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Can HIPC Reduce Poverty in Tanzania?

Anders Danielson *

October 2001

Abstract

While growth has increased in Tanzania during the past five or six years, it is still too low to have a visible impact on poverty. Indeed, recent evidence suggests that the amounts of both income and non-income poverty are roughly the same as they were a decade ago. Since debt relief provided under HIPC will free government resources, the initiative will potentially help reduce poverty through larger government expenditures on social sectors.

However, it is unlikely that Tanzania will be able to reach the situation projected in the decision point document: projections are extremely optimistic, and deviations from these are likely to lead to a rapid accumulation of debt, so debt sustainability—as reflected in the debt-to-export ratio—will not be met.

Keywords: Tanzania, HIPC, debt, growth

JEL classification: F34, F35, O19, O55

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1 Introduction

Tanzania in the past six years has convinced donors that it is serious about economic reforms. While growth has increased, it is still too low to have much impact on poverty in an economy where population growth is thought to be between 2.8 and 3 per cent per annum. Indeed, scattered and limited budget surveys from the 1990s suggest increasing poverty levels—both income and non-income—which of course make popular support for continuing reforms difficult to uphold. Preliminary results from the household budget survey (HBS) 2000 suggest, however, that non-income poverty has remained virtually constant.¹ If correct, this means that the claim often made—that the poor in Tanzania were made worse off by economic reforms in the 1990s—can be rejected.

Obviously, the pace at which Tanzania is currently travelling, about 5 per cent per annum in real terms, is far too slow to make a sizeable impact in the short or medium run. Hence the importance of Tanzania reaching the HIPC decision point in April 2000 and possibly the completion point later this calendar year: this could make the difference needed to speed up poverty reduction, both through the impact on growth and the freeing of government resources.

In theory, debt relief reduces poverty through three distinct channels. First, debt relief may increase economic growth. The idea is that debt relief stimulates private (foreign or domestic) investments and possibly international credit ratings. This may increase economic growth, thereby accelerating poverty reduction. Second, relief of government debt releases resources which the government can use for increased spending on, say, social sectors, which is likely to have an immediate impact on non-income poverty. Third, debt relief may be used to change policies. In particular, donors (or creditors) may buy reforms with debt relief, making the economic environment more conducive to growth and private initiative.

While Tanzania has improved its growth rate mainly due to economic reforms, the impact on poverty has been limited essentially because of two factors. First is the pattern of growth, which currently is biased to sectors with weak linkages to other sectors and with limited participation of the poor. Examples include mining and tourism. This implies relatively low poverty elasticities. Second is the institutional structure designed for delivering social services: it is weak, often characterized by inertia and leakages, and hampered by inadequate resources for non-salary recurrent expenditures.

HIPC will certainly help to free government resources: it is likely that it will be more or less fully additional. However, Tanzania's external gap remains, so external borrowing will continue. One implication of this—not always appreciated in the literature—is that the external debt will continue to grow. In fact, the decision point document calculates that the net present value (NPV) of the external debt in 2015 will be three times as large as the NPV of the external debt in 1999, the year before Tanzania started enjoying

¹ The preliminary results from the household budget survey have been published and show some inconsistency with regard to income poverty. Most likely this is because of seasonality: only three months' have been covered so far. Non-income poverty indicators are less likely to be sensitive to seasons and show some improvement (or at least no deterioration) when compared to the 1991/92 HBS. Policy conclusions from the available results are very cautious and most analysts recommend adopting a wait-and-see attitude in expectations of the final results, due in early 2002.

HIPC-relief. The key assumption, then, is fast economic growth—if rapid enough, the large debt in 2015 will be sustainable even though it will be much larger in dollar terms. This, in turn, leads to the question of how new loans will be used; by whom, in what sector and for what purpose?

The main argument of this paper is that Tanzania is not likely to reach the projections for growth, exports or poverty reductions as set out in various policy documents—including the PRGF (i.e., the agreement with the IMF, and the most important policy document), the decision point document (DPD) and the poverty reduction strategy paper (PRSP)—so the situation, say, in 2010 is likely be less bright that projected there. The key question is of course: what happens then? The purpose of the paper is to provide some foundation for asking that question.

In section 2, I briefly describe aspects of Tanzania’s progress to date, including the multilateral debt fund, which in Tanzania has worked very much (although with fewer conditionalities, and no debt stock reductions) as the HIPC. Section 3 describes the scenario projected in the two core documents, the decision point document and the PRSP, and confronts this with historical performance. In addition, some calculations on a ‘what-if’ basis are presented. Section 4 concludes.

2 Growth, debt and the HIPC Initiative

2.1 The evolution of the debt in the 1990s

Tanzania has followed the same pattern in the 1990s as many other highly indebted African countries—to increasingly rely on concessional finance. Coupled with five successful (in the sense that relief and/or reschedulings were agreed) Paris Club negotiations, this has had several implications for the evolution of Tanzania’s external debt. As Table 1 shows, debt concessionality has increased, as has the share of multilateral debt (the latter largely because bilateral debt relief) and the conditions of new commitments have improved (at least from 1993) on all four of the conventional indicators of softness.

In fact, Table 1 suggests 1993 to be something of a watershed in Tanzania’s external debt policy and position. Most trends change drastically around that year. Both the debt ratio and the debt service ratio start to decline, net transfers on debt become positive and interest payments (measured in dollars) start to decline. Admittedly, some indicators change later. Thus, for instance, total disbursements decline from 1990 to 1996 when the trend is reversed. Still, 1993 is a watershed, because of two reasons: it was the year when the government of Tanzania (GOT) formulated its first external debt strategy and it was the year when the forex regime was changed and the currency started to be traded in twice-weekly auctions. Prior to that, private firms or parastatals that wished to service their external debt did so by paying debt service in local currency to the Bank of Tanzania (BoT), but the BoT could not service the debt because of lack of foreign exchange. So the period before 1993 saw increases not only in accumulation of arrears, but also in the proportion of the debt guaranteed by the government as the BoT in effect had taken over the debt by accepting debt service in local currency.

Table 1
Debt and debt servicing 1990-99, Selected years
(US\$ million except as indicated)

	1990	1993	1996	1999
Long-term debt (US\$ million)	5,625	5,671	6,127	6,628
Flows on debt				
Disbursements	334	241	244	338
Principal repayments	116	106	168	123
Net flows on debt	233	111	145	225
Interest payments	62	116	104	71
Net transfers on debt	171	-5	41	154
Arrears				
Principal arrears	818	1,134	1,608	1,171
o/w: Official	629	905	1 324	998
Interest arrears	405	708	901	870
o/w: Official	280	568	726	760
Debt indicators				
Debt ratio (%)	171	188	126	91
Debt service ratio (%)	33	29	19	16
Short-term debt (%)	8	12	14	13
Concessional debt (%)	54	60	61	73
Multilateral debt (%)	32	37	39	41
Average terms of new commitments				
Interest (%)	1.2	1.9	1.3	1.3
Maturity (years)	34.7	35.7	35.4	40.1
Grace period (years)	9.2	8.7	9.2	10.3
Grant element (%)	71.8	68.0	72.7	77.6

Source: World Bank (2001; Vol. 2).

Table 2
Use of external debt
US\$ million and per cent

	1994	1995	1996	1997	1998	1999
BOP support	27.3	25.5	23.1	23.2	23.0	18.7
Transport	19.2	19.5	20.3	20.3	20.3	21.5
Agriculture	14.7	14.6	14.4	14.2	14.6	15.6
Energy and mining	10.0	10.9	11.3	12.3	12.5	13.2
Industries	9.5	9.2	8.6	8.2	7.7	7.8
Social welfare	3.2	3.7	3.9	4.3	4.4	4.9
Finance	3.1	2.9	2.8	2.6	3.3	3.7
Others	11.8	12.3	14.2	13.7	12.9	13.5

Source: Danielson and Mjema (2001; Table 10).

Table 2 depicts the use of loans by sector. The bulk is used in infrastructure—most of what is designated ‘agriculture’ in the table is, in reality, investments in rural roads, such as energy and transportation. In addition, between a quarter and a fifth of all loans are for balance of payment support. This includes all IMF credits and all programme loans from the World Bank. It is noticeable, however, that over half of all external loans are *not* being used for transport, agriculture and mining, the sectors that are often singled out as growth bottle-necks. This is a point to which I shall return below.

2.2 The role of the MDF/PRBS

While Tanzania has had a large and growing external debt for a long time, the relation between debt and debt servicing on the one hand and the ability to fight poverty on the other became clearer after 1995 when Benjamin Mkapa was elected president in the first multi-party elections ever. This event motivated, after some years of observation, Bigsten and Danielson (2001) to ask whether the ugly duckling would finally grow up. Mkapa emerged as a keen and determined reformer, sometimes even outdoing the international financial institutions (IFIs). Consequently, as honouring debt contracts was very important in Mkapa’s strategy, arrears were paid at an increasing rate and no new arrears (with one exception; see below) were accumulated. In addition, implementation of the cash budget in 1996 made the connection even clearer. The system, implemented to curb inflation and install some fiscal discipline into line ministries, made a clear list of priorities of expenditures. Debt servicing came first, followed by payment of salaries, and then everything else. Since non-income poverty is partly measured through access to education and health facilities, the cash budget initially decreased budgeted amounts of non-salary items to these sectors. Funds for maintenance, textbooks, medications and so on fell sharply. In addition, counterpart funds—the resources the government puts into donor-funded projects in order to increase ‘ownership’—became virtually unavailable, so implementation of donor-funded projects fell drastically. The servicing of debt, and in particular multilateral debt, came into focus. Not only was it observed that this was the only type of debt on which the government could not default without terribly harmful consequences for future external financing (assuming that the GOT would have reneged on its debt strategy), but also that debt servicing consumed sizeable amounts of the government’s resources. Interest payments on external loans accounted in 1996 for almost 11 per cent of total government expenditures.

This is the background for the multilateral debt fund (MDF). While bilateral donors had been providing debt relief through the 5th dimension since the late 1980s, there had been no coordinated efforts and the MDF can be seen as an attempt to create a mechanism for coordination and policy dialogue.

The construction of the MDF was very simple. Donors paid forex into an account at the Bank of Tanzania. The government withdrew funds as needed, i.e., as multilateral debts fell due. The condition stipulated by donors was that the government agreed to protect priority sectors, in the sense that these sectors should receive full funding as allocated in the budget.² Progress, including pledges, disbursement of funds into the MDF and

² It deserves to be pointed out, however, that there is no guarantee that all local currency funds released through the MDF are being used for social sectors. While some documents (notably the MDF/PRBS *Technical Note*) suggest that all local currency resources should be used for priority sectors, no such guarantees can be made: due to fungibility, it is impossible to trace resources and only broad conditions (as those agreed) can be binding: indeed, as long as total budgetary allocations to social sectors exceed the resources put in by donors, no ear-marking is possible.

withdrawals, were reviewed in quarterly meetings between the government and donors; this was also an opportunity for policy dialogue.

The system had several advantages. First, it was simple and thus transparent and relatively easy to monitor. Second, triggers were built in. Funds were earmarked for multilateral debt servicing and thus the government could withdraw funds only to the extent that it was required by the debt structure. Third, monitoring was inexpensive as the annual *Public Expenditure Review* exercise recorded budgetary allocations to sectors and did some expenditure tracking. Fourth, the system encouraged cooperation, both between donors and between donors and the government. While the government decides annually on priority sectors, donors have reserved the right to select sectors from those prioritized by the government. Consequently, while government priorities govern the allocation of resources, donor priorities are also heeded. Fifth, as disbursement was not linked to activities by the recipient—i.e., money could ‘rest’ in the account—no incentives were created for donors to circumvent the government in order to make disbursements timely to their own schedule.

When Tanzania reached the decision point under the HIPC Initiative in April 2000, it started to receive interim relief (i.e., relief on flows, but no stock reductions) and the remaining multilateral debt service was not sufficient to absorb MDF funds. The MDF was then transformed into a facility for budgetary support, the poverty reduction budget support facility (PRBS), that was set up on terms similar to the MDF. The most important difference between the MDF and the PRBS is that in the latter there is no built-in mechanism that triggers government use of the funds, so funds are used on an ‘as-needed’ basis instead. The condition of protecting social sectors and the quarterly meetings remain, however.

Table 3 shows actual allocations to social sectors under the MDF, both as a percentage of budgeted amounts and in millions of Shillings (in constant prices). Allocations to personal emoluments (PE) have been above target since early 1999 and with occasional blips so have allocations to other charges (OC). Consequently, the MDF/PRBS is likely to have contributed to larger actual allocations for social sectors, particularly for other charges. Under the cash budget system, other charges are treated as a residual, and even if OC allocations to priority sector are given priority *within* other charges, fluctuations and uncertainty in government income, both with regard to tax revenue and external funds, made planning difficult, and all sectors experienced frequent shortfalls of funds prior to the MDF.

However, things are not necessarily as bright as conventionally assumed. Table 4 shows allocations to education, broken down by type of expenditure and type of education. The total budget for all types of education declined between 1998 and 1999 and—in particular, since this has been a concern among donors and government alike—the expenditure of other charges per student declines, or at least shows violent swings for the entire period for which data are available.

Table 3
Allocations to social sectors in per cent of budgeted amounts
and in millions of Shillings in December 1994 prices

Year-quarter	Per cent of budgeted amounts		Actual allocations, millions of TSh	
	Personal emoluments	Other charges	Personal emoluments	Other charges
1998-IV	97	156	5,205	4,943
1999-I	98	132	4,779	3,664
1999-II	101	102	4,974	2,838
1999-III	133	101	6,824	3,864
1999-IV	133	61	6,759	2,277
2000-I	132	116	6,145	3,993
2000-II	132	122	6,192	4,248
2000-III	104	99	6,751	5,195
2000-IV	109	104	7,011	5,298
2001-I	108	109	6,849	5,557

Source: Reports prepared for the quarterly MDF/PRBS meetings; CPI deflator from BoT (2001: Table 7).

Table 4
The education budget, 1996-99
in December 1994 prices

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

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

2.3 Growth and poverty reduction

Despite positive growth in per capita incomes in the past years, several observers report deteriorating social indicators and possibly increasing levels of poverty in the 1990s. It deserves to be noted, however, that most observations are projections based on household surveys conducted in 1991 and 1993. Less comprehensive studies that cover more recent periods are available and they tend to confirm the trends projected from the earlier studies.³

In any case, it seems established that social indicators have deteriorated in the 1990s; in particular, primary school enrolment has fallen in the 1990s; infant and under-five mortality rates show a slight increase; and evidence of child malnutrition (both stunting and wasting) show no improvement over the past decade.⁴ The poverty reduction strategy paper, generated by the government in response to HIPC decision point conditions, suggests that poverty appears to have decreased during 1983-91 and increased in the following decade. Moreover, poverty in Tanzania can be characterized in five dimensions (PRSP: 7-8):

- Poverty is largely a rural phenomenon;
- The poor are concentrated in subsistence agriculture;
- Urban poverty is wide-spread and increasing;
- Vulnerable groups include the young, the old and large families; and
- While female-headed households do not have lower average incomes than male-headed, women are generally poorer than men.

These observations lead to two reflections. First, since poverty is a rural phenomenon⁵ it has to be fought in rural areas in general and in particular in subsistence agriculture. Second, since poverty appears to have increased in the 1990s—a period with positive per capita growth rates—the links between growth and poverty reduction are more complex than conventionally assumed.

The two reflections are interrelated. If poverty is a rural phenomenon and at the same time poverty has increased while the economy as a whole has grown, it means that growth has been concentrated in sectors or geographical areas where the poor do not

³ Sarris and van der Brink (1993); World Bank (1993), World Bank (1996). Later and less comprehensive studies include Narayan (1997) and two (unpublished) studies carried out by REPOA, one using the same format at the 1991 household budget survey covering households in rural Ruvuma, Dodoma and Mwanza, and one survey covering peri-urban households around Dar es Salaam. The 1991 household budget survey and the 1993 Human Resources Development Survey are extensively discussed in TAKWIMU (2000). The state of knowledge of poverty in Tanzania per 1996 is outlined in Danielson (1996).

⁴ One major reason for deteriorating social indicators is, of course, the cash budget coupled with limited success in raising additional revenue; another one is delays in protecting social sector budget allocations.

⁵ While urban poverty is wide-spread and increasing, it is likely to be a consequence of deteriorating conditions in rural areas and consequently can be expected to decline as poverty is successfully fought in rural areas.

benefit. In other words, economic growth is an unequal process and it would seem likely that an initial increase in income inequality is to be expected as a consequence of economic growth.⁶

Obviously, the poverty alleviation impact of a certain rate of growth will be different depending on the pattern of growth. It depends both on how the trickle-down process works and on how income distribution is affected. In addition, to properly measure the poverty alleviation impact of growth, we need several successive budget surveys which ideally should be designed so as to make results commensurable. As noted above, both major surveys are from the early 1990s and likely to be too close in time to allow for dynamic inferences. In addition, their design is dissimilar.

However, it is possible to calculate the poverty impact of growth from the available information, if only under rather restrictive assumptions. This can be used as a baseline result, and the impact of various possible scenarios may be calculated. Table 5 provides information on the poverty elasticities for the two major budget surveys disaggregated by geographical region. It is important to keep in mind that these elasticities—i.e., the percentage change in poverty (the population below a poverty threshold) when mean income increases by one per cent—are calculated for unchanged income inequality. Typically, this is not a realistic assumption and, indeed, it was argued above that in Tanzania poverty has increased in the 1990s precisely because growth has increased inequalities. Hence, the results in the table should be interpreted as a base for comparing simulations, nothing else.

Note that elasticities have been calculated against two different poverty thresholds—food poverty and basic needs poverty. The latter includes, apart from food, non-food items regarded as necessities. These include consumer durables, health and education, and other non-durables (details are in TAKWIMU 2000: Ch. 4). The basic needs poverty line is roughly 20-25 percent higher than the food poverty line.

Table 5
Poverty elasticities in Tanzania

	Stratum			
	Dar es Salaam	Other urban	Rural	Mainland
Household Budget Survey, 1991				
Food poverty	-3.90	-1.05	-1.18	-1.46
Basic needs poverty	-2.66	-0.84	-0.75	-0.69
Human Resource Development Survey, 1993				
Food poverty	-9.72	-5.29	-3.83	-3.14
Basic needs poverty	-2.56	-1.14	-2.81	-1.45

Source: TAKWIMU (2000: Table 50).

⁶ Note that this does not have anything to do with the celebrated ‘Kuznets curve’, i.e., the observation that a cross-country plot of some measure of inequality and per capita incomes will look like a U, turned up-side down. Kuznets’ study was on a sample of countries and it has proved difficult to generalize this observation (which is shaky as it is) to a time-series setting.

Although the figures in Table 5 are surrounded by strong assumptions, several interesting features stand out. First, the results differ substantially between the two surveys. This is mainly due to differences in the expenditure distributions; generally, the 1991 Household Budget Survey is thought to provide the more realistic picture (i.e., results in later less comprehensive surveys are easier to reconcile with these).

Second, the impact of growth on poverty is different in different parts of the country. It is not surprising, for instance, to find that the elasticities are substantially higher for Dar es Salaam than for the rest of the country. What is a bit surprising, however, is that the rural elasticity in the 1991 HBS is higher than that for other urban areas. Generally, one would think that partial poverty elasticities (as the ones in Table 5) are higher (in absolute terms) in urban areas.

Third, while reliable poverty elasticities are not abundantly available for African countries, those that do exist suggest that the poverty impact of growth in Tanzania (outside Dar es Salaam) is relatively low.⁷ This means that a relatively high rate of growth is required to achieve a given reduction of poverty. This observation reinforces the argument made above that high economic growth in Tanzania is absolutely necessary to reduce poverty in a sustained manner.

However, as was noted above, the elasticities in Table 5 are valid only if income distribution remain unchanged during growth. This is not realistic. Growth is by its nature an uneven process, favouring certain sectors or regions (or groups of people) over others. To take that into account, it is possible to calculate the rate of growth required to achieve the objective of the national poverty eradication plan (on which the projections in the poverty reduction strategy paper appear to be based): to halve poverty by the year 2015. Using the results from the 1991 Household Budget Survey (which appear to be the most reliable), we compare the baseline in Table 5 to two different scenarios—one in which inequality increased, from 1991 and onwards, by one per cent per annum and one in which inequality decreased by one per cent per annum. In both cases, inequality is measured by the Gini coefficient for which 0 represents complete equality and 1 complete inequality. The results are in Table 6.

The rationale for choosing these two scenarios is the following. Currently growth in Tanzania is geared towards mining and tourism. Both these sectors are geographically concentrated with limited linkages to the rest of the economy. If growth continues to be driven by these sectors, an increase in inequality is likely to follow. If, on the other hand, growth can be led by small-holder agriculture, it is more likely to decrease inequality: the rural areas in general, and subsistence agriculture in particular, contain the majority of the poor. If they experience a disproportional growth of income, the Gini coefficient is likely to fall.

The results are simulations and are thus indicative, and not to be interpreted to the letter. In any case, the table gives an idea of the rates of growth necessary under various assumptions. In addition, the current pattern of growth in Tanzania is perhaps such that the scenario in which inequality increases is the most realistic and, finally, it should be noted that required growth is very sensitive to what happens to inequality. In other words, should inequality increase more than one per cent (say, two per cent per annum),

⁷ A selective survey of the literature is in Danielson (2001).

required growth to halve basic needs poverty increases to over 9 per cent per annum in real terms.

Table 6
Required annual real GDP growth to halve poverty by 2015,
three scenarios

	Food poverty	Basic needs poverty
One % increase in inequality p.a.	6.5%	8.2%
No change in inequality	4.9%	7.3%
One % decrease in inequality p.a.	3.3%	6.3%

Note: Calculations are based on the results from the 1991 Household Budget Survey. Inequality is measured as the Gini coefficient. Population is estimated to grow at 2.8 % per annum.

Source: TAKWIMU (2000: Table 53).

3 Debt and debt relief under HIPC

3.1 Flow of debt under HIPC

While multilateral debt relief will lead to a substantial reduction of the existing debt stock, Tanzania's external financing gap remains, so external borrowing will continue. Table 7 shows the impact of HIPC on debt servicing. In the current fiscal year, for instance, the relief provided under the HIPC Initiative reduces debt servicing by almost 55 per cent. For instance, the US\$ 169 million in debt service relief provided in 2001/02, corresponds to about 11 per cent of total government revenue in 2000 and is more than the entire budget for the Ministry of Education.⁸

Note, however, from the table that the line 'official bilateral' included debt owed to non-Paris Club countries, e.g., Saudi Arabia and Kuwait. This debt is unlikely to be serviced at the rate shown in the table. In fact, Tanzania has consistently accumulated arrears on its non-Paris Club debt, and will continue to do so, the only exception to that rule being a case in which those creditor countries offer new loans on attractive (i.e., IDA) terms in return for debt servicing.⁹ This leads to an increase in the short-term debt stock, but the fact that non-payment of that debt is a conscious strategy has to be taken into account when evaluating the size and evolution of the total debt stock.

Note also that while the multilateral debt accounts for the major part when it comes to repayment of principal, the remaining bilateral, Paris Club debt accounts for the lion's share regarding interest payments. This, of course, is a reflection of the fact that multilateral debt (from IMF, IDA and ADF) is provided at lower interest rate than most bilateral debt. The fact that multilateral principal repayment is more dominant than bilateral principal repayment reflects the fact that the HIPC Initiative entails a large stock reduction of bilateral debt.

⁸ The Ministry of Education budget in 2000 was about TSh 120 billion, some US\$ 135 million. Note, however, that this cannot be used to gauge total spending on education: substantial amounts are channelled through the Ministry of Local Government. Nevertheless, the example shows the resources freed through debt relief are significant in relation to the government budget.

⁹ Interview with Peter Noni, Director of Economic Policy, Bank of Tanzania, 29 June 2001.

Note finally that interest payment on new debt, i.e., debt contracted after the commencement of HIPC in Tanzania, increases rapidly as share of total interest payments, reaching one-quarter in 2004/05. This reflects the rapid accumulation of new debt.

Some more details are in Table 8. The net present value of the debt that existed in 1999 declines from about US\$ 1.7 billion in 1999/00 to an average of about US\$ 1 billion in 2010-18. This means that HIPC relief is not ‘front-loaded’—most of the benefits are not delivered early in the process and therefore it takes some years before there is a significant reduction of the stock of ‘old’ debt. At the same time, new debt will be accumulated. Given relatively generous assumptions on flows of grant aid, foreign direct investments and export proceeds, the decision point document calculates this to increase from US\$ 200 million in 1999/00 to an average of almost US\$ 5 billion in 2010/18 (all figures in net present value terms). In other words, Tanzania’s total debt in 2010 will be about three times as large as it was prior to the country getting HIPC relief.

The reason why this development is consistent with a move towards debt sustainability is, of course, the assumption that the economy’s ability to carry a debt will grow over time. Consequently, the assumption is that even though Tanzania in 1999/00 was unable to carry a US\$ 2 billion debt on its shoulders, the economy will, some fifteen years later, be able to carry a debt three times as heavy. Focus, then, is on growth projections.

Table 7
Debt servicing after HIPC relief, US\$ million

	1999/00 ^(a)	2000/01	2001/02	2002/03	2003/04	2004/05
Total debt service ^(b)	235.5	153.3	141.8	143.8	148.5	158.2
Principal	167.4	97.5	82.3	80.4	81.4	81.4
Multilateral	83.2	47.8	30.2	25.9	42.2	53.9
Official bilateral	79.9	43	45.5	47.9	36.3	27.4
<i>o/w: Paris club</i>	61.4	23.1	28.2	31	24.6	23.3
Commercial	4.3	6.7	6.7	6.7	3.4	0
Interest	66.2	56.3	63.4	66.6	70.4	74.5
Multilateral	19.9	13.3	10.3	8.6	9.1	9.1
Official bilateral	43.4	33.4	38.8	37.3	35.9	35.1
<i>o/w: Paris club</i>	39.5	27.3	30.2	32.4	31.6	30.9
Commercial	1.0	1.5	1.1	0.7	0.4	0.4
New debt	3.1	8	12.3	16.8	21.2	25.5
Total debt service ^(c)	295	317.8	310.9	362.7	258.8	259
Debt service ratio ^(c)	24.8	24.6	20.9	25.6	13.7	12.5
Debt service ratio ^(b)	19.8	11.9	9.5	8.4	7.8	7.3

Notes: ^(a) Estimate

^(b) After HIPC relief

^(c) Before HIPC relief

Source: IMF/IDA (2000: Table 12).

Table 8
Net present value (NPV) of external debt after rescheduling, selected years
(US\$ million unless otherwise indicated)

	1999/00	2002/03	2005/06	Averages	
				1999/09	2010/18
NPV of total debt	1,876.9	2,616.6	3,279.0	2,943.5	5,885.4
NPV of old debt	1,674.5	1,570.7	1,510.0	1,553.2	1,041.6
NPV of new debt	202.4	959.0	1,768.7	1,390.5	4,843.8
Debt-to-export ^(a)	165.4	174.9	154.8	163.3	141.8

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

Source: IMF/IDA (2000: 32).

3.2 History and projections

The debt sustainability analysis (DSA) in the decision point document contains a number of explicit assumptions used to derive the conclusion of Tanzania's move towards a sustainable position under the HIPC Initiative. For the argument of this paper, three assumptions are of particular relevance:

- Real GDP growth increases to 5.5 per cent in 2001, to 6 per cent in 2002 and remains there throughout the period;
- Real proceeds from traditional exports grow at 4-6% per annum throughout the period;
- The export-to-GDP ratio increases from 13.6 per cent in 1999 to 18 per cent in 2015.

While it is rather difficult to reconcile the figures in the decision point document with those officially published by Tanzanian authorities, it is nevertheless possible to make some interesting inferences. Using IMF data, Table 9 shows the historical performance of GDP and exports. It suggests that there is little in recent history to motivate such projections. Moreover, some of the implied projections in the DSA appear extremely unrealistic, particularly in view of the fact that they relate to the average annual growth rate during an extended period of time. Here is an example.

Table 9
GDP and exports; real growth rates except as indicated

	1995	1996	1997	1998	1999	HIPC projection ^(a)
GDP	3.6	4.2	3.3	4.0	4.7	6.0
GNFS exports	17.4	14.1	-22.8	-11.8	0.1	13-18
<i>o/w</i> : traditional	12.8	0.5	-2.5	-23.0	-9.4	4-6
non-traditional	24.4	33.3	-44.6	9.4	12.6	21-27
Export ratio ^(b)	22.6	20.9	16.0	15.6	15.9	18.0

Notes: ^(a) Annual averages, 2000-2018.

^(b) Total exports as percentage of GDP.

Source: IMF (2000: Tables 1, 7 and 18); last column from IMF/IDA (2000).

According to BoT (2000: Table 4.4), traditional exports in 1999 were about 51 per cent of total exports; non-traditional exports—petroleum products, manufactures, and minerals—accounted for 49 per cent. With a GDP in 1999 of TSh 4,322 billion, total export proceeds (given the export ratio in the DSA) were TSh 587 billion. Of this, proceeds from traditional export amounted to about TSh 300 billion. Now, the projections in the DSA imply that (in real prices) GDP in 2015 will be some TSh 10,980 billion and traditional exports (assuming annual growth of five per cent) TSh 658 billion. However, to reach an export-to-GDP of 18 per cent, total exports would have to be TSh 1,976 billion, so non-traditional exports would have to be TSh 1,318 billion, *which represents a growth rate, between 2000 and 2018, of over 24 per cent per annum.*¹⁰

The DSA projections give the minimum growth rates compatible with a sustainable debt position in 2018; a short-fall in GDP growth implies a higher debt ratio and lower-than-projected export growth implies either slower growth (through import compression) or a more rapid accumulation of debt (if the external gap is financed through loans).

One such example is provided in the analysis by the US General Accounting Office (GAO 2000). Here, the decision point DSA calculations are taken as the base-case, and compared to situations in which export proceeds fall short of projections with one and two percentage points, respectively. In addition, GAO (2000: 54-6) considers two scenarios: one in which the increased external gap is financed by loans (on IDA terms) and grants in equal proportions and one in which the entire increase in the external gap is financed through increased borrowing (again on IDA terms). Table 10 shows the results.

Consequently, if projections are not realized, the country will probably not be able to reach debt sustainability at the end of the HIPC period. It deserves to be pointed out that failure to reach sustainability is not necessarily a consequence of inappropriate policies; unrealistic projections are another plausible cause. One interesting question in this regard, of course, is, what happens if the country fails to reach sustainability? The HIPC Initiative is supposed to be a ‘final exit’—a one-time opportunity for getting rid of the debt. However, unless very optimistic projections are met, Tanzania may find itself in a new debt trap a few decades into the new millennium, despite massive reductions in the now existing debt. It is noticeable that only little thought appears to have been devoted to this issue, at least in the officially available documentation.

Table 10
NPV debt-to-export ratio in 2017/18 under alternative assumptions

	Loans and grants	Loans
Base case	137	137
One percentage point fall in export proceeds	200	236
Two percentage points fall in export proceeds	280	358

Note: The base case corresponds to the IMF/IDA debt sustainability analysis. A sustainable debt is defined as a NPV of debt-to-exports to no more than 150 per cent.

Source: GAO (2000: Table 4), Table 4.

¹⁰ The required average annual rate of growth on non-traditional exports varies, of course, with the projected growth rate of traditional exports: from 21 per cent per annum when traditional exports grow at six per cent per annum to 27 per cent when the growth rate of traditional exports is four per cent.

4 Concluding remarks

While in theory debt reduction may affect the economy favourably in three different ways, the HIPC Initiative seems most promising when it comes to the flow effect—the impact on social spending of the freeing of government resources. As for policies, the high dependence of Tanzania on external resources and the determination of the current president seem to suggest that policy reversals are not a major threat to the current situation. And as for the stock effect—that debt reduction can increase growth through increased private investments, improved credit ratings or other channels—these are not given much prominence in the HIPC strategy.

But still growth is very important—not as an outcome of the HIPC process but rather as an input: without rapid economic growth, Tanzania will not be able to reach a sustainable debt position, given the size of the debt reductions and the projected future need of international borrowing. It is an open question how this growth—at the range of 8-9 per cent per annum for more than a decade—is going to be accomplished.

The major message of this paper is that macroeconomic projections may be useful—but only if they are based on a realistic assessment of the constraints facing the economy. This is probably not the case for the debt sustainability analysis of Tanzania, and the issue to be addressed is how growth can be speeded up and the acute problem of poverty speedily attacked.

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