

PART III : MONETARY MANAGEMENT

Chapter 9

Issues in Monetary Management in Tanzania¹

1. Introduction

On April 27, 1964, Tanganyika and Zanzibar combined to form one country which was named as 'The United Republic of Tanzania' on October 29, 1964. It shares its border with Kenya, Uganda, Rwanda-Burundi, Zaire, Zambia, Malawi and Mozambique. Its total geographical area covers 945.1 thousand square kilometers of which about 51% is agricultural land and 6% is covered by water. Low areas on the periphery receives about 50 inches of rainfall per annum which is adequate for good yields of perennial and annual crops. The central part of Tanzania is largely arid bush, having a mean rainfall of less than 30 inches. Only one-tenth of the land is cultivated and a slightly larger area is grazed. Tanzania's population is estimated to be 23.9 million in 1987 of which urban population is 29%. The annual average compound growth of total population during 1978-88 is estimated at about 2.8%. The density of population is about 26 persons per square km. About two-fifth of the population is economically actively engaged in Tanzania. The per capita GDP at factor cost at current prices is estimated to be T.Shillings 12,076 in 1988. At constant 1976 prices, it works out at T.Sh.1201 which is lower than in 1976. Personal income distribution in Tanzania is highly skewed with top 5% of households accounting for 33.5% of private income and top 20% households accounting for about 63% of private income. Poverty is widespread. About 60% of population lives below poverty level in rural areas and about 10% in the urban areas. Tables 1 and 2 provide information on the basic structural characteristics of the Tanzanian economy.

2. Main Objectives of Economic Policies

In 1967, six years after independence, the Tanzanian government adopted the Arusha Declaration introducing sweeping changes to embark on a new era of economic management based on socialist approach. Although substantial progress was made in the sphere of social equity, Tanzania experienced economic crisis conditions during the late 1970's and early 1980's. The crisis was caused by a series of external factors like successive droughts, oil price hikes, collapse of East African Community and the war with Uganda. To overcome this crisis, the government launched Economic Survival Plans in 1980 and 1981. However, only with introduction of a Structural Adjustment Programme (SAP) in 1982, a comprehensive approach to resolve the crises was initiated. This programme sought to provide an overall framework of measures with the objective to (i) restore financial and economic stability, (ii) stimulate agricultural development, (iii) improve efficiency, (iv) protect the provision of basic social services and (v) protect real income of the most vulnerable groups in the society. Although SAP had some positive impact, it was on the whole not successful in stimulating any major recovery in the Tanzanian economy. In mid-1986, therefore, the government introduced a new Economic Recovery Programme (ERP) covering a 3 year

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period 1986-87 to 1988-89) to overcome some of the deficiencies of the policies in SAP.

Table 1													
Selected Important Ratios for Tanzanian Economy, 1976-88													
(In percentage)													
Ratios	Years												
	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
1	2	3	4	5	6	7	8	9	10	11	12	13	14
1. Share in GDP at 1976 Prices													
a. Primary Sector	41.8	42.1	40.5	39.7	40.2	40.8	41.1	43.3	43.6	45.0	46.2	46.5	46.6
b. Secondary Sector	19.0	18.5	18.0	18.5	17.9	16.7	16.4	14.2	14.6	13.6	13.3	13.3	13.4
c. Tertiary Sector	39.2	39.4	41.5	41.8	41.8	42.5	42.5	42.5	41.8	41.4	40.5	40.2	40.0
2. GCF/GDP at 1976 at prices	25.8	29.7	28.0	29.9	26.1	27.3	28.0	20.2	26.8	31.4	29.6	28.3	26.3
3. GFCF/GDP at 1976 prices	23.8	26.3	25.7	28.0	24.0	24.9	25.8	17.7	24.9	29.7	28.0	26.7	24.8
4. Gross Savings/GDP at current prices	25.0	29.0	15.6	19.2	13.6	17.5	16.7	11.0	9.8	10.5	14.9	18.3	14.4
5. Tax/GDP at current prices	16.5	17.4	16.4	15.9	16.5	17.1	16.8	17.2	16.6	14.0	15.6	16.1	17.4
6. Per Capita GDP													
a) At Current Prices (in T.Shs.)	1362	1561	1681	1847	2072	2354	2729	3151	3811	5221	6715	8811	12076
b) At 1976 prices (in T.Shs.)	1362	1320	1303	1306	1295	1249	1217	1152	1154	1172	1181	1186	1201

Source: Bureau of Statistics, The President's Office, Planning Commission, Dar-es-Salaam.

The specific objectives of the ERP were to increase the output of food and export crops, to rehabilitate the physical infrastructure and raise capacity utilization through allocation of foreign exchange resources and restore internal and external balance by pursuit of prudent fiscal, monetary and trade policies. At the end of the ERP, considerable achievement was recorded in the performance of the real sector of the economy. Real GDP increased by 3.6% in 1986, 3.9% in 1987, 4.1% in 1988 and about 4.5% in 1989 as against an average growth of 1% during 1980-85. The revival in the real GDP growth meant that per capita output which had been declining steadily has now become positive. The main source of GDP growth has so far been agriculture with the contributing factors being favourable weather conditions, improved availability of inputs and the impact of attractive incentives to producers. The external sector, however, remains a problem area of economic management. The balance of payments position remains depressed in spite of increased exports particularly of non-traditional goods and increased external support improving the foreign exchange situation. At the end of ERP, exports are still only one third of import bill. The recovery in the agricultural production could not be translated into increase in exports due to structural bottlenecks including transport, processing and marketing.

The main objective of the monetary policy under the ERP was to control monetary expansion and reduce inflation. Credit to the government had to be contained during ERP. However, credit for the

<i>Table 2</i>	
External Account and Fiscal Position of Tanzania Averages for 1985-87	
(In percent)	
1. Export/Imports Ratio	32.8
2. Current Account Balance/GDP Ratio	-7.0
3. Capital Account Balance/Imports Ratio	1.5
4. Imports Support & Exceptional Finance/Import Ratio	5.8
5. Overall Balance/Import Ratio	-33.1
6. External Debt/Export Ratio	902.4
7. External Debt/GDP Ratio	76.4
8. Debt Service/Export Ratio	15.3
9. Government Expenditure/GDP Ratio	30.0
10. Government Revenue/GDP Ratio	16.5
11. External Finance/GDP Ratio	8.0
12. Domestic Non-Bank Borrowing/GDP Ratio	1.1
13. Bank Borrowing/GDP Ratio	0.9
14. Expenditure Float*/GDP Ratio	3.5
15. Tax/GDP Ratio	16.4
Source: Bureau of Statistics and BOT	
* Expenditure Float is defined as the amount of government cheques issued during a given year but unrepresented or uncleared through the BOT during that year.	

marketing of agricultural produce could not be contained within targets. The growth of this component of the total credit has been startling. Credit to the agricultural marketing institutions increased from T.Shs. 7.0 billion in June 1986 to T.Shs. 21.4 billion in June 1988 and T.Shs. 33.2 billion in June 1989. This has been partly due to exceptionally good crops (cotton and grains) and partly due to transportation, processing and marketing bottlenecks coupled with management deficiencies. Table-3 presents the targeted and actual annual growth rates in the total credit, money supply and prices during the ERP period.

The successor programme to ERP is the Economic and Social Action Programme (ESAP) covering the period 1989-90 to 1991-92. It stresses the consolidation of the gains so far achieved, intensification of

efforts in areas where positive results have begun to emerge, mitigating adverse effects of some measures affecting the human social dimension and taking further steps to ensure a sustained economic recovery. Its stated objectives include restoring internal and external balances and reducing the domestic inflation from 28% in 1988-89 to less than 10% in 1991-92.

The central objectives of the monetary policy during the next 3 years will be to sustain the growth of real GDP, to reduce inflation and to strengthen balance of payments position. These objectives are sought to be achieved through continued restraint on bank credit to government, and reforms of agricultural marketing and the financial sector.

It is proposed to revamp the financial sector with a view to improving the management of monetary policy and enhancing domestic savings. It is also proposed to maintain the positive interest rates attained during the ERP period and to improve efficiency and diversification of services in the financial system through institutional reforms.

3. Existing Financial Structure

The financial institutions in Tanzania form a very compact and highly differentiated structure as a result of the various nationalization and consolidation after the Arusha Declaration (1967) in the field of banking and credit. The main formal financial institutions existing in the Tanzanian financial system are:

- i) The Bank of Tanzania (BOT), the central bank which provides liquidity to banking institutions and the economy. It has legislative regulatory and supervisory powers over the formal financial sector in Tanzania. Chart 1 provides synoptic view of the main functions of BOT.

Chart 1: Functions of the Bank of Tanzania			
1.	Banking	Currency Issue Banker to Government Banker to Banks Banker to DFI's	
2.	Domestic Monetary Management (In terms of Finance and Credit Plan)	Govt.	Financing Budget Deficit Managing Govt. Debt Adviser to Govt.
		Banks & DFI's & SFI's	Short Term Loans - Advances, Bill Rediscounting - Interest Rate Policy - Control of Volume, Allocation & Terms & Conditions of Credit to their clients

Table 3						
Growth Rates in Total Credit, Money Supply and Prices: Targets and Actual, 1986-89						
Year	Total Credit		Money Supply		Inflation	
	Target	Actual	Target	Actual	Target	Actual
1986-87	12.6	29.8	10.0	23	25	28.9
1987-88	17.0	55.0	10.0	35	20	28.2
1988-89	17.0	30.0	10.5	24	15	28.1

Source: Economic Recovery Programme II, 1989-90 - 1991-92, Jan.1990. Government of Tanzania, Dar-es-Salaam.

3.	External Monetary Management	<ul style="list-style-type: none"> - Management of Foreign Exchange Reserves - Policy & Administration of Exchange & Import Controls - Export Promotion - Transactions with IMF - Exchange Rate of the T.Shilling 	
4.	Development	<ul style="list-style-type: none"> -Banks & DFI's & - SFI's 	<ul style="list-style-type: none"> - Medium & Long Term Loans - Contribution to share capital - Guarantee facilities - Supervision - Calling for Information - Provision of Training facilities

- ii) Three banks, viz. the National Bank of Commerce (NBC), the Co-operative and Rural Development Bank (CRDB) and the People's Bank of Zanzibar (PBZ) which provide commercial banking services. They also act as channels for government funds.
- iii) Two development finance institutions, viz. Tanzania Investment Bank (TIB) and Tanganyika Development Finance Company Ltd (TDFC) which provide long term development finance.
- iv) A savings bank viz., Post Office Savings Bank (POSB); a housing bank viz. Tanzania Housing Bank (THB); and the insurance/pensions funds, viz. National Insurance Corporation (NIC) and National Provident Fund (NPF).
- v) Two small financial institutions in the private sector, viz. Diamond Jubilee Investment Trust (DJIT) which accepts deposits and makes loans to small businesses and individuals mainly of the Ismaili Community; and the Karadha Company (KC) which is a hire/purchase company.
- vi) 381 savings and credit societies mainly in the urban areas and 201 multi-purpose cooperatives mainly in the rural areas which are involved in financial intermediation.

Chart 2 presents a synoptic view of the financial institutions in Tanzania.

It is important to note that, in Tanzania there is neither capital market nor a formal money market. Determination of effective interest rates and cash management of enterprises are, therefore, rendered very difficult. For the issue of bonds and treasury bills by the government, no secondary market exists. As a result, BOT ends up holding a very large proportion of these. At the end of March 1989 treasury bills outstanding amounted to T.Sh. 454 billion, and longer term government bonds totalled T.Sh.50 billion of which about T.Sh.33 billion were held by the BOT. NIC, NPF and POSB purchase a set amount of the bond issue and keep them to maturity. The absence of the bond and equity market has led companies and parastatals² to severe short term debt problems.

Chart 2 : Financial Institutions in Tanzania			
Institution	Form of Saving Mobilization	Type of Credit	Sector Receiving Credit
Bank of Tanzania	Currency Issue	Short, Medium and Long Term	Government, Commercial Banks and D.F.I's

² Parastatals are the organizations in the public sector wherein the government has the major share of ownership.

National Bank of Commerce & People Bank of Zanzibar	Acceptance of Demand, Savings & Time Deposits	Short, Medium and Long Term	Productive & Distributive Sectors of Government Economy
Tanzania Co-op. and Rural Development Bank	Acceptance of Demand, Savings & Time Deposits	Short Term Savings & Time Deposits	Co-op.Unions and Primary Societies; Small Businesses and Individuals
Tanzania Housing Bank	Savings and Time Deposits	Medium and Long Term	Building Construction & closely allied industries
Post Office Savings Bank	Savings and Time Deposits	Medium and Long Term	Government
Tanzania Investment Bank	None	Medium & Long Term Credit & Equity Investment	Commercial Agriculture and all types of industry
Tanganyika Development Fin.Co.Ltd.	None	Medium & Long Term Credit	Industry
National Insurance Corporation	Premium Income	Short, Medium and Long Term	Government
National Provident Fund	Provident Fund Contribution	Short, Medium & Long Term	Government
Karadha Company	None	Hire Purchase	Transport Finance
Diamond Jubilee Investment Trust	Acceptance of Demand, Savings & Time Deposits	Short, Medium and Long Term	Small Businesses and Individuals Community

On the other hand, Tanzania has an active informal financial market with foreign exchange dealings, funds transfer, debt and venture capital financing for businessmen. Table-4 presents brief monetary survey for Tanzania for the period 1987-89 which provides insights into the importance of the informal financial market in Tanzania. The ratio of currency to money supply works out at 35.35% for M2 and 51.43% for M1 in June 1989. The informal market has gained such prominence perhaps on account of inefficiencies and lack of adequate accessibility to the formal banking system. Interest rates in the formal system are not perhaps the main cause. Table-5 presents the interest rate structure in the formal banking system in Tanzania. As compared to a 31% p.a. maximum loan rates in the formal sector, interest rates in the informal market are estimated to be around 60% p.a. which cannot be considered very excessive particularly because the former do not include the high cost of transactions caused by inefficiencies. Even the informal market is very limited in its reach in Tanzania. Thus, smaller Tanzanian entrepreneurs face the major constraint of finance because neither formal nor informal financial systems cater to their needs.

<i>Table 4</i>				
Monetary Survey for Tanzania, June, 1987 to June 1990				
Millions of T.Shs.				
Items	June 1987	June 1988	June 1989	June 1990*
(1)	(2)	(3)	(4)	(5)
1. Net foreign assets of Banking System	-17,570.8	-13,120.8	-20,497.6	-23,008.7
2. Net claims on government	33,907.3	51,960.1	47,083.7	54,052.8
3. Lending to other domestic sectors	33,193.3	51,138.1	86,081.9	110,883.6
4. Other items	-466.0	-23,120.5	-20,269.4	-16,783.9
5. Total Money Supply (M2)	49,063.8	66,756.9	92,398.6	125,143.8
6. Currency in circulation outside banks	17,472.6	23,685.1	32,660.1	45,117.3
7. Demand Deposits	15,997.8	23,301.2	30,837.9	38,809.8
8. Money Supply(M1)	33,470.4	46,986.3	63,498.0	83,927.1
9. Savings Deposits	5,806.3	8,039.0	11,515.5	13,758.5
10. Time Deposits	9,787.1	11,731.6	17,385.1	27,458.2
Currency/M1 Ratio (in %)	52.20	50.41	51.43	53.76
Currency/M2 Ratio (in %)	35.61	35.47	35.35	36.05
*Provisional				
Source: <u>Bank of Tanzania: Economic and Operations Report for the year ended 30th June, 1989 and Quarterly Bulletins.</u>				

Table 5										
Interest Rate Structure										
Type of Deposits	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
A. Deposit Rates										
1. Savings	5.00	6.00	7.50	7.50	7.50	10.00	10.00	21.50	21.50	26.00
2. Short-term (31-91 days)	3.15-3.50	3.15-3.50	3.15-3.50	3.50	3.50	5.00	5.00	14.50	14.50	16.00
3. Fixed (3-60 months)	4.00-7.00	4.00-8.50	4.00-10.25	4.00-11.00	4.00-11.00	6.00-14.00	6.00-14.00	15.50-27.00	15.50-27.00	17.00-29.00
B. Lending Rates										
1. Short-term	7.50-12.00	7.50-12.50	8.00-12.50	9.50	9.50	11.00-16.00	11.00-16.00	18.00-29.00	18.00-29.00	20.00-31.00
2. Medium & Long term	5.00-11.00	4.00-12.00	5.00-13.50	9.00-13.50	9.00-13.50	11.00-16.00	11.00-16.00	19.00-29.00	19.00-29.00	21.00-31.00
3. Housing Mortgages	5.00-11.00	4.00-11.00	5.00-13.50	13.50	13.50	8.00-16.00	8.00-16.00	7.00-29.00	9.00-29.00	9.00-29.00
C. Government Securities										
1. Direct Advances	4.77	4.77	4.77	4.00	4.00	5.00	5.00	11.25	11.25	14.50
2. Treasury Bills	4.27	4.27	4.27	4.95	4.95	5.33-6.00	5.33-6.00	11.25-12.00	11.25-12.00	14.50-15.50
3. Treasury Notes	5.00	5.00	5.00	5.00	5.00	10.00	10.00	18.75	18.75	23.00
4. Stocks	6.00-7.50	6.75-7.50	7.00-7.50	7.25-7.75	7.50-8.50	7.50-8.50	12.00-16.00	21.50-27.50	21.50-27.50	24.00-29.00
5. Tax Reserve Certificates	4.00	4.00	4.00	4.00	4.00	6.00	9.50	13.00	13.50	16.50
Source: Bank of Tanzania										

4. Instruments of Monetary Control

As a central bank, BOT has wide powers to control bank credit and currency. These powers have been conferred on BOT by the BOT Act 1965 and the amendments of the Act in 1971 and 1978. In the original statute, BOT was given the powers to use the cash ratio in the case of banks³ and direct control instruments for banks and Specified Financial Institutions (SFI's).⁴ The amendments of the Act, however, gave additional power to use Liquid Asset Ratio (LAR) besides placing certain responsibilities on the BOT in matters relating to financial planning. The BOT has also been given various powers regarding inspection of banks and SFI's. The following excerpts from the BOT publication entitled 'Bank of Tanzania: Its Role and Functions', (1979; pp.45-46) provide details on the provisions contained in the amended Act on different instruments of control of banking and credit in Tanzania.

³ A "bank" is defined as any undertaking carrying on banking business in Tanzania. Banking business in turn is defined as the business of receiving money on current account subject to withdrawal by cheque.

⁴ SFI's: 'Specified Financial Institutions' which according to the definition are credit institutions other than a bank.

The Cash Ratio: The Bank has been empowered by the Act: (i) to ask all banks to keep certain minimum cash balances on deposits with it as reserves against their deposit and all other liabilities in Tanzania except the paid-up capital, reserves, credit balance in the profit and loss account, advances taken from the Bank and any other liabilities as the Bank may exclude by giving a notice in the Gazette; (ii) to prescribe different ratios against different kinds of liabilities; and (iii) to prescribe methods of computing the reserves. However the total of all the balances kept as reserves must not exceed 20 percent of these liabilities, the ratios and methods must be the same for all banks and, whenever any ratio is increased, it can be effective only 30 days after the notice of increase is given to the banks. If any bank fails to maintain the balances as required, the Bank can levy a penalty charge on it. The maximum rate for such a charge is 1/10 of 1% per day of the amount by which the actual balance is less than the balance required.

The Liquid Assets Ratio: All banks are required by the Act to maintain liquid assets equal in value to at least 20% of their deposit and other liabilities. These liquid assets are defined as cash on hand (i.e. with the bank itself), balances with the Bank, unencumbered securities issued or guaranteed by the Government - i.e. those securities which have not been pledged as a security against a loan and any other assets which are specified as liquid assets by the Bank giving a notice in the Gazette.

Direct Control Instruments: (i) Deposit interest rates: The Bank can prescribe the maximum interest rates to be paid on various types of deposits by banks and SFI's or the minimum rates that they must pay. In specifying these rates the Bank can choose whether to apply them to both banks or SFI's or only the banks, or only the SFI's or only to a group of SFI's. Whichever group is chosen the orders apply to all institutions in that group.

(ii) Control and allocation of bank credit: The Bank has been given powers to control the total volume of credit given by banks, its allocation amongst different sectors and the terms and conditions on which it is given.

(iii) Control and allocation of credit from SFI's: In respect of credit given by SFI's the Bank has been given powers similar to those for controlling bank credit.

Financial Planning: The Bank is required to collect all information necessary for the preparation of the annual Finance and Credit Plan, the Foreign Exchange Plan and other monetary plans and to participate in their preparation, implementation and monitoring. It has to submit at least one report every three months to the Minister on the implementation of these plans and/or general developments in the economy. Furthermore, if the Bank finds that in actual practice there are significant deviations from the targets set in the plans, it must recommend to the Government such measures to remedy the situation as it (the Bank) considers desirable.

Power to call for information: The Bank can call from banks and SFI's such information as is necessary for the proper discharge of its functions and responsibilities. The information can be published either whole or in part, but in doing so care must be taken that no information on the financial affairs of any individual customer of the banks or SFI's is published without his written consent.

Power to inspect banks and SFI's: The Bank can ask a bank or an SFI to produce for inspection by persons in its service, books, minutes, accounts, cash, securities, documents, vouchers and other things in the possession of the institution relating to its business. A copy of the Bank's report on the inspection has to be sent to the institution concerned. If in the Bank's opinion the report shows that the business of the institution is conducted in a manner detrimental either to the institution's own interest or the public

interest, the Bank may either ask the institution to take such remedial measures as the Bank directs or appoint, with the Minister's approval, a competent person to advise the institution on the remedial measures to be taken by it and the institution has to comply with the advice.

Penalties for non-compliance: Any bank or SFI which does not carry out any of the instructions given by the Bank under the various powers described above; and every officer of that bank or SFI is liable to a default fine.

5. Recent Experience in Monetary Management

Under the present monetary framework, the targets of the monetary policy are aggregate supply of money and credit. As we have stated earlier (Table 3) both the targets are totally frustrated in practice during 1987-89. The deviations resulting in constant upward revisions in credit growth are not only due to economic environment but also because of the conflicting objectives of the BOT which include maintenance of monetary stability and the promotion of rural and industrial development. Almost all financial institutions in Tanzania hardly perform any important financial intermediation function because they essentially act as fiscal agents of the government. As a result, the only real instrument of monetary policy in Tanzania is the refinancing facility provided by the BOT. Since this facility is available to banks, particularly NBC, at concessional rate, it has been used as a permanent source of funds and a potential source of profits for banks. The rate charged by BOT is lower than the savings and time deposits rates. However, it is felt that banks' failure to mobilize private deposits is a more crucial factor determining their borrowing from the BOT rather than the interest rate differential. The BOT funding of the banks' activities shot up from T.Sh. 7.4 billion or 15% of total banks' liabilities in June 1987 to T.Sh. 59 billion or 42% of liabilities in June 1989. Thus, BOT seems to be exercising hardly any control over the growth of money supply when it concedes almost automatically to the bank's requests for financing. Fueling inflationary forces is an inevitable consequence.

The other instruments of monetary policy like the reserve requirements are not effectively used for controlling the bank credit and hence the money supply. This instrument is rendered ineffective by the practice of the BOT to extend automatic overdraft facilities to the banks defaulting in maintenance of the Cash-Reserve Ratio (CRR). The interest rate policy has also not been used for restraining the growth of credit since it is considered essentially a means to subsidize parastatals and cooperatives. Moreover, cost of credit is not a consideration for the parastatals and cooperatives since government stands guarantee for them under all circumstances. The bank's lending are right now the directed lending with the direct intervention of government without any regard to credit worthiness in terms of credit appraisal, past performance and profitability of the venture. The banks do not behave as profit maximizing business entities. Rather they have been viewing their role as channelling official resources towards priority activities and expect government to stand guarantee for their lending. The official budget of the government does not include such borrowings. However, the net effect of all this is that the annual Finance and Credit Plan and other monetary plans prepared by the BOT lose their operational significance.

6. Problems in Monetary Management

Recent experience of monetary management in Tanzania reveals several problems which are discussed in the following paragraphs:

i) **Instability of the Money Multiplier:** In an economy where the informal financial sector is growing, the money multiplier tends to decline over time. This is because currency is the predominant

medium of transactions there. The liabilities of the non-institutional financial sector do not possess the attributes of money. Therefore, the credit operations in the informal financial sector do not create corresponding flow of deposits. Tanzania has a growing informal financial sector, as a result of which the money multiplier shows a declining trend with instability. (See Table 6). This renders the control of money supply through the monetary base difficult.

<i>Table 6</i>							
Money Multiplier in Tanzania, 1976-1989							
(Millions of T.Shs.)							
Year	Currency in circulation	Banks' Deposits	Other Deposits with BOT	High Powered Money (H)		Money Multiplier	
				Excl. OD	Incl. OD	Excl.OD	Incl.OD
1	2	3	4	5	6	7	8
1) 1976	2214.9	14.7	19.9	2229.6	2249.5	3.12	3.09
2) 1977	2565.0	38.3	19.7	2603.3	2623.0	3.21	3.18
3) 1978	3143.5	12.4	22.4	3155.9	3178.3	2.98	2.96
4) 1979	4278.2	109.9	169.7	4388.1	4557.8	3.15	3.03
5) 1980	5522.9	39.3	25.1	5562.2	5587.3	3.15	3.14
6) 1981	6950.0	186.8	42.5	7136.8	7179.3	2.90	2.88
7) 1982	8381.9	244.8	37.4	8626.7	8664.1	2.87	2.85
8) 1983	8717.3	176.4	37.4	8893.7	8931.1	3.28	3.26
9) 1984	11341.2	230.1	--	11571.3	11571.3	2.61	2.61
10) 1985	13556.6	473.4	7046.5	14030.0	21076.5	2.78	1.85
11) 1986	19451.6	269.5	8139.4	19721.1	27860.5	2.55	1.81
12) 1987	26328.5	1554.4	13468.4	27882.9	41351.3	2.38	1.61
13) 1988	33817.0	2360.1	16017.9	36177.1	52195.0	2.48	1.72
14) 1989 (June)	34980.3	1995.0	16282.0	36975.3	53257.3	2.50	1.73
1) Other Deposits with BOT include deposits of commercial banks corresponding to pipeline remittances abroad and sundry deposits such as BOT staff deposits. 2) Money Multiplier = M_2/H Source: Bank of Tanzania: Economic Bulletin for the Quarter Ended 31st March, 1989 and Economic and Operations Report, 1989.							

ii) **Instability of Demand for Money:** Over the last two decades, demand for money in Tanzania measured in terms of income velocity of narrow money (i.e. GDP/M1) has been found to be unstable. (See Table 7). However, income velocity of broad money (i.e. GDP/M2) has a clear U-shaped curve over the years 1976 to 1988 with the minimum reached in 1982. Its value can, therefore, be predicted statistically by fitting a quadratic time trend. For monetary management, however, more relevant is its interest elasticity the magnitude of which, along with the stability of the demand for money function, can determine the effectiveness of the interest rate policy for achieving monetary targets. The estimate of the interest elasticity of demand for money is not readily available for Tanzania though it is speculated that it is not likely to be very high.

iii) **Structure of Interest Rates:** BOT prescribes annually a detailed structure of deposit and lending rates for all financial institutions in Tanzania. The primary considerations in determination of the interest rate structure have been to channelize subsidies to the parastatals. As a result, real interest rates were negative for quite some time. Of late, when they have been raised significantly so as to turn positive, the response in terms of deposit mobilization and resource reallocation has been negligible. This is largely due to the underdeveloped condition of the financial sector and the system of directed credit in Tanzania. These problems are further aggravated by the fact that the spread of interest rates available to the financial institutions is not adequate in terms of meeting their administrative costs, risks and a margin for profits. The present structure of interest rates does not allow higher rates for higher risk loans, e.g. interest rates for mortgages of T.Sh.5,00,000 or less are 9% p.a. and for small enterprises and agriculture range from 20 to 23% p.a. as against the ranges of loan rates from 20 to 31%, deposit rates from 16% to 29% and government stock rates from 14.5% to 29% p.a.

Income Velocity of Circulation in Tanzania, 1976-1988					
Years	Money Supply in Million T.Shs. in December		GDP at Market prices (M.T.Shs.)	Income Velocity	
	Narrowly defined (M1)	Broadly defined (M2)		GDP/M1	GDP/M2
1) 1976	5331.8	6946.8	24419	4.5799	3.5151
2) 1977	6382.8	8346.7	28868	4.5228	3.4586
3) 1978	6826.9	9396.3	32169	4.7121	3.4236
4) 1979	10435.4	13806.6	36285	3.4771	2.6281
5) 1980	13345.9	17519.9	42118	3.1559	2.4040
6) 1981	15401.2	20694.7	49102	3.1882	2.3727
7) 1982	18323.2	24728.6	58226	3.1777	2.3546
8) 1983	20564.3	29127.4	70509	3.4287	2.4207
9) 1984	20537.1	30218.1	88892	4.3284	2.9417
10)1985	25270.2	38971.0	120621	4.7733	3.0951
11)1986	35809.5	50353.4	159648	4.4583	3.1706
12)1987	47130.6	66442.9	219036	4.6474	3.2966
13)1988	65400.9	89809.1	311478	4.7626	3.4682

Source: Bureau of Statistics and Bank of Tanzania.

iv) **Regulatory and Supervisory Framework:** This framework is provided by the 1960 Banking Ordinance as amended from time to time. However, in Tanzania, the system of relatively informal bank supervision has come into existence since banks are state-owned and are considered to be the fiscal arm of the government. The responsibility and authority of the BOT to intervene in the matters pertaining to

the financial institutions in Tanzania is not well defined because the banking legislation and subsequent Act establishing banks are inconsistent and outdated. The regulatory framework for bank operations is weak, e.g. there are no capital asset ratio requirements and the broadly defined liquidity ratios are hardly enforced.⁵ Loan classification rules, interest accrual rules, lending concentration limits, etc. are far from satisfactory, e.g. NBC's official financial statements show a 61% return on equity in 1988, although it is technically insolvent! This is explained largely in terms of inadequate provisioning and the accrual of interest on non-performing loans in the statements. Similarly, the audit procedures are weak and rules for reporting are not enforced. Securities taken against the loans are not properly documented and the government guarantees are hardly ever collected. On-site inspection of bank branches are rarely carried out perhaps because of understaffing of the Supervision Department of the BOT. All these features of the regulatory and supervisory framework in Tanzania impose serious limitations on the efficacy of the monetary policy in the country.

v) **Financial Insolvency:** The banks face the problems of insolvency due to illiquidity arising out of high arrears with poor prospects of recovery. If all provisions are properly accounted for and prudent capital adequacy ratios are maintained by the banks, their recapitalization needs are estimated to be about T.Sh.62 billion in total which is 22% of GDP, 75% of government expenditures and 109% of government revenues. Some new cash injections into the system have to be considered inevitable which imposes serious constraints on the tight money policy. Among the bank clients, the parastatals, marketing boards and cooperative unions are faced with serious problems of insolvency. The private sector firms are by and large able to withstand the adverse economic environmental changes due to their better management and commercial principles. As against 55% of the loans to the agricultural parastatals and cooperative unions, only 7% of loans to the private sector need provisioning.

vi) **Institutional Weaknesses:** Banking system in Tanzania suffers from institutional mismanagement and inefficiencies. Very simple type of transactions like cheque cashing, transfer of funds, etc. involve very time consuming procedures with the result that, private individuals and companies are forced to minimize their business with banks. Facilities and procedures compel the rural borrowers to come personally all the way to Dar-es-Salaam to finalize arrangements! Staff training is inadequate and technical facilities are deficient. Personnel and salary policies and procedures demotivate the existing staff and create difficulties in hiring new staff. The pool of qualified labour is very limited in Tanzania and is often lured away into the private sector jobs. The salary structure of the bank employees and civil servants vis-a-vis the private sector jobs is a major issue and has much wider implications.

vii) **Lack of Competition:** NBC dominates Tanzania's financial system. Its current accounts are 13 times, deposits/saving accounts are 12 times and loans and overdrafts are 14 times as large as its nearest competitor, CRDB. Term lending is offered by TIB, TDFL and CRDB (for agriculture). THB is the only supplier of mortgages in the formal market in Tanzania. Stock market does not exist and equity finance is not readily available. The informal market is increasing in importance but its reach is limited. Thus, lack of effective competition has made the system weak and inefficient. It also reduces the effectiveness and efficiency of the monetary policy. Right now, the barriers to competition in Tanzanian financial system are: (a) rigidity of interest rate structure, (b) system of directed credit allocation, (c) ownership structure, (d) size of financial institutions, (e) inadequate salary and incentive structure for the staff as well as management, and (f) poor financial conditions of the banks.

⁵ Banks are required to maintain minimum deposits with BOT, not exceeding 20% of liabilities, and to keep liquid assets not less than 20% of liabilities.

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