honoured and so capital providers, public and private, were required to bear much of the risk *de facto*, through renegotiation of debt payments. The need for renegotiation demonstrated the inadequacy of the previous contracts: insufficient attention had been paid to contingencies. With regard to private capital inflows, the high risk environment would have been better suited to equity than to bank loans since capital suppliers would then have explicitly borne the risks which with bank lending they only bore implicitly. Public capital providers have no direct equivalent to the choice between equity and bank lending, but the same considerations apply. Contracts in which payments from Africa in return for the initial inflow are unrelated to contingencies which powerfully effect the capacity to make those payments are inappropriately specified and run the risk of default and renegotiation. Default is intrinsically highly undesirable because it undermines the sanctity of contract and thereby weakens the reputation of the defaulting party in all future contracts. The donor's reputation is also undermined to the degree that it ignores breach of contract in order to avoid a loss of its own gains from the aid relationship.

Contingencies should therefore be included explicitly in the aid contract to minimise the risk of unavoidable default. Additionally, donors should want to include contingencies as a means of providing insurance which the private market has failed to supply. For example, during a drought or a temporary decline in the terms of trade it is appropriate for aid to cushion consumption. Rather than this been done by means of ad hoc emergency relief, it is better made more reliable by incorporation into the aid contract. Thereby, governments know that they have some insurance, whereas with emergency relief they have an incentive to allow problems to escalate into crises.

Were risk the only reason for poor performance then contingent contracts would be simple. However, in providing insurance, donors face the standard moral hazard problem (although the aid community tends to use the language of dependency). The moral hazard problem is that the recipient of the aid will change behaviour, for example, maintaining a more overvalued exchange rate or reducing tax effort. Contracts should therefore be conditioned on observable aspects of effort, such as exchange rate policy. In many cases, however, effort is difficult to observe and only outcomes -- like tax revenue -- that are correlated with effort are readily observable. This strengthens the argument for inclusion observable contingencies over which the recipient has no control, such as the terms of trade and the weather, since these help the donor distinguish low effort from bad luck. This leads into a discussion of conditionality which is deferred to Chapters 9 and 10.

A third reason for poor performance is if the donor has made errors. These can be of two types. The donor and the government may have agreed upon an economic policy which subsequently comes to be understood as not being best-practice. For example, the rural development policy agreed between Sweden and the government of Tanzania during the 1970s can now be seen to have been mistaken in many respects not readily knowable at the time. The present consensus in favour of outward-oriented policy and minimal state involvement in productive activity represents a convergence of views based in part on evidence that was not available at the time of the Arusha Declaration. In such cases, poor performance is endogenous to the aid programme but not culpably so (as long as the donor and the government jointly learn as best practice evolves).

A more radical way in which donors might make errors is if they overestimate the scope for development. In such a case, performance would only be poor relative to an erroneous counterfactual. On the whole development performance other than in Africa has exceeded expectations, and so arguments along these lines would need to be Africa- (and particularly Tanzania-) specific. What is clear is that the reforms underway in Tanzania represent a major shift in development paradigm. A counterfactual that implicitly assumes that institutions, attitudes and capabilities can be reconfigured as readily as relative prices is bound to produce a sense of frustration and stalled progress among donors and raise questions about the government's commitment to reforms, even if progress is proceeding rapidly when judged by more reasonable standards.

9. UNDERSTANDING CONDITIONALITY

While there are undoubtedly economies of scale in the delivery of aid (associated for example with accumulated country experience and a spreading of administrative overheads), increasing the size of an aid program eventually brings diminishing marginal benefits to the donor even when the aid is channelled through a high-quality policy environment. But the quality of the policy environment exerts a fundamental influence on aid effectiveness independently of program size. This realization has been a central feature of donor thinking about aid to Tanzania since at least the early 1980s.

A very simple example illustrates how a policy distortion can make the contribution of aid negative. Consider a two-sector small economy described by the production possibility frontier shown in Figure 9.1, which is assumed to be operate with a capital intensive importables sector (M) and a labour intensive exportables sector (X). Being small it faces given world prices for both goods so that production at world prices would be at A which would produce a national income, measured in terms of importables at world prices, of y^*. Suppose however that domestic policy favours heavy protection of the import-substituting sector. Domestic relative prices are then given by the tangent at point B which corresponds to a level of national income y, measured in world prices. The domestic price distortion thus lower national income relative to the free-trade configuration. Consider now what happens to the economy with an aid inflow which is devoted entirely to investment (so that we ignore the fungibility between consumption and investment). Given the structure of domestic prices the aid inflow will be attracted into the capital-intensive import-competing sector, and production will occur at C which *lowers* future GDP (to y_A) relative to the no-aid situation.[1] If however the aid flow were accompanied by conditions requiring the elimination of protection production would move to a point D and a *higher* future GDP. Only if it could enforce this conditionality would a donor concerned about output growth at world prices give aid to this economy. The example just cited is extreme but it makes the central point that there are circumstances in which the effectiveness of aid is not intrinsic to the

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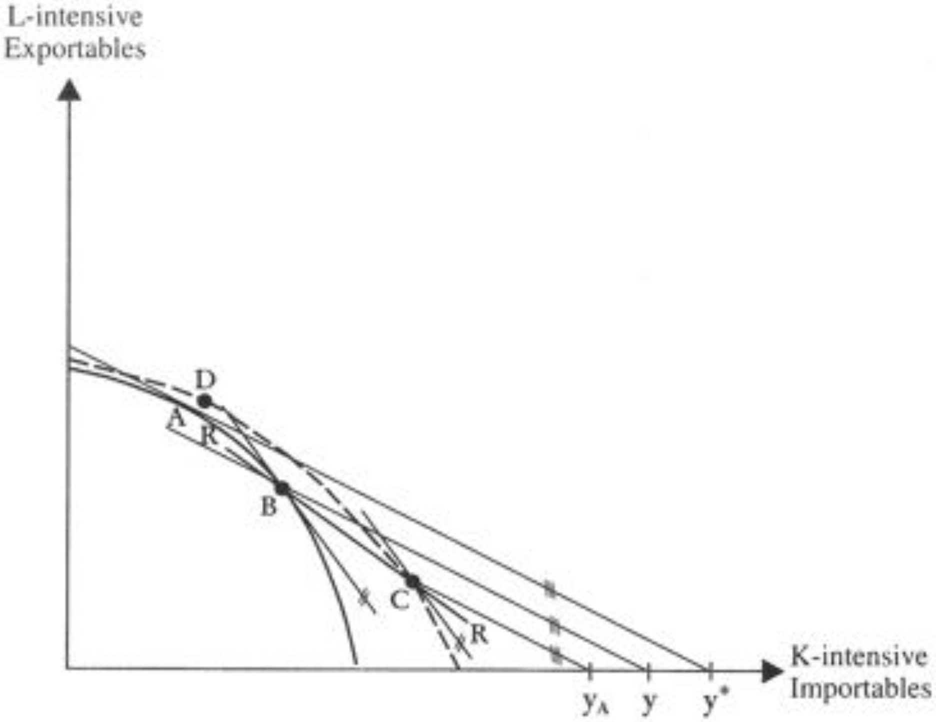
Figure 9.1: Aid-Financed Investment Under Protection of Capital-Intensive Import-Substituting Sector



macroeconomics of aid itself but rather to the interaction of aid and the policy environment. In spite of its obvious limitations -- for one thing, donor aid clearly adds to current consumption and to human capital formation as well as to physical investment -- this caricature captures important features of the Tanzanian environment of the 1970s and early 1980s. The entire policy regime favoured the continued expansion of an import-substituting parastatal sector that produced major losses at world prices.[2] At the height of the import compression phase in the early 1980s, effective rates of protection in industrial sector averaged 500 percent (Mans (1993)), as import compression raised the rewards to production for the protected domestic market and foreign exchange was channelled to favoured users at highly overvalued prices. The relative price of capital goods was lowered by direct rationing of credit at below-market interest rates and by the preference of donors for supporting capital expenditures in the public sector rather than recurrent ones, producing exactly the kind of capital-intensity bias in the import-substituting sector depicted in the example. It should be clear that given these initial conditions the effectiveness of aid without policy reform was bound to be limited and may well have been negative on the margin. In the remainder of this section we therefore focus on some issues of aid and conditionality. We commence with a discussion on why such policy distortions may exist in the first place and how this may lead to the emergence of policy conditionality, either demanded by the donor or requested by the recipient government. An important extension to these results is the case where for various reasons the donor cannot fully monitor the true effort of the recipient government. Aid flows can substitute for efficient policy action on the part of the government and this is a particular problem when the donor is unable to determine whether particular outcomes are due to bad luck (arising from external shocks) or to slack economic management. Understanding these moral hazard features in the relationship between the donor and recipient government points towards a set of design issues.

9.1 The Emergence of Inappropriate Policy Environments

There are three reasons why the policy environment may remain poor. The first is that governments may simply be mis-informed as to the consequences of a policy. A good example

[2] The distorting of decisions away from the maximization of value added at world prices operated not only with respect to capital, but also with respect to rural land and labour, formal sector employment, and access to imported inputs and consumer goods (Collier (1991) provides a detailed discussion).

of this can was the view that maintaining an overvalued official exchange rate was a means of avoiding cost-push inflation. If government believed this, then it would not of its own accord devalue the official exchange rate even though had it done so it would have found its previous views to have been incorrect.[3]

A second reason for the existence of what are seen by the donors as "bad policies" is that donors and the government have divergent preferences over policy choices. We do not need to discuss in detail why preferences may diverge, but possible explanations would include different weights placed on investment over consumption, divergent views on the trade-off between current employment and future growth, and the choice between import protection and export promotion as a means of fostering growth. A further source of divergence arises where the donor and recipient hold different views about distributional issues. For example, there may be domestic political constraints on governments requiring the use of distortionary transfer mechanisms. An overvalued official exchange rate is one such mechanism which taxes exporters surrendering their export proceeds at the official rate and subsidizes importers with access to foreign exchange priced at the official rate. Even though such transfers may be necessary for a government to remain in power, donors may not acknowledge these political constraints.

A third case for bad policy is where both the government and the donor agree that the policy is bad but if the government cannot signal its commitment to new policies due to reputational problems. Credibility problems of this form are endemic to policy reform because of the intrinsic time-inconsistency of government actions. Governments have the sovereign power to alter economic policy (for example through tax rates), and the knowledge that they have an incentive to alter the tax rate once the private sector has made irreversible commitments (ie investments) will deter the private sector from acting in the first-best interests of the government. Such credibility problems disappear if the government is able to offer a means of pre-commitment to a set of policies. Getting around this problem requires that governments either find mechanisms to pre-commit themselves not to reverse policy changes or find mechanisms to create a reputation for not reversing previous policy.

[3] This argument is made in the context of Uganda by S.Morris (1994).

9.2 Aid and Conditionality in the Face of Bad Policy

Conditionality, and particularly macroeconomic conditionality, has emerged as an important component of adjustment lending in the 1980s and 1990s. While conditionality may in part reflect bureaucratic or managerial requirements within the donor country, or may simply represent a convenient form of packaging and coordinating the donor community's policy advice, by far the most important motive is in terms of addressing inappropriate policy environments. Of the three reasons why a bad policy environment may exist, the first is the easiest to handle. Conditionality provides a means of forcing governments to "see the error of their ways". The more interesting cases are when there are disagreements between the donor and the government and where there are credibility problems. A simple model of aid and disagreement can be found in Appendix 1 to this chapter. The model considers a simple case where there are only two activities which can be financed by aid, namely the creation of infrastructure and the provision of patronage. Throughout it is assumed that donors receive utility from aid flows but that their relative preferences for the two activities financed by aid differ from those of the government (this is the essence of the disagreement, and that we assume that the donor places a larger weight on the provision of infrastructure than the government).[4] Moreover there is some opportunity cost to the aid dollar, either in terms of domestic uses or as an allocation to another country. Finally it is assumed that even though donors may place a low weight on patronage, it may not be possible for political reasons to reduce the amount of such goods financed through aid.

The principal implications from the model are as follows. First, while disagreement between donor and recipient undercuts the "gains from aid", an equally fundamental effect is to undercuts the ability of the participants to capture these gains without conditionality. Conditionality delivers efficiency gains and in many cases allows aid flows to be larger. In effect, conditionality serves to commit the recipient to reducing the relative price of the infrastructure in terms of patronage.

Secondly, if the donor has strong bargaining power it may be possible to sufficiently alter the relative cost of infrastructure in term of patronage that the gain in terms of the provision of

[4] Thus patronage and infrastructure are catch-all terms for activities relatively more highly valued by the recipient and donor, respectively.

infrastructure may be greater than the aid inflow. In such circumstances the aid inflow is associated with a greater-than-proportional increase in infrastructure and a decline in the level of patronage relative to the non-aid position. Conversely in the situation where the recipient has strong bargaining power, conditionality would be pareto-improving but a greater share of the gains from conditionality would accrue to the recipient. The increase in infrastructure provision would be smaller than the aid inflow and the level of patronage would rise above the no-aid position. These points are illustrated in Figure 9A.3.

Third, political solvency conditions may place a lower bound on the supply of the patronage goods and this will therefore limit the gains to conditionality enjoyed by the donor. This case is also illustrated in Figure 9A.3. More generally, the position of the contract curve will reflect the level of disagreement between the donor and recipient, the opportunity cost of aid to the donor, and also the domestic resources of the recipient. Changes in any of these factors will shift the whole contract curve. Movements along the contract curve, on the other hand, reflect the bargaining power of the parties, although the model presented here does not provide an explanation of the bargaining power. Nonetheless it is possible to consider the effect of changes in the determinants of the "outside option" of donor and recipient. First, as the donor and recipient increasingly disagree in their preferences between "infrastructure" and "patronage" the contract curve will flatten and for each aid level the contract curve level of "infrastructure" will be higher. Second, as the own resources and the outside option for the recipient deteriorates then the contract curve extends towards the x-axis and if the donor enjoys bargaining power this will move the outcome in favour of the donor. Third, as the donor's opportunity cost of aid increases, and as its outside option improves, the maxima of the donor's utility curves move to the right and thus all points on the contract curve move horizontally in favour of the donor. For each level of aid, the provision of infrastructure is higher and the provision of patronage is lower than before.

These simple results are quite consistent with the evolution of conditionality in Tanzania since the late 1970s. The aid relationship was characterized by broad agreement between Tanzania and its donors in the 1970s; as stated in the lead quotation to chapter 7, if the Arusha experiment had not existed, the western donors would have had to invent it. Agreement was enhanced not only by the pro-rural, pro-equity, pro self-reliance dimensions of the Arusha strategy but also by the

impeccable standards of public service embodied by President Nyerere. The Arusha strategy was particularly attractive to donors with a strong ideological bent towards socialism. Agreement meant little perceived role for conditionality, and indeed little was imposed in the 1970s.

In terms of macroeconomic policy, disagreement first emerged over the exchange rate as evidence of a secular export decline became apparent in the late 1970s. The IMF's attempt to impose conditionality on the exchange rate, a view supported early on by more market-oriented donors, was spurned the early 1980s by President Nyerere, with the support of the more sympathetic donors. For donors who viewed exchange rate adjustment as essential, disagreement without conditionality meant reductions in the amount of aid they were willing to provide. Aid fell starting in 1980. Donor views hardened with the emergence of the Berg Report criticizing African governments for creating their own difficulties, with the tilt towards conservative, market-oriented governments in major industrial countries, and with the emergence of high real interest rates and unemployment in the United States and Europe. By the mid 1980s the Tanzanian economy was in extraordinary straits and as the sympathies of the Nordic donors turned against President Nyerere, it was obvious that bargaining power was completely in the hands of the donors and that aid flows would fall permanently in the absence of a conditionality package -- centred on the exchange rate but now including a wide range of other requirements. Aid resumed when the agreement with the IMF was reached in 1986.

By this interpretation the capitulation of President Nyerere in 1985 reflected changes in the relative outside options of the donor community and the domestic groups opposed to reform *within a framework of disagreement*. But the growing macroeconomic crisis also strengthened the hand of groups within the government who favoured policy reforms similar to those being pushed by the IMF. In this sense the succession of President Mwinyi, himself strongly sympathetic to market-based reforms, suggests not only a donor victory over the exchange rate and similar issues, but also an immediate reduction in the degree of conflict between donor and recipient and thus, in the framework of the model, a reduction in the need for conditionality. In contrast, however, conditionality has remained important, and indeed has become increasingly tight as bargaining power has further shifted towards the donors in light of increasing domestic demands for accountability and the emergence of pressing other external uses for funds --

including in Eastern Europe and the former Soviet Union.

The persistence of conditionality in the face of broad agreement about the policy framework leads us to the third case discussed above, in which there are impediments to the government moving to the jointly preferred configuration. The Tanzanian political economy has been remarkable for its continuities -- including its ability to weather the collapse of the crisis period without serious domestic unrest -- and a dramatic reconfiguration in favour of headlong reform was clearly out of the question in the mid 1980s. President Nyerere retained immense popular support and remained highly influential as Party Chairman (until 1990). More fundamentally, two decades of state-led growth had disenfranchised those groups with most to gain from reforms -- the rural producers -- and created an enormous public sector with powerful vested interests that were at risk with each further step of reform. Inevitably therefore, the donors have continued to prefer a more rapid pace of reform than the politically-constrained government. If we re-cast the earlier discussion in terms of the differing preferences between the blocking coalition on one hand and the government/donor on the other, the same analysis applies. The evolution of tighter conditionality during the 1990s -- and its extension into politically sensitive areas like public sector retrenchment and privatization -- is then consistent with government being in agreement with the donor, with conditionality being able to alter the behaviour of the blocking coalitions.

9.3 Credibility

We have emphasized that a lingering asymmetry in the desired speed of reform -- within an overall context of agreement -- provides some explanation for the continuation of tight policy conditionality in Tanzania. A final role for conditionality in an overall context of agreement is to help the government commit to policies that are in its own interest but which it lacks the credibility to carry through alone. Examples include export promotion schemes which require budgetary outlays. The effectiveness of such schemes is undermined by a simple time-consistency problem: the government promises subsidies in return for more exports, but once the private sector has irreversibly committed resources to the export sector, the government faces strong pressure to renege, having achieved its objective. Papageorgiou *et al* (1992) find poor budgetary support was a major reason for ineffectiveness of export subsidies in a sample of developing

countries; in Tanzania, a duty drawback scheme for exports had little success as an export promotion device in the late 1980s for the same reason (Mans (1993)). Similar difficulties plague any policy that relies for its success on a private sector supply response, including trade liberalization and real exchange rate depreciation. As long as adjustment costs are important for the private sector, resource movements will be less responsive to relative price signals when governments have low credibility than when their credibility is high.

In the limit, the lack of credibility in government policy may be self-fulfilling. The private sector expects a trade liberalization to be reversed and therefore aggressively builds inventories of imported goods in the short period of low relative prices; this depletes the government's reserves and crushes the domestic import substituting sector, leading to a re-imposition of controls. Governments therefore have an incentive to use aid (and also the design of aid) to purchase credibility for its programme so that the private sector will respond to the policy reform. This requires, of course, that failure to adhere to the contract conditions on the part of the government must be met by a cessation of aid on the part of the donors.

In general it would appear that government credibility problems are not as profound for the Tanzanian government as they have been are in some neighbouring countries (e.g., Uganda and Zambia) where major policy reversals have been more dramatic and frequent. Part of this may precisely be because the donors have accommodated a gradualist approach with respect to variables other than the exchange rate -- and with the exchange rate, precipitous action was earned by the donors during the war of attrition in the early 1980s. Investment has been strong during the reform period, suggesting that expectations of reversal are not paralysing this aspect of the private sector response, although we have also emphasized that the sectoral reorientation of investment in response to real exchange rate depreciation has been limited. One aspect of policy in which government credibility is probably most at risk is with respect to the hardening of budget constraints in the parastatal sector. Moving NBC's lending to a commercial basis required the transferral of substantial amounts of its uncollectible claims, mainly on the parastatal sector, to the Government. The Government now bears the burden of committing credibly not to bail out NBC again. Should major bad debts arise, however, the Government's concern for the viability of the financial system as a whole would compel it to intervene. The question is therefore whether donors -- who are effectively financing the recapitalization of NBC -- are in a stronger position than the Government to make the bailout a one-time event. It is likely that the need to answer to domestic constituencies, and reputational concern vis-a-vis other recipients, would strengthen the resolve of donors if approached for a repeat performance. But in the meantime there is a strong argument for close monitoring and technical assistance to NBC to prevent the re-emergence of bad debts.

Appendix 9A: A Model of Aid and Conditionality

9A.1. The motives of donor and recipient

There is a conflict of interest over the allocation of resources, particularly aid flows between two alternative uses, "patronage" (P) and "infrastructure" (I). The recipient government gets positive but diminishing marginal utility from both objectives and seeks aid inflows in order to increase its own utility. For simplicity, we assume that the recipient's utility function takes the separable form

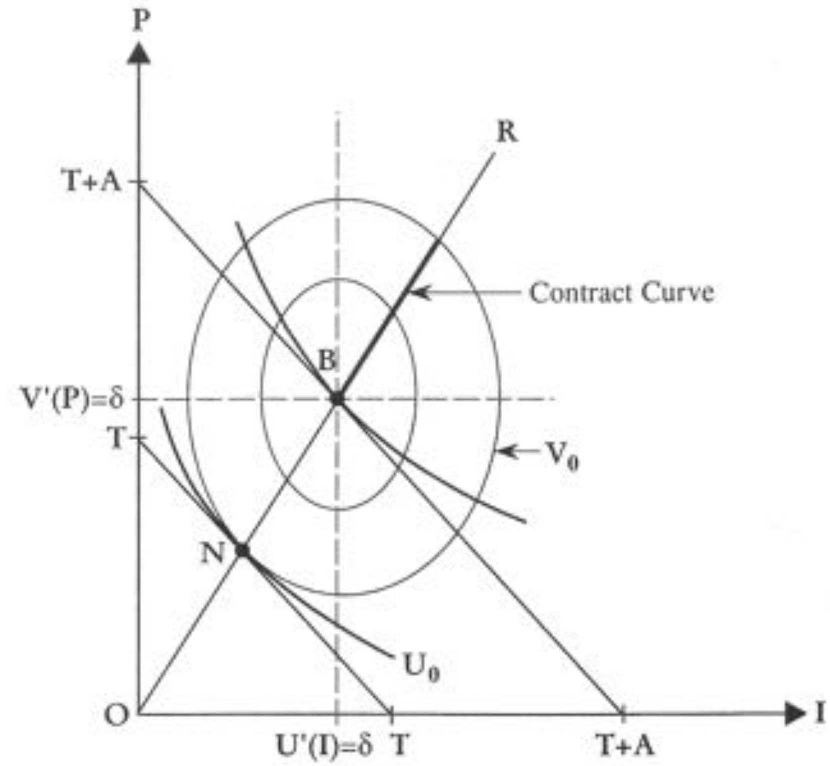
(1) $$U(I,P) = u(I) + v(P), \quad v',u' > 0,\ v'',u'' < 0.$$

In the absence of aid, the recipient has total resources T to allocate between the two activities. If the price of each activity is 1 and the amount of aid received is A, the recipient's budget constraint takes the form

(2) $$I + P = T + A.$$

Figure 9A.1 shows the recipient's allocation of total resources with and without aid in amount A, assuming that the aid comes without conditionality. The 'no-aid' point is N, with utility level U_0; since both infrastructure and patronage are normal goods, increases in aid will be allocated to both activities on the margin. We have assumed for simplicity only that U is homothetic, so that the expansion path associated with changes in total resources, OR, is a ray from the origin.

Figure 9A.1: Unconditional Aid Under Agreement



N: No-aid point

B: "Bliss" point (optimum for both players)

The donor's preferences reflect three key features. First, the donor has limited resources and therefore has alternative uses for each dollar of aid, which may be to reduce domestic taxes or to allocate to another country. Second, disagreement is a matter of degree and we want to allow for cases in which disagreement is either negligible or dramatic. Third, disagreements (if any) are fundamentally over the relative weight to be placed on the recipient's domestic objectives. We can capture these features by assuming that the donor's utility depends not only on the recipient's utility but also on the donor's own domestic activity, D:

(3) $$V(I,P,D) = U(I,P) - \theta v(P) + \delta D$$

The case of complete agreement[5] is where $\theta = 0$: in this case, the donor takes the recipient government's utility as its own and is only constrained by the existence of competing demands at home. Disagreement occurs when $\theta \neq 0$, and we will focus on the case in which $\theta = 1$. In this case, the two players differ radically over the value of patronage: the recipient values it but the donor does not value it at all.[6] We have assumed in (3) that the donor's utility is linear in its domestic activity, D; this simplification eases the analysis and is natural to the extent that aid is a very small portion of total government expenditure by the donor.

The donor's budget constraint takes the form

(4) $$A + D = R,$$

where R is the total revenue available for aid or domestic uses. We can therefore rewrite the donor's preferences, using (1), (3) and (4), as a function of I and P:

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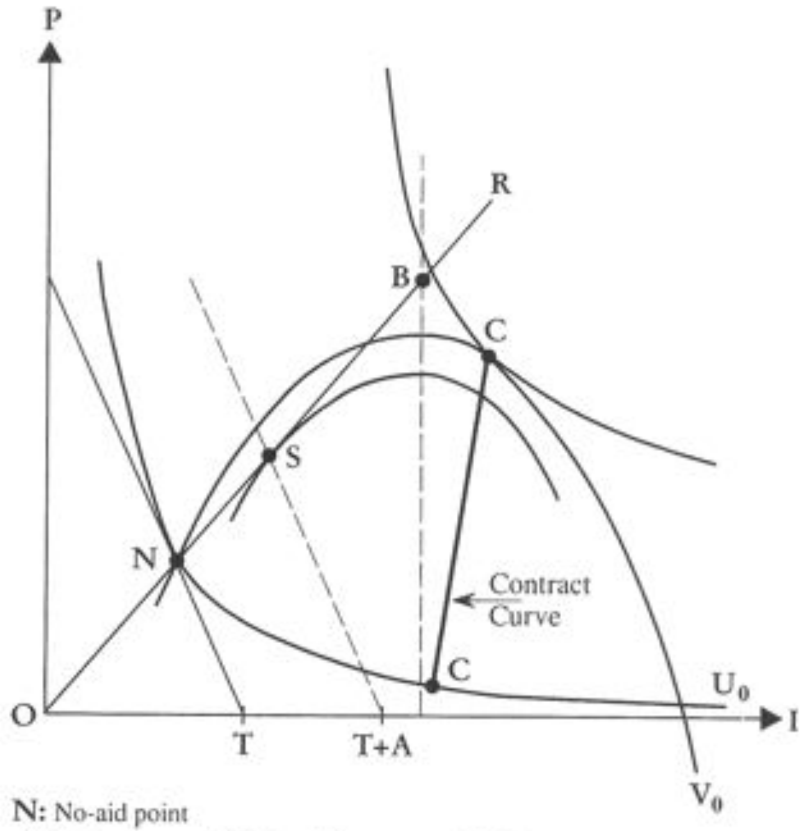
[5] If there is no conflict between the recipient government and its own constituents, then 'agreement' means roughly the same thing as 'altruism'. But in general the two diverge, and disagreement between the donor and the recipient may not indicate a failure of altruism on the part of the donor but rather a difference between how the two players trade off the welfare of different groups within the recipient country.

[6] Disagreement would be even more radical if $\theta > 1$, since in this case the donor gets negative marginal utility from patronage; one can also imagine a situation in which the recipient cares only about patronage. The latter case can be approximated by setting $\theta = 1$ (the donor doesn't care about patronage) and allowing the marginal rate of substitution between I and P to go to infinity (the recipient always chooses arbitrarily small I).

(5) $$V(I,P) = u(I) + (1-\theta)v(P) + \delta(R + T - I - P).$$

Figures 9A.1 and 9A.2 show the donor's indifference curves for the cases of agreement and disagreement. It is clear from (5) that these have zero slope at the value of I satisfying $u'(I) = \delta$, and that (given the concavity of u) movements to the left or right of such points leave the donor worse off. In the agreement case, a symmetrical statement can be made about P: the indifference curves are vertical at the value of P satisfying $v'(P) = \delta$, and utility falls with vertical movements above or below such points. Indifference curves are therefore ovals in the agreement case, centred on the 'bliss' point B; in the disagreement case, they are inverted parabolas centred on the same I axis.

Figure 9A.2: Unconditional Aid Under Disagreement



N: No-aid point

S: Stackelberg equilibrium [donor moves first]

We also identify the indifference curves corresponding to the 'no-aid' levels of utility U_0 and V_0. It is clear that 'gains from aid' are available in either situation. In the agreement case, both donor and recipient are made better off by increases in aid that move the solution up the recipient's expansion path towards the donor's bliss point. There is no gain for the donor in trying to move the recipient off the expansion path; the two players have identical marginal rates of substitution at all points on that path. At point B, further increases continue to make the recipient better off but by less than the donor's opportunity cost (δ). The donor is therefore made worse off. The 'contract curve' of Pareto-efficient agreements is the (heavily shaded) portion of the expansion path between the donor's bliss point and the point at which the donor's utility falls back to the no-aid level.

In the disagreement case, the set of points at which donor and recipient have identical marginal rates of substitution is given by the upward-sloping curve CC, which originates at a point of zero patronage and rises up to cut the expansion path from below. The contract curve -- the set of efficient allocations -- is the (heavily shaded) portion of CC that lies between the no-aid utility levels.[7]

2. Equilibria without conditionality

How much aid will be provided? The answer depends on the strategic environment. In this section, we assume that the donor chooses the amount of aid and makes a 'take-it-or-leave-it' offer to the recipient, with no attempt to enforce conditionality of any sort. In this 'Stackelberg' environment, the donor knows that the recipient will choose a point on its expansion path once the aid has been transferred. The donor's task is therefore simply to choose its own most preferred point on the recipient's expansion path, subject to the constraint that aid be nonnegative.

The solution in the agreement case is apparent from Figure 9A.1. The donor simply chooses its bliss point B, equating the marginal utility of both I and P with the opportunity cost δ (which is the marginal utility of the domestic activity). Not surprisingly, the players end up on the contract

[7] Allocations on the contract curve are Pareto efficient: starting from the contract curve, it is impossible to change the level of aid or the mix between infrastructure and patronage without making at least one of the players worse off.

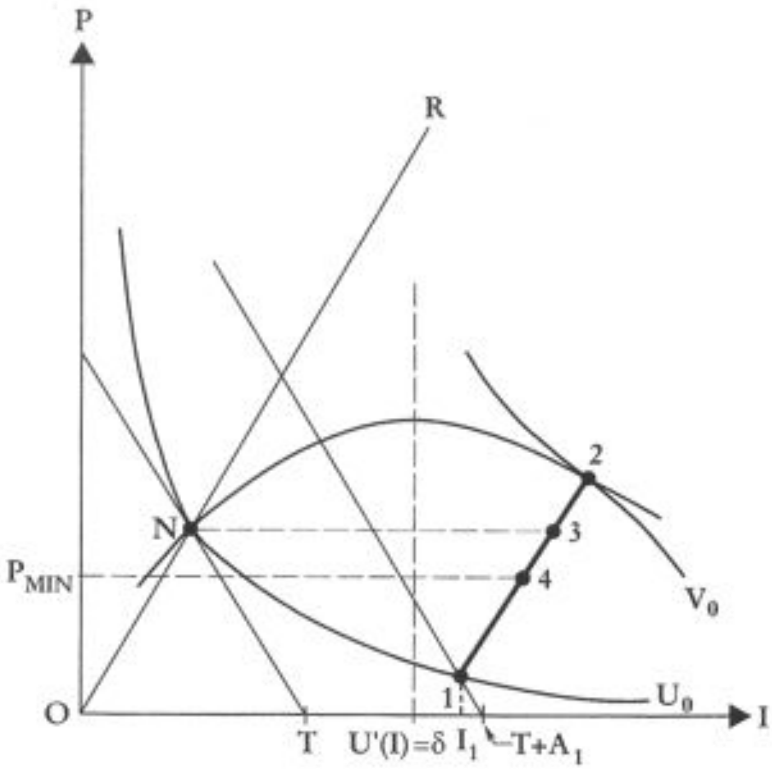
curve. Under disagreement (Figure 9A.2), the donor chooses the unique point of tangency between one of its indifference curves and the recipient's expansion path, provided this point (S) lies above the no-aid point N (this is the case in the Figure). When S lies below N, aid is zero. It is apparent from the figures that aid is lower when the players disagree than when they agree. Moreover, the disagreement outcome is off the contract curve and is therefore inefficient.

3. Costless Conditionality

There is no role for conditionality when the players agree.[8] The equilibrium in the absence of conditionality is on the contract curve; the players therefore start at a Pareto efficient allocation, from which it is by definition impossible for the recipient to bind itself to an action that will increase the utility of both players. Figure 9A.3 shows the case in which the donor's offer is of the form [A,I], where A is the amount of aid provided and I is the minimum amount of spending on infrastructure allowed in the aid 'contract'.

[8] There may not even be a role for conditionality targeted to credibility when the donor's preferences over domestic objectives are identical to the recipient's. The donor's threat to cut off aid will be just as incredible as the recipient's promise to perform the desired action.

Figure 9A.3: Aid with Conditionality



The contract at point 1 takes the form $[A_1, I_1]$

In effect, the recipient is binding itself to lowering the effective price the donor must pay (in terms of aid) for an additional unit of infrastructure. Both aid and infrastructure spending are unambiguously higher in the 'binding' equilibrium, and both players are better off. It is clear, however, that the contract curve cannot be reached through a pre-emptive move by the recipient that lowers the effective price of aid to the donor.[9] The contract curve can be reached, however, by contracts of the form [A,I] -- indeed, any allocation to the right of the recipient's expansion curve and in the interior of the region circumscribed by U_0 and V_0 can be reached by a contract of this form. These place a minimum level on the desired activity -- or equivalently, a maximum level on patronage -- and in that sense mimic conditionality clauses familiar from actual aid relationships. The Stackelberg equilibrium is at point 1, where aid is devoted entirely to infrastructure and all the gains from conditionality have gone to the donor. An alternative (perhaps less natural) Stackelberg equilibrium, in which the recipient makes a take-it-or-leave-it offer, is at point 2, on the other end of the contract curve. Bargaining equilibria will generally lie in between. The equilibrium at point 3 is characterized by no change in patronage, so that aid goes dollar-for-dollar into infrastructure. This outcome would require that both donor and recipient have some bargaining power.

Figure 9A.3 shows the effect of a political solvency constraint -- which we assume for the sake of simplicity imposes an arbitrarily large penalty on the recipient if patronage falls below P_{MIN}, but otherwise leaves the recipient's marginal rate of substitution between the two goods unchanged. The recipient will then never accept an arrangement with $P < P_{MIN}$, and this limits the potential gains from conditionality by restricting possible outcomes to the portion of the contract curve to the northeast of point 4.

[9] Such a strategy would rotate the recipient's expansion path downwards, and the donor would pick its most preferred point from the modified expansion path.

10. DESIGNING CONDITIONALITY

T he arguments of the previous section discussed possible ways of explaining the emergence of conditionality in the aid relationship. There are two important design issues that need to be addressed. The first issue is how "incentive" or ex ante contracts can address the moral hazard problems which arise when the donor is unable to separate bad luck from weak effort on the part of the government. The second concerns whether a contract should be designed as an "incentive" to perform good policy or whether it should be a "reward" for having done so. We deal with each in turn.

10.1 Moral Hazard and Conditionality

The contracts and conditionality discussed in the previous section make the implicit assumption that once agreed, the conditions of the aid disbursement can be monitored and verified. In reality the problem is less clear. The problem facing the donor is that it wishes to finance the formation of infrastructure but at a low cost in terms of government slack or "patronage". The infrastructure, however, is produced by combining aid and the own resources of government,[1] but the observed level of government resources is due partly to the state of the world and partly the policy reform and the effort put into tax collection. The problem is a standard principal-agent one with the following feature. If the recipient is risk averse in the sense of being willing to give up some aid on average in order to obtain some degree of insurance against shocks to its own resources (e.g. it is willing to "pay" for an aid contract in which aid is negatively correlated with the terms of trade) and the donor is risk-neutral, the efficient risk-sharing arrangement is for the donor to bear all the risk and to provide the recipient with full insurance against shocks to own resources. However, if this requires insuring against shocks that are observable only to the recipient, and if tax effort is also unobservable to the donor, the recipient will have a strong incentive to relax domestic tax effort and claim compensation for a poor state of the world. Thus aid ends up being allocated partly towards infrastructure and partly towards substituting for domestic tax effort. Knowing this the contract offered by the donor will not insure the recipient

[1] Even if the full cost of the infrastructure was met by the donor we can assume that the donor's principal interest in seeing the infrastructure function effectively which requires some own-resource input.

fully but will tie aid to the outcome for own resources. However a feature of the contract will be that good outcomes are "over-rewarded" relative to their level of tax effort or policy reform while poor outcomes are "under-rewarded" because the donor cannot distinguish luck from effort.[2] In other words, in order to provide an incentive for the government to put in a high tax effort some of the insurance effect is sacrificed.

If donors are interested in reducing the deviation from the efficient risk-sharing contract and governments who are committed to good governance are risk averse, there is an incentive from both sides to tighten conditionality in order to distinguish luck from effort. This is easily achieved by defining the contract contingently in terms of some measure which is observable to both parties and is correlated with either the state of the world or the effort of the government. Since this gives both parties additional information on the state of the world it is easier to infer whether a poor outcome was due to poor effort or a bad state of the world. The loss of efficiency in the contract is relative to the case where the donor can directly view the state of the world.[3] It is important, however, that the additional information is outside the control of the government. In most cases this will be some indicator such as the international terms of trade when the economy is a price taker. Alternatively, contracts could be specified on a tournament basis where aid flows were conditional on both the absolute outturn and the outturn relative to neighbouring or comparable economies. This latter contract obviously controls for common regional effects although not for unobservale country-specific effects.

[2] see Rees (1985).

[3] An example illustrates the case (see Rees (1985)). The recipient can choose three levels of governance, Q = {1,2,3} and there are two outcomes for I and Z {0,1}. Suppose the individual probabilities for I and Z are

Q =	1	2	3
I=0	0.8	0.5	0.2
I=1	0.2	0.5	0.8
Z=0	0.9	0.5	0.1
Z=1	0.1	0.5	0.9

Clearly, if we only looked at I then the recipient will be paid well (I=1) when in fact the governance level is low (Q=1) 20% of the time. If the contract is defined over Z and I then the joint probability {I=1,Z=1,Q=1) is only 2%. Conversely, of course the risk of not being paid for full effort {Q=3, I=0}} fall from 20% to 2% {Q=3, I=0,Z=0}. Note also that the payment for full effort {Q=3} when conditions are good {Z=1} and a good outcome is now 0.8*0.9 = 0.72 which is lower than the contract solely on I=1. Thus good luck is not overpaid (because it is due to a good luck) and bad luck is compensated for.

10.2 Conditionality: Ex post or Ex ante?

There are two viable and alternative approaches linking aid to policy. One is detailed *ex ante* conditionality backed by credible threats of aid reduction. In this approach the donor specifies desired policy and monitors adherence to it. The ideal version of this model is one in which the specification and monitoring are so tight, and the penalties so severe, that moral hazard problems are avoided and the government implements precisely the programme desired by the donor.

The alternative approach is for donors to use *ex post* evaluation without specifying in detail how performance will be evaluated other than as a contest between a group of potential recipients (in other words a much more general form of the tournament contract noted above). The ideal version of this approach is that governments compete to design and implement programmes which they judge that donors will regard favourably when the programmes are evaluated.

The advantage of the *ex ante* approach is that, if successful, policies change precisely as the donor desires and so the policy objective is completely achieved. The disadvantage is that the donor rather than the government owns the programme. The lack of government ownership has four detrimental features. First, it has connotations of neo-colonialism and so may be offensive. Secondly, it precludes capacity-building in government, particularly in the area of policy making since there is no learning by doing. Thirdly, the government has some informational advantage over the donor and so, if it chooses to do so, is likely to be able to stay one step ahead in terms of meeting measured performance indicators in ways which do not actually deliver what the donor wants. Fourth, and arguably most important, the government cannot accumulate reputation because it cannot demonstrate that its actions in implementing policies are chosen rather than imposed.

Ex post conditionality on the other hand has the advantage that governments must own the programmes which they implement, with the consequent advantages of ownership. Ownership may provide the opportunity for reputations to be built independently of the donor, while it may alleviate the worst of the moral hazard problems associated with the *ex ante* contracts. However there are also a number of drawbacks. The first is that should a government choose to misuse aid it is free to do so during the period for which aid has been unconditionally pre-committed.

Secondly, the "beauty contest" phenomena may be severe as governments compete to catch the eye of bilateral donors each of whom may have separate and possibly inconsistent objectives. Coordination between donors then becomes an important issue, not just periodically, but also continuously.

Between these two very different, but viable, approaches is the middle ground of lightly specified *ex ante* conditionality which characterised early adjustment programmes. Such programmes are liable to three types of failure. First, because contingent events are not adequately specified, performance can fall below specified requirements for reasons beyond the control of the government. The donor then faces the choice between adhering to the conditions and thereby withholding aid, and condoning a breach of the conditions, thereby weakening credibility. Secondly, performance can fall below specified requirements because of government choices, and the donor is then faced with the choice of whether to withhold aid and, if so, for how long. Failure to withhold can be presumed to remove the subsequent credibility of conditions, but donors have sometimes chosen to withhold aid only for a short period before reopening negotiations. This produces both a low expected price for breaching the conditions and an uncertainty about aid flows that complicates macroeconomic management and may further discourage private responses to relative price signals. If conditions are to be imposed, then their design should be that they are breached only by choice (i.e. contingencies are fully specified) and that the penalties are so severe (subject to credibility) that they will never be called. Thirdly, the programme might fail despite the government's adherence to the letter of the conditions because it has found ways of evading them. For example, if the government is required to reduce budget subsidies to state-owned companies, it may achieve this by removing the budget subsidy but offsetting the effect by requiring state-owned banks to lend to them. This meets the letter of the condition but fails to achieve the true objective of the condition because of poor specification. The logic of failures of this type is gradually to close loopholes by adding more detailed conditions. That is, there is a tendency for this type of conditionality to evolve into the first of the two more viable options.

There is a considerable contrast between the reputational consequences of these three approaches to monitoring: loose *ex ante* conditionality; tight *ex ante* conditionality; and *ex post* evaluation. Loose conditionality invites default. This is costly not only because it fails to achieve its objectives but also because the government acquires a reputation as a defaulter. Tight conditionality, as discussed above, precludes the scope for the acquisition of reputation. By contrast, *ex post* evaluation increases the incentive for the government to acquire reputation. These differences may have important effects upon growth. Private investment in Africa is low partly because of the limited credibility of reform programmes: hence, an aid relationship which induces, rather than discourages reputation-building is likely to have repercussions on the rate of private investment and through this onto the growth rate.

Conditionality in Tanzania has been essentially of the *ex ante* type, with the donors and IFIs specifying the conditions required for disbursement of each tranche of funds. Thus the suspension of the IMF enhanced structural adjustment facility in fiscal 1993/94 was the direct result of severe breach of programme targets with respect to domestic credit expansion. Of late, however, *ex post* conditionality has begun to emerge in Africa, particularly in the area of governance. Among Tanzania's neighbours, this is most marked in Kenya where the aid moratorium by the IFIs and bilateral donors elicited a domestically-generated reform programme built around various developments in the area of governance and economic liberalization. In Tanzania, the outlines of a move towards *ex post* conditionality are apparent in the clear expressions of aid fatigue from donors at the consultative group meetings in 1992 and 1993. Donors expressed strong sympathy with the general program outlined by the Tanzanian government (in consultation with the World Bank and IMF) but also a clear scepticism about the government's commitment to maintaining the pace of reform and a willingness to shift resources out of Tanzania if general performance was not adequate.

While African governments in general have a poor track record on policy reversal (e.g., Nigeria and Zambia), Tanzania's record can without excessive exaggeration be characterized as one of "resolute action" (to borrow a phrase from Mans (1993)), not only in the implementation of "good" policy in the reform period but in all three major phases of the aid relationship, beginning with the development and implementation of the Arusha strategy. Given the size of aid flows, the overriding role of the World Bank and IMF in domestic policy formulation, and the existence of powerful vested interests in the public sector, however, the issue of ownership of reforms is clearly relevant.

It is not obvious that external donors will themselves have sufficient credibility with which to underwrite the credibilty of the government. In all cases donors as well as governments have a credibility problem since the domestic private sector (and foreign investors) are not certain that donors will implement penalties. This problem is obviously worsened if *ex ante* conditionality contracts are not adequately specified in terms of contingencies, as discussed above. However, even when well-specified, the breach which triggers withdrawal will generally be of a technical nature, and although such breaches have the advantage of being clear-cut, they have the disadvantage of seeming too trivial for sustained withdrawal so that expected penalties may be too light to discourage default. By contrast, *ex post* evaluation has the disadvantage of being less clear-cut: an overall judgement is being made about the past record of government A versus government B, so that a bad government might anticipate that there is more scope for fudging over poor performance. However, this has the offsetting advantage that, once the decision is made to withdraw, the grounds are non-technocratic and so the withdrawal is more credibly persistent. Whichever strategy donors choose to follow, credibility can only be built up through reputation, and this is likely to require that, until reputation is acquired, there will be instances of bad default as a result of which donors must make sustained withdrawals.

Reputations are not, however, the only mechanism for circumventing the problems of time-inconsistency in government policy. The alternative is to introduce *ex ante* strategies which will make it very costly to renege on policy commitments in the future. These have the advantage of effectively pre-committing a government that may not fully own the reforms at the time of their implementation. By contrast, *ex ante* conditionality defined over essentially short-term and quite costlessly reversible policy measures such as budget targets, sectoral expenditure allocations, credit targets and other nominal macro-aggregates are most clearly prone to policy reversal and will, as a consequence, elicit short-term responses by the private sector or responses heavily weighted towards sectors relatively impervious to a possible reversal. New investment will tend to be concentrated in the high-turnover low fixed-cost sectors, such as finance, retail and import-export trade, or in areas like residential construction where reforms offer the opportunity to address accumulated inadequacies but do not expose the investor to serious losses in the event of a reversal. The sectoral investment responses may be quite substantial but the form of the investment reflects the intrinsic time-inconsistency of the policy reforms.

While some weighting of investment in favour of short-term commitments and residential construction is apparent in Tanzania, these investments --- particularly in retail and import-export trade -- may reflect high social returns to these activities after two decades or repression of private trade, rather than time consistency problems associated with the possible reversal of policies. Indeed, important aspects of the Tanzanian reforms have undoubtedly had a partially irreversible effect on the political economy. The liberalization of internal and external trade, for example, removed important constraints on the urban informal sector and created strong and politically important interests that will oppose any serious reversal of these policies. Whether or not these reforms were fully owned initially by the government, the principal benefit of ownership has tended to accrue in the creation of conditions that have reduced the incentive for the government to act in a time inconsistent manner.

It is clear that this argument must rest on the ability of newly created interest groups to offer a credible threat that policy reversal will be costly to government. Here the shift towards multi-party elections may be very important, and the *ex post* conditionality which has been used by many donors as a means of encouraging democratization will provide the *ex ante* conditionality with an important boost by providing groups benefitting from economic reform with the political weight to ensure that reforms are not reversed.

An area of reforms that would easily create a powerful and concentrated lobby against reversal is privatization. Progress has been slow in this area, however. Privatization targets agreed with donors in May 1993 envisioned the completion of 50 sales or liquidations in a priority list of 97 parastatals in 1993 and 1994; as of early 1994 action had been completed on fewer than 10, and of these the majority were the result of a pilot program of privatization in the leather industry dating from the mid 1980s. A chief constraint to more rapid movement in this area is the political cost of retrenching managers and employees; this suggests a natural role for donors in "buying off" these groups and assisting in their relocation.

11. AID AND DUTCH DISEASE

Even in the absence of the types of policy distortion discussed above, large aid inflows present potentially serious problems of macroeconomic management. In this section, we focus on potentially dysfunctional general equilibrium effects of aid that operate through the real exchange rate. Inflows as large as those received by Tanzania substantially augment the economy's income and tend to increase domestic spending on all goods, both traded and nontraded. But the direct supply effect of the inflow is in terms of traded goods only. The result is an excess demand for nontraded goods, which tends to push up the price of these goods relative to traded goods and produce a shift of labour and other factors of production into the nontraded goods sector. This effect is the source of a potential "Dutch disease", whereby the gains from foreign inflows are undercut by a loss in external competitiveness.

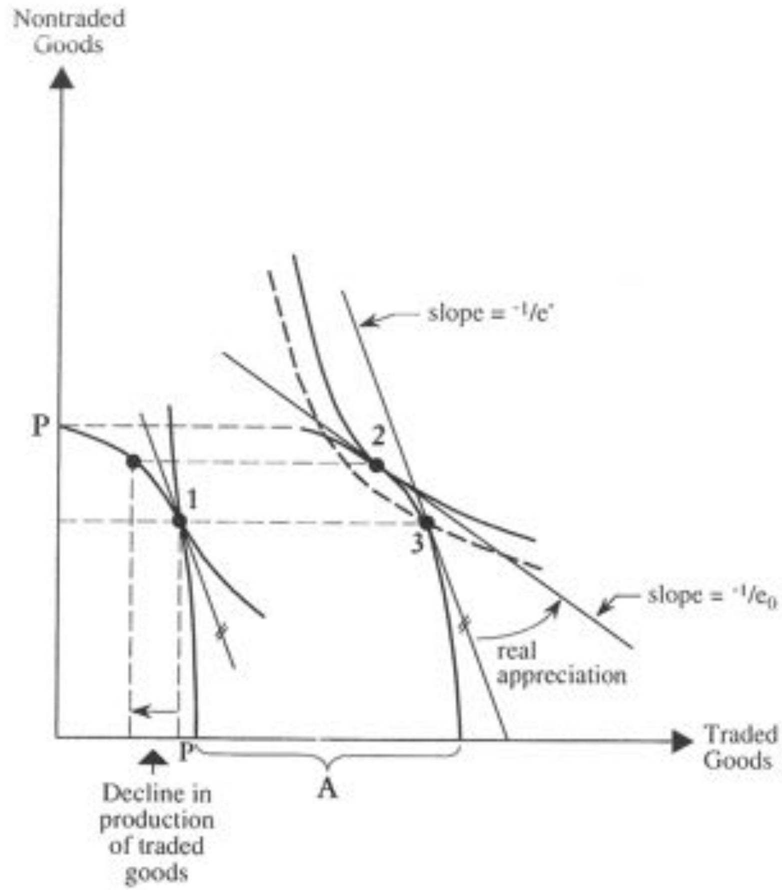
11.1 Some Real Appreciation May Be Warranted

When is the Dutch disease a disease? We develop two broad points below. First, some shift of resources out of traded goods production may well be a desirable response to a substantial aid inflow. This is particularly true if the inflow can reasonably be regarded as long-lasting, since in this case the inflow represents a substantial contribution to the country's "permanent income", and a permanent increase in consumption of nontraded goods is warranted. The issue is essentially one of degree; real appreciation becomes a disease when the induced movement out of tradables is excessive. Second, when disease effects *are* present, the cure is not necessarily a reduction in the amount of aid. Provided the source of the disease can be identified -- which is necessary if one is to meaningfully distinguish a "disease" from a natural and optimal response to foreign inflows -- there will typically be a policy intervention that can cure the disease with no reduction in aid. The issue therefore becomes one of policy design and capability, not of macroeconomic dysfunction intrinsically associated with aid.

Figure 11.1 the familiar but important point that some real appreciation may be warranted in response to an increase in aid. The economy is assumed to be small in international markets, facing fixed world prices for its exports and imports. The domestic relative price of traded goods is the (exogenous) world terms of trade as modified by the relative protection granted to the export and import sectors. Provided the nominal protection rates are constant (an assumption we relax below to incorporate quantitative restrictions on imports), we can consolidate imports and exports into a single "traded good" and study the allocation of production and consumption between this composite good and goods that by their nature (e.g., public administration) or by virtue of high transport costs (e.g., services or construction) do not enter international trade.

Feasible production combinations of traded and nontraded goods at full employment are given by the curve PP. If the economy cannot borrow internationally and receives no aid, this curve also gives the economy's consumption possibilities, and equilibrium in the absence of aid occurs at point 1, where both producers and consumers face a domestic relative price of nontraded to traded goods of e_0. Now consider the effect of an inflow of aid in amount A. We assume for simplicity that the aid inflow is permanent, so that it increases the country's command over consumption in current and future periods by exactly the amount of the current inflow. Increases in consumption of traded goods can be obtained from the aid inflow itself, as indicated by the movement in the consumption possibilities frontier, which shifts to the right by A. Nontraded goods, in contrast, can be obtained (by definition) only through domestic production. In the absence of intersectoral resource movements consumption would shift to 3, where welfare has permanently increased due to the rise in consumption of traded goods. But consumption is now unduly biased in favour of traded goods, and welfare would be even higher if resources could be shifted into the production of nontradeds. The optimum is at point 2, where the increased income represented by aid has been split between increased consumption of traded goods and increased consumption of nontraded goods.

Figure 11.1: Aid and the Real Exchange Rate



The real exchange rate enters the picture because it provides the relative price signal that accomplishes the shift from 3 to 2 in a market economy. At point 3, there is excess demand for nontradeds and excess supply of traded goods; this drives up the price of nontraded goods relative to traded goods and the resulting shift in relative profitability induces the shift in production. At point 2 consumers and producers both face a higher relative price of nontraded goods -- an appreciated real exchange rate, e' -- than before the aid inflow.

In Figure 11.1, aid produces a real appreciation, a contraction of the traded goods sector, a reduction in gross domestic saving, and a worsening of the trade balance. The key point is that these responses are not dysfunctional; they represent the welfare-maximizing response to a permanent increase in the country's international purchasing power. These magnitude of these effects would be altered, but not their general thrust, by a recognition that aid is not permanent. A temporary aid boom would increase permanent income by much less, so that the optimal response would involve a smaller reduction in gross domestic saving, a smaller real appreciation, and a smaller (but permanent) movement of resources into nontraded goods. Gross national saving and the current account (net of aid) would rise by a substantial portion of the aid inflow, allowing foreign assets to rise by enough to provide for the increase in future consumption of traded goods after the fall in aid.

The example is idealized in many respects, but it provides useful background for a discussion of when the real appreciation accompanying aid inflows actually constitutes a "disease".[1] Three potential sources of Dutch disease effects are potentially important for Tanzania. In what follows we briefly discuss three sources of "Dutch Disease" effects. The first arises when the government or private sector treat a temporary aid boom as permanent. The real exchange rate then appreciates excessively in response to the increase in current spending on nontraded goods. The second arises when agents correctly see the temporary nature of an aid boom, but domestic capital

[1] The implications for saving, investment and the current account are also instructive. For example, under the realistic assumption that the country is unable to borrow in international capital markets, a temporary aid flow should improve the current account (after transfers) by less relative to the counterfactual than it would if the country were already able to borrow against its future income. Gross domestic saving should also rise by less, since a larger portion of the inflow will be consumed in the current period. Domestic investment will increase by more for a borrowing-constrained country than for an unconstrained country, since the domestic real interest rate in terms of traded goods will fall in the former case.

markets are inadequate for financing the temporary slump in profitability in the traded goods sector. In this case the real appreciation may not be excessive, but the sectoral output response is excessive due to capital market imperfections. The third arises when the traded goods sectors are the source of growth spillovers. These spillovers call for production subsidies in any case, but a failure to increase subsidies in the face of an aid inflow reduces welfare relative to what could be achieved with an optimal policy response.

11.2 Overoptimism and Adjustment Costs

A temporary aid boom that is treated as permanent by either the private sector or government will substantially increase current spending on nontraded goods, producing a large real appreciation and a substantial movement of resources into the nontraded goods sector. When the aid disappears, this will be followed by an equally substantial real depreciation and a reversal of the resource movement. Since resource movements are costly, welfare is lower when agents overreact than when they correctly treat a temporary boom as temporary.

Adjustment costs can be quite high under realistic circumstances. First, if nominal wages are rigid downwards and the nominal exchange rate fixed (or following a predetermined rate of crawl), the contraction of nontraded production cannot take place without a transitional period of open unemployment. The costs of this unemployment -- which would not appear if the aid were permanent, since the expansionary phase involves rising wages and prices -- might well be larger than the benefits of temporarily higher relative consumption of nontraded goods that would be enjoyed through the initial movement of labour into nontraded goods.[2]

Second, entry of firms into the traded goods sector may require substantial fixed initial investments in information and marketing. If a temporary period of real appreciation causes exporting and import-substituting firms to shut down -- which it is more likely to do if the appreciation is believed to be essentially permanent -- these fixed investments will be lost. Moreover, in this case the real depreciation that is required to overcome re-entry costs and induce

[2] The need for transitional unemployment would be much reduced if the authorities used nominal exchange rate depreciation as a way of reducing the cost of labour to producers of traded goods. The traded goods sector would then more readily absorb the labour being shed by the contracting nontraded goods sector.

a re-expansion of the traded goods sector once aid flows have fallen will be more substantial than the initial real appreciation. Particularly if wages are rigid so that the required real exchange rate depreciation requires aggressive nominal exchange rate depreciation, the collapse of a temporary aid boom confronts policymakers with a choice between a rapid depreciation policy -- which they are likely to regard as dangerous on inflationary grounds -- and a re-imposition of heavy effective protection in the traded goods sector.

Third, a substantial portion of aid typically accrues to the government, where recurrent spending decisions are difficult to reverse given the creation of vested interests and where capital expenditures often have long-lasting recurrent cost implications. Budgetary decisions taken under the over-optimistic assumption regarding aid can therefore create long-lasting pressures for inflationary domestic financing when the financing provided by aid disappears.

Finally, an environment in which there are large fluctuations in government spending and the real exchange rate in response to temporary aid booms and busts (or commodity booms and busts) undercut government credibility and is likely to reduce the supply response to policies like trade liberalization or fiscal reform that are designed to stimulate resource reallocations and factor accumulation by the private sector.

11.3 Capital Market Imperfections and De-industrialization

Domestic capital market imperfections tend to heighten the costs associated with temporary aid booms. Even when the boom is correctly perceived as temporary the temporary reduction in profitability for firms in the traded goods sector will drive some of these firms out of business if they are not able to finance these short-run losses by borrowing against their future profits.

11.4 Growth Spillovers and the Optimal Subsidy

Dutch disease becomes a more serious long-run issue if the sectoral allocation of resources matters for growth. Cross-country evidence on the role of export performance and economic openness in economic growth suggests that there are important positive externalities generated by firms producing for world markets. While the exact nature of these spillovers is unclear, the

evidence favours manufacturing and other nontraditional exports over primary commodity exports and relatively open, tariff-protected import-substituting sectors over quota-protected sectors. A substantial aid inflow therefore tends to penalize all the relevant sectors (and primary exports as well) by appreciating the real exchange rate and shifting resources towards firms producing for the domestic market (nontradeds and quota-protected import-substitutes). This version of Dutch disease is more important when aid is permanent than when it is temporary. There is a direct analogy between the unfortunate effects of aid in this situation and the unfortunate situation of being well endowed with exportable primary products (since these are not particularly associated with growth spillovers). In both cases, the country's static 'comparative advantage' (here broadly construed to include nontradables) is shifted away from the positive spillover sectors, and this compounds itself over time producing lower growth. It is conceivable that higher aid may actually make the country worse off, by reducing the present value of growth spillovers by more than the direct contribution of aid to permanent income.

11.5 Aid Spent Entirely on Traded Goods Has No Effect on the Real Exchange Rate.

Before proceeding, we note two circumstances in which an aid inflow has no effect on the real exchange rate. The first is when the government increases its spending on traded goods by the entire value of the inflow and leaves its spending on nontraded goods unchanged. In this case, private sector incomes and spending are unchanged and since the government's spending on nontraded goods is also fixed there is no pressure on the real exchange rate. The second is when there are quantitative restrictions on imports -- converting these eminently tradable goods into nontraded goods on the margin -- and the government loosens these restrictions dollar for dollar with the aid inflow, making no change in its own spending behaviour. In this case, provided the import restrictions remain binding, private sector spending on imports rises by the full amount of the aid inflow and again there is no effect on the real exchange rate.[3]

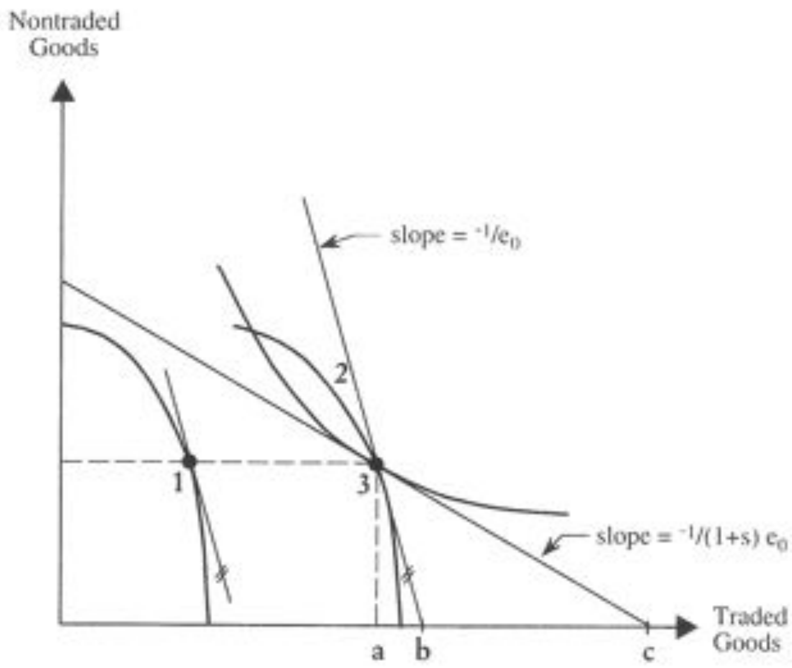
[3] With quantitative restrictions in place, the domestic relative price of exports to imports is endogenous and we can no longer treat traded goods as a single good. Figure 11.1 is therefore inappropriate, although the analysis easily generalizes and everything we have said about the real exchange rate now applies to the real exchange rate for exports.

11.6 Curing Dutch Disease: Aid Cuts or Policy Intervention?

The common feature of these interpretations of aid-induced Dutch disease is an excessive contraction of the traded goods sector during the period of high inflows. This makes the ultimate reduction of aid more costly than it would otherwise have been. The result is a kind of aid dependence in which the donor is confronted with an unpleasant choice between forcing a painful contraction in the nontraded goods sector or -- it would appear -- throwing good money after bad. *The Dutch disease effects of aid are, however, largely avoidable through appropriate policy intervention.* While cutting aid is appropriate in a variety of circumstances, *it is never, in the absence of policy implementation problems, a first-best response to dutch disease problems.*

Figure 11.2 illustrates this point by demonstrating that a production subsidy to the traded goods sector can neutralize the effect of an aid inflow on the intersectoral allocation of resources. In the absence of intervention, the inflow appreciates the real exchange rate and shifts the production point in favour of nontraded goods, from point 1 to point 2. But point 3 can be attained -- thus avoiding the intersectoral shift -- by a production subsidy to traded goods at the rate ba/ca. The subsidy separates the relative prices faced by producers -- which remain at the original real exchange rate -- from those faced by consumers -- which move against nontraded goods in order to discourage the spending of aid on nontraded goods. The appropriate subsidy is an increasing function of the amount of aid (see van Wijnbergen (1984)). It is important to note that if the entire traded goods sector is to be protected, a combination of import tariffs and equal export subsidies will not suffice. Such a policy leaves the domestic relative price of traded goods unchanged and therefore will be completely offset by a rise in the price of nontraded goods.

Figure 11.2: Neutralizing Dutch Disease via Production Subsidy



The point generalizes to the case in which growth spillovers are generated by only a subset of the traded goods sectors. In this case a selective production subsidy to the relevant sectors is appropriate. Again, a trade policy intervention, such as an subsidy to nontraditional exports, is inferior to a production subsidy; but in this case, the problem is not that the subsidy will fail to prevent resources from moving into nontraded goods, but that it will generate a consumption loss by distorting the relative prices of traded goods faced by domestic consumers. It is therefore a second-best alternative that may be appropriate if other considerations prevent the use of a production subsidy. It is important that if trade policy intervention is used on the import side, quantitative restrictions are avoided. These prevent foreign competitors from accessing the domestic market on the margin and have generally been associated, both in Tanzania and elsewhere, with rent-seeking, growing inefficiency, and a conspicuous lack of the kind of spillovers associated with an outward orientation.

11.7 Project vs Programme Aid

To this point we have treated aid inflows as unrestricted and have not distinguished between the spending patterns of the public sector and those of the private sector. But two key features of aid are (i) that much of it accrues to the government, either directly or in the form of countervalue payments, and (ii) that the direct spending effect of aid is typically restricted in certain respects, particularly when aid is in the form of project finance.

When aid is unrestricted and the government has access to non-distortionary tax instruments, the share of aid accruing to the government as opposed to the private sector does not matter for the real exchange rate except to the degree that the government's spending behaviour differs on the margin from that of the private sector. Thus the real exchange rate will appreciate if any portion of aid-financed government or private-sector spending falls on current nontraded goods. An increase in the share of aid accruing to the government will further appreciate the real exchange rate provided that the government's share of spending on current nontraded goods is larger on the margin than the private sector's share. It is irrelevant, moreover, when aid is unrestricted, whether the portion that accrues to government is received directly in the form of foreign exchange or sold to the private sector in return for countervalue payments. What matters in either case is how the government's spending on traded and nontraded goods changes; private spending and the real

exchange rate are then determined as residuals given the production capacity of the economy. In fact, in this case it does not even matter, under the additional assumption that the private sector is competitive, whether the private sector pays countervalue for the imports it receives under aid! The relative price of these imports in the domestic market is determined by the aid inflow and the government's spending response, and the payment of countervalues is essentially a transfer from the public sector to the private sector (and one that can be unwound through non-distortionary taxes).

When aid comes in the form of project finance, bringing with it a specific combination of spending on traded and nontraded goods, effects on the real exchange rate can be more complex. It is useful to distinguish the case in which the expenditures in question would have been undertaken anyway and the case in which the recipient would not otherwise have undertaken the project. In the first case, the aid is completely fungible and it is As if it were entirely unrestricted. In the latter case, the government must fit a partially or fully financed additional project into its budget, and this will mean some combination of a rise in overall spending and a shift in spending away from other activities. The overall effect on real exchange rate, however, provided non-distortionary taxes are available, depends only on the net change in spending pattern.

The effects of aid on the real exchange rate are therefore straightforward in principle when there are no serious problems of government finance. But the financing of government spending is costly in practice, and this means that the government's behaviour cannot be divorced from the way in which aid is channelled into the economy. We consider two implications of this.

Consider first the non-payment of countervalues. This is essentially a transfer to the private sector and could in principle be neutralized by a rise in lump-sum taxes. But in the absence of nondistortionary taxes, the more likely effect is an increase in inflationary financing. More importantly, in practice the transfer has been directed largely towards the parastatal sector, and has amounted to a way of keeping inefficient firms producing. Growth would have be more rapid, at least in the medium run, if the foreign exchange had been channelled towards those firms who could use it most efficiently. One way to accomplish this would be to enforce payment. Of course, it is important to be clear about the counterfactual. If the underlying issue is a reluctance to undertake the politically painful task of imposing hard budget constraints on inefficient parastatals, it is not clear that requiring payment of countervalues would have accomplished this and delivered the accompanying efficiency gains. Payment of countervalue might simply have shifted to the government budget or the banking system, and ultimately to the central bank.

Consider next the distinction between project aid and import support. Does the latter imply a more overvalued exchange rate? The essential issue would appear to be that import support carries conditions that limit the government spending response, by tying countervalue payments to reductions in government debt, either external or internal; while project aid embodies in the first instance an increase in government spending. With import support, the net effect is that more foreign exchange is made available to the private sector than would have been the case without aid; the real exchange rate appreciates. With project aid, less of the foreign exchange inflow is made available to the private sector, since some of the aid has been tied directly to government imports; but at the same time, the government's demand for nontraded goods may have changed in response to the local currency costs of the project. If the government's demand for nontraded goods is unchanged by the project -- so that the portion of aid financing directed to local currency costs ends up reducing government borrowing from the banking sector -- then the net effect of the project aid is to appreciate the real exchange rate by less than the equivalent amount of import support.

11.8 Dutch Disease in Tanzania, Then and Now

Was "Dutch Disease" important during the 1970s and early 1980s, in the sense that the real exchange rate would have been less overvalued and export volumes would have declined appreciably less if aid had been lower? The answer is that aid played a secondary role. The entire state-led, import-substituting policy package was highly biased against exports, both in terms of current production and in terms of the allocation of investment, but the package was not driven by aid. It is not that aid had no effect; aid filled the gaps created by poor export performance and in doing so, it supported an appreciated real exchange rate. But if aid had been lower, it is not clear at all that export performance would have been much better. When aid did fall between 1980 and 1985, the government responded in part with a reduction in explicit taxation of the export sector, but mainly with a shift to monetary financing (rather than adjustment of government spending) and imposition of tight import rationing (rather than devaluation) to protect capital

goods imports. The exchange rate appreciated even faster as aid fell than it had during the aid boom of the late 1970s.[4]

How about during the reform period? Dutch disease was clearly not an issue early in the reform period, since aid flows were buying policy changes that were pro-tradeables, and these effects swamped the spending effects of the aid. Aid has been extremely large, however, and it would be difficult to argue that the real exchange rate will not follow a more appreciated path in the 1990s than it would if aid were lower, assuming no change in the policy regime. The two questions are (i) has the economy moved too slowly into traded goods, so that it is insufficiently prepared for a possible reduction in aid by say 20 percent over the next five years or so, which would convert the current situation into a temporary boom? (ii) given that aid will remain large even if it falls by some amount, is the overall structure of incentives sufficiently tilted towards tradeables to capture positive spillovers? In our view the second of these question is the more important; but the appropriate policy response may well be identical. The question is whether the government's trade and industrial policies are giving sufficient promotion to sectors competing in the world market, given the tendency of aid to un-protect these sectors by appreciating the real exchange rate.

Disaggregated trade data are available only through 1991. For what it is worth, they show a clear shift towards manufacturing and "other" exports as against traditional export crops, petroleum products, minerals, and re-exports:

	1981-85	1986-88	1989-91
Share of manufactured and "other" products in total exports	24.5	30.7	38.1

It is difficult to know to what degree these shifts reflect changes in the composition of overall export volumes (as opposed to relative world prices), and to what degree they reflect greater "officialization" of previously smuggled nontraditional exports than of traditional exports. The

[4] Dutch disease effects do not appear to have operated strongly through the parallel real exchange rate either. Van Wijnbergen (1986) finds that aid has a small and statistically insignificant effect on the parallel real exchange rate in Tanzania over the period 1969-83.

former has probably operated to some extent given the steady decline in world coffee prices since the mid-1980s (until very recently). But the data are at least consistent with the hypothesis that export volume responses have been at least as strong in nontraditional exports as in traditional exports. On the import side, the trade liberalization beginning with the own-funds scheme in 1984 has put serious pressure on the import-competing sector -- the World Bank estimates that average effective protection levels dropped from 500 percent in 1984 to 150 percent in 1985. Much of this was desirable, given the extreme inefficiency of large portions of that sector, particularly the parastatals. But weaknesses in customs duty collection, particularly on goods coming through the own-funds window (where pre-shipment inspection was not required until fiscal 1992 (Mans (1993)), have clearly contributed to de-protecting of the import-substituting sector.

12. CORRUPTION

Public sector corruption represents a more important concern for donors in Tanzania currently than at any time in the past. As with other aspects of poor economic performance, the appropriate response depends on the diagnosis of the problem. We argue here that the increase in observed corruption is probably greater than the actual increase in corruption and that an important part of the actual increase represents a transitional phenomenon. There are a variety of interventions open to donors that can help minimize the incentives for corruption.

Tanzania had a reputation for low corruption at least until the late 1970s, in part the result of strong norms of equality and public service personified by President Nyerere and embodied in formal constraints on wealth accumulation by public officials. Public sector corruption undoubtedly increased during the early 1980s. This was partly in response to the increasing tightness of price and exchange controls -- which implied rising differentials between official prices (of goods and foreign exchange) and prices in illegal parallel markets, and therefore increasing rewards to illegal activity -- and partly under the pressure of declining real wages in the public sector. The latter effect made corruption less costly by lowering the cost of losing one's job. More fundamentally, by the mid-1980s real wages were low enough that finding alternative sources of income was a matter of survival rather than choice.

There are at least two reasons why actual corruption has probably increased less rapidly since the mid-1980s, including the most recent period, than observed corruption. The first is that democratization has opened up the political debate, so that the press has been much more active than previously in exposing evidence of public sector corruption. This will undoubtedly accelerate with the upcoming elections. With promotion of the private sector at centre stage in the economic reform program, the shift from a press dutifully reporting on the government's attempts to uncover "economic saboteurs" in the private sector in 1983 to a press keen on identifying public sector abuses could not be more dramatic.

The second reason why the rise in perceived corruption may not correspond to a rise in actual corruption is that market liberalization -- exchange rate liberalization, commercialization of NBC lending, trade liberalization, domestic price decontrol -- has removed a whole range of mechanisms through which the government not only influenced relative prices and the allocation of resources, but also delivered "hidden" transfers to politically favoured groups that might have been considered unacceptable if done openly.[1] Exchange rate unification is a particularly clear example; overvalued exchange rates meant a large implicit income transfer from exporters remitting at the official rate to favoured importers able to purchase foreign exchange at the official rate. The replacement of quantitative import restrictions by tariffs is another example, as is the recent abolition of NBCs maximum lending rate and the move to commercialize its lending policies. In each case, the pre-existing policy could be defended on the grounds of its allocative intentions, rather than as a transfer from a set of unwitting "losers" to a set of "winners". The closing off of these mechanisms, however, raises the question of compensating the losers; if the government is under continuing pressure to do this, the compensation may occur through mechanisms that are more easily identifiable. The net amount of transfer may well fall even though the observed level of corruption increases. Government tolerance of nonpayment of countervalues is a prime example; rather than an increase in net corruption, this essentially reflected the substitution of a visible transfer for previously hidden transfers occurring through exchange rate overvaluation. Customs exemptions granted at the highest levels -- generally thought to have played an important role in the revenue collapse of 1992/93 -- may well be another example.

While the recent increase in corruption is probably overstated, it is highly likely that some net increase in corruption has occurred. One reason is the continued pressure on public sector real incomes due to budgetary stringency. An equally important reason, however, and one that is particularly relevant since 1992, is the retrenchment process that is currently underway in the public sector. In the context of a stagnant or falling total sector wage bill, the general deterioration in public sector efficiency associated with falling real incomes can only be halted by a reduction in public sector employment. Retrenchment of workers was therefore part of the civil service reforms initiated in 1992/93, with 10,00 workers retrenched in that year and 20,00 per

[1]This paragraph draws on Coate and Morris (1994).

year scheduled for the following two.[2] The prospect of retrenchment can have a powerful effect on the incentives for corruption. At the extreme, workers who know in advance that they will lose their jobs in six months time have very little to lose from being fired. Their general performance will deteriorate, and an increase in corruption is one aspect of this. Moreover, they now have a strong incentive to "capitalize" the lost future benefits of their position by increasing their bribe-taking or other corruption in the short run. Pre-announced, but not implemented, retrenchment is therefore a recipe for increased corruption.

When workers do not know whether they themselves will retain their jobs, the effect of a general increase in the probability of being retrenched whether the retrenchment is merit-based or not. If it is not, then an increase in the probability of retrenchment acts exactly like pre-announcement without implementation. The discounted value of public sector employment, and thus the implicit penalty from being fired, is reduced, and corruption rises. If retrenchment is merit-based, there is a strong influence in the other direction. Workers are then competing for a limited number of remaining jobs, and this is likely to reduce corruption.

The arguments just made for public sector employees applies with equal force to managers and workers attached to parastatal firms. If privatization means job loss, an increased probability that this will occur in the near future reduces the cost of being sacked in the near term and undercuts all aspects of employee or management performance, including increasing the incentives for asset-stripping and other abuses of the privileged access afforded by public sector employment.

The transitional corruption associated with anticipated downsizing of the public sector raises important questions of policy design. Merit-based retrenchment is clearly preferable to other forms. With respect to worker retrenchments, administrative inadequacies and the strong Tanzanian tradition of not drawing distinctions among workers are important constraints to the implementation of merit-based retrenchment.[3] There is therefore a strong argument for avoiding

[2] The total of 50,00 workers represents roughly 15 percent of government employment (excluding parastatals). The World Bank's 1993 Public Expenditure Review argues that public sector employment should be cut by a third in the 3-year period starting 1994-95.

[3] This tradition means that historical evidence on job performance -- e.g., performance reviews by supervisors -- make few distinctions among workers and therefore are of little use in identifying low-productivity employees.

pre-announcements that make it clear which workers will be retrenched, and an even stronger argument for avoiding delays once the groups to be retrenched have been identified.

On the parastatal side, there are a number of strategies available to help contain the transitional corruption related to downsizing. First, a hardening of budget constraints will reduce opportunities for asset-stripping, since one of the key "assets" that would otherwise be stripped is the firm's credit with NBC (thus reducing the value of the firm by increasing its outstanding debt). Second, the detailed audit reports of the Tanzania Audit Corporation provide information that can be acted upon much more vigorously, so that managers in poorly performing parastatals are made more directly responsible for performance. Third, management buyouts should be encouraged as a means of privatization, particularly for small parastatals where this is a realistic option; these offer the most direct incentives against asset stripping, both by management (for obvious reasons) and by employees (since the benefits from improved employee monitoring will accrue to the managers).

A second explanation for the increase in corruption following liberalization is that, at least at the early stages, democratization means public sector tenure in office is less secure, mainly in higher-level posts. Corrupt officials and ministers consequently raise their rate of extraction of rents. Obviously one of the principal objectives of democratization is to increase accountability of public servants with the express purpose of reducing corruption. The two forces are most likely to be imbalanced in the short run, as the decline in expected tenure in office may be more rapid than the emergence of systems and norms of accountability. Corruption therefore rises in the short run, although the long run impact of democratization is likely to reduce it.

We emphasized at the outset of this section that any donor response to an increase in perceived corruption must depend on the diagnosis of the cause, and in particular whether it is due simply to corruption being more visible, and whether the effects are transitional. Many of the reforms already instituted in Tanzania have embodied concerns about enhancing accountability of institutions to shareholders or to the electorate. More generally, capacity and constituency-building institutional reform holds out the greatest promise for developing accountability. One of the consequences of institutional reform, however, is that the process of reform itself may engender corruption-increasing activities on the part of interest groups likely to suffer from the

reform. Since indigenous systems and norms of accountability under a liberalized framework may be slow to emerge, the key design issue facing donors becomes the design of reforms which provide the right incentives to the "losers" so that corruption is minimized.

A final issue regarding corruption is the role of high-level leadership. We have emphasized the "carrot" of reasonable wages and the "stick" of losing one's job as key determinants of good performance by public sector employees and as important disincentives to corruption in particular. Corruption is clearly driven by social norms as well as by these narrower calculations, however, and part of the increase in corruption perceived recently in Tanzania may in part be associated with the perception by ordinary Tanzanians that corruption has for the first time begun to permeate the top levels of government. One of the key arguments in favour of *ex post* conditionality of the type we discussed in chapter 10 may be that it enhances the government's incentive to invest in a reputation for low corruption.

13. POLICY IMPLICATIONS OF THE MACRO ANALYSIS

Tanzania's economic reforms of the past ten years have radically transformed its political economy. The reforms have not taken place without struggle between Tanzania and external donors, but by and large the dynamic has come from within, as the failure of the state-led, inward-oriented Arusha strategy increasingly limited the policy options of government and strengthened the hand of the more reform-minded groups in the public and internal debate. The first phase of reforms has achieved many of its targets, and the economy is working. The transformation to a viable, sustainable economy based on the private sector is far from complete, however. The second phase -- with reform of the parastatals and civil service high on the list -- has barely begun. The second phase involves changes that are extremely demanding administratively and impose large and concentrated costs. They will therefore be considerably more difficult to implement, even in the presence of continued consensus at the highest policy levels, than the earlier changes in the trade and exchange rate regime. This is particularly true given that civil service reform and other institutional changes are precisely a response to a crisis in the effectiveness of the public sector.

In the interim the supply response to the re-orientation of relative prices achieved in the first phase has almost certainly been distorted and limited by the continuance of soft budget constraints in the parastatal sector. This has naturally caused disquiet and a sense of stalled progress among Tanzania's donors. Donors focused particularly on evidence emerging in the early 1990s of serious irregularities in the collection of counterpart revenues from import support; their holding back of import support during the investigation of this issue, while justifiable, contributed to the poor revenue performance in 1992/93 and the termination of the IMF program. The revenue collapse was also driven by a reduction in customs duty rates, designed to enhance compliance, but donors have been further troubled by the widely held impression that the steep fall in revenues was largely the result of a failure to limit customs duty exemptions and other special privileges.

During the second half of the 1980s, the Tanzanian government worked collaboratively with external donors -- though the broad lines of policy formation were largely at the behest of the donors, not the government -- under the correct assumption that aid flows would be large and increasing. Donors were able and willing to impose tight conditionality, and the Government

delivered on sufficiently important and visible components of the agreements to justify continuation. The situation has shifted to some degree in the 1990s, with conditionality increasingly geared towards detailed, institutional reforms and an emerging scepticism among donors about the Government's genuine interest in further reform. There is some possibility that the current levels of aid, which are clearly not sustainable in the long run, may fall substantially in the near future.

The reforms ahead are more difficult than the ones accomplished thus far, the upcoming election puts the government puts it under severe political strain to compromise fiscal and monetary targets (witness Ghana, Kenya, and Zambia before multi-party presidential elections), the likelihood of major retrenchments is increasing the incentive for opportunistic behaviour by public sector managers and employees, and to top it all off, fiscal pressures in donor countries are making for "fatigue" even in the absence of Tanzania-specific difficulties. Yet there is substantial evidence that the Tanzanian government is making a genuine effort at getting the difficult reforms underway. Financial sector reform has now already begun. Meridien and Standard Chartered are competing deposit and trade finance business away from NBC, and NBC itself has begun to harden budget constraints in the parastatal sector by moving its lending on to commercial principles. The Bank of Tanzania has acquired considerable independence vis-a-vis the President's office and the Ministry of Finance (though not vis-a-vis donors) and is now primarily responsible for the formulation of interest rate and exchange rate policy. LART and the PSRC are up and running; although neither has concluded even a small fraction of its business, there is learning-by-doing in these early stages as basic principles applicable in different cases are developed. The Investment Promotion Centre has approved a large number of medium and large-scale investment projects with private sector and foreign ownership, mainly in Dar es Salaam and other urban centres (Bagachwa (1992)). In the central government, adoption of the Rolling Plan and Forward Budget represents a major movement from a year-to-year, crisis-oriented process -- essentially the rule since at least the late 1970s -- to a 3-year planning cycle in which the government's longer-run priorities are brought to bear at all levels of the budget process. The cash budget under the IMF shadow program -- an extraordinary measure given the absence of a genuine stabilization problem in Tanzania (unlike in Zambia and Uganda where similar measures have been implemented) -- is putting strong pressure on the Ministries to prioritize, and on the Treasury and Customs to improve revenue performance; perhaps equally importantly, by rendering exemptions and special treatment more obviously costly, it is likely to increase pressures on the President's office, Prime Minister's and Minister of Finance's offices.

There are, however, many positive directions in which donors can still move, and are moving, on the macroeconomic front. *Export promotion is one of the most glaring.* Experience shows that an important drawback of export subsidy schemes is their lack of fiscal credibility; promotion requires *ex post* outlays, and promises to deliver may be time-inconsistent. Aid organizations have a clear ideological interest in export promotion, a reputational interest given that they have vocally championed its merits, and a selfish interest given that success in exports is a key to self-reliance for the recipient in the longer run. *Assistance to retrenched workers and management is another.* The Rolling Plan and Forward Budget embodies a vision of a leaner government involved in a smaller range of core activities. This vision of a reduced public sector represents a powerful convergence of views both among Tanzania's donors and within Tanzania. Nonetheless, of all the reforms brought on board since the early 1980 it represents the purest repudiation of the Arusha principles and comes into sharpest conflict with precisely the groups that have benefitted from their application over a quarter of a century. It is not surprising, therefore, that one of the chief constraints holding back civil service retrenchment and to some degree parastatal reform, is the political cost of undercutting the livelihoods of a vocal and relatively well-educated group of the population (Bagachwa (1992)) -- a group that if not successfully "bought off" will be able to defend itself through the strong vestiges of the party, such as the Tanzania workers union. Donors can be involved in providing golden parachutes and assisting in relocation. In the absence of serious progress on reducing the employment in the central government, there will be no exit from the low-wage-low-productivity trap and little probability that donor funds channelled through the government structure will produce high payoffs. *Rehabilitation and further extension of roads, particularly in rural areas, is a third.* Roads are a public good and therefore essentially the responsibility of the public sector. A major improvement of the rural road network would increase the supply response to relative price and marketing reforms by lowering transport costs; it would also promote competition, therefore substituting to some degree for the Government's lack of regulatory capacity. *Assistance in revamping customs data collection and improving coverage of the informal sector in the national accounts is a fourth.* The data in Tanzania are extremely poor, and have probably deteriorated under the collapse of incentives in the public sector and the apparently rapid expansion of informal

sector activities during the reform period. Information is a commodity with intrinsic externalities. The central bank, the ministry of finance, and the donor community may all be interested in better and more timely customs data, but under general budgetary stringency and institutional stress there may be little effective pressure on Customs -- and few resources available -- to improve its efforts. Donors might reasonably see themselves in a long-run role in this respect; it is not that data collection and management involves technology that is difficult to transfer, but rather that many of the externalities to such collection accrue internationally -- to the donor countries particularly -- and thus justify a continuing external role.

How hard should donors push on privatization? The question is difficult. To the degree that Tanzania's public sector has been uniquely privileged since the Arusha Declaration, its private sector has been uniquely suppressed and is uniquely unprepared, both financially and in terms of entrepreneurial experience, to undertake the medium-to-large-scale operations of parastatal firms in the industrial sector. The Indian community is better poised in this respect but there remains a serious political resistance to allowing a concentration of industrial activity in non-African hands. Moreover, ownership may be a poor proxy for efficiency. Evidence from Kenya, for example, suggests that quasi-public firms (in which the government has only part ownership and chief executives are not political appointees) out-perform both private and public firms. The hardening of budget constraints through the banking system is therefore likely to be the most important measure in providing the right incentives for parastatal management -- not only those whose firms are viable at world prices but also those who are not and whose managers therefore have the strongest incentives to abuse credit allocated on non-commercial terms. Budget hardening has moved first from the budget, with the cut in direct subventions to parastatals, to the Bank of Tanzania, with the elimination of automatic lending to parastatals and the NBC and the more careful monitoring of counterpart funds collection, to the NBC itself, which is now under strong pressure to apply commercial principles in its lending and has already shifted its new lending away from the parastatals to a marked degree. Ultimately, of course, the pressure for financing the waiting export crop or for supporting a collapsing NBC resides with the Bank of Tanzania -- or with the donors. Having supported a major bailout of the banking system, the donors face the difficulty of credibly committing not to do so again. They therefore have a strong interest in monitoring the performance of NBC to prevent a renewed deterioration of its balance sheet, and in supporting its capacity to evaluate credit risks on commercial terms.

Some progress on privatization is important in the short run, however, in order to establish credibility of the PSRC (thus exerting a demonstration effect on parastatal managers) and establish precedents applicable to firms in different industrial sectors and in differing states of financial viability. There seems to have been very little progress in the disposing of firms -- like Mufindi -- that are clearly unviable at world prices. Donors may have a role to play in making it possible for the PSRC to dispose of firms without requiring that the new owners retain employees or operate the firm as a going concern.

What is the role of import support in the next five years or so? To a recipient government clear about its own priorities, a dollar of import support -- provided it is truly untied -- is more valuable than a dollar of support that is tied to a project. From the donor's side, import support is a vote of confidence in the recipient's overall programme. In these respects import support is uniquely well adapted to the kind of *ex post* conditionality that we have argued may provide strong incentives for the continuation of meaningful reforms by the Tanzanian government, and for a re-establishment of its earlier reputation for lack of corruption. If import support is to play this role, donors must be prepared to cut it when the situation deteriorates sufficiently. We do not think the situation warrants a cut in import support at this point. The government is keenly aware of donor disquiet with the pace of reforms, and is moving ahead on many fronts. With respect to corruption in particular, we have cautioned against overreacting to the current situation. Much of the observed increase in corruption may simply be pre-existing corruption coming to light or changing form in light of the closing off of easy transfer mechanisms like exchange rate overvaluation. More importantly, a transitional increase in corruption may be a side effect of the very reforms that the donors desire, particularly the downsizing of the public sector. A more constructive response would be to aid the government in its efforts to establish accountability and to aid in compensating the "losers" from reform.

What about the overall size of the aid program? We do not believe that concerns about "dutch disease" weigh strongly in favour of a reduction in the overall aid budget for Tanzania. It is true that with the exchange rate regime largely liberalized, changes in external flows would be likely to depreciate the real exchange rate for exports more substantially than if the authorities responded -- as in the early 1980s -- with a tightening of import controls. But any aid-driven inter-sectoral shift of resources can in principle be offset by sufficient fiscal incentives to

traded goods sectors. More importantly, our view is that the effect of aid on the overall policy environment is still its primary macroeconomic effect, and that this effect is still highly positive, as it has been throughout the reform period.

Part 5: Conclusions

14. IMPACTS OF SWEDISH AID ON TANZANIA

14.1 Introduction

This small study was given a huge task, to analyze the impact of Swedish aid to Tanzania over three decades. To do a proper evaluation of the impact of Swedish aid on the Tanzanian economy, one would have to specify a counterfactual, and then try to compare development with and without Swedish aid. We do not have a good enough basis for such an experiment. Our discussion of the impact of Swedish aid has therefore been somewhat tentative, by necessity. Still, we hope that it will contribute to the debate on Swedish aid to Tanzania, and on Swedish aid in general.

We assume that Swedish aid is motivated by wanting to address poverty, and that basically the motive behind this is altruism. This means that Sweden wants to concentrate aid to the poorest countries, such as Tanzania, which in turn normally are those countries where it is most difficult to run projects and programmes effectively. The first dilemma of aid is thus that we want to aid particularly those countries where in all likelihood it will be most difficult to get aid to work effectively. This must be kept in mind when judging the results.

In this report we have looked at the impact of Swedish aid on Tanzania from several angles. In this chapter we step back and provide some general observations. In Section 14.2 we consider the impact of aid on economic growth. Since it is extremely hard to link aid directly to growth, we also consider the impact of aid on some growth determinants. We then look at the scant evidence that is available on changes in income distribution and poverty, and discuss the impact of aid there in Section 14.3.

14.2 Aid and Growth

Official GDP numbers suggest that real incomes per capita in Tanzania are not much different now then they were in 1970. The pattern is one of stagnation over the 1970s, dramatic reduction in incomes during the crisis period of 1979-85, and slow but definite growth during the reform period starting in 1986. Corroborating evidence of the recent recovery is provided by Booth (1993), who reports that ERP was considered positive by rural people, particularly the poorest groups, both in terms of goods availability and in stimulating economic activity.

Comparisons of survey data for 1976 and the early 1990's suggest that changes in rural incomes have been less dramatic than suggested by official GDP aggregates. This suggests that rural incomes fell by less in the crisis period due to the availability of subsistence and parallel market activities, and they rose by less in the recovery period. Urban incomes, in contrast, fell markedly during the crisis period, and have recovered very strongly since the mid-1980s, although this is less true for some higher income households, e.g. those in government employment. There may be some impression from preliminary statistics that growth has slowed in the 1990's relative to the late 1980's, but the official data is essentially useless for making such judgements.

What can we say about the effect of aid on growth determinants in Tanzania? If we first consider physical capital formation, it is obvious that aid in the 1970's contributed to a high investment rate, but because of the inward-looking, state-directed strategy, the quality of investments became low. Investments declined only moderately in the crisis period, although capacity utilization fell dramatically. Finally, there has been a dramatic increase in capital formation since the reforms started in the mid-1980s, and there is now also a considerable increase in private investment. The recent increase is obviously related to the aid boom. The quality of investments is higher than in the previous period, but still generally low. This may be due to the fact that there still have been only relatively small changes in ownership and the orientation of investment, that is, parastatals still play a large role.

Sweden's earlier attempts to support industry directly did not fare well, and Sweden has shifted from direct support to indirect support of productive activities. This is a sensible change, which also reflects the shift in Swedish strategic thinking about the role of aid, which has been underway since the mid-1980's (see SIDA, 1994a). A substantial share of Swedish aid has therefore in recent years gone to investments in, and rehabilitation of, economic infrastructure. These investments seem to show good returns, and they also help to create an enabling environment for economic activities. It seems obvious that aid, including Swedish aid, has made it possible for Tanzania to achieve higher investment rates than what would otherwise have been possible.

The major areas of human capital formation that are relevant are health and education. Sweden has mainly contributed to education. Although the results of the projects have been mixed, the projects undertaken contributed to the early improvements in the supply of skills in Tanzania. Unfortunately, it has been difficult to sustain the advances and many of the achievements of the 1970's have since been eroded. The budget support provided in recent years has at least helped to contain the decline of the public educational system, but it is certainly in a very poor state.

Apart from transferring external resources into the country, aid also has an effect on policy formation. This indirect effect may at times be more important than the direct resource transfer effect. It could be both positive and negative. We have argued that aid in the 1970's and in the first half of 1980s indirectly supported a strategy that later turned out to be unviable. Donors gradually became more and more critical in the early 1980's, particularly with regard to the appreciated exchange rate. Sweden was reluctant to join in the critique and, together with other sympathetic donors, Sweden probably helped make it possible for the traditionalists in the Tanzanian government to delay economic adjustment. In this period it is therefore probably fair to say that, although the direct effects of aid were positive, these were counteracted by the negative indirect effect of preserving a policy regime detrimental to growth. The latter effect is impossible to quantify, since one needs to know both how sensitive the Tanzania government would have been to the extra pressure that Sweden could have exerted and also how much extra growth an earlier change would have brought about.

Still, the costs of delayed reforms may have been substantial. However, since about 1986 aid has increased in support of market reforms, and for this period the impact of aid on the policy environment has instead been decidedly positive. The donors in this period have been essentially in agreement about the requirements for aid to Tanzania.

Much of the aid provided by Sweden in recent years has been geared to support the economic reform programme. Poor governance is obviously a severe problem in Tanzania today, and the poor quality of the public administration must certainly have retarded economic growth. Swedish efforts to support public sector management probably have been beneficial, but such effects are hard to measure.

The ability of the country to sustain long-term economic growth and to reduce its current, very high aid dependency will depend on the levels of domestic savings, tax revenues and export performance. The domestic savings rate appears to have gone down during the recent aid boom, but the data is very shaky. Still, this is the effect one would expect. It should be noted, however, that at the same time there has been an investment boom, so there has not been any dramatic increase in the consumption share.

At present close to half the budget is financed by donors. This is certainly too high a figure to be acceptable in the long term. It is partly a reflection of the current problems in revenue collection, as discussed above. We do believe, however, that those problems are caused to some extent by the reform process and the present political instability. The problems are being addressed by the government in several ways, but this is an issue that donors should follow closely. It is not unreasonable to assume that tax efforts may be more lax when there is an abundance of aid.

Finally, we have the issue of export performance. There is considerable evidence showing that export success is closely related to economic growth, and if aid has effects that are detrimental to exports, this is a serious problem. The focus of the discussion has been the so called Dutch disease effect, that is that aid inflow leads to an appreciation of the real exchange rate. We have discussed this issue extensively above, and concluded that the picture with regard to Tanzania is somewhat mixed. During the Nyerere years the whole policy package was highly biased against exports, but this package was basically not aid driven. Still, by making it possible to finance imports, aid did support an overvalued exchange rate, and it probably also helped extend the period of inward orientation. In the first years of the reform period, aid increased dramatically, while at the same time the real exchange rate depreciated a lot. Then aid supported pro-export reforms. Now the exchange rate is market determined, which means that aid inflows will tend to have an appreciating effect on the exchange rate. We return to this problem in our policy discussion in Chapter 15.

Looking at the growth record of Tanzania, it is hard to argue that aid has had a very positive effect on economic growth. The growth rates recorded, however, depend mainly on factors other than foreign aid. The country for a long time followed a development strategy that turned out to be unviable, and the economy has also been exposed to a series of external shocks. It is not possible to disentangle the overall growth effect of aid (or of Swedish aid) in this context. We have, however, discussed the relationship between aid and the factors that are important for economic growth. We have pointed out that the direct effects of resource transfers in most cases are positive, although the effects have often been smaller than expected. We have then argued that the indirect effects on policy are very important. Here, Swedish aid is of course only a small part, but in the case of Tanzania the Swedish stand does matter. It is possible that Swedish aid made it possible to delay adjustments in the first part of the 1980's, and thereby exerted a negative influence on growth. Since the mid-1980's, however, this situation has been reversed, and aid has supported sensible policy changes. We have also touched upon the effects on domestic savings, tax efforts and the real exchange rate, and noted that aid may negatively affect these variables. Again quantification is difficult.

14.3 Aid and Equity

We saw above that there is somewhat conflicting evidence about changes in per capita incomes over time, but according to the Cornell-ERB study, both urban and rural incomes

seem to have increased between 1976 and 1991. What can we say about inequality? Comparing household budget surveys, the World Bank (1993) finds that inequality has been increasing since 1969. The Gini-coefficient was estimated at 0.39, then it rose to 0.44 in 1976/77, and finally it rose again to 0.57 in 1991. According to this study, the period of crisis and subsequent adjustment has implied increasing inequality. It is also argued that, while initially rural inequality was lower than urban inequality, the situation is now reversed. Both have increased, but the rural one at a more rapid rate. Increasing inequality is not an undisputed result, however. There does exist some as yet unpublished work suggesting that there has even been a reduction in inequality. We can thus not draw any definite conclusions about changes in inequality at this stage.

The World Bank (1993) also specifies two poverty lines. Households with less than 50% of the mean adult equivalent income were classified as poor, while households that were unable to afford certain basic needs were classified as hard-core poor. On these criteria, about 50% of the population live in poor households, while 36% live in households classified as hard core poor. Poverty is mainly a rural phenomenon, where 59% of people living in rural areas are poor, against 39% of those in the urban areas. About 90% of the hard-core poor live in the rural areas, mainly in farm households. The differences between poor and non-poor households are also reflected in differences in their access to basic needs such as water, decent housing, and education. The results achieved in Tanzania with regard to poverty eradication are obviously very much below what was hoped for.

Table 14.1: Some Social Indicators for Tanzania and Sub-Saharan Africa

	1980		1985		1990/91	
	Tanz	SSA	Tanz	SSA	Tanz	SSA
Life expectancy at birth (Years)	47	47	48	49	48	51
Infant mortality (Per 1000)	122	127	117	118	115	107
Average daily calorie intake (Kcal per capita)	2244	2107	2229	2040	2206	2120
Primary school gross enrolment rate (per cent)	93	70	72	68	63	69

Source: World Bank (1993)

The social indicators in Table 14.1 suggest that Tanzania, during the 1980's has had a development, which in several respects, has been worse than that of the average for Sub-Saharan Africa. Tanzania does well with regard to caloric intake, but on the other three indicators it has done poorly. Life expectancy has hardly increased, and infant mortality has decreased more slowly than for SSA. The most dramatic changes, however, is the large decline in primary school enrolment. From a situation in 1980 with an enrolment rate of 93%, way above the average for SSA, it was by 1990/91 down to 63%, well below the SSA average. This is an indiction of the serious decline that the public sector has undergone in the 1980s. Thus, even if average incomes have increased since the mid-1980s, there also may have been an increase in inequality, and there has certainly been a deterioration in access to and quality of public services.

We have noted that the vast majority of the poor are to be found in the rural areas. The welfare of this group will depend on its income, as well as on its access to different forms of public goods, such as education and health services. Aid that contributes to income growth and improved provision of public services in the rural areas would therefore have

beneficial distributional effects. Much Swedish aid was initially directed directly to the provision of welfare services to the rural population. Sweden also provided considerable support to the agricultural sector. These early efforts did not produce the desired results. The experiences from Tanzania have shown that distributional ambitions, which are not backed by a sound economy, are unsustainable. The ambition in the reform period has been to stabilize the economy and to provide a basis for economic growth. In the long term, this is important also for the rural poor, but one would like to see a pattern of growth that benefits the rural population also in the short term.

The incomes of the rural population will depend on the demand for its products and on its asset. Many studies have shown that changes that increase demand for the poor man's assets or his products tend to improve income distribution. Policy changes in the 1980's tended to shift relative prices in favour of agriculture, and thus did have a beneficial effect on the incomes of the rural population. In the longer term, however, income increases require investments, and it is not clear what the investment response has been in the rural areas. There are indications, however, that the present aid boom has had larger effects in the urban areas than in the rural areas. How to spread activity to the rural areas in an effective manner, therefore, still remains a key question. The creation of an enabling environment for rural investment is high on the agenda.

At the same time that the government managed to improve the policy environment for producers, its ability to finance services such as health, education, and public infrastructure of relevance to the poor has been declining. Since aid in the second half of the 1980's has financed a large share of the budget, it has at least helped to preserve some services. Thus, to the extent that aid finances public goods which are widely available, it should have a beneficial impact on the distribution of economic welfare. Swedish aid to publicly provided social services, and direct budget support, would be examples of this.

Growth-oriented support, such as that to economic infrastructure, has indirect effects on the poor via their incomes, but whether it increases or decreases inequality is in general impossible to say. It will, of course, to some extent depend on the type of infrastructure aided. We will get back to this issue in the final chapter. Growth is a necessary prerequisite for long-term poverty eradication, as well as the provision of public goods such as education and health services to the poor. Progressive distribution policies must in the long run, in any economy, be based on a stable economy. Growth is not a sufficient condition for long term improvements for the poor strata of the population, but it is a necessary condition.

15. CONCLUSIONS FOR SWEDISH AID TO TANZANIA

In this chapter we draw together the policy implications of our analyses. Most of these have been discussed in greater detail in previous chapters. Since the study is a broad overview, the policy conclusions that can be drawn will also be of a general nature. We are not in a position to present a complete aid programme for Tanzania.

15.1 How Much Aid?

Should Sweden give aid to Tanzania? This is a political decision, and the allocation of aid to Tanzania must be weighed against allocating money to other poor countries. There are, however, a few reasons for continuing with aid to Tanzania. Tanzania is still one of the poorest countries in the world, and it is a country with which Sweden has long-established relations and which is well known to the Swedish aid apparatus. The last few years of structural adjustment have seen dramatic improvements in the policy environment, and the private sector is coming alive. However, progress with regard to institutional reform of, particularly, the parastatal sector and the civil service, has been slow. There are also worries about the lack of transparency and good governance, but we would caution against overreacting in the short term. We have argued that deterioration may be a consequence of the process of reform and democratization, and if so, it may be temporary and solvable. If the situation with regard to governance does not improve in the longer term, it should have consequences for the amount of aid allocated to the government of Tanzania.[1] We will get back to this issue below when discussing the conditions of aid.

When deciding on the amount of aid to a country, the issue of aid dependence should also be considered (see discussion in White and Voss, 1994). This continues to be very high for Tanzania with aid being about 40% of GDP. This is a big increase since the mid-1980's.[2]

[1] At a sectoral level Sweden has already reacted to bad governance - for import support when the issue of countervalues was not solved and for education and parts of the forestry support.

[2] It should be noted, however, that previously the relative importance of aid was understated by the overvalued exchange rate. On the other hand ,it has always been overstated because of the poor coverage of activities in the official GDP. If aid is adjusted for debt service the ratio falls, but the extent of aid dependence is still worrying.

One way to lower the ratio would be to reduce aid, but given the delicate situation in Tanzania in the run up to the election we do not think this is the right time to contemplate a reduction. Moreover, Tanzania may also have to set aside more resources to service its large debt, which means that the aid requirements of Tanzania will continue to be high.

Another aspect to consider when deciding on the amount of aid is absorptive capacity. We have noted the poor state of the civil service, while at the same time arguing that an effective civil service is a necessity. The ability of the administrative machinery to handle aid effectively is thus a major problem that needs to be addressed. The direct approach is to try to help reform the system so that it can cope. This is underway in many institutions, but it is undermined by the generally poor status and morale of the civil service. For it to be effective, one also needs progress on civil service reform. Secondly, one needs to use aid forms that are administratively simple and do not overburden the apparatus. Thirdly, one could seek alternative channels for aid. One needs to work on these three areas to make it possible to channel aid effectively. In a situation with poor administrative capacity and a alrge debt burden it would also make sense to shift resources to debt service. This will make it possible for Tanzania to use more of its own resources for development, and a reduced debt should also stimulate private investment.

15.2 What Type of Aid?

Given that aid to Tanzania continues, where does aid has its comparative advantages? Where can aid be effectively used, and where is it better to leave the activity to domestic agents?There is also the issue of division of labour among donors. The fact that an activity is appropriate for donor intervention does not necessarily mean that Sweden should be involved. Coordination among donors should mean that many important areas are left untouched by SIDA.

The Tanzanian government is overstretched. The government of Tanzania cannot finance the whole public sector structure and pay the wages that are required for effective work in that sector. Donors should be wary of creating new public sector institutions, but shoul

instead concentrate on strengthening the core network.Swedish support to central institutions is an example of such aid.

To improve public sector performance, there must be serious civil service reform. Politically, a reduction of the civil service is very difficult, because of retrenchment costs etc. SIDA could, for example via the use of the countervalue, finance retrenchment or the cost of severance payments of redundant civil servants. This will be very healthy in the long term, and will also put some little capital in the hands of a number of individuals (rather than the government) who might do something productive. A similar opportunity exists in supporting retrenchment of workers and managers in down-sized or privatized parastatals.

Balance of payments (or budget) support is an appropriate way of channelling money into an economy like the Tanzanian one, where there is limited ability to absorb new projects at the same time as there are serious recurrent cost problems. Previously, countervalues were not paid consistently, and this is a necessary requirement for this type of aid. Failure to pay up undermines the stabilization efforts and softens the budget constraint. Sweden refused during 18 months to pay out import support before the Tanzanian authorities implemented appropriate guidelines and instituted measures to deal with the arrears. The current handling of countervalue payments is improved, however.

Budget support as well as support to projects on the priority list of the government, is essentially support to the government policy package. Given that this is the form of aid, the donor cannot shift the structure of expenditure directly. If this is to be achieved, he must instead specify conditions for minimum shares going to certain expenditures, or put a ceiling on other types of expenditures. Primarily one should consider expenditure shares for, primarily, education and health. This should, however, not be done by Sweden unilaterally. Like with other general conditions of this nature, there should be coordination among the bilateral donors and the IFTs, for example in the context of the Public Expenditure Reviews.[3] With a shift in this direction, donors would need to work out a new type of guidelines for

[3]Sweden has recently together with with IBRD, EEC, UK and Noreay taken part in a PER with this purpose. There are also discussions on a Social Sector Strategy as a framework for the provision of social services.

monitoring and auditing, since this would have to be of another form than current project evaluations. One could use simplified procedures for accounting, e. g. in terms of broader criteria of programme implementation. Look further below at our discussion of ex post evaluation.

Another type of public good, apart from education and health services, that we believe it is very worthwhile to support is the roads. We do believe that a major extension and improvement of the road network in the peripheral areas of the country would contribute very significantly to the incomes of poor rural groups. We have noted above that this is a group that really needs support, at the same time as it is difficult to find efficient forms for such support. This type of investment could crowd in investments, in the tradables sector. What will be the main issue in this area is, of course, whether the Tanzanian government at different levels will have the capacity to maintain the extended network in the future. Capacity-building here would thus have to focus on strengthening the relevant institutions in this area. SIDA argues that this sector is already overcrowded with donors, but we think it might be worth taking a second look.

A conclusion from our review of projects and programmes was that support to economic infrastructure in general, not just to roads, seemed to work well, although we were at times a bit worried about the efficiency of the institutions or firms that are to handle the investments once they are there. Still, we would recommend a continuation of support to these types of activities, but with close attention to the need for commercialization of the organizations involved. SIDAs is already involved in institution development efforts.

We have discussed the problem of currency appreciation, and argued that the first best response to this is not less aid, but production subsidies to firms in the tradables sector, or simply export subsidies. One could actually consider export promotion in the form of both price and non-price incentives. There remains a lot to be done on the latter side, such as further liberalization of marketing in agriculture, and extensions or improvements of the rural network. Duty drawbacks were tried in the 1980's, but with little success largely because of inadequate budgetary support. Here is a natural role for aid support.

Alternatively, one could introduce interest subsidies, that is, the introduction of a subsidy to banks to make it possible for them to charge lower interest rates for exporting firms. There are, of course, complications with these kinds of systems in Tanzania. The government must have the capability to handle it and the integrity to allocate the money on merit. These administrative issues will therefore require careful consideration.

Donors should not try to do too complex things. It is too complex to intervene directly into production activities, be it agriculture or industry. It requires too much local knowledge. Donor interventions related to production should instead be directed to the creation of an enabling environment for the private sector. This may of course include the creation of institutions that can provide finance for the private sector, but the allocation of these resources should be left to the market. The private sector in Tanzania need to be strengthened. One way to do this would be to set up a charitable trust fund, support a venture capital institution (SWEDEFUND has just entered such a scheme), or even support a bank in Tanzania. This could then function as a financial institution that places its money in projects on a commercial basis. This would be one way to channel money into the country, without using the governmental channels or competing with them. Some experimentation with new forms of aid would be welcome.

A major concern is poor provision of services in rural areas as well as the lack of institutions supporting agriculture. We would like to make sure that more resources are used for expenditures that are relevant to the rural population, and they should be spent in such a way that the results are sustainable. The HESAWA project is an attempt to deal with this problem. It is obviously directed at what should be the main target group for Swedish aid, the rural population. It aims to provide social services that obviously would be welfare improving in the rural areas. However, are the results sustainable? Serious commitment from the central authorities for regional activities may be required for long-term viability. Thus, we would like to see a thorough analysis of this and other attempts at building up social services from below,with very little reliance on central government.

Sustainability of activities is the major worry with regard to current aid to Tanzania. All support requires careful assessment of affordability, given the level of external support likely to be forthcoming. If inconsistent and unsustainable standards of service provision are to be avoided, a sector approach is usually preferable to project aid.[4] In situations where recurrent costs are a serious problem, as is the case in Tanzania, donor support is especially appropriate for programmes which require higher expenditure now to permit lower expenditure later, and which therefore to some extent have their sustainability built in: Privatisation, civil service retrenchment and infrastructure rehabilitation are examples of this.

To improve sustainability of aid activities, priority areas of aid should correspond to key sectors of government expenditure. Activities on which the government puts low priority run a high risk of decline once donors withdraw support. Priority areas in Tanzania that we believe should be supported are social services and economic infrastructure. To make these work in the longer term, administration need to be strengthened. Institution-building is therefore also important. Particularly, local and regional administration are in a very poor state, which means that it is very difficult to deliver public services effectively to the rural areas. It is obviously hard to get aid to work in Tanzania, but SIDA is already extensively involved in the sectors that we identify as important. The work of phasing out should continue.

15.3 On What Conditions?

In this report we have discussed the relationships between aid and policy and policy conditionality extensively. We concuded from this discussion that it is desirable that the Tanzanian government "owns" the programmes to a higher degree than it does at present. To achieve this, donors should delegate more responsibility to the government, while at the same time creating incentive structures for good behaviour. At present, the donors feel an

[4] "The justification for recurrent cost support in particular requires a careful evaluation of affordability and replicability of similar standards at the level of the sector as a whole. Donor supported islands of excellence in a sea of underfinancing are a poor use of resources, and ultimately unsustainable when donor fashions change. It is therefore desirable that proposals to support recurrent costs take a wider perspective, and it will normally be sensible to consider such proposals as part of a coordinated package for a whole sector or at least for an institution" . (ODA, 1994, pt 11)

acute conflict between this type of solution and an effective handling of the projects that they finance. In Tanzania, SIDA tries to by pass the central government and to work on the district level, with extensive SIDA control of payments as well as execution of the projects. What will the long term implications of this be? Can effective project islands survive and have positive indirect effects on the surroundings, or does the hostile environment eventually force a project collapse? After all, well functioning projects in a failing overall structure are not proof of a good aid programme. This is particularly true in areas normally covered by government ministries, where an important output of any project should be a strengthening of Tanzanian government capacity to formulate and execute similar endeavours.

In general, one should have the ambition that projects must not become isolated islands (Sweden may have done so less than many other donors). However, there may be instances when the country only has one institution of its kind and where it is of strategic importance. Maybe a donor could then take a more long term responsibility for preserving the institution. Swedish support to the Bureau of Statistics may be such an example. Both government institutions and donors need better statistics about for example trade flows and informal sector activities. It is therefore not unreasonable that SIDA should consider paying recurrent costs of such an institution for an extended period.

Project documents should include a discussion of how and when the withdrawal of SIDA support is to take place. All projects that start should have a specified end-point in time (or an argument for indefinite or very long-term support).They should define the responsibility of the government of Tanzania. If the Government is not willing to commit itself, the project should never start. For the commitment to be credible a greater share of the project cost should be covered by the Tanzanian government from the very start.

Due to weak institutional capacity it has been very difficult to realise the aim that the recipient should handle projects. Responsibility for implementation has increasingly been taken away from the government of Tanzania. There is an obviously a conflict between giving responsibility to the recipient, and financial accountability. In this report, we have argued that ex post conditionality can provide strong incentives for reforms, and for a reestablishment of the government's earlier reputation for low corruption. To some extent there has already been a move toards ex post conditionality, with less of total aid being disbursed within country frames and more under thematic programmes.

The donors as a whole or individual donors should not shift completely towards ex post conditionality. There is a clear role for ex ante conditionality - not least in terms of providing a means of transfer of advice and expertise and providing some pre-specified contractual obligations, but also for the reasons about the creation of constituencies which will "punish" governments for reneging on ex ante commitments. It is best to think of the aid and conditionality relationship as a two part contract with prior payments within a state-contingent ex ante-conditionality framework and then further aid flows based on ex post considerations.

There is a need for improving the design of ex ante conditionality to focus more on state-contingency in contracts. There are two important reasons for this. First, if conditionality is not state contingent then the typical conditionality contract will reward good luck and punish bad luck. If the donors are not in a position to separate good luck from "effort" then ex post conditionality will reinforce this, and there will be a bias in the allocation of aid money towards those enjoying good luck. The second reason is that the most convincing arguments for a shift towards ex post conditionality revolve around the question of reputation. Part of the inability to generate reputations is that the ex ante conditionality, which is not state contingent, typically does not allow any revelation of effort or commitment for the reasons discussed above. Credible governments have an incentive to demonstrate commitment or effort and this can be achieved better with state contingent contracts.

There will be some need for donor coordination also with regard to ex post conditionality. What is required is to find the appropriate balance between ex ante and ex post. For example, governments may have cash flow problems such that although they are committed to reform they are unable to implement reforms without additional aid resources provided ex ante. Similarly, although ex post conditionality does not specify conditions for the

potential recipient it is still important that the rules of the game are made clear and that they are internally consistent between donors.

A shift towards ex post conditionality would also make it easier to allocate aid as general budget support, which we have argued is desirable for a number of reasons. In the case of ex post conditionality, once the decision to disburse is made - ex post - the donor must logically relinquish any claim on how the resources are allocated within the country. If the government is truly of the "right type" then it will manage the resource flow and the countervalue funds in a manner consistent with the wishes of the donor. If the recipient government spends it all on non-productive expenditure, inflation and patronage, then (a) the donor has misjudged the type of the country and (b) the country will not win the contest for aid money the next time. With the ex post approach the rules of the game will allow the donor to distinguish good and committed governments from bad ones.[5] A shift towards a general form of support of the Tanzanian government, giving it increased responsibility and ownership could help restore the quality of government. However, if this approach is chosen, then the donor must be prepared to walk out if the situation deteriorates sufficiently. The government should be made aware that there are other equally poor countries that are competing for the funds.

15.4 Aid Management

In the situation that Tanzania has been in until recently, it was very difficult to trust the results of project analyses. The economic imbalances meant that there were all kinds of distortions and economic shocks could change the picture dramatically. With the market reforms of recent years, however, project analysis will come into its own again. Prices are now a good guide for resource allocation decisions, and the country has achieved a measure

[5] There is one caveat to the argument that there should be no conditions on disbursement of the ex post conditionality and that relates to the Dutch Disease problems. Suppose for example the attribute the donor is rewarding ex post is export diversification. In this case the winner will receive an aid "price" which by appreciating the real exchange rate may undermine the benefits gained in pursuit of the price. It may be necessary, therefore, to ensure that the implicit tax on exporters associated with the aid inflow is offset by some subsidy or compensation, wither by way of a subsidy on exported output, export production (possibly on the cost of credit) or on investment.

of macroeconomic stability.

In this new situation, more efforts should be made to refine project analysis. In appraisals and evaluations, costs are seldom weighed against benefits in a systematic fashion. The quality of project evaluations in Tanzania has improved, but even today qualitative analysis dominates, while cost-benefit or cost effectiveness analyses are rare. The sustainability problem must also receive closer attention. The implications of projects for future government recurrent costs are not sufficiently considered, which means that there is a risk that either SIDA has to finance them indefinitely, or that they will collapse when SIDA leaves. SIDA should specify from the very beginning how its engagement in a project is to be phased out, and thus force the Tanzanian government to commit itself from the beginning.

Aid coordination does exist in Tanzania. Most important are the Consultative Group meetings, which have been held annually since 1986. The Joint Government- Donors Meetings are held quarterly, and donors also meet among themselves monthly. Still, in spite of these improvements, UNDP (1993) concluded that effective aid coordination is not in place. The main obstacle is, of course, that the government institutional capacity to coordination is weak. When there are over fifty donors there are bound to be overlaps.[6] It also makes aid management in Tanzania too much of a donor-driven process. Responsibility for implementation has increasingly been taken away from Tanzania. More attention needs to be given to the institutional strengthening of Tanzania's administration in the field of project formulation and appraisal, as well as auditing, monitoring and evaluation.

[6] There existed more than 2000 projects in the early 1990s, with enormous problems, for the Tanzania government, of management, expenditure control, and disbursements of funds.

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List of Persons interviewed

Ms Cecilia Adam Kinndo, Cooperation Union
Ms Helena Altvall, DCO SIDA
Mr Anders Berlin, REWA SIDA
Mr Stefan Dahlgren, PLAN SIDA
Mr James Donovan, PLAN SIDA
Mr Göran Engstrand, REWA SIDA
Mr Ernst Eriksson, FORV SIDA
Mr Mats Grönlund, DCO SIDA
Ms Kerstin Grönman, ekonomibyrån SIDA
Mr Ole Poul Hansen, Danish Embassy
Ms Anna Holmryd, UD
Ms Annika Idemalm, PLAN SIDA
Mr Sjef Ijzermans, Netherlands Embassy
Mr. D. Kamori, Managing Director, National Bank of Commerce
Mr Kange, Institute of Tax Administration
Mr. R. Kapella, Customs House
Mr. R. Khijjah, Commissioner for Monetary and Fiscal Affairs, Ministry of Finance
Mr S.J Kimaryo, Deputy Managing Director TANESCO
Ms Scholastica Kimaryo, Team leader UNICEF/UNHCR
Dr. C. Kimei, Director of Research, Bank of Tanzania
M. Konishi, Resident Representative, World Bank
Mr Erik Korsgren, DCO SIDA
Mr K A Larsson, PLAN SIDA
Mr. D.A. Lugina, Deputy Director General, Tanzania Audit Corporation
Dr A. Mbelle, Economics Department, University of Dar Es Salaam
Mr. J.S. Mhando, Manager of Imports Data Analysis, Directorate of Import Licensing
Mr Cosmas Mogella, DCO SIDA
Mr Mrisho, PS, Ministry of Industry
Ms Beatrice Mutabazi, Deputy director TBS
Ms Carin Norberg, SIDA
Mr Lars Norvik, DCO SIDA
Dr. Odunga, Deputy Principal Secretary, Ministry of Finance
Dr N. Osoro, Economics Department, University of Dar Es Salaam
Mr Thomas Palme, Ambassador, Swedish Embassy, Dar Es Salaam
Mr Pfeiffer, USAID
Ms M. Pili, TAMWA Tanzania Media Women Association
Ms Marja Ruohmäki, FORV SIDA
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Mr. N.N. Shimwela, Coordinator of Parastatal Sector Reform Commission
Mr Lars Stigendahl, Tanzania Bureau of Statistics
Ms Maria Stridsman, SIDA
Mr A Ström, PLAN SIDA
Mr. . E. Taha, Resident Representative, IMF
Dr Brian van Arkadie, Dar Es Salaam

Mr Bo Westman, DCO SIDA
Mr Tuolio Zanoni, PLAN SIDA

TERMS OF REFERENCE

Review of Swedish development co-operation with Tanzania

1. BACKGROUND

The new government report of forms of management and co-operation in overseas aid (SOU 1993:1) proposes the elaboration of country profiles and country studies as an essential tool for the management of aid to individual countries.

Over the period 1965/66-1991/92, Swedish aid payments to Tanzania have amounted to 9,3 milliard SEK (c. 17,4 milliard SEK in constant January 1992 prices). Sweden is today one of the largest donor countries. No comprehensive analysis has been made of Swedish aid to Tanzania which takes account of other donors' experience or places emphasis on the results achieved by Swedish aid.

This is the background to SASDA's intention to carry out a review of Swedish aid to Tanzania over the period 1965/66-1991/92, and particularly on its development after 1980.

2. OBJECTIVE

The review will :

a) analyse the effect and effectiveness in the sense of appropriateness to the objectives set (or 'external' effectiveness) of the aid given;

b) analyse its cost-effectiveness (or 'internal' efficiency);

c) make recommendations to improve its effectiveness and efficiency in development co-operation withTanzania in the future.

d) make proposals for the methodology to be employed in analysing and following up the effectiveness and efficiency of aid in other country studies.

3. CONTENT

The study should provide answers to the following questions:

a) What has Sweden supported in Tanzania?
b) Why has Sweden supported Tanzania in this way?
c) What results have been achieved?
d) Is Swedish development co-operation with Tanzania reasonable in relation to the countrys' structure of production, economic policy and political conditions?
e) Has Swedish aid been cost-effective?
f) What have other donors done in Tanzania and what do they intend to do in future?
g) What should Sweden do in the future?

3.1. What has Sweden supported in Tanzania?

The analysis will be based on a comprehensive time-series of Swedish aid to Tanzania, broken down as follows:

1) by authority (Ministry of Foreign Affairs, SIDA, BITS, SAREC, Swedecorp);
2) by channel (bilateral co-operation, multilateral co-operation, NGOs, companies);
3) by final product (sectors: direct production, social sector, services, imports, public-sector management, policy);
4) by macroeconomic function (external consultants, local costs, imports, credit, debt operations);
5) by final recipient (public sector, private sector).

The analysis will also highlight information about commitments, payments, carry-over of funds and types of grant. It will be supplemented by a short description of the contributions made.

3.2. Why has Sweden supported Tanzania in this way?

The study will examine:

1) applications from recipients;
2) policy considerations by the responsible authorities and the government;
3) discussions between donors and recipients;
4) decisions; and
5) communication of decisions to the recipients with special emphasis on comments or observations about content and execution.

3.3. What results have been achieved?

This part of the study will analyse, summarise and draw conclusions from:

1) evaluations carried out by Sweden;
2) evaluations made by other donors;
3) evaluations made by Tanzania;

More detailed consideration will also be given to contributions which are of particular importance in Swedish aid to Tanzania.

The review will analyse the macroeconomic effects of Swedish aid and the effects of total aid on Tanzania. Analysis will focus on the effects on growth and distribution in general, on selected sectors (of interest for Swedish aid), and on aspects of fungibility or additionality (effects on savings, public expenditure and investment). The 'crowding-out' and 'crowding-in' effects will be examined if possible.

The management of aid flows will be analysed with regard to the recipients' economic policy, financial programmes and budgetary process (rates of exchange, equivalent value in local currency and incorporation in the state budget). It assumes that effective aid demands that the recipient takes steps to implement different co-operation programmes and makes the hypothesis that good macroeconomic management of the flow of aid is a condition of effectiveness.

Has Sweden applied the concept of conditionality? If so, what requirements does it set? Report and follow up on conditionality.

3.4. Is Swedish development co-operation with Tanzania rational?

The reasonableness of Swedish contribution will be considered with respect to:

1) the recipients' resource base and economic strategies as reported in policy documents (development plans and analyses):
2) the recipients' priorities as shown by analysis of Tanzanias national budgets (current outlay and investment plans);
3) public expenditures review;
4) analyses made by the World Bank, IMF and possibly other donors;
5) analyses carried out or commissioned by Sweden;
6) the democracy objective of the recipients.

3.5. Has Swedish aid been cost-effective?

The review will include a broad analysis of administrative costs per aid project to Tanzania.

3.6. Aid from other donors

Development co-operation with other donors will be covered, analysed by channel, product, macroeconomic function and recipient.

3.7. What should Sweden do in the future?

Working from points 1-5 above, the review will make recommendations for the future orientation of development co-operation.

Particular attention should be paid to the recipient country's strategic planning documents for the future, the World Bank's and IMF's future-oriented analyses and estimates of the need for financing.

4. RESPONSIBILITY FOR EXECUTION OF THE REVIEW

The study will be carried out by Arne Bigsten at the Department of Economics, University of Gothenburg, who will be responsible for planning and for discussions with SASDA. He will also be responsible for recruitment of research assistants to work on the project.

5. TIMETABLE

The study will begin on 15 September 1993 and the final report be presented to SASDA on 1 June 1994. SASDA and Arne Bigsten will agree a date for interim reports as the review proceeds.

6. INTERIM REPORTING

Bigsten will present his final report in English with a summary in Swedish (c. 20 pages) to SASDA on 1 June 1994 at the latest. A preliminary report will be presented during April 1994. The report may be published in a series of SASDA reports by agreement with the author.

The final report will be in WordPerfect 5.1 or 5.2 in printed form and on diskette.

SASDA

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