

PART TWO

THE CENTRAL BANK AND MONETARY
AND CREDIT POLICY IN TANZANIA, 1966 TO 1972



Chapter I

THE BANK OF TANZANIA

1. LEGISLATION, ORGANIZATION AND EARLY ACTIVITIES

(a) *The Bank of Tanzania Act*

On 23 December 1965, the National Assembly passed what is officially known as the Bank of Tanzania Act and described as "an Act to provide for the Establishment, Constitution and Functions of the Bank of Tanzania as a Central Bank, to provide for the Currency of Tanzania, to provide that the Bank shall be Banker to the Government and shall have certain powers in relation to other Banks and Financial Institutions, to extend the Banking Ordinance to Zanzibar and to make certain amendments to the Law relating to Banking and Exchange Control, and for connected purposes." This Act received the President's assent on 6 January 1966.

The Bank's principal functions are listed in Article 5 as "to issue currency, to regulate banking and credit, to manage the gold and foreign exchange reserves of Tanzania and to perform any function conferred upon it (or to act as the agent of the Government in respect of any function conferred on the Government by or under any international agreement to which Tanzania is a part." The same Article specified that "Within the

context of the economic policy of the Government, the activities of the Bank shall be directed to the promotion of credit and exchange conditions conducive to the rapid growth of the national economy of Tanzania, due regard being had to the desirability of fostering monetary stability."

The Governor is the legal representative of the Bank, signs its most important documents and is responsible for the Bank's management and the direction of its business and affairs. Under his supervision, the Director-General is responsible for day-to-day management and for such functions and decisions as the Governor may delegate to him.

The Board of Directors consists, in addition to the Governor and Director-General, of the Principal Secretary to the Treasury and not less than eight nor more than ten other directors¹. These latter are appointed by the Minister of Finance for three-year terms of office. Persons excluded from service on the Board of Directors are members of the National Assembly, holders of public office, and anyone who is a director, officer, employee or shareholder of any bank or financial institution subject to the Central Bank's control.

The Board has to meet at least every two months; half the members constitute a quorum, provided one of them is the Governor or the Director-General. Decisions so urgent that they cannot await the convening of a Board meeting may be taken by the Governor (or in his absence the Director-General) and the Principal Secretary to the Treasury, and subsequently reported to the Board at its next regular meeting.

¹ Originally their number was five, but this was altered by a 1971 amendment to the Bank of Tanzania Act. (Bank of Tanzania, *Economic and Operations Report*, June 1971, p. 33).

The Bank's authorized capital of twenty million shillings was fully paid up at the moment when it initiated its activities¹. A general reserve fund and a consolidated fund were to be built up from profit appropriations, as follows: So long as the general reserve fund was less than the authorized capital, at least one quarter of annual net profits was to be transferred to it, and thereafter, until it was three times the amount of capital, at least one eighth of net profits. Any remainder of net profits is to be paid into the consolidated fund, except that if, at the end of the financial year the government were indebted to the Bank, the remainder of net profits is to be used for discharging or reducing this debt and only the residual profit, if any, paid into the consolidated fund.

Losses in excess of the general reserve fund are charged upon the consolidated fund, reconstitution of which is a first charge on subsequent profits.

The Bank's accounts are audited by an auditor appointed by the Minister of Finance, to whom the Bank, in addition, has to submit an annual report on its operations together with a balance sheet, as well as quarterly reports on the economic situation, with special reference to financial developments and the policies followed by the Bank.

The Bank of Tanzania Act then goes on to set out in detail the powers and functions of the new central bank, as regards the currency issue, relations with the government and other public authorities, financial relations with other banks, control of banking

¹ Part of the required sum was made available to the government by the East African Currency Board, which divided its total reserves of 40 million shillings equitably among the three East African countries. See East African Currency Board, *Report for the year ended 30th June, 1966*, p. 90.

and credit, management of the gold and foreign exchange reserves, and miscellaneous powers and functions.

Currency. The unit of currency in Tanzania is the shilling, the par value of which is determined by the President on the advice of the Central Bank and in accordance with relevant international agreements to which Tanzania is a party.

Relations with the government and other public authorities. The Bank of Tanzania is the banker, and acts as the fiscal agent, of the government, in which capacity it may: accept deposits and effect payments for the account of the government or public authorities, either directly or, where it has no agency or branch, through another bank of its choice; act as agent for the government in servicing the public debt; purchase, sell, transfer or accept for custody government securities, cheques, bills of exchange, gold, foreign exchange, etc. The Bank may, furthermore, make direct advances to the government for the purpose of offsetting fluctuations in budget receipts and disbursements, up to 20 per cent of the government's average annual ordinary revenues¹ and for at most 300 days. These advances bear interest at a rate to be agreed with the government, but not less than 3 per cent annually.

There are certain further limitations on operations in government securities. The Bank's holdings of them may not at any time exceed 25 per cent of average annual ordinary revenue, or 10 per cent thereof if the securities mature later than twelve months from the date of acquisition.

Apart as specified in the Act, and described above, the Bank may not directly or indirectly extend any credit to the government or any public authority.

¹ Average annual revenue refers to the average of the three financial years immediately preceding the year in which the relevant calculation is made.

Financial relations with other banks. The Bank of Tanzania is the bankers' banker, and to this end may open accounts for other banks, accept deposits from them, and collect money and other monetary claims on their behalf. It may in addition provide such additional services to banks as an interbank clearing, and it may purchase from, sell to and rediscount on behalf of banks bills of exchange, promissory notes and other credit instruments, provided they bear the endorsement or acceptance of a bank, mature within 180 days from the date of acquisition or rediscount, and are issued for specified purposes¹. Certain bills of longer maturity, up to 270 days, may be acquired or rediscounted by the Bank at its discretion, subject to their being backed by additional security. The Bank may, finally, grant loans and advances to banks for a duration of up to six months, on the pledge of government or government-guaranteed securities or rediscountable credit instruments.

Control of banking and credit. The Bank of Tanzania had a wide range of instruments for credit control².

In the first place, it may require banks, from time to time, to maintain minimum cash balances with the Bank as reserves

¹ Permissible purposes are to finance

- "(i) the purchase or marketing of produce, the importation or exportation of produce and other goods, or the transportation of produce and other goods within Tanzania;
- (ii) the storage of non-perishable goods and products which are duly insured or deposited under conditions assuring their preservation in authorized warehouses or in other places approved by the Bank;
- (iii) industrial or agricultural production."

² Some of them are listed in Part IV, Articles 47-52 of the Bank of Tanzania Act, e.g. powers in respect of reserve requirements, interest charges on deposits, control of the volume, terms and conditions of bank credits; others are specified or implied elsewhere, e.g. open market operations, determination of the official discount rate, control of the Treasury current account, etc.

against deposit and other liabilities; it may vary these ratios at its discretion, and it may prescribe different ratios for different kinds of liabilities as well as the method of computing the reserves, subject to their not exceeding 20 per cent of any bank's liabilities. Special penalty charges are applicable to banks which fail to maintain the required minimum balances.

Secondly, the Bank of Tanzania has powers to set maximum or minimum rates of interest payable by banks and other financial institutions on deposits. Different rates may be set for different types of banks or financial institutions, but there may not be any discrimination within any one group.

Thirdly, the Bank of Tanzania has powers to control the volume, terms and conditions of credit extended by banks, again on a non-discriminatory basis and subject to no bank being required to reduce any existing credit prematurely. The same controls may be applied to other financial institutions in respect of credit extended through loans, advances or investments.

All banks and financial institutions have to furnish the Central Bank with information on their activities, at such time and in such manner as the latter prescribes. The Bank is free to publish this information, subject to not disclosing the financial affairs of any customer of banks or financial institutions.

Management of gold and foreign exchange reserves. In its management of the country's gold and foreign exchange reserves, the Bank of Tanzania is enjoined by law to use its best endeavours never to let external assets fall to less than the value of four months' imports, calculated on the average of the last three preceding years.

Reserve assets may be gold; convertible foreign exchange in the form of demand or time deposits with foreign central banks

or with the Bank's agents or correspondents abroad, documents or instruments customarily used for making payments or transfers in international transactions, as well as notes and coins; securities issued or guaranteed by foreign governments or international financial institutions; and finally, any other liquid external asset at the Bank's discretion but subject to prior consultations with the International Monetary Fund and to the Finance Minister's approval.

The Bank of Tanzania may import, export, sell and hold gold; acquire, transfer, hold and invest balances in foreign currencies; effect any kind of transactions in foreign exchange, but only with banks, the government and other public authorities, foreign central banks, banks and financial institutions, foreign governments and international financial institutions, to the strict exclusion of private clients. The Bank also has powers to administer any law on exchange control.

Miscellaneous powers and functions. These include the power to act as banker to foreign banks and financial institutions operating in Tanzania, to promote the creation and development of a money market or securities market, and to advise the government on matters of monetary and credit policy.

The final section of the Act deals with a number of transitional arrangements concerning subscription for initial authorized capital, reception of East African Currency Board assets, and the Bank's preliminary acts and expenses.

(b) *The Bank's image as conveyed by the law*

Considered as a whole, the Bank of Tanzania Act is in no way innovatory. On the contrary, it seems to go out of its way to establish a traditional and reassuring image of the Bank's future policy — an approach in some contrast with President Nyerere's

declared intention of making a socialist state of Tanzania¹, but at the time fully justified by the need to step carefully in an extremely difficult and precarious situation².

When the Bank of Tanzania was set up, the East African Currency Board was in dissolution, and the primary necessity was to muster domestic and international confidence for the new central bank³, the more so as Tanzania carried a deal of responsibility for the break-up of the East African currency union⁴, to the obvious displeasure of international financial institutions. There can be no doubt that one of the chief purposes of the conservative approach of the law was to regain the favour of these institutions.

This aim is evident in the law's strict limitations on government borrowing from the Bank, in the Bank's independence *vis-à-vis* government, in the requirement of high liquidity for all lending assets, and in the high ratio of gold and foreign exchange reserves to monetary circulation.

It is worth examining these points in more detail. Government borrowing from the Bank of Tanzania, as we have seen, is subject to limitations both as to total amount and as to duration. In practice, this means that any budget deficit can be financed only within the limits of short-term, countercyclical policy.

¹ See, e.g. J.K. Nyerere, *Freedom and Unity*, Dar es Salaam, 1966, p. 133, 162 ff., 255 ff.

² See N. Groes, *The Possibility of Monetary Policy in Tanzania*, University College, Economic Research Bureau Paper 66.2, Dar es Salaam, 1966, p. 2 f.

³ It was most important to create confidence among the public to the effect that the Bank of Tanzania was going to be able to maintain the currency's fixed par value, for otherwise the most dire consequences would have ensued, such as indiscriminate price rises, black markets, balance-of-payments deterioration, capital flight, a dwindling of foreign aid funds, difficulties and losses in the conversion of the East African into the new Tanzanian shilling, etc. See N. Groes, *ibid.*, p. 2-3.

⁴ Cf. above, Part One, Chapter 2, p. 66-67.

The degree of statutory independence enjoyed by the Bank's management is very considerable. Under Articles 6 to 10 of the law, the Governor and the Director-General have full powers of management without limitations or controls, and without having to account to the government for their actions. They are, of course, appointed by the President, which implies that they must enjoy his confidence, and the presence of the Principal Secretary to the Treasury on the Board of Directors ensures collaboration and agreement with the Minister of Finance. In practice, therefore, the Bank of Tanzania no doubt enjoys less independence than might appear from the wording of the law.

As regards the liquidity of the Bank's loans, advances, rediscounts, etc., maturities are in general limited to less than one year. These provisions clearly run counter to a developing country's need to expand long-term credit, but they reinforce the Bank's independence *vis-à-vis* the government and are clearly intended as safety limits for commercial banking.

Gold and foreign exchange reserves, finally, are required at any moment to cover four months' imports. This seems at first sight a very high proportion, especially since one of the chief criticisms levelled at the East African Currency Board was precisely that the reserve coverage of its currency issue was much too high. But this provision was no doubt drafted with an eye not so much on the currency cover as on external payments and especially the trade balance. In addition, the Bank of Tanzania was endowed with all the typical functions of a central bank, and as such was bound to need higher reserves than a mere issuing agency like the Currency Board. Nevertheless, the reserve ratio does appear higher than necessary, and the only reasonable explanation is that the overriding purpose of the law was to buttress confidence in the country's currency and credit institutions.

A somewhat different picture emerges, on the other hand, from the law's provisions with respect to credit control and monetary policy. In these matters the Bank is endowed with ample powers, ranging from reserve requirements to the determination of the volume and conditions of credit extended by commercial banks and other financial institutions.

Certainly the Bank's powers in these matters go well beyond the traditional instruments of quantitative credit control and leave room for selective controls as well. There is no sign here of any kind of traditional approach, as is only right in the light of the almost universal view that the central banks of developing countries must look for new and different means of intervention¹.

All in all, then, the Bank of Tanzania Act adopted a traditional approach in its rules governing the Bank's principal functions, with the sole exception of credit control. Authoritative opinion in Tanzania² holds this approach to have been extremely useful and expedient in facing up to initial difficulties, but it is also thought that these difficulties were perhaps exaggerated at the time, especially with reference to the immediate need of gaining confidence at home and abroad, while on the contrary the need to promote rapid economic growth may have been underestimated to some extent.

There is no doubt, however, that by the establishment of a central bank certain definite expectations were created in Tanzania

¹ For full discussion of this point see Giordano Dell'Amore, "Banking Policy and Savings Policy in African Countries", in: *The Mobilization of Savings in African Countries*, Milan, International Savings Banks Institute and Cassa di Risparmio delle Province Lombarde, 1972; Giordano Dell'Amore, *I sistemi bancari*, *op. cit.*, p. 900 ff.; Arnaldo Mauri, *Il mercato del credito nei paesi sottosviluppati*, *op. cit.*, p. 31 ff. and the full bibliography therein.

² N. Groes, *op. cit.*, p. 7-8.

with respect to what it could, and would, do to speed up economic development¹ in the country's given economic and social situation at the time.

One set of expectations had to do with the institutional set-up and the working of the credit market. In East Africa as a whole, it will be recalled, the credit market was dominated by the commercial banks, especially the British Big Three, given that non-bank financial intermediaries were still at an early stage of development and loans by-passing the customary banking and credit circuits counted for little². All this applied very much to Tanzania, where financial intermediaries other than commercial banks carried less weight than in Kenya and where the three big expatriate banks were in a position of almost uncontested oligopoly. It was thought, therefore, that the Bank of Tanzania would regard it as one of its main tasks to restrict the autonomy of the commercial banks and to loosen the credit system's dependence on Great Britain. We shall see presently that the difficulties of exercising such controls and the choice of a particular type of economic policy eventually led to the nationalization of the whole banking system. In the more general terms of making the credit market more responsive to development needs, it was expected that the Central Bank would help to reduce the very considerable spread between lending and borrowing rates, that it would promote the use of bank money and encourage credit to the local economy.

Another, perhaps rather less important, set of expectations had to do with the development of the money market. This was

¹ N. Groes, *op. cit.*, p. 8 ff.; M. Gaskin, *Monetary Flexibility in Dependent Economies*, East African Institute of Social Research Conference Papers, January 1965; Bank of Tanzania, *Economic and Operations Report*, June 1967, p. 26 ff.

² Some forms of direct credit were common among the Asian community.

on an extremely small scale in Tanzania, because of the scarce supply of Treasury Bills and commercial bills of exchange, and because there were hardly any institutional investors nor financial intermediaries whose business rested on the circulation of short-term credit instruments. Furthermore, interbank relations within the country were scant, since the expatriate banks had few dealings with each other and preferred to turn instead to their Nairobi offices or indeed to their London head office¹.

The development of a local money market was, no doubt, a long-run hope, while much more stress was placed on the Bank's role in promoting the growth of a capital market and on its monetary policy.

It was thought that the Bank should create the necessary conditions both on the side of the demand for capital and of its supply, that it should rationalize the whole set of state and parastatal organizations whose activities had a bearing on the capital market, and that it should organize such a market with a view to a steady flow of transactions and limited fluctuations in interest rates.

In the field of monetary policy, it was felt that traditional instruments of credit control were ineffective², and that, therefore, selective controls should be applied to the benefit of exports, import substitution and key sectors of economic development.

¹ The situation was different in Kenya, where intensive interbank relations had already given rise to an incipient money market.

² When the Bank of Tanzania was set up it was generally thought that discount rate manipulation was not very effective, and that open market operations were ruled out until such time as there was an efficient securities market and there was less need to support bond prices; the most promising means of credit control seemed regulation of reserve requirements, and the Bank was expected to use it widely and frequently. In the event, however, this means of credit control was never used in Tanzania.

We shall see later how the Bank of Tanzania tried to meet these expectations and how it responded to the claims made upon it — what in fact was the real content of its operations in practice. But for the moment there is one last point which it seems of interest to discuss, as indeed it has been widely discussed in Tanzania. This is the question why a regime which is essentially socialist in its economic policy choices, failed to adopt the same approach to monetary and credit matters and instead chose to model its central bank on the typical pattern of non-socialist countries, though, to be sure, some allowance was made for the specific problems of underdevelopment¹. The first explanation that comes to mind is that at the time when the Bank of Tanzania was set up this question simply did not arise at all and could not have been envisaged in these terms. Private enterprise was so predominant in the credit system and, more generally, throughout the economy that the creation of a socialist-type “mono-bank” was completely ruled out. The question really did not arise until 1967, when the entire system of commercial banks was nationalized in implementation of the principles propounded by the Arusha Declaration.

It is common knowledge that in almost all socialist countries nationalization of the banking system was quickly followed by the creation of a single large bank combining the functions of issuing bank, commercial bank and control of plan implementation².

¹ See John Loxley, *The Monetary System of Tanzania since 1967: Progress, Problems and Proposals*, University College, Economic Research Bureau (Restricted) Paper 69.6, Dar es Salaam, 1969, p. 3-5.

² Much has been written on this subject; see, e.g., Cassa di Risparmio delle Provincie Lombarde, *Il sistema monetario e creditizio dell'Unione Sovietica*, Milan, 1970; George Garvy, *Money, Banking and Credit in Eastern Europe*, Federal Reserve Bank of New York, 1966.

With fully centralized physical planning and the development of financial planning as an exact reflection, in money terms, of the quantitative targets of the physical plan, there is no longer any need for a separate institution having as its main function the formulation and implementation of monetary policy, and the functions of currency issue and control of foreign exchange movements assume a routine character requiring no discretionary powers. But in Tanzania economic decisions were not as centralized as, say, in the Soviet Union; rather, the situation resembled that of Czechoslovakia, Hungary or Yugoslavia, where decentralization of decision-making, the greater discretion of enterprises and the possibility of divergence between physical and financial plans led to an enlargement of the role played by the banking system beyond mere administrative functions. In some cases growing differentiation resulted once more in a separation of central banking functions from those of commercial banking¹.

The Soviet system was clearly not applicable in Tanzania, where the activities of the public sector were governed by loose indicative planning and those of the private and the co-operative sector were virtually unplanned; in any case there was no detailed overall physical plan and financial planning was in its infancy. Tanzania needed an active and flexible institution, indeed, just as any country with a decentralized market economy, an institution specifically performing central banking functions.

However, after the Arusha Declaration the structure and functions of the Bank of Tanzania did begin to change, and with them its image as a central bank as outlined above.

¹ See George Garvy, *op. cit.*; Gregory Grossman, *Money and Plan*, Berkeley University, California, 1968; Ivan Meznerics, *Banking Business in Socialist Economy*, Budapest, 1968.

The formulation and implementation of monetary policy became easier with the cessation of the banking system's dependence on foreign decision centres, and the use of traditional instruments of credit control can now give way to frequent contacts and close collaboration among credit institutions. But the most significant change in the Central Bank's image is perhaps that monetary policy as such is losing importance as against financial planning. The Bank will have to build up comprehensive flow-of-funds accounts and, in the total absence of reliable information on the sources and use of funds in industry and trade, should also prepare forecasts regarding the major financial variables and collect data on *ex-post* flows by which to check the degree of target implementation, thereby enabling the Ministry of Economic Affairs and Development Planning (DEVPLAN) to prepare annual and longer-term financial plans.

The implication for the Bank of Tanzania is that its mere watchdog function with respect to the implementation of DEVPLAN guidelines and the possible application of credit controls to this end, should be replaced by a more active role in monetary and financial planning. This explains the emphasis placed from the outset on building up the Bank's research department as a planning and forecasting unit.

Another of the Bank's functions which is bound to gain importance is control of financial institutions in the country, assistance to nascent new ones (e.g. the Tanzania Finance Company, the National Bank of Commerce and the Karadha Company) and their rationalization with a view to easing efficient planning; the proliferation of unneeded institutions would only create a risk of misallocation of investment resources and raise costs through diseconomies of scale.

More will be said later about how and to what extent the Bank of Tanzania has been responding to this new challenge and what progress has in fact been made with financial planning.

(c) *Early activities — currency conversion*

The Bank of Tanzania Act was passed on 23 December 1965 and published on 6 January 1966; the Bank of Tanzania opened its doors for business in June 1966, after its official inauguration by President Nyerere on the 14th of that month.

On that very day it started issuing the new Tanzanian currency, for conversion of all the money circulating in the country. It was essential that the new Central Bank should quickly gain the public's confidence, and to this end it meant to deal with the conversion very expeditiously. It fully succeeded, not least thanks to a widespread prior publicity campaign and to President Nyerere's appeal in his inaugural speech¹, when he impressed upon the population that it was nothing short of a national duty to come forward as soon as possible to exchange old banknotes against new ones — which, incidentally, bore the President's effigy.

Tanzania's new currency unit was the shilling, subdivided into 100 cents, and its par value, like that of the other two East African countries' new currencies, was fixed by agreement with the International Monetary Fund at 0.124 414 grams of fine gold².

At first the Bank of Tanzania issued only banknotes for substitution, in the interests of simplifying conversion operations.

¹ Julius K. Nyerere, *Freedom and Socialism*, Dar es Salaam, 1968, p. 175. See also N. Groes, *op. cit.*, p. 4.

² This was equivalent to 250 shillings per troy ounce of fine gold, and 7.142 86 shillings per U.S. dollar.

Coins were not issued until August 1966, and in the meantime people continued to use Currency Board coins, which were made available to the Bank in large quantities¹.

To ease conversion, all commercial banks received, before it actually began, a deposit of new national banknotes (and later of coins). As and when any bank redeemed a sizeable amount of old banknotes, it consigned them to the East African Currency Board at any of the latter's Tanzania offices, which remained open throughout the first stage of conversion. The Currency Board credited the Bank of Tanzania with these amounts, and the Bank in turn credited the commercial bank concerned with the same amount; the Currency Board either paid an equivalent sterling sum to the commercial bank's head office in London (in the case of the British expatriate banks) or handed over to the government of Tanganyika or Zanzibar an equivalent sum in securities and sterling². In order to supply the Bank of Tanzania at once with a working balance of foreign exchange assets, the East African Currency Board initially converted into sterling all the money consigned to it up to 80 million shillings.

At the moment when conversion began, in June 1966, the Currency Board had holdings of Tanzania government securities in an amount of 52 million shillings, of which 10 million pertinent to Zanzibar. All Treasury Bills were liquidated by 25 June, and the remaining securities by 6 July 1966.

The Currency Board's notes ceased to be legal tender on 14 September 1967, and its coins on 10 April 1969, but banks still

¹ The Bank credited the Currency Board with a corresponding amount or else simultaneously acquired sterling assets; the Currency Board acted merely as the Bank of Tanzania's agent in supplying the coins, while full responsibility rested with the Bank itself.

² Treasury Bills were valued at current prices, other securities at face value.

continued to redeem both. Just how quickly the bulk of the currency conversion was in fact accomplished can be seen from Chart 2.

On 1 January 1971, the three East African central banks themselves assumed responsibility for such further conversion operations as were still necessary. By that time, the East African Currency Board had virtually wound up its activities and its residual assets were distributed among the three central banks. In Tanzania, the terminal date for conversion was fixed for 31 December 1972, after which the Bank of Tanzania would no longer accept any of the old currency. In the months preceding that date, the Bank carried out a campaign urging people to exchange all their remaining holdings, so as to minimize hardship cases after the deadline¹.

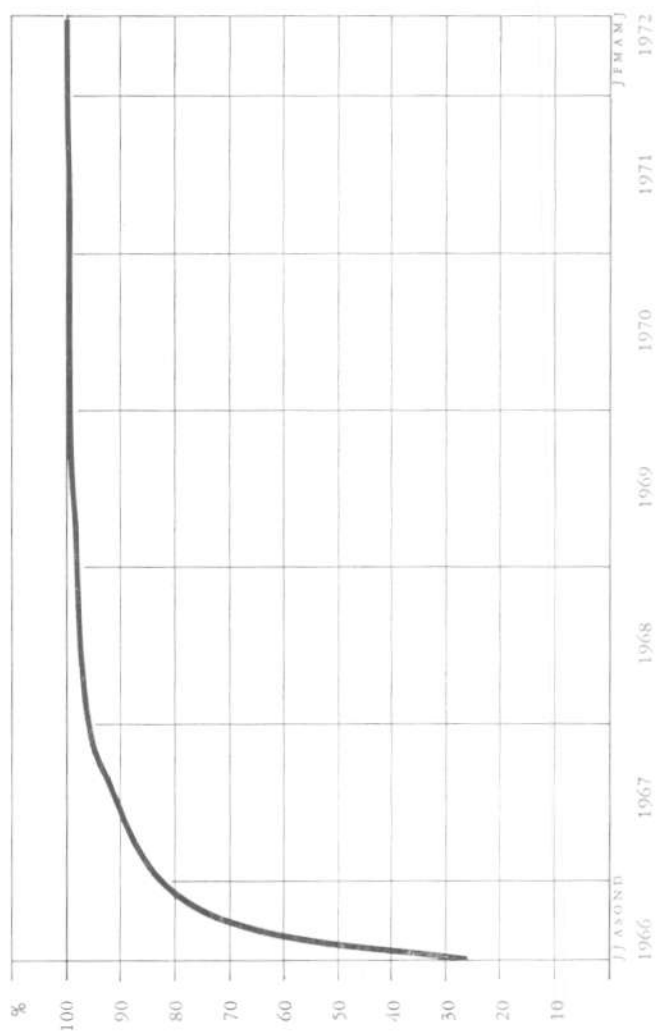
(d) *Organization*

From its inception, the Bank of Tanzania had its seat in Dar es Salaam. Almost at once the Bank opened several subsidiary offices elsewhere in order to facilitate distribution of the national currency; in 1966, it thus opened an office in Zanzibar and others at Moshi, Mwanza and Tanga, in Standard Bank premises. In the following year, after the nationalization of commercial banks, these three offices were taken over by the National Bank of Commerce, and new temporary district offices were opened at Maswa, Mahenge, Mbinga and Kibondo; at the same time a number of mobile units began touring throughout the country — all in the interests of speedy currency conversion. Later, in 1968, the Mwanza and Moshi offices were separated from the National Bank of Commerce.

¹ Bank of Tanzania, *Economic and Operations Report*, June 1972, p. 38.

CHART 2

TANZANIA: CONVERSION OF EAST AFRICAN CURRENCY BOARD NOTES AND COINS
(CUMULATIVE DATA)



At present, the Bank of Tanzania has its headquarters in Dar es Salaam, one branch each in Zanzibar, Moshi and Mwanza, and an up-country office at Tanga. Elsewhere it uses the premises of the National Bank of Commerce.

The Bank's staff numbered 140 on 30 June 1967, and in subsequent years, as new branches were opened, gradually increased to their present number of more than 200. Most of them are highly competent and experienced men, and among them are a number of foreign experts seconded by central banks throughout the world and by international organizations, and serving for fixed terms generally between 1 and 3 years.

The Bank's management is headed by the Governor and the Director-General. It had originally six departments (domestic, foreign, research and statistics, accounting, secretariat, audit), but after a reorganization in 1968/69 their number was raised to nine, each headed by a manager responsible, via the Director-General, to the government. In 1972 a tenth department was added, when responsibility for import licensing passed from the Ministry of Commerce and Industries to the Minister of Finance, and the Bank had to take on the relevant day-to-day administrative functions. At present, then, the Bank of Tanzania has ten departments, as follows: accounting, administration, audit, banking, currency, exchange control, foreign, import licensing, research and statistics, and securities.

2. CURRENCY ISSUE AND MONEY SUPPLY

(a) *Currency issues by the Bank of Tanzania*

The Bank of Tanzania has the sole right to issue banknotes and coin in and for Tanzania. It has done so in the amounts shown in Table 25, which gives gross circulation figures for the

TABLE 25

TANZANIAN NOTES AND COIN IN CIRCULATION, 1966 TO 1972
(end-year figures in million shillings)

Year	Notes	Coin	Total	Composition per cent Notes	per cent Coin
1966	412.4	19.1	431.5	95.6	4.4
1967	504.5	34.6	539.1	93.6	6.4
1968	526.6	41.7	568.3	92.7	7.3
1969	597.6	52.7	650.3	91.9	8.1
1970	801.2	59.8	861.0	93.0	7.0
1971	985.7	63.5	1,049.2	93.9	6.1
1972 (30th June)	896.1	76.9	973.0	92.1	7.9

Source: Bank of Tanzania, *Economic and Operations Report*, various years, Tables 3 and 4.

TABLE 26

COMPOSITION OF NOTE CIRCULATION, BY DENOMINATIONS, 1966 TO 1972
(end-year percentages)

Year	5 sh.	10 sh.	20 sh.	100 sh.	Total
1966	11.8	19.1	36.3	32.8	100.0
1967	9.3	23.6	31.6	35.5	100.0
1968	10.5	16.8	32.2	40.5	100.0
1969	9.9	15.9	30.0	40.6	100.0
1970	8.6	15.1	30.9	45.4	100.0
1971	6.6	12.8	28.8	51.8	100.0
1972 (30th June)	3.7	12.8	28.4	55.0	100.0

Source: Bank of Tanzania, *Economic and Operations Report*, June 1972, Table 3.

years 1966 to 1972. The distribution pattern of the various denominations of notes and coins is shown in Tables 26 and 27.

It will be seen that over that period the note circulation more than doubled, and the coin circulation quadrupled. These different rates of increase are reflected in the composition of the currency

TABLE 27

COMPOSITION OF COIN CIRCULATION, BY DENOMINATIONS, 1967 TO 1972
(end-year percentages)

Year	5 cents	20 cents	50 cents	1 sh.	5 sh.	Total
1967	3.2	9.5	22.0	65.3	—	100.0
1968	5.3	8.9	17.0	68.1	—	100.0
1969	5.5	8.2	15.6	70.8	—	100.0
1970	6.0	9.2	18.7	66.0	—	100.0
1971	6.0	8.3	17.6	63.3	4.8	100.0
1972 (30th June)	5.3	7.3	14.4	52.1	20.9	100.0

Source: Bank of Tanzania, *Economic and Operations Report*, June 1972, Table 4.

circulation, the share of coins in which rose from 4.4 to 7.9 per cent. Clearly, there were not enough small denominations around initially, and so more coins had to be minted to meet the economy's requirements.

(b) *Growth and composition of the money supply*

Of all the economic statistics available in Tanzania, those on the components of money supply are the most detailed and up-to-date. End-month totals of the monetary circulation are published within two weeks, and figures regarding commercial bank deposits are submitted weekly to the Bank of Tanzania, for its internal use.

The series have to be used with some reservations, as will be explained below¹; but for the moment let us examine the figures for money supply (narrow definition, i.e. currency outside banks plus demand deposits) in Table 28. It will be seen that total money supply increased by 100 per cent from the end of 1965

¹ See footnote on p. 135 below.

TABLE 28

MONEY SUPPLY, 1965 TO 1972
(end-year figures in million shillings)

Year	Currency in circulation outside banks	Demand deposits	Total	Increase in money supply per cent	Demand deposits per cent of total
1965	382.0	370.0	752.0	—	49.21
1966	550.0	450.0	1,000.0	32.98	45.00
1967	511.7	680.4	1,192.1	19.21	57.06
1968	528.6	768.8	1,297.4	8.83	59.26
1969	605.0	931.8	1,536.8	18.45	60.63
1970	818.4	980.4	1,798.8	17.05	54.50
1971	986.4	1,192.1	2,178.5	21.11	54.72
1972	1,201.1	1,257.6	2,458.4	12.85	51.15

Sources: For the years since 1967, Bank of Tanzania, *Economic and Operations Report*, June 1972, and *Economic Bulletin*, March 1973; for 1965 and 1966, *East African Economic and Statistical Review*.

to 31 December 1972, that is, at an annual average rate of 19.5 per cent. The rates of increase are very similar for the two components of money supply: for bank deposits the average annual increase was 19.9 per cent and for currency in circulation outside banks the corresponding figure was 19 per cent. Accordingly, the proportion of bank money in total money supply remained remarkably stable; it was 49.21 per cent at the end of 1965, and 51.15 per cent seven years later.

It is interesting to compare Table 28 with the earlier Tables 1, 6 and 16, even though the latter refer mostly to East Africa as a whole and the figures for Tanzania cannot be accurately disaggregated. The first two of these tables show increases in money supply at much slower rates than in post-independence Tanzania, and indeed, as there has been occasion to note, there was at times a sharp deflationary tendency. Table 16 shows that

in East Africa as a whole demand deposits at commercial banks accounted for a much higher proportion of the total money supply than they do in Tanzania. Nevertheless, in comparison with the average of other African countries Tanzania can still boast a rather high proportion, though it has not risen much since independence.

Another thing that Table 28 shows is that the growth of money supply was not evenly distributed over the period under consideration. On the contrary, the rates of increase fluctuated sharply from year to year, in response to different circumstances.

The spectacular increase in 1966 was no doubt due in part to the changeover to a less restrictive monetary regime, and in part also to favourable business conditions at home and to export growth. In fact, the foreign sector in that year made the biggest single contribution to the increase in the monetary base.

In the following year things went less well, largely because of certain misgivings aroused by the Arusha Declaration; there was less inflow of foreign funds and some capital flight, with depressing effects on the monetary circulation. This factor was still operative in 1968, when, in addition, the country suffered a recession; accordingly, money supply rose less than in any other year in the period. In 1969 recovery set in, prices remained stable and exports flourished, all of which caused money supply once more to expand faster. But the foreign sector's contribution was eclipsed in so far as falling international prices offset part of the gain from a higher volume of exports; the main contribution came instead from government, via an expansion of credits by the Central Bank.

By 1970 some concern was beginning to be felt lest such a high rate of money creation might sooner or later generate serious inflationary pressure and cause prices to rise. Accordingly, restrictive measures were applied, of which more will be said later.

At that time, there was actually no sign as yet that the growth of money supply was pushing up prices, but it did lead to some shortages of goods and the balance of trade deteriorated.

Money supply still went on expanding considerably in 1971, but thanks to the Treasury rather than to the foreign sector, which indeed began to absorb liquidity. In 1972, finally, the rate of expansion dropped sharply, and at the same time prices climbed and the country's economy was going through a very difficult time.

There remains the interesting question of the relationship between money supply and gross domestic product in the years since independence. Table 29 shows the growth of GDP together with the M/Y ratio, that is, the ratio of money supply to GDP. Comparing these figures with those of Table 28, the first thing that strikes the eye is how much less fast GDP has been growing since 1965 than money supply. The annual average rate of income growth was 7.2 per cent at current prices compared with 19.5 per cent for money supply. It follows that very little of the additional money supply was in fact absorbed by income growth and the price level.

Secondly, it can be seen from Table 29 that the ratio of money supply to GDP¹ has been rising steadily throughout². Again comparison with the earlier, pre-1965, behaviour of the M/Y

¹ On the significance of this ratio in developing countries see Arnaldo Mauri, *Il mercato del credito nei paesi sottosviluppati*, op. cit., p. 14.

² Some reservations need to be made concerning the statistical data entering into the ratio.

(a) The figures for money supply in 1966 and, to a lesser extent, those for the following years are part estimates, in that they were obtained by summing a known datum, i.e. the total of Bank of Tanzania notes and coin in circulation on 31 December, with an estimate, i.e. the residual circulation of East African Currency Board notes and coin. This was a hazardous estimate, for it meant first determining the probable amount of the circulation before conversion

ratio as shown in Table 6 is useful, even though the absolute data are not homogeneous and, therefore, not directly comparable. But at least we can compare types of behaviour, and we see that until 1965, under the East African Currency Board, the ratio had a continuous downward tendency, while the transition to an independent and managed monetary system led to a reversal of the deflationary tendency and indeed to explosive money creation.

By 1970 it was beginning to be feared that so high a rate of expansion in money supply might lead to inflation, and prices did

began and then subtracting the total amount of redemptions to date, allowing for the probable outflow of money from Tanzania to the rest of East Africa as well as for a residual presumed unrecoverable.

- (b) Changing criteria were applied from one year to another in the classification and recording of deposits.
- (c) The greatest source of error is no doubt that while the money supply series includes Zanzibar, that of GDP is limited to Tanganyika. This would not matter so much if income growth in Zanzibar had been relatively stable and if the payments mechanism had been the same in both countries. But it seems as though neither of these conditions obtained. Since Zanzibar's gross domestic product can obviously not be estimated, it would be helpful if, at least, the money supply data could be appropriately disaggregated. From 1970 on, the Bank of Tanzania has been publishing the money supply series excluding the Zanzibar figures.
- (d) Other errors may derive from the incidence of seasonal variations on money supply. The statistics refer to 31 December, but in Tanzania the pattern of agricultural production causes a peak in the last four months of the year, so that the figures certainly overstate the situation for the other eight months. Furthermore, the seasonal peak itself normally varies from one year to another. Seasonal factors have little effect on income statistics, but may well distort monetary ones.
- (e) As regards the GDP series, finally, the chief criticism must be that most probably GDP at factor cost is not the most suitable indicator of the incidence of price rises on income growth. To this end it would be better to use GDP at market prices, but this series is not included in the official statistics.

(See John Loxley, *The Behaviour of the Tanzania Money Supply 1966-1970 and the Use of Monetary Indicators*, University College, Economic Research Bureau Paper 71.3, Dar es Salaam, 1971).

TABLE 29

GROSS DOMESTIC PRODUCT (AT CURRENT PRICES) AND THE M/Y RATIO, 1965 TO 1971

Year	Gross domestic product at factor cost million shillings	Annual GDP increase per cent	Ratio of money supply to GDP
1965	5,671	—	0.133
1966	6,518	13.1	0.153
1967	6,792	4.2	0.176
1968	7,205	6.1	0.180
1969	7,554	4.8	0.203
1970	8,232	8.9	0.218
1971	8,704	6.0	0.250

Source: Compiled from United Republic of Tanzania, *The Economic Survey 1971-72*, Dar es Salaam, 1972, p. 5, and Table 28 above.

indeed rise steeply in 1972¹. Until then, however, it may legitimately be concluded that the growth of money supply, far from generating inflation, led in part to a steady increase in real income, but that the bulk of it was absorbed by the greater spread of money throughout the economy². Here we certainly have the primary explanation for the behaviour of money supply in post-

¹ Note the following figures of the rise in the general price index (1963 = 100), published by the Bank of Tanzania in its *Economic Bulletin*, March 1973 (Table 27).

Years	1965	1966	1967	1968	1969	1970	1971	1972	1973
General price index	109.4	114.7	116.6	122.0	124.4	128.4	135.5	145.7	153.7

(December figures, except those for 1973, which refer to March).

² Some idea of the extent of the economy's monetization can be glimpsed from official statistics, even though in this case they must contain an element of guess. Subsistence production accounted in 1965 for 32.2 per cent of GDP, and in 1971 for 27.6 per cent, while of course the share of the monetary economy's production rose correspondingly. (United Republic of Tanzania, *The Economic Survey 1971-72*, p. 5-6).

independence Tanzania: a great deal of new money was needed simply for the enlargement of the monetary sector of the economy, and so to make good the deflationary effects of the Currency Board's policy in the past.

In two fields, particularly, the demand for money was growing. One of them was agriculture, where the use of money was beginning to penetrate even to the most remote areas, and the other was the public sector of industry, where many new enterprises were set up especially after the Arusha Declaration and, of course, needed both cash and deposits for their working balances ¹.

3. RELATIONS WITH THE BANKING SYSTEM, MONETARY AND CREDIT POLICY

(a) *Relations of the Central Bank with commercial banks and other financial institutions*

One of the most important functions of a central bank is to control the structure and operations of the banking system via direct and indirect lending ². The central bank thus becomes the bankers' banker, because of its multiple relations with commercial banks and of the sheer size of the financial flows between it and them.

The Bank of Tanzania, as we have seen, is provided by law with ample powers in this respect. Like most central banks at a certain stage of development ³, the Bank of Tanzania is barred

¹ They often kept a lot of liquid assets, preferably in cash rather than in deposits.

² See Giordano Dell'Amore, *Economia delle aziende di credito - I sistemi bancari*, op. cit., p. 842-843.

³ See Giordano Dell'Amore, *ibid.*, p. 894 ff.; Arnaldo Mauri, *Il mercato del credito nei paesi sottosviluppati*, op. cit., p. 39-42; R.S. Sayers, *Central Banking after Bagehot*, London, 1957, p. 118.

from direct dealings with the public. It may not accept deposits from the public, but, apart from banks and financial institutions, only from the government and from certain public authorities and foreign institutions, and it may not lend directly to private borrowers.

Given that Tanzania has a large, public commercial bank, the National Bank of Commerce, there is actually no need at all to allow the Central Bank to deal directly with the public. On the contrary, this might well weaken its control over the banking and credit system, not to speak of detracting it from its other important duties.

For purposes of bank supervision and credit control, the Bank of Tanzania has the right to ask commercial banks for statistical information. Great progress has been made with statistical work since 1966, thanks largely to the Bank's Research and Statistics Department, which, availing itself of the Bank's legal right to do so, has been publishing monthly data on commercial banking.

The law also provides for information to be submitted at the Bank's request by "specified financial institutions", and accordingly a list was drawn up in 1969 of various national institutions¹ and ten foreign insurance companies which henceforth were to be subject to the Central Bank's control.

The Bank of Tanzania Act says nothing about how the Central Bank is to control the structure of the banking system. Major decisions in this matter have so far been taken by special

¹ Diamond Jubilee Investment Trust (Tanzania) Ltd., Industrial Promotion Services (Tanzania) Ltd., Karadha Company Ltd., Local Authorities Provident Fund, Local Government Loans Board, Monetary Agencies (Tanzania) Ltd., National Provident Fund, National Insurance Corporation of Tanzania Ltd., National Development Credit Agency, Permanent Housing Finance Company of Tanzania Ltd., Tanganyika Development Finance Company Ltd., Tanganyika Post Office Savings Bank, Workers Development Corporation, and Zanzibar Post Office Savings Bank.

legislation (e.g. the nationalization law in 1967), and for minor ones, like those concerning the branch network of banks, there are no particular rules and the banks are free to use their own discretion. In practice, however, at least the National Bank of Commerce always acts in agreement with the Bank of Tanzania even in decisions of this kind, if they are at all important.

The Central Bank, furthermore, has powers to fix certain interest rates to be applied by banks and other financial institutions. Borrowing and lending rates actually in force during the years 1961 to 1972 are shown in Table 30.

In its financial relations with other banks, the Bank of Tanzania accepts deposits from them and, as lender of last resort, makes advances to them. The banks so deposit some of their free reserves, and also a certain amount for clearing purposes.

Immediately after its inception, it will be recalled, the Bank of Tanzania opened accounts with the commercial banks to facilitate conversion operations. It then used the same accounts for setting off amounts owing between commercial banks, and thus carried on the clearing previously handled by the East African Currency Board and the banks' Nairobi and London offices and correspondents. But the clearing was important only before the banking nationalization in 1967, when there were still a fair number of commercial banks. Thereafter, when only three and, later, two of them were left, there was little need for clearing, and this is no doubt one of the reasons why bank deposits with the Bank of Tanzania have been declining so much since 1968 (Table 31).

The banks' remaining deposits consist of funds earmarked for reserve or else temporarily in excess of lending.

In addition to these free reserves of banks, the latter could, under the law, be required by the Bank of Tanzania to maintain

cash balances against deposit and other liabilities. The Central Bank indeed has powers to prescribe different ratios for different kinds of liabilities, up to 20 per cent. But in practice it has never introduced reserve requirements, but always preferred more direct means of credit control. By and large, however, it relied heavily on moral persuasion until 1972, rather than on the more incisive techniques it has powers to use. For this reason the item "Banks' deposits" among the Central Bank's liabilities includes no obligatory reserves, but merely such funds as the banks freely decide to deposit. The amounts involved, as Table 31 shows, fluctuate a good deal, a circumstance which needs some comment.

Leaving aside for the moment the peak figures of 1966, 1968 and the first half of 1969, recurring monthly fluctuations are due simply to the commercial banks' changing liquidity situation in response to the seasonal pattern of the economy. When harvests are poor, farmers take up less in crop loans and the banks have spare funds they can deposit with the Central Bank; the same happens when there is an inflow of funds from abroad. On the other hand, deposits usually fall under the impact of restrictive monetary policy measures.

As regards the large deposits in 1966, 1968 and 1969, they have to do with the Bank of Tanzania's so-called Money-Employed Scheme. The idea was to prevent the commercial banks from investing their excess funds abroad, and to this end deposits with the Central Bank beyond a certain amount were automatically converted into Treasury Bills, and when they fell below the given limit, were equally automatically reconverted into cash. These funds earned interest at the Treasury Bill rate less $\frac{1}{4}$ per cent commission, and banks took advantage on a large scale of this facility while it lasted, until the middle of 1969; the sharp fall in deposits in 1967 was due to nationalization of the banking

TABLE 30

INTEREST RATES IN TANZANIA, 1961 TO 1972
(end-year figures, per cent per year)

	1961	1962	1963	1964	1965	1966
<i>Bank of Tanzania</i>						
Rediscounts and advances						
Commercial bills						
Crop: 90 days	—	—	—	—	—	5.00
91-180 days	—	—	—	—	—	5.00
Others (1): 90 days	—	—	—	—	—	5.25/6.00
91-180 days	—	—	—	—	—	5.75/6.50
Treasury Bills (35 days) (2)						
Rediscounts	—	—	—	—	—	4.88
Advances	—	—	—	—	—	5.38
<i>Commercial banks</i>						
Deposits	3.50	3.00	3.00	3.00	3.00	3.00
Savings	—	—	—	—	—	—
Time: 7 days' notice	4.50	3.50	3.50	3.50	3.50	3.50
3-6 months	4.75	3.75	3.75	3.75	3.75	3.75
6-9 months	5.00	4.00	4.00	4.00	4.00	4.00
9-12 months	8.00	7.00/10.00	7.00/10.00	7.00/10.00	7.00/10.00	7.00/10.00
Lending						
<i>Other financial institutions</i>						
Post Office Savings Bank	2.50	2.50	2.50	2.50	2.50	2.50
Deposits						
Permanent Housing Finance Co. (3)						
Savings accounts	5.00	4.50	4.50	4.50	4.50	4.50
Deposit accounts	—	—	5.50	5.50	5.50	5.50
Fixed-term deposits: 1 year	—	—	6.00	6.00	6.00	6.00
2 years	6.00	5.50	5.50	5.50	5.50	5.50
Lending	—	—	—	—	—	—
Rural Development Bank (4)						
Short-term lending	—	—	8.50	8.50	8.50	8.50
Long-term lending	—	—	7.50	7.50	7.50	7.50

	1967	1968	1969	1970	1971	1972 (June)
<i>Bank of Tanzania</i>						
Rediscouts and advances						
Commercial bills						
Crop: 90 days	5.00	5.00	5.00	5.00	5.00	5.00
91-180 days	5.50	5.50	5.50	5.50	5.50	5.50
Others ⁽¹⁾ : 90 days	5.25/6.00	5.25/6.00	5.25/6.00	5.25/6.00	5.25/6.00	5.25/6.00
91-180 days	5.75/6.50	5.75/6.50	5.75/6.50	5.75/6.50	5.75/6.50	5.75/6.50
Treasury Bills (35 days) ⁽¹⁾						
Rediscouts	4.36	4.57	4.27	4.27	4.27	4.27
Advances	4.86	5.07	4.77	4.77	4.77	4.77
<i>Commercial banks</i>						
Deposits						
Savings	3.50	3.50	3.50	3.50	3.50	3.50
Time: 7 days' notice	3.00/3.50	3.00/3.50	3.00/3.50	3.00/3.50	3.00/3.50	3.00/3.50
3-6 months	4.00	4.00	4.00	4.00	4.00	4.00
6-9 months	4.25	4.25	4.25	4.25	4.25	4.25
9-12 months	4.50	4.50	4.50	4.50	4.50	4.50
Lending	7.00/10.00	6.50/10.00	6.50/10.00	6.50/10.00	6.50/10.00	6.50/10.00
<i>Other financial institutions</i>						
Post Office Savings Bank						
Deposits	2.50	2.50	3.00	3.00	3.00	3.00
Permanent Housing Finance Co. ⁽¹⁾						
Savings accounts	4.50	4.50	4.50	4.50	4.50	4.50
Deposit accounts	5.50	5.50	5.50	5.50	5.50	5.50
Fixed-term deposits: 1 year	6.00	6.00	6.00	6.00	6.00	6.00
2 years	5.50	5.50	5.50	5.50	5.50	5.50
Lending	—	8.50/9.50	8.50/9.50	8.50/9.50	8.50/9.50	8.50/9.50
Rural Development Bank ⁽¹⁾						
Short-term lending	8.50	8.50	8.50	8.50	8.50	8.50
Long-term lending	7.50	7.50	7.50	7.50	7.50	7.50

⁽¹⁾ The rate depends on the purpose for which the bill was drawn.

⁽²⁾ For Treasury Bills of all maturities rediscouts are $\frac{1}{2}$ per cent, and advances 1 per cent, above the current rate for bills.

⁽³⁾ Before 1967, figures refer to the First Permanent (East Africa) Ltd.

⁽⁴⁾ Before 1970, figures refer to the National Development Credit Agency.

Source: Bank of Tanzania, *Economic and Operations Report*, various years, Table 9.

TABLE 31

BANK OF TANZANIA: BANKS' DEPOSITS AND LENDING TO BANKS, 1966 TO 1973

(end-month figures in million shillings)

Year and month	Banks' deposits	Lending to banks	Year and month	Banks' deposits	Lending to banks
1966 - June	25.7	89.8	1971 - September	2.7	59.0
December	30.2	87.9	October	5.0	124.0
1967 - June	1.2	8.9	November	0.5	150.0
December	1.6	53.6	December	2.7	163.0
1968 - June	43.6	5.5	1972 - January	0.3	110.0
December	49.0	82.0	February	0.4	162.0
1969 - June	47.5	—	March	2.3	97.0
December	1.6	34.0	April	0.9	125.0
1970 - June	6.3	—	May	2.6	84.0
December	3.0	71.0	June	5.1	16.0
1971 - January	0.8	53.0	July	9.1	37.0
February	3.1	45.0	August	3.5	110.0
March	1.5	36.0	September	3.8	135.0
April	2.9	17.0	October	3.6	121.0
May	2.3	9.0	November	2.7	78.0
June	3.9	55.0	December	2.7	136.0
July	1.8	55.0	1973 - January	1.5	137.0
August	2.0	79.0	February	1.8	61.0
			March	4.7	—

Source: Bank of Tanzania, *Economic Bulletin*, March 1973, Tables 1 and 2.

system, when banks suddenly needed much less funds for clearing. In 1969 the Money-Employed Scheme effectively came to an end when it was decided that Treasury Bill issues were henceforth to be tailored to the Treasury's needs rather than to those of the banks; deposits with the Central Bank beyond a certain amount now earned $\frac{1}{2}$ per cent less than 35-day Treasury Bills.

On the other side of its financial relationship with commercial banks, the Bank of Tanzania, as lender of last resort, makes

advances to them. The relevant provisions of the Bank of Tanzania Act have been set out above under 1.; the point of interest in the present context is that the Bank has powers to regulate the conditions at which it refinances the banking system, and that it does in fact charge different rediscount rates for different kinds of bills, as shown at the head of Table 30. Rediscounts of Treasury Bills and advances against them, it will be noted, are regularly one-half and one point, respectively, dearer than the current Treasury Bill rate, or, in the case of securities issued or guaranteed by the government, than their current market yield. These penal rates are intended to keep recourse to this source of funds down to a minimum. By contrast, the Bank of Tanzania has always been anxious to encourage banks to rediscount bills, especially seasonal crop bills, so as to counteract the traditional practice of borrowing abroad for this purpose.

Table 31 shows the success of this policy, in so far as lending to banks in fact displays a marked seasonal pattern. Year-to-year fluctuations in the peak months are closely related to the harvests, and the peak period itself, though it always occurs towards the end of the year, is subject to shifts according to weather and harvesting conditions.

(b) *Monetary and credit policy*

The Bank of Tanzania Act gives the central Bank very wide powers with respect to monetary and credit policy — wider indeed than those possessed by most other central banks both in advanced and in developing countries¹. The chief instruments at

¹ For a detailed discussion of instruments of credit control in developing countries see Arnaldo Mauri, *Il mercato del credito nei paesi sottosviluppati*, *op. cit.*, p. 29-38.

its disposal for quantitative and selective credit control may be summarized as follows:

- (i) powers to prescribe and vary reserve requirements with discretion to set different ratios for different kinds of bank liabilities;
- (ii) determination of the official discount rate and rate on advances;
- (iii) open market operations;
- (iv) powers to set maximum and minimum rates of interest payable on deposits by banks and other financial institutions;
- (v) direct control of the volume, terms and conditions of credit extended by banks and other financial institutions.

In practice, the Bank of Tanzania has never used its powers under (i) to (iii), but has often exercised the others. It has fixed maximum lending rates for commercial banks and consumer credit, has prescribed changes in borrowing rates, has discounted and made advances on commercial bills and public securities at the request of the National Bank of Commerce and other banks, has introduced selective restrictions on the total volume of bank credit, etc.

More than anything else, however, the Bank relied on moral persuasion, on the formula "sit down and discuss". Especially since the nationalization of the banking system, all the major decisions of credit policy have been agreed in advance with the leading banks and financial institutions. In a certain way bank nationalization has had the effect of reducing the Central Bank's powers in the traditional sense, but has led to its playing a more active part of leadership in economic development and has enhanced its responsibilities in building a sound and efficient credit structure¹.

¹ P. Kamuzora, "Central Banking", in: National Bank of Commerce, *Bank Magazine*, No. 10, December 1970, p. 18.

Now let us look in more detail at monetary and credit policy in Tanzania, from the inception of its Central Bank to our days¹.

Until 1969 the Bank of Tanzania's main concern was not so much to regulate the volume of credit to the economy, but rather to do everything possible to get a sound credit system established and helping it in a phase of profound structural transformation, especially by making sure of an acceptable degree of liquidity.

During the Bank's first year, 1966, the economy experienced rapid growth, thanks to expansion both of foreign trade and at home. Although the Bank of Tanzania had declared itself able to provide the banking system with the funds it needed to meet peak seasonal credit demand, it did not in its first year try to substitute the external sources of finance on which the expatriate banks habitually drew, nor did it do anything to influence the rates charged by banks for this type of lending.

This policy had the advantage that the expatriate banks refinanced themselves by selling sterling assets to the Central Bank and thus enabled it steadily to increase its foreign reserves.

At the end of the year the ratio of the banks' liquid assets to total deposits was still rather low. The Central Bank did what it could to help; it added to its own foreign assets and to its security portfolio and stepped up both its discounts and advances to commercial banks, thus offsetting the liquidity squeeze deriving from seasonal credit demand and from the transfer of government deposits to the Bank of Tanzania.

The boom of 1966 was followed by recession due both to poor harvests and to fears and uncertainties aroused by the Arusha Declaration in February 1967 and the subsequent measures taken

¹ See Bank of Tanzania, *Economic and Operations Report*, various years, and *Economic Bulletin*, various issues.

by the government to implement it, i.e. the nationalization of the banking system and insurance companies together with the establishment of public ownership in key sectors of the economy.

During the first half of 1967 a considerable part of crop loans was repaid and credit demand declined as producers drew down their stocks of raw materials and finished products, likewise in response to the uncertainties of the political climate. But later demand for credit expanded sharply, partly because consumer demand, too, declined for the same extra-economic reasons, and partly because the nationalization measures deprived many sectors of continued access to foreign sources of finance.

The Bank of Tanzania took the view that this was no more than a temporary situation and asked the banks to meet the increased demand for credit, subject to certain conditions, i.e. that credit applications be carefully scrutinized and screened so as to prevent or at least minimize capital exports, and that banks with foreign connections try to obtain funds abroad.

In agreement with the National Bank of Commerce (NBC) a set of instructions was drawn up and transmitted to all NBC branches and agencies.

The Bank of Tanzania's main concern at that moment was to prevent any undesirable capital outflows. It declared itself ready to stand by with discounts and advances to the banking system and to arrange additional refinancing in case of need. For the first time ever, the commercial banks received all the funds needed for seasonal credit from the Central Bank. The latter in no way tried to restrict its lending to banks for their seasonal requirements, but took the view that credit expansion at that time of year must follow crop results and had no harmful implications either for foreign reserves or for domestic prices, since the extra liquidity could soon be mopped up again at the end of the marketing season.

The economy took a turn for the better in 1968, but the recovery was evident in manufacturing more than in agriculture. The trade balance, it is true, closed with a deficit of 116 million shillings, compared with a surplus of 151 million in 1967; but since that deficit was more than offset by capital inflows, the balance of payments was comfortably in surplus in both years. Consequently, liquidity increased both in the banking system and outside it. Higher non-bank liquidity had the immediate effect of raising commercial bank deposits, especially those on time, as well as investment in Treasury Bills. The banks expanded their lending to sectors other than agriculture, so that bank liquidity in effect underwent little change (the annual average rose from 19.1 per cent in 1967 to 21.4 per cent in 1968); only the National Bank of Commerce increased its liquid assets appreciably, especially during the second half of the year. At this point the Bank of Tanzania showed itself disinclined to expand bank liquidity any further by refinancing, and asked the banks to meet their requirements by interbank loans.

This suggestion was an extremely interesting one, because it had not been at all clear until then whether the Central Bank was in favour of collaboration between the National Bank of Commerce and the National Co-operative bank, or of greater competition between them.

In the course of 1969 both money supply and the volume of credit expanded at a much faster pace (see Table 28). Although this did hardly anything as yet to push up prices, it did begin to cause concern for the future and for this reason was followed by a credit squeeze in 1970. The trade balance was in surplus to the tune of 82 million shillings, as a result not so much of export growth as of a drastic fall in imports thanks to the incipient activities of a number of import substitution industries. Such

export growth as occurred was entirely attributable to Zanzibar and its exceptionally good clove harvest; hence all the connected operations went through the People's Bank of Zanzibar and the liquidity-creating stimulus remained concentrated there and did not spread to the rest of the country. The chief factor in the monetary and credit expansion of 1969 was the Bank of Tanzania's increased lending to the government. This will be discussed in more detail presently; for the moment, the point of interest is what policies the Central Bank adopted in an effort to offset the monetary effects of its increased lending to the public sector¹. In 1969 it asked the commercial banks to take up large quantities of government securities, with the result that their medium- and long-term portfolio rose from 39.6 to 142.7 million shillings within the twelve months following 31 December 1968 (Table 32), while their Treasury Bill holdings declined over the same period from 104 to 41 million and the Central Bank's total lending to the government increased from 31.8 to 148.3 million.

But the effect was not as restrictive as it was meant to be, because commercial bank credits to the economy rose by 21 per cent. Nevertheless, overall expansion was no doubt less than it would have been without the above directive, witness the fall of the loan/deposit ratio from 73.1 to 70.6 per cent.

The outstanding feature of monetary policy in 1970 was the restrictive line adopted to hold back monetary and credit expansion in adverse business conditions. External payments were a source of major concern, with the trade balance showing a deficit of no

¹ Since government payments are effected via the branch network of the commercial banks, higher Central Bank advances to the government, when used, lead to credit balances for the commercial banks, which raise their own liquidity and thus create the conditions for large potential liquidity expansion throughout the system. (For the use of this circumstance as an instrument of monetary policy see Arnaldo Mauri, *Il mercato del credito nei Paesi sottosviluppati*, op. cit., p. 35).

TABLE 32

GOVERNMENT BORROWING FROM BANKS, 1966 TO 1973
(end-month figures in million shillings)

Year	Bank of Tanzania				Commercial banks			Total
	Direct advances	Treasury Bills	Govt. stocks & Treasury Notes	Total	Treasury Bills	Govt. stocks & Treasury Notes	Total	
1966 - December	—	35.8	48.0	83.8	6.0	10.1	16.1	99.9
1967 - December	19.0	3.5	41.6	64.1	30.0	12.7	42.7	84.3
1968 - June	—	27.7	38.7	66.4	37.0	30.5	67.5	133.9
December	—	12.5	19.3	31.8	104.0	39.6	143.6	175.4
1969 - June	—	43.8	9.4	53.2	73.1	93.3	166.4	219.6
December	—	133.8	14.5	148.3	41.0	142.7	183.7	332.0
1970 - March	—	98.1	11.1	109.2	19.8	162.1	181.9	291.1
June	—	222.7	15.0	237.7	19.9	152.3	172.2	409.9
September	162.0	228.7	11.2	401.9	—	152.4	152.4	554.3
December	216.0	190.0	10.2	416.2	—	152.4	152.4	568.6
1971 - March	117.0	240.1	14.7	371.8	—	194.9	194.9	566.7
June	128.0	293.5	16.7	438.2	—	250.1	250.1	688.3
September	233.0	316.8	27.7	577.5	—	250.1	250.1	827.6
December	274.0	333.9	30.1	638.0	15.0	279.6	294.6	932.6
1972 - March	257.0	291.0	30.2	578.2	99.0	296.9	395.9	974.1
June	203.0	238.4	118.5	559.9	99.0	313.3	412.3	972.2
September	254.0	224.6	118.3	596.9	99.0	333.0	432.0	1,028.9
December	202.0	234.4	118.2	554.6	99.0	360.2	459.2	1,053.8
1973 - March	178.0	205.1	127.6	510.7	99.0	383.9	482.9	993.6

Sources: Bank of Tanzania, *Economic and Operations Report*, various years, and *Economic Bulletin*, March 1973, p. 23.

less than 422 million shillings. Exports did expand moderately, so the bulk of the deficit must be attributed to import growth in step with the faster pace of investment for purposes of economic development. While the country's net external position was thus deteriorating, considerable credit expansion at home became an additional cause of concern.

By the end of 1970 the government's total borrowing from the banking system had risen to 569 million shillings (Table 32), and the latter's lending to the private sector had increased during the year by 23 per cent. The credit expansion had adverse effects on external payments, in so far as it enabled the government to import goods for which foreign aid had been promised but did not subsequently materialize. Similarly, the higher volume of medium- and long-term credits extended by the National Bank of Commerce encouraged investment projects which needed imported capital goods, and the establishment of its subsidiary, the Karadha Company Ltd., for consumer credit, occasioned an expansion of credit for the hire-purchase of transport vehicles, most of them not of domestic production.

The balance-of-payments situation became so bad in September 1970 that the Bank of Tanzania decided it was time to pull the brake sharply. The most important of the restriction it introduced was a ceiling of 1,000 million shillings on NBC credits; minor measures included a cut in expenditure for study abroad, curbs on remittances to absentee landlords resident abroad, and hire-purchase controls via limits on instalment credit for the purchase of private cars.

The 1,000-million credit ceiling was applied selectively. Seasonal crop and marketing credits were exempt, but severe restrictions were to be placed on lending to sectors which spent most foreign exchange and which imported goods of other than prime necessity. Once again the Bank of Tanzania chose the method of moral persuasion. All the measures concerned were discussed in advance with representatives of the banking system, and especially of the National Bank of Commerce; but for the first time in the history of the Central Bank's relations with the banking system, the negotiations proved rather tough, because of

differences of opinion as to the most expedient policy to adopt. Eventually full agreement was reached and the National Bank of Commerce acquiesced in the restrictions on its credits.

Nevertheless, all through the year and the first half of 1971 money supply kept on expanding rapidly. The main reason was that exporters were unable to repay their loans on schedule because of delays due to the transport system; in addition the government was still borrowing heavily from the banking system and commercial firms failed to reduce their claims on the banks, as was meant to happen.

Accordingly the restrictions, which at first were intended to apply for only three months, had to be renewed and other, permanent measures were introduced. Ever since 1970 the Bank of Tanzania has firmly pursued a restrictive line, and this was one of the chief reasons for the decision to draw up annual Finance and Credit Plans. Both the Bank of Tanzania and the National Bank of Commerce took part in the discussions for the preparation of the first such plan and for the definition of the principles governing credit to the economy and allocations to separate sectors.

From the middle of 1971 on and throughout 1972, the rate of increase in money supply slowed down considerably, as the restrictive measures began to bite. But at the same time the domestic economic situation deteriorated, witness the unprecedented and explosive rise in the price level (the general index (1963 = 100) rose from 135.5 in December 1971 to 148.1 in September 1972). The Bank of Tanzania blamed world inflation and the re-alignment of currencies at the end of 1971, and to some extent also the government's financial policy. There is a presumption that in the future the Central Bank will rely more heavily on finance and credit planning, and through this means on the selective use of

its own powers; no doubt its main concern will be to limit lending to the central government.

The wider aspects of credit planning and the role of the banking system will be discussed in more detail in Chapter II below.

4. RELATIONS WITH THE TREASURY

(a) *The Bank of Tanzania as banker and fiscal agent of the government*

Generally speaking, the functions of a central bank *vis-à-vis* its government fall under the following headings: handling of the government's cash transactions, servicing of the public debt, collaboration in the implementation of the government's financial policy¹, and advice on monetary and financial policy².

The Bank of Tanzania is by law endowed with all these functions, with particular emphasis on financial advice to the government³.

Now, it is of course impossible that there should be any divergence between the policies of the government and the Bank of Tanzania; nevertheless the latter does have a wide margin of

¹ On this point Giordano Dell'Amore (*Economia delle aziende di credito - I sistemi bancari, op. cit.*, p. 867) writes: "This collaboration takes two forms: direct advances to the Treasury, and occasional or systematic help in placing public loan issues as well as in keeping bond prices to the level judged most expedient at any time", and, further on (p. 868): "Advances to the government by the central bank may take the form of overdrafts on current account, but often predominantly that of holding public securities, which then become the main counterpart of the note issue. The bulk of securities nowadays are those of the floating debt, i.e. Treasury Bills, which back the activities of one of the most important sectors of the credit market".

² See G. Dell'Amore, *ibid.*, p. 879-880.

³ See P. Kamuzora, *op. cit.*, p. 17-18.

discretion and autonomy, especially in its advisory functions. It is clearly not expected simply to rubber-stamp any and all of the government's proposals, but to come forward with an independent opinion based on its own research and analysis.

The Bank of Tanzania handles cash transactions on behalf not only of the central government and its ministries, but also, by arrangement, of any other public authority. To this end it holds public deposits originally taken over from the Standard Bank (Table 33). The Bank likewise acts as the government's official agent in transactions with international organizations, such as the World Bank, the International Monetary Fund and the African Development Bank.

In servicing the public debt, a function which it has been discharging since the end of 1966, the Bank of Tanzania issues and redeems government securities, and pays interest on them.

The composition of Tanzania's public debt is shown in Table 34, and while it is not our purpose here to examine public debt policy in detail, some brief comments are warranted on the part played by the Bank of Tanzania and the banking system as a whole in financing the government. The first point that needs to be stressed is that there never has been anything like quantitative debt management for monetary purposes; the Treasury's prime aim has simply been to raise funds for its own short-, medium-, and long-term requirements — witness the uninterrupted and mostly steep rise in the public debt¹. Speaking in qualitative terms, three interesting features of the public debt emerge: (i) the proportion of the floating debt in the total public debt is small, though growing, (ii) the foreign debt accounts for a preponderant

¹ Only in 1972, when inflation got rather out of hand, did the rate of growth in the total public debt slow down appreciably.

TABLE 33

CENTRAL GOVERNMENT DEPOSITS WITH THE BANK OF TANZANIA, 1966 TO 1973
(end-month figures in million shillings)

Year and month	Deposits	Year and month	Deposits
1966 - June	82.0	1971 - March	2.7
December	136.6	June	2.8
1967 - June	59.8	September	2.1
December	5.0	December	1.7
1968 - June	93.4	1972 - March	2.9
December	97.8	June	2.9
1969 - June	40.3	September	5.8
December	66.1	December	2.6
1970 - March	38.4	1973 - March	1.4
June	14.2		
September	2.7		
December	3.7		

Source: Bank of Tanzania, *Economic Bulletin*, March 1973, Table 2.

proportion of the national (other than floating) debt, and (iii) the holdings of the banking system account for a fairly high proportion of the floating debt, but for very little of the rest.

(b) *The Bank of Tanzania as lender to the Treasury*

The government of Tanganyika first obtained financing from the East African Currency Board in 1957, when the latter took up 20 million shillings' worth of medium- and long-term public securities. The first subscription of Treasury Bills followed in 1960.

The government of Tanganyika made increasing use of Treasury Bills to finance temporary cash shortfalls; the same happened in other East African countries, especially Uganda, so that in time an East African Treasury Bill market developed. This

TABLE 34

PUBLIC DEBT: COMPOSITION AND ANNUAL INCREASES, 1967 TO 1972
(end-June figures in million shillings)

	1967	1968	1969	1970	1971	1972 (31 March)
A. Floating Debt (Treasury Bills) increase (<i>per cent</i>)	69.5	137.2 97.4	139.0 1.3	264.2 90.1	381.1 44.2	436.0 14.4
of which held by: Central Bank						
commercial banks	2.0	28.0	44.0	222.7	296.0	289.3
total banking system	30.0	37.0	73.1	19.9	—	99.0
Proportion of floating debt held by the banking system (<i>per cent</i>)	32.0	65.0	117.1	242.6	296.0	388.3
	46.0	47.4	84.2	91.8	77.7	89.06
B. National Debt increase (<i>per cent</i>)	1,138.7	1,163.2	1,470.2	1,835.6	2,431.9	2,574.3
of which: internal	—	2.15	26.39	24.85	32.49	5.86
external (<i>per cent</i>)	335.9	455.5	588.5	819.9	1,021.0	1,099.1
of which held by: Central Bank	802.8	707.7	881.7	1,025.7	1,410.9	1,475.2
commercial banks	70.50	60.84	59.97	55.88	58.02	57.30
total banking system	45.9	38.7	9.4	15.0	16.7	30.2
Proportion of national debt held by the banking system (<i>per cent</i>)	10.2	30.5	93.3	152.3	250.1	296.9
	56.1	69.2	102.7	167.3	266.8	327.1
C. Total public debt (A + B) increase (<i>per cent</i>)	4.9	5.9	7.0	9.1	11.0	12.71
Proportion of floating debt in total public debt (<i>per cent</i>)	1,208.2	1,300.4	1,609.2	2,099.8	2,813.0	3,010.3
	—	7.6	23.7	30.5	34.0	7.0
	5.8	10.6	8.6	12.6	13.5	14.48

Note: What is classified in Tanzanian statistics as National Debt is exclusive of Treasury Bills. The National Debt includes funded and unfunded government stocks, loans and bonds, as well as some private loans.

Sources: Bank of Tanzania, *Economic and Operations Report*, various years; United Republic of Tanzania, *The Economic Survey*, various years.

market enjoyed the support of the East African Currency Board, which always kept prices high whenever slack demand by other investors made it necessary. It will be recalled that until February 1964, thanks to the Currency Board's support, Treasury Bill rates always kept about 1/8 per cent lower in East Africa than in London, and that subsequently the Board prevented local rates from rising as sharply as London ones did, which would have depressed prices.

Just as soon as the Bank of Tanzania was set up, it agreed with the Treasury to carry on the Currency Board's support policy, and it also undertook to rediscount Treasury Bills held by commercial banks. Similarly, the Central Bank's "Money-Employed Scheme"¹, while primarily designed to prevent commercial banks from investing their excess funds abroad, in effect redirected these funds into finance for the Treasury.

Table 35 gives details of Tanzania Treasury Bill issues by holders. It will be seen that in the second half of 1966 and early in 1967 the Treasury needed and borrowed little short-term cash. On 30 June 1966 the outstanding Treasury Bill issue amounted to 102.2 million shillings, but in none of the 19 months that followed did it ever exceed 78.5 million. The drop in the middle of 1966 was due to the government's receiving payment for some maturing long-term assets, which took care of any extra cash requirements. During the second half of 1967, the Treasury did need some cash, but instead of issuing Treasury Bills it took up a direct advance from the Bank of Tanzania in the amount of 19 million shillings (see Table 32). This was repaid in 1968, and until the third quarter of 1970 the Treasury made no further claims of this kind on the Central Bank

¹ See under 3 (a) above.

TABLE 35

TREASURY BILL ISSUES BY HOLDERS, 1961 TO 1973

(end-month figures in million shillings)

Year and month	Bank of Tanzania or EACB ⁽¹⁾	Commercial banks	Public authorities	Others	Total
1961 - June	46.0	—	—	—	46.0
1962 - June	54.0	—	28.0	—	82.0
1963 - June	62.0	—	24.0	—	86.0
1964 - June	56.0	—	33.7	—	90.7
1965 - June	90.0	—	53.7	—	143.3
1966 - June ⁽¹⁾	—	—	102.2	—	102.2
September	40.0	—	35.3	—	75.3
December	36.1	6.0	18.8	1.3	62.2
1967 - March	14.3	1.4	36.2	1.6	53.5
June	2.0	30.0	35.6	1.9	69.5
September	1.6	30.0	33.6	1.8	67.0
December	3.7	30.0	27.0	6.2	66.9
1968 - March	25.2	36.9	37.6	44.0	143.7
June	28.0	37.0	28.4	43.8	137.2
September	63.0	20.0	34.5	44.9	162.4
December	12.6	104.0	15.7	4.3	136.6
1969 - March	0.1	78.0	17.6	4.6	100.3
June	44.0	73.1	17.0	4.9	139.0
September	84.4	43.0	17.6	5.8	150.8
December	134.3	41.0	14.8	7.0	197.1
1970 - March	98.1	19.8	12.0	7.1	137.0
June	222.7	19.9	17.4	4.1	264.2
September	228.6	—	32.9	6.1	267.2
December	190.0	—	83.2	6.6	279.8
1971 - March	241.8	—	79.2	9.3	330.3
June	296.0	—	81.2	3.9	381.1
September	318.9	—	74.5	5.9	399.3
December	336.7	15.0	51.5	3.9	407.1
1972 - March	289.3	99.0	41.3	6.4	436.0
June	238.8	99.0	49.3	9.2	396.3
September	225.6	99.0	40.6	9.2	374.4
December	235.5	99.0	26.1	6.6	382.7
1973 - March	205.4	99.0	43.4	11.4	359.2

⁽¹⁾ Until June 1966 Treasury Bills held by the East African Currency Board, thereafter by the Bank of Tanzania.

Sources: Bank of Tanzania, *Economic and Operations Report*, various years, and *Economic Bulletin*, March 1973, Table 20.

After 1967 the Treasury Bill circulation increased and remained fairly high throughout 1968. Commercial banks and other investors had begun in 1967 to invest surplus cash in Treasury Bills; at first, the Bank of Tanzania supplied these out of its own portfolio (see Table 35), but subsequently overall demand for them grew. The Treasury, in its turn, raised the weekly tender and introduced a new two-year, 5 per cent issue.

In 1969, when the Money-Employed Scheme came to an end, commercial banks switched from Treasury Bills to medium- and long-term securities, but the resulting decline in Treasury Bill issues was short-lived because the Central Bank soon stepped in. During the last six months of that year the government's total debt to the Bank of Tanzania nearly trebled (see Table 32).

All in all it can be said that until 1970 the Treasury's financial requirements remained within altogether acceptable limits. But after the first quarter of that year the Treasury for the first time had to rely on large-scale Treasury Bill purchases by the Central Bank and soon afterwards also to ask for substantial direct advances. The Central Bank not only took up the bulk of new issues, but also bought in from the commercial banks, so as to enable the latter to maintain an adequate degree of liquidity at a time of greatly expanding domestic lending.

The situation has not changed much since 1970. Advances to the Treasury have remained high ever since, and so have the Central Bank's Treasury Bill holdings. The commercial banks started buying Treasury Bills again at the end of 1971, when they were flush with liquidity because of the credit restrictions.

The funds supplied to the government by the Bank of Tanzania and the rest of the banking system are more than ten times as large today as they were in 1966. The increase is most marked in the case of the commercial banks, which, however,

take up mostly medium- and long-term securities. The Bank of Tanzania, on the other hand, provides only negligible funds other than for the short term, and its lending to government has risen less — by little over 800 per cent since 1966.

(c) *Development of a securities market*

Although the government and the Bank of Tanzania have repeatedly stated their intention to develop a securities market, nothing much has in fact been done about it since 1966.

As regards Treasury Bills, any attempt to organize a market was, until 1970, frustrated by their scant supply at a time when the Treasury needed little cash. In any event, the Central Bank had other means of controlling commercial bank liquidity, without open market operations in short-term Treasury paper. Non-bank businesses, furthermore, preferred to keep their liquid funds in bank deposits rather than in Treasury Bills, so that the chief buyer was always the Central Bank.

It intervened far less, on the other hand, in the market for government and government-guaranteed securities with more than a year's maturity, because its holdings of such paper are strictly limited by law. As a result the banking system played a smaller part than it might have done in financing economic development, even at times when there was no danger of any undesirable pressure of demand on disposable real resources.

Under the Bank of Tanzania Act, the Central Bank "may, with the approval of the Minister [of Finance], promote, and subscribe to, hold, and sell shares in any corporation established by, or with the approval or under the authority of, the Government for the purposes of promoting the development of a money market or securities market in Tanzania or of improving the financial machinery for the financing of economic development in Tanzania"

(Art. 59). Accordingly, the Bank in 1966 took part in discussions for the reorganization of the Tanzania Finance Company (TAFCO), but although it at first decided to acquire some of that company's equity, it later withdrew when it became clear that TAFCO was having little success in mobilizing private savings for equity investment.

All in all, then, the Bank of Tanzania has done little to help develop a money and stock market. To some extent its attitude is, of course, in line with the economic philosophy of the country since 1967; an economic system in transition towards socialism has no need to develop a capital market in the traditional sense (e.g. a stock exchange), but its chief problem is the mobilization and allocation of available financial resources through appropriate institutions and planning machinery.

5. RESERVES, EXCHANGE CONTROL AND FOREIGN RELATIONS

(a) *Gold and foreign exchange reserves*

One of the Bank of Tanzania's functions is to pool and manage the country's currency reserves. The law, it will be recalled, requires that reserves shall cover at least four months' imports calculated on the average of the last three preceding years; reserve assets are gold, convertible foreign exchange, and securities issued or guaranteed by foreign governments or international financial organizations. Certainly the problem of external payments was one of the most difficult facing the Tanzanian economy, and also one of those to which most care was devoted¹.

A country's foreign exchange position is a good indicator of the stability of its currency's external value and more generally

¹ See M.J.H. Yaffey, *Balance of Payment Problems of a Developing Country: Tanzania*, Munich, IFO, 1970.

of the strength of its economy, and it may therefore be worthwhile taking a close look at Tanzania's official reserves and the commercial banks' net foreign position since 1966 (Table 36).

The Bank of Tanzania started life in 1966 with a very reasonable amount of foreign assets. It was entitled by law to acquire sterling assets from the government against national currency, and did so on the scale of 81 million shillings. In addition, the commercial banks on 14 June 1966 transferred to the Central Bank 25 million shillings' worth of their foreign exchange reserves which they had previously held in deposit with the East African Currency Board. In the months that followed conversion operations brought in further assets, and so did the Bank of Tanzania's practice of buying sterling assets from the commercial banks rather than providing them with funds through rediscounts and advances.

By the end of December 1966 the Bank of Tanzania's net official reserves (excluding the IMF gold tranche) amounted to almost 390 million shillings and thus only just fell short of the prescribed 4-month import coverage, which at the time would have been 400 million.

In 1967, an early seasonal rise in reserves was followed by a sharp decline due to a balance-of-payments deficit. By the end of the year the gap between existing and required reserves had widened to 82 million shillings. However, the country's total net foreign position at that date, at 557.8 million shillings, was comfortably in excess of the prescribed minimum. What happened was that in the course of the year the commercial banks' net foreign assets, which include credits granted to them, had risen very considerably thanks to the foreign credits obtained by the National Bank of Commerce. Thus the decline in official reserves was more than offset.

TABLE 36

FOREIGN EXCHANGE POSITION, 1966 TO 1973

(end-month figures in million shillings)

Year and month	Bank of Tanzania			IMF gold tranche	Central government	Net official position	Com- mercial banks' net position	Total net position
	Net foreign exchange assets	SDRS	Total					
1966 - June	160.1	—	160.1	28.6	...	188.7 ⁽¹⁾	39.6	228.3 ⁽¹⁾
Dec.	389.7	—	389.7	28.6	2.9	421.2	30.5	451.7
1967 - June	420.8	—	420.8	28.6	4.8	454.2	124.4	578.6
Dec.	397.7	—	397.7	28.6	6.3	432.6	125.2	557.8
1968 - June	490.5	—	490.5	29.3	1.7	521.5	135.2	656.7
Dec.	512.5	—	512.5	30.0	4.1	546.6	102.8	649.4
1969 - March	540.3	—	540.3	30.0	6.6	576.9	147.5	724.4
June	544.5	—	544.5	30.0	6.3	580.8	179.1	759.9
Sept.	504.2	—	504.2	31.4	5.0	540.6	211.8	752.4
Dec.	530.9	—	530.9	31.4	1.9	564.2	248.6	812.8
1970 - March	552.1	38.4	590.5	31.4	3.9	625.8	315.5	941.3
June	433.4	38.4	471.8	31.4	1.3	504.5	346.0	850.5
Sept.	366.4	13.4	379.8	31.4	5.1	416.3	337.3	753.6
Dec.	388.6	13.4	402.0	49.3	4.5	455.8	313.8	769.6
1971 - March	367.7	45.5	413.2	49.3	3.2	465.1	313.3	779.0
June	413.8	45.2	461.1	49.3	—	510.3	388.2	898.5
Sept.	425.0	45.2	470.2	49.3	4.5	524.0	412.1	936.1
Dec.	316.3	49.1	365.4	53.4	3.3	422.1	490.5	912.6
1972 - Jan.	313.5	83.6	397.1	53.6	2.0	452.7	498.7	951.4
Feb.	262.0	83.6	345.6	53.6	3.7	402.9	517.9	920.8
March	383.9	52.3	436.2	53.6	2.7	492.5	550.9	1,043.4
April	413.2	52.6	465.8	53.6	1.3	520.7	553.4	1,074.1
May	437.7	52.1	489.8	53.6	4.7	548.1	581.5	1,129.6
June	512.8	52.1	564.9	53.6	2.1	620.6	551.5	1,172.1
July	494.3	52.1	546.4	53.6	4.5	604.5	563.7	1,168.2
Aug.	477.0	52.1	529.1	53.6	3.5	586.2	551.2	1,137.4
Sept.	542.1	52.1	594.2	53.6	1.4	649.2	572.5	1,221.7
Oct.	574.9	52.1	627.0	53.6	1.1	681.7	594.0	1,275.7
Nov.	628.3	52.1	680.4	53.6	3.1	737.1	624.0	1,361.1
Dec.	680.2	52.1	732.3	53.6	0.8	786.7	632.9	1,419.6
1973 - Jan.	732.9	52.1	785.0	53.6	3.1	841.4	669.8	1,511.2
Feb.	766.2	52.1	818.3	53.6	-0.6	871.3	642.1	1,513.4
March	774.8	57.9	837.7	59.5	-0.5	891.7	706.1	1,597.8

⁽¹⁾ Excluding central government holdings.Source: Bank of Tanzania, *Economic Bulletin*, March 1973, Table 7.

In the following year, the reserve position improved along with external payments, which did well especially during the first four months. Like almost anything else in Tanganyika, foreign reserves are subject to marked seasonal influences; they always tend to rise in the early months of the year, when the trade balance has the benefit of export receipts for agricultural commodities, and weaken towards the end of the year when the whole economy is in a tight financial position pending the new harvest. Seasonal influences can either push up reserves, as in 1968, or counteract their decline. Throughout 1969 and 1970, for instance, official reserves were on a steady downward trend except for the first three or four months of both years, when export receipts for agricultural commodities were coming in.

Nevertheless, the reserve position deteriorated sharply in the course of these two years, and Tanzania more than once had to have recourse to international monetary facilities. By August 1970 net official reserves were down to 373 million shillings including special drawing rights (SDRs), their lowest since 1966 and a very sharp drop from the August 1969 level of 509.6 million. At that moment Tanzania boosted its currency holdings by using 25 million shillings' worth of its first allocation of SDRs and in January 1971 it received a second allocation of SDRs in the amount of U.S. \$ 4,494,000, equal to 32 million shillings¹.

In 1972, finally, official reserves rose again, not least thanks to the more general measures of economic and monetary policy in force since 1970. On 1 January, a third allocation of \$ 4.45 million, or 34.5 million shillings, of SDRs brought Tanzania's total

¹ Shortly before, in December 1970, Tanzania's IMF quota was increased under a general review involving all countries. Tanzania's quota was raised from 32 to 42 million dollars; 25 per cent of the increment, of course, had to be paid in gold, which the Bank of Tanzania bought for 17,857,143 shillings' worth of its foreign exchange assets.

allocations to 111.1 million shillings, of which 52.1 million remained available for use by the end of the year, after another drawing of 33.8 million shillings in March 1972 to make good the previous month's fall in reserves. From then on until March 1973 official reserves rose almost uninterruptedly by altogether some 400 million shillings, thanks to surpluses in external payments. Exports did very well after good harvests, and imports were successfully held back by the new import licensing system.

Although the law expresses the amount of foreign reserves to be maintained in terms of import coverage (four months), it is of some interest to look also at the extent to which since 1966 they have been covering the currency circulation. The figures are shown in Table 37, from which it will be seen that currency coverage was persistently high in the early years, and indeed if the commercial banks' net foreign position were counted in as well, coverage exceeded 100 per cent. This high coverage, it will be remembered, was one of the chief criticisms often levelled at the Bank of Tanzania. But in 1970 the situation changed radically, given that official reserves dropped while currency issues kept increasing at a quickening pace. In 1972 there was another reversal of trend, with the currency coverage by official reserves once more exceeding 50 per cent and, in terms of the total net foreign position, 100 per cent.

It is rather more interesting, however, to look at the import coverage by total reserves, in the broadest sense. It does not really matter to what extent the currency circulation is covered at any given moment, so long as there is an adequate amount and assortment of currencies at hand to satisfy the requirements of foreign trade. In this respect the figures of Table 37 show that the ratio of the total net foreign position to imports kept rising until 1969, then dropped when the trade balance got into difficulties, and finally took a distinct upward turn again in 1972.

TABLE 37

CURRENCY AND IMPORT COVERAGE BY FOREIGN RESERVES, 1966 TO 1972

Year	Official reserves/currency circulation per cent	Total net foreign position/imports	
		per cent	days
1966	90.31	26.74	98
1967	73.76	34.39	126
1968	90.18	35.42	129
1969	81.64	47.53	173
1970	46.69	33.84	124
1971	34.82	33.44	122
1972	57.23	48.70	178

Source: Compiled from data in Bank of Tanzania, *Economic and Operations Report*, various years.

(b) *The par value of the shilling*

When Tanzania replaced the East African shilling in 1966 by its own currency, it did not alter the existing par value and exchange rates. As before, the buying rate for sterling was 19.994 shillings, and the selling rate 20.012. The Kenya and the Uganda shilling were convertible at par.

The first major difficulties arose when sterling was devalued in 1967. Tanzania decided not to devalue the shilling, notwithstanding the high cost involved¹. This decision was dictated by the following considerations².

¹ It has been calculated that the sterling devaluation cost Tanzania 37 million shillings, a loss which, under Art. 15(3) of the Bank of Tanzania Act, was transferred to a special Revaluation Account.

² See *Speech by the Honourable Minister for Finance Introducing the Estimates of Revenue and Expenditure 1968-69 to the National Assembly on 18th June 1968*, Dar es Salaam, Government Printer, 1968.

- (i) The adverse effect of the sterling devaluation on Tanzanian exports was expected to be no more than marginal;
- (ii) No undue rise in imports was expected, nor any sharpening of competition to the detriment of domestic products, in so far as the government was confident it could counteract such developments by appropriate fiscal measures;
- (iii) The net loss occasioned for Tanzania by the diminished purchasing power of sterling assets could in any case not have been made good by devaluing the shilling, since both claims and debts were expressed in sterling;
- (iv) A devaluation of the shilling would have pushed up domestic prices and wages;
- (v) Exchange control could be applied to deal with any possible speculation against the shilling due to doubts about its ability to hold its parity;
- (vi) Devaluation of the shilling would have meant breaking prior agreements with the other two East African partners.

However, as a precaution against speculative capital outflows, the Bank of Tanzania asked the commercial banks not to increase their credits to importers, in order to discourage any premature settlement of foreign debts, and exporters in their turn were warned that any unjustified delay in the receipt of payments due to them would make them liable to fines and other penalties. In addition to thus forestalling adverse leads and lags in foreign trade, foreign and foreign-controlled companies whose financial requirements were normally covered by their parent houses were barred from obtaining any credit in Tanzania, except with the approval of the Central Bank and even then not more than before devaluation.

Great Britain, in its turn, after the sterling devaluation asked the countries of the sterling area not to reduce their sterling reserves any further and to maintain the previous proportion of sterling in total reserves. In exchange, Great Britain offered a dollar guarantee for all sterling balances in excess of 10 per cent of any country's official reserves. The Bank of Tanzania, which had in the meantime begun to diversify its reserves, showed itself somewhat reluctant to accede to this British request.

The decision not to devalue the shilling was proved right by subsequent events, and it did not even turn out to be very costly for the country. There was, to be sure, a loss because reserve assets were worth less, but there were also advantages in respect of the many sterling loans outstanding.

In the years that followed international monetary developments caused no major damage to Tanzania and the par value of the shilling was not altered until August 1971, when dollar convertibility came to an end. At that moment Tanzania decided to peg the shilling to the dollar and to let it float with the latter rather than with the pound. Uganda and Kenya at first kept their currencies pegged to sterling, but in October followed Tanzania's originally unilateral decision. In December 1971, all three countries altered the par value of their currencies from 250 to 271.42857 shillings per troy ounce of fine gold, thus officially confirming an effective devaluation of 7.9 per cent.

(c) *Exchange control*

Ever since the beginning of the second world war the countries of East Africa, like the rest of the sterling area, have been subject to exchange control. This is not, of course, an autonomous central bank function, but a delegated one to be exercised under the authority and in agreement with the Treasury.

When it was announced, on 10 June 1965, that Kenya, Uganda and Tanzania were to set up separate central banks and have separate currencies, the three countries also introduced exchange control *vis-à-vis* the rest of the sterling area. The immediate intention was to prevent a capital outflow, especially to India and the United Kingdom; within East Africa payments remained completely free.

As of 16 April 1966 the Bank of Tanzania took over from the government the administration of exchange control, and on 1 August 1966 its relevant powers were extended to Zanzibar as well.

Initially, exchange control was applied only to capital movements to and from outside East Africa, and for the rest was limited to checking the authenticity of the operations concerned. But on 7 February 1967, consequent upon the nationalization of the banking system, Tanzania applied controls also to capital movements — though not to current payments — with Kenya and Uganda¹. This was announced as a temporary measure and in fact was abrogated within a few months, as soon as confidence had returned.

There was no major change at all in 1968, except for the prohibition to import banknotes of the East African Currency Board from outside the currency area. In the following year, however, a number of rules were changed after prior consultation with the governments of Kenya and Uganda, and with the approval of the Minister of Finance. The ceiling on the capital export allowance for emigrants was lowered from 100,000 to 50,000 shillings, and the foreign exchange travel allowance for tourists abroad from 5,000 shillings a year to 4,000 shillings once every

¹ See I.N. Resnick, *Convertibility in East Africa. The Tanzania Position*, *op. cit.*

three years. Furthermore, remittances abroad by foreigners resident in Tanzania were limited to the transfer of one third of their earnings, provided these accrued under a regular contract, failing which the rules governing emigrants were applicable.

In 1970 the position even within East Africa became intolerable, in so far as the lack of uniform fiscal legislation in a regime of completely free capital movements led to persistent capital flight from Tanzania, to contraband trade and to unrecorded payments. Consequently, Tanzania introduced exchange control *vis-à-vis* Kenya and Uganda on 17 March 1971, and not only as regards capital transfers, for there was also a blanket prohibition of any import and export of Bank of Tanzania banknotes. For the first time, too, a Foreign Exchange Plan was drawn up for 1971/72.

Tanzania was not the first of the three partners to introduce controls on the movement of banknotes within East Africa; it had been preceded by Uganda in 1970, and was soon followed by Kenya. These restrictions are still in force, and indeed were subsequently reinforced.

In November 1971 full responsibility for the day-to-day administration of import licensing was transferred to the Central Bank.

The Financial Laws (Miscellaneous Amendments) Act of 1972 raised the penalties for exchange control offences and strengthened the Central Bank's powers of investigation. New limitations were introduced on the sale of air tickets for abroad, and the tourist allowance was again reduced, this time from 4,000 to 2,000 shillings once every three years.

To judge from the latest figures for official reserves, it would seem that these measures are beginning to have the desired effects, but no relaxation is being contemplated for the time being.

(d) *Relations with the other East African countries*

Ever since the three East African countries set up their own separate central banks, there has been insistent talk of harmonizing and co-ordinating monetary policies. At the outset, the three currencies were freely convertible within East Africa.

The Governors of the three central banks held a first meeting at Kampala on 11 October 1966, and reiterated their readiness to co-operate. But the controls introduced by Tanzania the following February, while they lasted, certainly brought a severe setback to these good intentions.

The signature of the Treaty for East African Co-operation on 6 June 1967 brought into being the East African Community, which was formally inaugurated on 1 December of the same year. The existing Common Market and Common Services Organization were reorganized and strengthened, and in addition it was decided to set up a common East African Development Bank. Provision was made for the central bank governors to meet at least four times a year for discussion of their common problems. At first, all this certainly did lead to a certain amount of collaboration, but as time went on and political relations among the three countries deteriorated, while each had its own different internal problems, the incipient union became purely formal — especially after the introduction of exchange control in 1970 and 1971.

Chapter II

FINANCIAL ASPECTS OF ECONOMIC PLANNING IN TANZANIA

1. ORIGINS OF FINANCIAL PLANNING IN TANZANIA

There was little financial planning in Tanzania until 1970. All that even the Second Five-Year Plan contains in regard to financial aspects is a list of investment targets together with possible sources of finance and the annual government budget.

For 1971/72 a Finance and Credit Plan was drawn up for the first time, and this is now done annually. This innovation can be regarded as a really serious attempt to improve and enlarge the scope of planning machinery, and its introduction can best be understood in the light of the effects following the far-reaching institutional changes in Tanzania after 1967.

Initially, these changes fostered the formation of investable capital in the public sector, improved Tanzania's external position and generated a high rate of economic growth, in real terms. But from 1970 all this changed. The public sector's undue propensity to spend was fast eroding disposable resources, the credit system became much less conservative than it had been in colonial times, and there were no automatic brakes and controls on the expansion of liquidity in the system. Public investment expenditure soared in 1970 and was largely financed by government borrowing from the banking system, money supply grew by more than 20 per cent,

prices began to rise and foreign reserves fell well below the prescribed minimum. The government responded by a drastic cut in expenditure, and the Bank of Tanzania by applying selective credit controls.

As regards planning machinery, it was decided that the Annual Plans, which had first been introduced in 1970, were henceforth to be accompanied by, likewise annual, Foreign Exchange Plans and Finance and Credit Plans. But before discussing the latter in detail, it will be convenient first to look at the current Five-Year Plan and at the annual central government budget, which together define the tasks of financial planning — that is, to make sure of the necessary supply of financial resources and to find ways and means of raising it by appropriate measures.

2. THE SECOND FIVE-YEAR PLAN 1969-1974: INVESTMENT TARGETS AND SOURCES OF FINANCE

The Second Plan aims at an annual growth rate of 6.5 per cent in the gross domestic product. This requires investment growth at 10 per cent a year, involving a total of 8,085 million shillings over the five-year period as a whole. Of this amount, the central government is to invest 3,055 million, the parastatal organizations and co-operatives 2,300 million, the East African Community 580 million, and the private sector 2,150 million shillings. The requisite growth rates are 10 per cent for central government development spending, 20 per cent for the parastatals and co-operatives, and 7 per cent for private investment.

Let us look separately at the three respective investment targets¹.

¹ United Republic of Tanzania, *Tanzania Second Five-Year Plan for Economic and Social Development, 1st July 1969 - 30th June, 1974. Volume I: General Analysis*, Government Printer, Dar es Salaam, 1969, chiefly Chapter XVI.

TABLE 38

SECOND FIVE-YEAR PLAN, CENTRAL GOVERNMENT DEVELOPMENT
BUDGET: SOURCES AND USE OF RESOURCES
(million shillings)

Sources		Uses	
External	1,600	Central Government programme	3,055
Transfer from recurrent budget	620		
Security sales	1,335	Parastatals	650
Other local	150		
Total	3,705	Total	3,705

Source: United Republic of Tanzania, *Second Five-Year Plan for Economic and Social Development*, Dar es Salaam, 1969, p. 213.

(a) *The central government development budget*

The 3,055 million shillings which, under the plan, the central government is to invest directly, are made up of 2,750 million to be spent by the ministries and an amount of 305 million for local cost of the Tanzania-Zambia rail link. In addition, government contributions to parastatals are scheduled at 650 million, bringing the total central government development budget for the five years to 3,705 million shillings.

Some 200 million for the rail link are to be covered by drawing down Chinese commodity credits, and these are included in the figure of 1,600 shown for external sources in Table 38. Under the First Plan, 78 per cent of central government investment spending was to have been financed from external sources, but in the event 65 per cent of it was covered from domestic sources during the first four years — in absolute terms, 708 million shillings were raised locally in four years as against an original five-year target of 450 million. This time, some 55 per cent of government development spending during the Second Plan is

TABLE 39

SECOND FIVE-YEAR PLAN: PARASTATAL INVESTMENT
(*thousand shillings*)

	Total investment	Government contribution
TANESCO (Tanzania Electricity Supply Co. Ltd.)	456,900	174,000
NDC (National Development Corporation)	781,000	240,000
NSIC (National Small Industries Corporation)	6,500	
NAFCO (National Agricultural and Food Corporation)	112,300	
TTC (Tanzania Tourist Corporation)	203,000	
STC (State Trading Corporation)	20,000	100
TSC (Tanzania Sisal Corporation)	92,500	20,000
LSMB (Lint and Seed Marketing Board)	12,000	—
NAPB (National Agricultural Products Board)	25,000	—
Tobacco Board	7,100	—
Tea Authority	88,500	10,000
Dairy Board	9,000	—
NMC (National Milling Corporation)	10,100	—
NHC (National Housing Corporation)	278,000	110,000
National Parks	29,600	21,000
Computer Corporation	4,000	4,000
NIC (National Insurance Corporation)	15,000	—
NBC (National Bank of Commerce)	26,000	—
Bank of Tanzania	4,500	—
NCB (National Co-operative Bank)	1,300	—
NDCA (National Development Credit Agency)	1,600	1,600
Co-operatives and Workers Development Corporation	100,000	—
Others	4,000	4,000
Total	2,287,900	584,700
NDCA (net lending) ⁽¹⁾	143,000	65,000
NSIC (net lending) ⁽¹⁾	3,600	—
Grand total	2,434,500	649,700

⁽¹⁾ Net medium- and long-term lending, which is not direct investment activity by the parastatal sector.

Source: United Republic of Tanzania, *Second Five-Year Plan for Economic and Social Development*, Dar es Salaam, 1969, p. 212.

scheduled to be covered by external sources, but, if account is taken of expected recurrent government spending during the five years, the foreign contribution drops to 12 per cent.

(b) *Parastatal investment*

Parastatals and co-operatives are scheduled in the Second Plan to invest altogether 2,300 million shillings over five years, of which 650 million are to be contributed by the central government. The breakdown of expenditure by spending agency is shown in Table 39, together with the pertinent government contribution.

The largest single investment programme is that of the National Development Corporation (NDC), which is responsible mainly for development in manufacturing, processing and mining; its total planned investment expenditure of 781 million shillings is to be financed mainly from government and foreign sources.

The next-biggest spender is the Tanzania Electricity Supply Company (TANESCO) with 457 million shillings; of these the government is to contribute 174 million, 71 million will be self-financed and the rest, some 46 per cent of the total, is to come from external sources.

In all, between 35 and 40 per cent of the parastatal investment expenditure is scheduled to be covered by external finance. The TANESCO programme is among those which are to rely most heavily on foreign funds, since it is expected that there should be no difficulty in obtaining direct long-term loans for such a highly productive investment.

Two new public corporations, the National Agricultural and Food Corporation (NAFCO) and the Tanzania Tourist Corporation (TTC) have been assigned major investment programmes, of 112 and 203 million shillings respectively. NAFCO is responsible for

agriculture and agricultural processing, and is to spend the bulk of its money on new state farms and on the promotion of wheat growing and animal husbandry, for which latter purpose funds have already been allocated by the International Development Association (IDA), a subsidiary of the World Bank.

The Tanzania Sisal Corporation (TSC) is to invest mainly in diversification schemes, and is to spend 92.5 million shillings, of which government will contribute 20 million. Another 88.5 million shillings are to be spent by the Tea Authority, the Tea Board's successor, mainly to develop local processing.

Relatively little investment is planned for distribution agencies; between them, the National Agricultural Products Board, the Lint and Seed Marketing Board, the Tobacco Board and the Dairy Board are to spend 53 million shillings. While these agencies, together with co-operative unions, are mainly concerned with the marketing of agricultural commodities and their investment is earmarked for related purposes, they also extend credit to co-operatives for cultivation and harvesting, using both their own operational funds and bank credits, especially from the National Bank of Commerce and the Tanzania Rural Development Bank¹.

The investment target of 203 million shillings for the Tanzania Tourist Corporation reflects the government's concern with the development of the tourist industry, which in the long run is expected to become a major foreign exchange earner. Government contributions will be available to finance the bulk of the Corporation's programme, and there is provision for equity

¹ The Tanzania Rural Development Bank was set up in 1971 to take over from the National Development Credit Agency, and is responsible for long-term loans to agriculture, including the whole rural sector. Although under the Second Plan government contributions to the NDCA were scheduled at 65 million, this may prove insufficient if the new bank is fully to discharge its broader functions.

participation in companies partly financed by foreign groups. Another 29.6 million shillings are earmarked for a closely related programme concerning National Parks; some 9 million of this is expected to be covered by external loans and grants, the rest by government contributions.

Although the Plan leaves housing investment largely to private enterprise, an amount of 278 million shillings has been earmarked for the National Housing Corporation, the government being expected to contribute 110 million of this total.

(c) *Private sector investment*

Private investment is foreseen in the Second Plan only for a limited range of activities (Table 40). The total of 2,150 million shillings is subdivided as follows:

- (i) More than one third for residential construction and other building;
- (ii) about one third for road transport equipment;
- (iii) more than 10 per cent to be spent by large-scale construction contractors importing equipment for the expanding construction industry;
- (iv) the remaining 10 to 15 per cent on miscellaneous agricultural and manufacturing equipment.

(d) *Supply of foreign exchange*

Among the difficulties and problems involved in the implementation of the investment programmes outlined in the Second Five-Year Plan, the supply of foreign exchange funds looms large. Although the watchword of the Second Plan is "self-reliance", that is, development through the maximum mobilization of domestic resources, Tanzania is in fact still heavily dependent on foreign countries for the import of technical

TABLE 40

SECOND FIVE-YEAR PLAN: PRIVATE SECTOR INVESTMENT
(million shillings)

Housing	600
Other building	175
Transport	750
Construction equipment	250
Other machinery	275
Total	2,150

Source: United Republic of Tanzania, *Second Five-Year Plan for Economic and Social Development*, Dar es Salaam, 1969, p. 213.

know-how, plant and machinery. For this, foreign exchange is needed, and a shortage of foreign exchange may become a possible constraint on capital formation and economic development.

The trade balance and the balance of payments, as we have seen, have been causing acute problems in the last few years. The planners foresaw this when they drew up the programmes for 1969-74 and pointed out that the faster pace of investment was bound to raise the import bill for capital and intermediate goods as well as transport equipment¹. Restrictions on consumer goods imports and the development of import substitution industries were to keep this rise in "reasonable bounds", but even so export growth was not expected to match import expansion. Diamond exports were declining, so were world prices for agricultural commodities, and though exports to the East African partners were expected to grow at a high rate, this was a small market.

Among the invisibles, a steady increase in overseas debt payments was not expected to be more than partially compensated

¹ *Second Five-Year Plan*, *op. cit.*, p. 214.

by growth in investment incomes, tourist receipts and other invisible items.

As against the current balance-of-payments deficit, the Second Plan assumes net capital inflows for the central government and parastatal programmes, rising from 273 million shillings in the first year to 406 million in the fifth.

This leaves a lot to be found from domestic resources, and indeed the document concludes by stressing that the achievement of the planned investment level will require

- “(i) continued vigorous mobilization [of resources] through the budget, both through a tax policy which ensures that revenues grow slightly faster than monetary incomes, and restraint on the growth of non-developmental spending;
- (ii) an increased channelling of savings to the public and parastatal sector through the various public financial institutions¹.”

3. CRITICAL APPRAISAL OF THE SECOND FIVE-YEAR PLAN

In introducing this chapter on planning, we said that the Second Five-Year Plan cannot be regarded as initiating financial planning in any real sense. It really is an indicative plan, which lists investment programmes and possible sources of finance, and highlights major problems.

Nor is this the Plan's only weakness. Many of its economic calculations really are extremely vague. Take for instance the Central Government Development Budget². It is estimated that

¹ *Ibid.*, p. 216.

² See John Loxley, “Financial Planning and Control in Tanzania”, in: *Towards Socialist Planning*, Dar es Salaam, Tanzania Publishing House, 1972, p. 60 ff.

almost 17 per cent of it is to be financed from current budget surpluses, on the assumption that current expenditure would not grow faster than real income, and that another 40 per cent would come from other domestic sources. These percentages are not justified by precise calculations, but it is estimated that the bulk of the local funds can be raised by security sales mainly to parastatal financial institutions. The rest of the investment programme, it was hoped, would be financed from external sources. Although the total amount involved here almost exactly corresponds to that budgeted for the First Plan, when in the event only one third materialized, this time the forecast is probably more realistic, in the light of foreign aid flows in recent years. Still, that too is only an estimate; there are few solid facts behind it, and indeed it anticipates an improvement on recent aid performance. Nor is there any indication regarding the time schedule of actual receipt of foreign aid.

The estimates on which the calculations for plan financing are based can thus hardly be described as reliable. The same must be said about other figures in the Plan. For example, it is assumed that private sector investment will increase at an annual rate of 7 per cent, but nothing at all is said about where the money is to come from, except that there is a presumption that the whole programme will be financed from domestic sources. But the worst set of figures is that relating to parastatal investment. The planners themselves admit that the parastatal — as indeed the private — investment programme is made up of indicative targets. When the Plan was being prepared, little was known about the parastatal sector's capacity to generate profits or to initiate and implement investment projects. Certainly there is no programme for

productive activities other than infrastructures. A whole volume of the Second Plan is devoted to a detailed description of projects, but few of them seem to have been investigated in commercial or socio-economic terms — perhaps because at the time the government had very limited facilities for such studies. By the government's own admission there was often less connection than there should be between the targets and policies outlined in the first part of the Plan and the means of achieving them, that is, the projects set out in the second part¹. The vagueness of the Plan has had at least two unfortunate consequences.

First of all, many projects have been put in hand without detailed cost/benefit analysis and without reference to how they might fit into a socialist development strategy; they were carried out for the simple reason that they figured in the Plan in the first place. Secondly, the Plan's failure to define strategies in line with the stated political aims of socialism and self-reliance, especially in the industrial sector, together with the vagueness of its indications about sources of finance, led the parastatal agencies to give priority to projects to be realized with foreign funds (and often with foreign management, too). In recent years, to the sure, the banks, the Treasury and the Ministry of Economic Affairs and Development Planning (DEVPLAN) have tightened their control over investment, loans and management contracts between the parastatals and foreign firms, but these controls are still of the *ex post* type — in other words, they come into play only once a project is already under way, and have no influence on initial project selection. What the Plan lacks is a clearly defined strategy of investment choice.

¹ The United Republic of Tanzania, *The Economic Survey and Annual Plan, 1970/71*, Dar es Salaam, 1970, p. 89.

Since the Second Plan was published, incidentally, much of the investment originally left to private enterprise has been transferred to the parastatal sector with the nationalization, in 1969, of the construction of dwellings for rent and of the bulk of passenger transport, measures taken to counteract illegal capital exports. In any case, tighter exchange control has curtailed private investment.

Finally, the Second Plan was rather wide of the mark in its balance-of-payments forecasts. The planners worked out projections for exports on the basis of world prices and expected output of each export product; they estimated imports of capital goods and intermediate goods on the basis of the investment programmes of all sectors, and assumed that consumer goods imports would be kept constant thanks to import substitution; and they made projections for the invisibles. The conclusion was that there was likely to be a deficit in the balance of payments on current account. As against that, it was assumed that the central government and parastatal investment programmes would be able to attract foreign funds, so that a net inflow on capital account would soon offset the current deficit, add enough to foreign reserves to keep step with import growth, and still leave a small surplus in the early years of the Plan.

But as time went on many of these forecasts proved wrong, largely because the time schedule of investments was so loose, and because the planners really had very little knowledge of import requirements and of the sources and conditions of finance for investment projects. Things took a really bad turn in 1970 when the balance of payments deteriorated sharply, and as a result an annual Foreign Exchange Plan has been drawn up since 1971/72 and enforced by strict controls.

4. ANNUAL PLANNING

(a) *The central government budget*

Until 1970, the central government's annual budget was probably the one effective form of financial planning, and it still constitutes the basis of the newly introduced Annual Plans.

The problem of budgeting is how to cover investment and non-productive expenditure by tax revenue and borrowing. It is a problem that is partly technical and partly political, in so far as it involves a choice between cutting expenditure or raising more funds by taxation, inflation or foreign loans.

Taxation is already very high in Tanzania and any further increase in the tax burden is held to be politically unacceptable. It is not expected, therefore, that tax revenue can go on keeping nearly so far ahead of income growth as it had been doing¹. Barring inflation and unduly costly loans from abroad, the only way of having a current budget surplus available for investment, as planned, is to keep a very tight rein on current expenditure.

But it has already become clear that the Second Plan's limits to the rate of growth of current expenditure are unrealistic, in so far as they do not make sufficient allowance for the current expenses generated in the course of time by capital investment. The inevitable conclusion for the future is that the capital programme will have to be cut².

Nor are the controls on current spending nearly tight enough. Overspending by ministries can remain undetected for months,

¹ John Loxley, "The finance of government spending in Tanzania since Independence", in: Tanzania Investment Bank, *Rasilimali - Tanzania Investment Outlook*, [1972], p. 24.

² United Republic of Tanzania, *The Annual Plan for 1971/72*, Dar es Salaam, 1971, p. 15.

and although all payments have to go through the Central Bank as the government's banker, there are no arrangements for checking documents to make sure whether any particular payment is justified under the relevant budget appropriation and whether the requisite funds are available at the given moment. The control functions of the Bank of Tanzania concern only the government's overall position with regard to revenue and expenditure, and in some cases to each separate ministry's expenditure position. It is perfectly easy, therefore, to overspend any particular appropriation and to transfer money from one chapter to another without the Central Bank ever knowing about it — or, for that matter, apparently caring. The reason for this is that controls are supposed to be the Treasury's business; but since the offices concerned are extremely slow in discharging their task, the result in practice is that these controls are virtually inoperative and that a very large area of activities simply remains outside the mechanism of financial planning.

Another budgeting problem is that of the allocation of funds to different government departments. This is done at present in rather informal negotiations among the spending ministries, the Ministry of Finance and the Ministry of Economic Affairs and Development Planning, the one setting a ceiling for current expenditure and the other for capital expenditure. Because of this informal procedure, the final result obviously owes much to the personality of the men concerned and to the efficiency or otherwise of each ministry's organization. This leaves a wide margin of arbitrariness, which might be reduced if the government tried to define precise criteria for investment evaluation. But there are no systematic criteria of this kind, and even if there were many ministries would be unable to carry out detailed feasibility studies, nor would DEVPLAN be in a position to appraise them.

In all fairness it must be added that great strides forward have been made in recent years in an effort to introduce some planning units into ministries and to decentralize planning procedures. But no solution has been found so far to the problem of what principles to apply to current spending.

(b) *Annual Plans*

In the Second Five-Year Plan, provision was made for the preparation and publication of Annual Plans for the implementation of the Five-Year Plan's broad targets¹. The idea was to supplement the government's annual development budget with a document presenting an analysis of the state of the economy, an evaluation of plan implementation and a review of government policies, so as to make possible an evaluation of performance in different sectors of the economy and an assessment of existing problems, to provide a basis for making alterations in plan targets, strategy, programmes, project priorities and policies, to make possible a more accurate estimate of resources available to the government, and to suggest measures necessary for the following years' plan implementation.

Understandably enough, the first Annual Plan, for 1970/71, fell somewhat short of these ambitious aims². It did contain a useful discussion of the problems of public sector institutions, but by and large was not much more than a detailed government development budget, with a list of parastatal projects and their likely sources of finance. It was incomplete in so far as it did not cover all the parastatals' financial flows and included only the

¹ *Second Five-Year Plan*, *op. cit.*, p. 220-221.

² United Republic of Tanzania, *The Economic Survey and Annual Plan 1970/71*, *op. cit.*, p. 73-124.

projects of the parastatal holding companies, and not those of their affiliates. Nor did it say anything about how the projects under the development budget were to be financed. It was not really a plan, but merely a more detailed but still incomplete public sector budget.

The second Annual Plan was less explicit in discussing implementation in the public sector, but introduced considerable improvements in other respects¹. For every project to be financed under the development budget, it made a clear distinction between local and foreign sources of finance, and for the parastatal projects it presented a detailed analysis of sources of finance in terms of self-financing, development budget, local short- and long-term borrowing and private foreign participation. It also contained progress reports for each separate economic sector, reviewed current problems and the future outlook, and for the first time made an attempt to appraise the implementation of regional development programmes.

The third Annual Plan, for 1972/73², follows much the same pattern. It contains an overall review of the state of the economy and fairly thorough sectoral analyses, but the treatment of regional development programmes is still summary. The document contains a long list of planned projects with sources of finance divided into local and external, but does not give evidence of much progress in checking performance in the actual implementation of the guidelines and projects of the preceding year. Two novelties are a more precise indication of priorities, and suggestions for plan implementation in future years.

¹ *Id.*, *The Annual Plan 1971/1972*, *op. cit.*

² United Republic of Tanzania, *The Annual Plan 1972/1973*, Government Printer, Dar es Salaam, 1972.

5. ANNUAL FINANCE AND CREDIT PLANS

Since 1971/72, a Finance and Credit Plan has been part of annual planning. This is without doubt the most important innovation.

The Second Five-Year Plan devotes an entire chapter to "Capital Formation and Financing the Plan", but deals only indirectly with credit problems with reference to specific sectors such as agriculture, industry, housing, etc., without anything like an overall appraisal of the role of money and credit in the Tanzanian economy. Nothing at all is said about the growth of money supply and the volume of credit, either in quantitative or in qualitative terms.

The decision to introduce annual foreign exchange as well as finance and credit plans was no doubt dictated by the need to keep public expenditure targets compatible with stability of the currency's purchasing power at home and abroad. They are regarded as the basic tools of short- to medium-run macro-economic policy¹, and the idea is eventually to develop full flow-of-funds accounts, in terms both of planned and of actual flows.

Given the nature of the Tanzanian economy, these plans are in part forecasts, since, for example, it is impossible to plan precisely for export products whose output depends on weather, and hence also to quantify the related credit requirements.

The main tools used to implement the two plans are the following:

- (a) control of the money supply;
- (b) allocation of available bank credit between government and other users;

¹ *Ibid.*, p. 4.

- (c) selective credit allocation to non-government users giving priority to export and agriculture;
- (d) allocation of resources of non-bank financial institutions to agreed uses;
- (e) control over inter-company lending;
- (f) control over foreign short- and long-term borrowing;
- (g) comprehensive exchange control on invisible transactions;
- (h) firm import control over consumer goods;
- (i) control over repatriation of export proceeds.

The key figures for planned and actual performance under the 1971/72 Finance and Credit Plan for the development budget are set out in Table 41. In most cases the outcome is seen to differ quite considerably from the original targets. The contribution from current budget surplus fell far short of the target, because current expenditure was not cut enough and because of the incidence of expenses deriving from past investment. Foreign funds and government non-bank borrowing were somewhat less than planned, and consequently the government had to borrow more from the banking system — which, as has already been pointed out, is one of the most worrying aspects of Tanzania's present economic situation. Another cause for concern is the fall of credits to the economy; while the increase in money supply (broad definition, including time and savings deposits) kept close to the planned figure, its distribution was very different from what it was meant to be, since the whole of it was due to government borrowing and spending¹.

The 1971/72 Finance and Credit Plan was geared to an increase of money supply of not more than 10 per cent. Hence the targets for public sector spending were set in such a way that

¹ Bank of Tanzania, *Economic and Operations Report*, June 1972, p. 33.

TABLE 41

FINANCE AND CREDIT PLAN 1971/72: TARGETS AND PERFORMANCE
(million shillings)

	Planned	Provisional outcome
Recurrent budget surplus	101	51*
Government borrowing: non-bank	130	126*
Government borrowing: bank	150	277
Foreign grants and loans	374	330*
Expansion of bank credit: non-government domestic	90	— 79
Increase in money supply (incl. time and savings deposits) (per cent)	10	10.5

* Estimate.

Sources: United Republic of Tanzania, *The Annual Plan 1972/73*, p. 5; Bank of Tanzania, *Economic and Operations Reports*, June 1972, p. 31-33.

residual bank credit, after deduction of other domestic and foreign sources of finance, would not exceed a level compatible with the planned rate of increase in money supply. This meant fixing a ceiling to credit expansion for all sectors, including the parastatal and private sectors. The Plan did not specify how these limits were to be applied, but left this to the discretion of the National Bank of Commerce. But it was not an easy task, and in the event several months passed before the NBC and the Bank of Tanzania worked out the details. It was decided to distribute the permissible volume of credit on the basis of territorial priorities, giving preference to the most backward areas and leaving a sufficient margin for the takeover of private activities by co-operatives and District Development Corporations¹, as well

¹ It has already been mentioned that planning machinery in Tanzania has recently been decentralized. There was some discussion at the time as to whether this would have any consequences for the credit system, and the conclusion was

as for export promotion and import substitution; import credits, on the other hand, were to be severely restricted.

All in all, the system of annual Finance and Credit Plans surely must be considered as a very creditable effort to build monetary policy into economic planning. So far, these Plans have not presented a comprehensive flow-of-funds account, but then the data for this are simply not available. The Finance and Credit Plan's chief weakness is, once again, the inaccuracy of data regarding the parastatal sector. By the planners' own admission the list of projects to be financed is not complete, and many of those listed still await approval; and the figures for sources of finance, especially foreign ones, are very rough approximations. However, attempts are being made to improve the planning system for the entire parastatal sector. If they succeed, much arbitrariness and ambiguity will be removed from the relations between the parastatal sector and the National Bank of Commerce, and if projects are defined in more detail, the Bank will be able to exercise its control functions more effectively.

6. THE FINANCE AND CREDIT PLAN FOR 1972/73¹

Like its predecessor, the Finance and Credit Plan for 1972/73 aims, in its own words, "at maintaining the balance between public sector investment and available resources". The main tools for achieving this balance are listed as government revenues and

that at least for the time being no major change need be involved. But it does seem that this new system of applying credit controls, while not amounting to decentralization of the mechanism as such, does in some way reflect the advent of decentralization elsewhere, since regional problems are now coming to the fore and the banking system is coming to play an important part in the implementation of regional development targets.

¹ United Republic of Tanzania, *The Annual Plan 1972/73*, *op. cit.*, p. 9-12.

expenditures, internal and external borrowing, external balance and reserves, and domestic credit and money supply.

The twin objectives are "growth with stability", in other words, economic growth in real terms, in conditions of internal and external monetary stability. This, it is pointed out, will call for a greater degree of co-ordination and control over the sources and uses of funds by parastatals, bank and non-bank financial institutions and the private sector. The estimates for 1972/73 are an attempt to cover all the major institutions' sources and uses of funds, and as such are a definite improvement on the preceding year, even if not all the earlier shortcomings and deficiencies have as yet been made good.

On the basis of past performance and current outlook, it is estimated that monetary GDP should grow during the year by 8 to 9 per cent. The major individual targets are set out below.

(a) *Finance of the government sector.*

Total financial resources available to the government for the development budget during the year 1972/73 are estimated at 978 million shillings (Table 42). Of these, 55 million are to come from *current budget surplus*, the figure being estimated on the assumption that current revenue will grow by 9-10 per cent and that current expenditure will not rise by more than 9 per cent.

The estimate for *non-bank domestic borrowing*, at 160 million, is well above the previous year's original forecast and, even more so, the outcome (Table 43). The Plan goes out of its way to stress the importance of non-banking financial institutions playing a bigger part in mobilizing savings and channelling them into investment in government paper. The bulk of the year's increment is expected from the National Insurance Corporation and the National Provident Fund.

TABLE 42

FINANCE OF THE GOVERNMENT SECTOR: ESTIMATES FOR 1972/73 AND 1973/74

(million shillings)

	1972/73	1973/74
I. <i>Recurrent budget</i>		
1. Revenues	2,045	2,237
2. Recurrent expenditure	1,990	2,145
3. Surplus	55	92
II. <i>Development budget</i>		
1. Sources of funds		
Surplus in recurrent budget	55	92
Non-bank domestic borrowing	160	165
Government borrowing from banking system	195	195
Other internal grants	27	30
External loans and grants	541	454
Total resources	978	936
2. Uses of funds		
Central government	640	653
Transfers to parastatals	338	283
Total expenditure	978	936

Source: United Republic of Tanzania, *The Annual Plan 1972/73*, p. 10.

Government borrowing from the banking system, which widely overshot the target in 1971/72, is to be limited to 195 million shillings, of which 95 million through NBC investment in government stock and the remaining 100 million through Bank of Tanzania purchases of Treasury Bills.

External aid is expected to contribute 541 million shillings, equal to 55.4 per cent of the estimated total.

(b) *Money supply and credit allocation*

The growth of money supply during 1972/73 is to be restricted to about 12 per cent, which amounts to some 340 million shillings, allowing for 60 million to be added to reserves.

TABLE 43

NON-BANK HOLDINGS OF GOVERNMENT STOCK, 1969/70 TO 1973/74
(million shillings)

Holders	1969/70 Actual	1970/71 Actual	1971/72		1972/73 Estim.	1973/74 Estim.
			Original estimates	Likely actual		
Insurance companies						
NIC	16.2	10.7	9.0	7.5	20.0	22.0
Others	—	2.1	2.5	2.0	2.5	2.5
Provident funds						
NPF	66.7	67.0	75.0	75.0	83.0	90.0
Others (government and local authorities)	11.4	11.7	7.0	13.5	15.0	15.0
Other sources	73.6	52.0	36.6	28.6	39.5	35.5
Total	167.9	143.5	130.1	126.6	160.0	165.0

Source: United Republic of Tanzania, *The Annual Plan 1972/73*, p. 11.

TABLE 44

FINANCE AND CREDIT PLAN 1972/73: TARGETS (RECAPITULATION)
(million shillings)

Sources of development finance	Planned for 1972/73
Recurrent budget surplus	55
Government borrowing: non-bank	160
Government borrowing: bank	195
Foreign grants and loans	541
Expansion of bank credit: non-government domestic	100
Increase in money supply (per cent)	12

Source: United Republic of Tanzania, *The Annual Plan 1972/73*, p. 10-12.

Total bank deposits are expected to rise by about 220 million, or about 12 per cent, and the ceiling on new commercial bank lending to the domestic sector (other than government) is set at 100 million.

The key figures of the 1972/73 Finance and Credit Plan are recapitulated in Table 44.

