THE PRESENT CRISIS OF THE TANZANIAN ECONOMY: NOTES ON THE ECONOMICS AND POLITICS OF DEVALUATION *(1)*

By

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INTRODUCTION

On returning to Tanzania exactly after one year, I have been struck by three phenomena:

First, much of the economic policy debate within the Government and the international community in Dar-es-Salaam is amazingly enough still centered around the question of devaluation. Essentially the same kinds of arguments are being rehearsed now as they were 12 months back.

Secondly, there is a widespread impression among the aid agencies, and particularly among some of the friendly donor countries here that the Government of Tanzania is deeply divided on this issue, and that the opposition to devaluation comes mainly from the President. It is believed that all the technical economic arguments – and the 'technocrats' in the Government and among the ministers – are in favour of a devaluation. The President's stand is regarded as simply 'political' and without economic logic.

Thirdly, as far as the economy itself – the 'patient' – is concerned, I am impressed by the fact that although production and capacity utilization are lower now than twelve months back, the economy has not actually collapsed. Despite dire forewarnings to the contrary, and despite its extremely serious difficulties, it continues to function. The basic economic organisation is intact. Inflation continues to be a major problem, but it is running at much the same rate as a year ago. The inflation rate has not visibly accelerated and there is no evidence that Tanzania is heading towards Latin American rates of inflation.

I am most disturbed by the first two points and the following reflections are prompted by them. As a professional economist, I think that there are powerful and legitimate arguments against a very large Tanzanian devaluation of the kind being proposed by the International Monetary Fund (IMF) *(2)*. The view that such a step, instead of improving the economy, may make the situation much worse is not without foundation in serious scientific analysis or economic experience. I hope that the friends of Tanzania will consider this question on its merits and not simply assume that all the economic wisdom lies on the side of these two international organisations. Most observers will agree that in a turbulent continent, Tanzania, notwithstanding its many shortcomings, is still one of the few oasis. It will be tragic if as a result of the well-meaning and seemingly easy economic policy course of devaluation – changing only a single price – urged on it by some of its friends, the country is destabilised.

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The main purpose of this paper is to analyse the nature of the disequilibria which the Tanzanian economy faces and to examine whether or not a large devaluation of the currency will provide a suitable solution for the country's economic difficulties. Such a discussion is also of much wider interest in the present international context. The world economic crisis of the last four years which has adversely affected most countries, both developing and developed, has had particularly devastating consequences for the African economies *(3)*. A large number of the latter have had to seek assistance and conclude conditionality agreements with the IMF to cope with the severe balance of payment problems which have resulted from the crisis. Invariably the Fund's adjustment programmes for the African countries have included *inter alia* large devaluations of their domestic currencies.

An analysis of the question of devaluation for an economy like Tanzania's – which is essentially an exporter of commodities (coffee, cotton etc...) and an importer of manufactures – should also be relevant to other African countries whose economic structures are broadly similar.

THE STRUCTURAL DISEQUILIBRIUM OF THE TANZANIAN ECONOMY

The central problem of the Tanzanian economy today is external disequilibrium, the imbalance on external payments. All the other disequilibria which the economy manifests in budgetary balance, in capacity underutilisation, in shortages of goods, in inflation – are all directly linked to and stem from the external disequilibrium. It requires no great act of imagination to see that if the external payments constraint was relaxed, increased imports would permit higher levels of agricultural and industrial production. This in turn will reduce prices and at the same time restore budgetary balance as the government revenues depend heavily on sales and excise taxes which will benefit from higher levels of economic activity.

However, the external disequilibrium of the economy is not simply a financial problem. It is basically one of the imbalance in the structure of production of the economy, and it is also a long-term problem. In a previous paper *(4)*, I defined this notion in the following way:

> *«The Tanzanian economy is in long-term structural disequilibrium in in the sense that the productive economy is unable to generate sufficient exports to pay for the required imports (i) at a socially desired rate of economic growth, (ii) at a socially acceptable exchange rate and (iii) at a normal level of current account deficit».*

The qualifications (i) to (iii) in the above definition are clearly important. At a low enough growth rate (e.g. large negative growth), the economy may be in balance of payments equilibrium, but that is not what is socially desired. Similarly, it is arguable that at a low enough exchange rate for the shilling, the current account might eventually balance; however, even if it is true, this may generate a socially unacceptable rate of inflation

or a distribution of income. As for the 'normal level of current account deficit', this is best illustrated by reference to table 1, which portrays the nature and dimensions of Tanzania's long-term structural disequilibrium.

The table shows that Tanzania, as a cash crop exporting economy, traditionally enjoyed a surplus on its trade in goods and services. This situation continued until towards the end of 1960's when Tanzania embarked on a purposive programme of economic development. This led to trade deficits which were financed by foreign borrowing and external aid. The deficits in fact reflected the surplus accruing on capital account due to foreign aid provided by donor countries for infrastructural, industrial and other developments.

Table I – The Tanzanian Balance of Payments: Trade Balance in Goods and Services: 1965–1980

1 Year	2 Merchandise Trade Exports (T.sh.m)	3 Imports (T.sh.m)	4 Balance (T.sh.m)	5 Balance on services	6 Col. 4 as % of current GDP	7 (Col.4 ÷ Col.5) as % of current GDP
1965	1,475.9	1,410.0	65.9	–	1.07	–
1966	1,889.9	1,694.9	195.0	–72.9	2.77	1.73
1967	1,796.9	1,637.6	159.0	–	2.15	–
1968	1,719.0	1,833.7	–114.7	–	– 1.45	–
1969	1,756.5	1,710.1	46.4	177.3	.55	2.67
1970	1,797.2	2,274.2	–477.0	225.9	– 5.21	– 2.74
1971	1,913.1	2,725.6	–812.5	208.8	– 8.11	– 6.03
1972	2,312.7	2,882.9	–570.2	256.0	– 9.99	– 3.7
1973	2,581.1	3,478.9	–897.7	190.1	– 6.85	– 5.4
1974	2,878.1	5,377.0	–2,498.9	181.7	–15.6	–14.49
1975	2,764.0	5,709.4	–2,945.4	480.9	–15.49	–12.96
1976	4,108.0	5,349.5	–1,241.5	466.4	– 5.3	– 3.3
1977	4,464.2	6,161.3	–1,697.1	155.7	– 5.8	– 5.2
1978	3,670.6	8,797.7	–5,127.1	210.1	–15.3	–14.72
1979	4,484.3	9,073.2	–4,588.9	306.0	–12.2	–11.37
1980	4,702.2	10,261.9	–5,559.7	156.1	–15.6	–15.1

Source: Bank of Tanzania, *Economic Bulletin*, various issues.

During the early 1970's, the 'normal' level of current account deficit was on average approximately 5 per cent of the current G.D.P., which was easily financed by external sources. However, the deficit increased sharply during 1974–75 (due primarily to drought and a change in the terms of trade). It reverted back to its normal and financable level in 1976 and 1977.

The long term structural disequilibrium of the economy lies in the fact that since 1977, the trade deficit, as a proportion of G.D.P., has been at an abnormally high level – in the low teens. Restoration of equilibrium requires that the productive structure of the economy be transformed in such a way that the external deficit reverts to its 'normal' level – say 5 %

of G.D.P. -- as speedily as possible whilst maintaining reasonable economic growth. The figure of '5%' embodies the judgement that for a 'least developed country' like Tanzania, the international community, despite the overall slowdown in the quantum of foreign aid, will be willing to provide external resources to that extent.

Table 1 does not include data for 1981 and 1982. The recently available preliminary statistics suggest that the current account deficit has been substantially reduced as a proportion of G.D.P. in these two years. This recorded improvement in the foreign balance has, however, been achieved at the expense of a fall in the level of total production. G.D.P. fell by 3% in each of the years 1981 and 1982. Thus in terms of the earlier definition, the economy continues to be in long-term structural disequilibrium despite the reduced payments deficit. The correction of the disequilibrium requires changes in the pattern of agricultural and industrial production so that at a given level of national production, the trade deficit can be narrowed. The central issue of economic policy is how to proceed towards achieving that aim both in the short and the long-terms.

THE ECONOMICS OF DEVALUATION IN TANZANIA

One obvious method of structural adjustment is a devaluation of the country's currency, which is supposed to stimulate exports by reducing their price in terms of foreign currency, and to reduce imports by increasing import prices in local currency. In text-book economics, advisability of the devaluation depends on the values of the relevant elasticities for imports and exports – how much exports are encouraged and imports discouraged by a given percentage change in price. However, modern economic analysis recognises that a devaluation is a much more complex undertaking: although superficially it involves the changing of a single price, it has profound repercussions throughout the economy. A proper economic case for an exchange rate adjustment (downward or for that matter upward) must rest on a careful *empirical* analysis of the following kinds of questions:

(1) The size of the net effect on the balance of payments.
(2) The time period over which the effects on exports and imports occur: is it six months, one year or 5 years? Are imports affected earlier than exports?
(3) The certainty of the effects.
(4) The impact on the rate of inflation and income distribution. Again what is the short-term dynamics of these effects? Will the impact on inflation occur sooner than on foreign balance and what will be its implications? Will that set in a chain reaction of wage changes, further inflation, financial instability etc...?

Outside the sphere of orthodox equilibrium economics, in the real world of dynamic inter-actions, every one of these questions is vitally important in a decision about devaluation. This is not just a matter of academic refinement but lessons which economists have learnt from the actual experiences of devaluation in several countries. As a consequence, the

economics profession is today much more skeptical about the efficacy of devaluation as an instrument of structural change than it used to be *(5)*

In a commodity exporting country like Tanzania, the general view would be that at least in the short-term (say over a one-year period), exports are unlikely to be encouraged by a devaluation since a small country can sell whatever quantity of a commodity it wishes at internationally determined prices. The short-term elasticity of commodity *production* is also usually relatively small. Other things being equal, imports could be discouraged by their higher prices, but in a country like Tanzania, all 'inessential' imports have already been restricted by direct central bank controls. Any further limit on imports will inevitably curtail domestic production even more. To the extent that imports may need to be restricted further for balance of payments reasons, from a social point of view, this is best achieved on the basis of social priorities determined by the government rather than the private profitability criterion of the market.

In view of this low short time price-elasticity of foreign balance in a commodity exporting country, there is a presumption against devaluation which would need to be outweighed by other factors to make it a useful policy instrument. Hence one answer to the rhetorical question (which is posed by the international aid agencies in Dar-es-Salaam) that if Sweeden is willing to devalue, why not Tanzania, is that other things being equal, the economic case for devaluation is usually much stronger for a country which mainly exports manufactures than for one which predominantly exports commodities. A second answer is that notwithstanding the fact (a) that Sweden is a small and extremely open economy operating in a fiercely competitive world of manufacturing trade and that (b) the economy suffers from a 'basic structural imbalance' (to use Mr. PALME's phrase), he devalued the kroner only by 16 per cent last October. What the IMF or the World Bank are asking Tanzania to do is to devalue the shilling against the U.S. dollar from its present rate of approximately 10 T.shillings/dollar to anywhere between 25 to 35 T.shillings/dollar. A third answer is that the Swedish devaluation has not been uncontroversial and it remains to be seen whether or not it willl be successful. Even for industrial countries, the evidence concerning the success of devaluations in changing the 'basic structural imbalance of the economy' has not been reassuring *(6)*. Fourthly and most importantly, the case for or against a Tanzanian devaluation must surely be judged on its own merits and not by relevance to Sweden.

In the Tanzanian debate *(7)* about exchange rate adjustment, one or more of the following arguments have been advanced to support the case for a devaluation:

(1) Devaluation, it is suggested, will have a positive effect on the balance of payments even in the short-term because (a) it will reduce leakages through smuggling; (b) discourage the parallel market in foreign exchange and thus diminish the loss of foreign exchange to the government through that channel; and (c) even though commodity exports may not be increased in the short-term, there will be a favourable impact on the *manufacturing* balance.

(2) Devaluation, it is believed, will have a *long-term* favourable effect on the foreign balance.
(3) Both in the short or the long-term, it is argued that a devaluation will help to restore the government's budgetary balance.
(4) Devaluation is necessary in order to correct the appreciation of the Tanzanian shilling against currencies other than the U.S. dollar, as a consequence of the shilling being pegged to the dollar and appreciation in the value of the latter.
(5) Devaluation, it is argued, is essential since the Tanzanian rate of inflation has been much greater than the world rate of inflation.

Since the IMF often employs similar arguments to prescribe large devaluations for other commodity exporting African and Third World economies, these deserve careful and systematic analysis. The question of the impact on foreign balance (i.e. matters under (1) and (2) above) will be discussed in the next section; those concerning fiscal balance, internal and external inflation, etc... (i.e. (3) to (5) will be examined in the other sections.

DEVALUATION AND FOREIGN BALANCE

As far as the impact of a devaluation on the foreign balance in the *short-term* is concerned, the IMF's case for expecting a favourable effect rests entirely on considerations concerning smuggling and the parallel market in foreign exchange. The Fund's papers do not provide any empirical estimates of how *much* foreign balance will be improved, but merely argue on broad, general grounds that a devaluation of the kind they are recommending will reduce the scope of the parallel and illegal markets and hence increase the official foreign exchange resources. On closer inspection, however, these general arguments do not appear convincing. The main reason why a 'profit maximising' Tanzanian coffee producer may sell his produce illegally in a foreign country is not so much because the Tanzanian shilling is over-valued, but that from abroad, he can import luxury goods (hi-fi equipment, white goods etc...) whose import is prohibited on social grounds in Tanzania. Unless, therefore, Tanzania changes its social priorities, and allows importation of such luxury items by those who directly earn foreign exchange, this kind of producer will continue to illegally export his coffee even if the Tanzanian shilling was devalued to 20 or 40 shillings to a dollar. It is, therefore, unlikely that a devaluation alone will make a significant difference to the level of smuggling activity *(8)*.

Similarly with respect to the parallel market for the foreign exchange, the primary determinant of demand in this market is the desire of a section of the business community and other rich Tanzanians to repatriate some of their wealth abroad. The exchange rate on this market is not therefore determined by the underlying health of the economy or current account considerations, but by reasons of capital flight. Experience from other countries suggests that a small devaluation in such circumstances is

ineffective in this respect. On the other hand, a large devaluation is likely to make matters worse rather than better. This is because such devaluations normally bring in their train an increase in the rate of inflation, wage demands, etc... (see further next section) and greater uncertainty, thus intensifying the pressures for capital flight through illegal channels. Thus if the shilling is devalued from 10 to 30 shillings to a U.S. dollar, the illegal market rate, instead of being lowered, may go up from 50 to 100 shillings *(9)*.

I, therefore, remain extremely skeptical that the short-term foreign balance will be improved by a devaluation on account of its effect either on smuggling or on the parallel market in foreign exchange.

The third argument, under this heading – the *short-term* effect on foreign balance in *manufacturing* – has *prima facie* more substance to it. Again the proponents of this view do not provide any quantitative estimates of the effects on manufacturing exports and imports. The IMF do not apparently consider such effects significant enough to even put this forward as an important reason for recommending a Tanzanian devaluation.

However, in an earlier paper *(10)*, I have examined this question in detail. My conclusion was, and still is, that despite the depressed level of world economic activity, there was still some scope for increasing Tanzania's manufacturing exports. But this objective would be best achieved not by a general devaluation, but instead by (a) concentration on a small number of large exporting items (e.g. textiles, cement), and (b) by offering at the point of export differing amounts of subsidies on these products. In conceptual economic terms, the policy (b) amounts to a system of multiple exchange rates, but it is administratively simpler to operate it in the form to export subsidies. With respect to manufactured imports, as argued earlier, they are not competing with domestic production but at their current level are an absolutely essential complement to it. If anything, this consideration makes the economic argument for *selectivity* and hence multiple exchange rates (to be administered in the form of export subsidies and, if necessary, import duties) even stronger.

There is a much better case for expecting a favourable effect of a devaluation on foreign balance in the *long-term*, whether in agriculture or in manufacturing. However, in relation to the long-term, the following points should be kept in mind: First, with respect to agriculture, although a devaluation may provide an *incentive* to increase production of export crops at the expense of say food crops, such production possibilities may only be realised if there is increased availability of infrastructural (e.g. transport) and other vital agricultural inputs (e.g. fertiliser, water). The provision of these inputs is likely to have a far greater quantitative effect on export crop production than any price incentive resulting from a devaluation. Second, even in the long run, in the circumstances of an economy such as that of Tanzania, a system of multiple exchange rates (operated through export subsidies and import duties) is economically more efficient than a single depreciated rate for the currency *(11)*. Thirdly, it is extremely important to note that in this context, the 'long-run' is crucially dependent on what happens in the short-term. This is for the simple reason

that the supposed favourable long run effects of a devaluation on foreign balance can work only to the extent that there is an «effective devaluation» – i.e. the devaluation is not nullified by an increase in the domestic rate of inflation. Thus the 'long run', as is sometimes blithely believed, does not provide any escape from the short-term dynamics of devaluation in terms of its interacting effects on prices and wages and on the rest of the economy.

DEVALUATION, INFLATION AND THE BUDGET: THE POLITICS OF DEVALUATION

It is essential to the logic of an 'effective devaluation' that there should be a cut in real wages, by making all imported goods (and their substitutes) more expensive in relation to workers' incomes. An IMF programme of devaluation, credit restraint, tight budget, 'liberalisation' of domestic and foreign trade regimes, if sucessfully implemented, has two extremely important short-term effects on the economy: (i) it leads to a cut in overall consumption and real wages; and (ii) it leads to a redistribution of income away from those who produce for the domestic market to those who are involved in production for exports or import substitutes.

The seeds of inflation and political destabilisation lie precisely in these two intended effects of a devaluation. As KALDOR points out *(12)*, «The main objection to this approach is that it assumes that devaluation is capable of changing the critical price and wage relationships within a country in an effective manner, even when domestic fiscal and monetary policies are incapable of bringing about these results. But it cannot be taken for granted that the internal distribution of income, which is the outcome of complex political forces, can be effectively changed by devaluation. It is more likely that a large-scale devaluation will cause an internal price upheaval (at the cost of a great deal of additional inflation) which will end up by reproducing much the same price relationships – between prices and wages and between internal and external prices – as prevailed before the devaluation».

Inflation is not just a simple monetary phenomenon: otherwise the world would have got rid of it a long time ago by merely reducing the 'money supply'. It is embedded in the struggle over distribution of income, or as we argue in Cambridge, it arises from inconsistent claims over the national income. Let us illustrate in simple terms how this process would work in Tanzania. With fixed total production in the short-term, a devaluation would mean that the real wages of workers and government employees (say) in Dar-es-Salaam would have to be reduced further in order to benefit (say) the coffee growers in Kilimanjaro: to transfer income from the non-exporters to the exporters. In view of the fact that there has already been a large fall (perhaps of the order of as much as 50%) in the urban standards of living in Tanzania during the last three years, a further fall resulting from a large effective devaluation would inevitably lead to compensating wage demands. Such demands, if they are not met, would produce political conflicts; on the other hand, if they are met, this would fuel inflation and thus require even more nominal devaluation and the process would then repeat itself.

Thus it is no accident that the IMF programmes of devaluation in many developing countries have led to the worsening of inflationary conditions and serious political conflicts. «Several hundred people died during food riots in Morocco (which signed an SDR 819m agreement in March 1981) last June, while protestors took to the streets in Sudan in January after price rises for basic commodities followed agreement on an SDR 198m in October. Both governments were attempting to meet targets agreed with the Fund» *(13)*. As Mr. Duncan NDEGWA, Governor of the Kenyan Central Bank, told an IMF seminar in Nairobi, austerity measures like cuts in consumer subsidies 'impose tremendous adverse effects'.

In this context, the Kenyan case is of particular interest. The effects of the IMF policies on Kenya have recently been analysed by Dr. Tony KILLICK, Director of the Overseas Development Institute in London. Dr. KILLICK observes that the Government of Kenya is 'rather conservative, pragmatic and generally market oriented'. There is also no 'great ideological divide... the Treasury does not disagree with the thrust of the IMF policies... (and) the principle of conditionality is not contested'.

Yet three higher conditionality agreements between Kenya and the IMF have broken down *(14)*. As Dr. KILLICK points out, «If successful stabilisation and good working relationships with the Fund are not feasible in Kenya, it is unclear where else in Africa they might be achieved».

It has been suggested that Tanzania has a more stable political system than Kenya and would, therefore, be in a better position to implement the IMF policies. However, in this connection, the following points deserve attention: (i) the size of the devaluation and other measures which the Fund is asking Tanzania to adopt are much harsher than those imposed on Kenya; (ii) these measures would be implemented in conditions which are far worse in the sense that Tanzania has already had more austerity during the last three years than Kenya; (iii) and perhaps most importantly, unlike in Kenya, the IMF's programme goes against the whole grain of the Tanzanian political system, on which ultimately Tanzania's political stability is founded.

The above analysis of the political economy of devaluation provides the essential background to an examination of the more technical arguments which have been put forward by the IMF, the Treasury and others with respect to devaluation and fiscal balance. It is suggested that whatever the arguments about foreign balance, devaluation is desirable for the very important reason that it will improve the Government's budgetary balance.

Before assessing the validity of this argument in its own terms and considering the numbers which have been generated to support it, it seems to me that there are certain elementary questions which need to be asked, which regrettably the Treasury has failed to do. Why is one interested in improving the budgetary balance? Is it because this will aid the *real* economy – production, employment etc..., or reduce the rate of inflation, or is it an end itself? On the IMF and Treasury's own estimates, a devaluation induced budgetary improvement does not achieve any of these desirable

objectives. To the extent there is any improvement in production, it is in the short-term entirely due to an increase in foreign aid, not devaluation. The rate of inflation actually *increases* rather than being decreased as a consequence of devaluation.

It may be argued that the rate of inflation will be reduced in the long run. This argument, however, completely abstracts from the crucial political economy and short-term dynamic considerations outlined earlier. With fixed total production in the short term, a devaluation cannot improve the fiscal balance simply by fiat; somebody has to pay for it in real terms by a reduction in his or her current social benefits or an increase in his or her taxes. What is being implied is that the people will accept this cut in their real incomes brought about by a devaluation which they will not if implemented directly through domestic fiscal and monetary policy. This seems to me to under-estimate people's wisdom in such matters.

Whether or not the budgetary balance will actually improve as a consequence of devaluation and associated measures will depend in a very important way on the rate of inflation. This in turn is function of the degree of political consensus in the society about the proposed redistribution of income. Thus the estimates *(15)* of the rates of inflation contained in the Treasury or the IMF exercises on this question are not simply some technical data, but essentially represent their respective political assessments of the redistributive conflict.

DEVALUATION, TECHNICAL ADJUSTMENT, AND 'REAL EFFECTIVE' EXCHANGE RATES

With respect to the economics of devaluation, there are two further technical arguments, mentioned earlier, which remain to be considered. First, there is the view put forward by the Treasury that a technical adjustment of the exchange rate is required since as a consequence of the Tanzanian shilling being pegged to the U.S. dollar, the former has appreciated relative to other currencies (due to a rise in the value of the dollar). We need not spend too much time on this matter, as Mr. John LOXLEY in a recent paper has examined this issue thoroughly. He comes to an unequivocal conclusion that there is no ground 'for any further technical adjustment'. On his figures, the currency-weighted effective exchange rate for the shilling has in fact depreciated by nearly 2% since the last technical adjustment in March 1982.

However, in the same paper, Mr. LOXLEY suggests that there is nevertheless 'a powerful argument for devaluation at this time based not on effective rates but on what is happening and has been happening since the mid 1980's to real effective rates'. Essentially, he argues that since the Tanzanian rate of inflation has been greater than the rate of inflation among Tanzania's trading partners, the shilling should be devalued to compensate for the differences in the inflation rates. This line of reasoning, which is also increasingly employed by the IMF to recommend currency depreciations in developing countries, has a certain surface plausibility; it therefore deserves systematic examination.

It may be useful to start by considering certain historical experience which is relevant to this issue and with which I am personally familiar. This is the recent case of Mexico where I had been an economic adviser. A very similar argument had been advanced by the IMF and the Mexican Central Bank in support of a Mexican devaluation in 1981, i.e. that since the Mexican rate of inflation was greater than the U.S. rate (the U.S. being Mexico's main trading partner), Mexico should devalue to compensate for this. For all the reasons outlined above, my colleagues and I at the Ministry of Industry had argued that a devaluation would lead to a further divergence in the Mexican and U.S. rates of inflation, hence require a further devaluation and this in turn will lead to a wage-price spiral, financial instability, etc... In 1981, the Mexican rate of inflation was 28% and the U.S. rate was about 10% i.e. a difference of 18 percentage points. A devaluation of the Mexican peso in February 1982 set in train a sequence of events much as had been predicted: inflation, wage demands, further devaluation. As a consequence, the Mexican rate of inflation by the end of 1982 was about 100% p.a., and the divergence from the U.S. rate of inflation (5% in 1982) had widened to 95 percentage points.

However, Mr. LOXLEY or the IMF do not base their argument on this issue or empirical evidence, or actual experience, but on a very old economic theory called the purchasing-power parity doctrine. There has been a vast literature on this subject since Gustar CASSELLS first propounded it earlier this century. The subsequent work shows that the theory is valid only under extremely restrictive assumptions; its application to a country like Tanzania requires major modifications, none of which Mr. LOXLEY cares to specify.

Very briefly *(16)*, first, under conditions of competition, the theory makes sense only if it is interpreted in terms of costs rather than prices. Secondly, with respect to 'costs', the only relevant element relates to the value added by domestic operations, excluding the element of imports in total costs. Thirdly, there is a major problem of measuring parity in terms of costs if the *relative* costs of different commodities and services greatly differ as between one country and another. If, say, the ratio of the cost of a unit of A (a manufactured commodity) to the cost of a unit of B (a raw material) is fives times higher in country X than the corresponding ratio in country Y, and the weight of the two commodities in the total output of each country is also very different, there is no unique way of deciding how the level of costs *in general* in the two countries are related to each other in terms of a common currency. There is no particular virtue in comparing averages of the two countries; nor is there any reason to suppose that such a «parity» rate is one at which the balance of payments on current account will also be in equilibrium.

These considerations suggest that the application of the purchasing-power parity doctrine to a country like Tanzania is essentially valid only in relation to the 'domestic' element of the costs of primary products. But as in the earlier case of manufactures where it was argued that a multiple exchange rate (administered in the form of tariffs and subsidies) was preferable to a single exchange rate, here again there may be a whole zone of rates

rather than a single exchange rate which is equally desirable from the point of view of the balance of payments. It is only when the exchange rate becomes so over-valued that the customary standard of living of workers in the primary sectors is unduly depressed in relation to that of the other sectors of the population (or in relation to their own previous living standards), with unfavourable effects on the production of export crops, that an adjustment is called for.

In the case of Tanzania, there has clearly been a fall in the standard of living of the producers of primary products during the last three years, as indeed there has been of all sections of the population. It is however, difficult to believe that the *relative* standard of living of primary producers or the rural population has declined more than of say urban wage earners. The evidence I have seen points to the contrary, but this matter clearly needs to be kept under close review.

CONCLUSION: THE INTERNATIONAL POLITICS OF DEVALUATION AND TANZANIA'S POLICY CHOICES

To sum up, the foregoing discussion suggests that there are powerful arguments against a devaluation – and even more so against large devaluations of the kind being proposed by the IMF in Africa – in a commodity exporting country, and particularly in a centrally planned economy where the foreign exchange allocation is essentially carried out by the Central Bank on the basis of social priorities. This does not, however, in any way mean that a commodity exporting centrally planned economy like Tanzania should never devalue. Rather, such a country should carefully examine (a) the extent and (b) the consequences of any proposed devaluation by asking and answering all the questions listed in page 31 ; for, otherwise, there is a serious possibility that the devaluation may make the economic situation worse rather than better. In addition, the country should also examine the relative merits of a general devaluation with those of more selective and targetted action by means of multiple exchange rates which may be administered in the form of subsidies and tariffs. The basic case against the very large devaluation required by the IMF conditionality for Tanzania is that its positive effects on the balance of payments and production in the short to medium term are small and highly uncertain. However, the negative effects on inflation and income distribution over the same time horizon are large and certain *(17)*.

To go back to the beginning, the opposition to a programme of large devaluation and associated measures as proposed by the IMF and the World Bank, is thus not some odd quirk of the Tanzanian President, but has a solid foundation in economic analysis. In view of this, it is regrettable that these two international organisations should attempt to force a small country like Tanzania to change its economic policies without at all adequate technical justification that this would yield net benefit to the people of Tanzania. This is, however, certainly in keeping with the IMF's record, and though regrettable, not surprising. What would be particularly unfortunate is if Tanzania's friendly donor countries, instead of persuading the

Fund and the Bank to adopt a more reasonable economic stance, pressure Tanzania into following a path which its leadership has very good reasons to wish to avoid.

It should be clear from the analysis of this paper that what is really at stake in this debate about exchange rate adjustment in Tanzania is not simply some technical issues, but in fact the whole course of Tanzania's future development. Very briefly, the Fund/Bank programme would push Tanzania towards market-oriented, non-socialist development, in return for which they will provide some economic assistance. The alternative path before the Tanzanian people is to attempt to solve their grave economic crisis within the framework of their existing economic and political institutions, but without Fund/Bank assistance. In view of the seriousness of the economic situation, the latter path is an extremely difficult one, particularly in the short run. However, as Chairman Ndugu Julius NYERERE told the CMC National Conference last October:

> *«We lost territory in November 1978. But we won the war which followed. Now, as well as reporting that we have suffered a setback on the economic front, I am also saying that if we decide to fight this economic war, then we shall win it».*

A more detailed analysis of some of the economic policy issues involved in pursuing the non-IMF path will be presented in a subsequent contribution.

FOOTNOTES

1. This is a revised version of a paper which was originally written in January, 1983 while I was an economic adviser to the Ministry of Development Planning of the Government of Tanzania. The paper is being published in a book of essays in honour of Dr. S. Nigam.
2. The IMF was asking Tanzania at that time to devalue the Tanzania shilling by 250 to 300 per cent (in terms of foreign currency) from its then parity of nearly 10 shillings to a U.S. dollar to between 25 to 35 shillings to a U.S. dollar. As in the case of the Fund's adjustment programmes for many other African countries, the IMF conditionality for Tanzania, apart from a large devaluation of the currency, included in the short run the following elements: (i) a reduction of the public sector borrowing requirement by means of reducing or eliminating consumer subsidies and many other social expenditures; (ii) an increase in interest rates to raise domestic savings; and (iii) reduction of money supply. In addition, in the short to medium term, the IMF stipulated that Tanzania should change the 'inefficient' structure of its economy by measures such as favouring the production of export crops over that of food or manufacturing, private sector economic activity over the public, parastatal or cooperative production, the allocation of resources by market forces (for example by 'liberalizing' price controls or import controls) rather than directly by the government. This paper is concerned only with examining the range of issues connected with devaluation, which is a central element of the IMF programme.
3. See for example UNCTAD (1983), World Bank (1983).
4. See Singh (1982).

5. The Chicago and Cambridge schools of economics, which normally have very different views about the functioning of the economic system, do agree on one point: that exchange rate adjustment is in *general* not a suitable method for structural change and that its major consequence is to generate inflation. The reasoning in each case is, of course, different: the Chicago economists base their case on the 'law of one price' and the Cambridge economists on the concept of real wage resistance. See McCallum and Vines (1981).
6. See Kaldor (1978).
7. The following have been the main contributors to the Tanzanian policy debate on exchange rate adjustment: the IMF, the World Bank, a team of economists from the ILO/JASPA, the Treasury and Ministry of Planning. The IMF, The World Bank and the Treasury have supported devaluation for one or more of the reasons listed above; the ILO/JASPA team and the Ministry of Planning have generally opposed it. The size of the recommended devaluation also varies; IMF suggests a devaluation from its present value of approximately 10 shillings per U.S. dollar to anywhere between 25 and 35 shillings per dollar; the World Bank recommends a lower range and the Treasury's figure has been lower still – about 15 shillings per U.S. dollar. By European standards, except for the last, these are of course all 'large' adjustments of the exchange rate.
8. See also discussion in page 36 which also bears on this issue.
9. In the economist's language, not only the demand for foreign exchange may increase for reasons given in the text, the 'supply price' of illegal foreign exchange may also rise for similar reasons.
10. See Singh (1982).
11. For a detailed discussion of this issue, see Kaldor (1982).
12. See Kaldor (1982).
13. *Financial Times,* April, 1982.
14. Those who suggest that if only Tanzania had accepted the less harsh IMF terms of last year, the problem would have been solved by now should ponder over the Kenyan example (and that of several other countries). With the worsening world economic situation, any agreement with the IMF last year would most likely have broken down by now and there would have been tough conditionality (similar to what is being proposed now) for renewing the agreement.
15. I note that neither the Treasury nor the IMF state the methodology by which they arrive at these inflation estimates.
16. This statement of some of the essential modifications to the theory is based on Kaldor (1982).
17. Subsequently, in 1983, the Tanzanian Government devalued the currency from 10 shillings to 12 shillings per U.S. dollar (as against the IMF demand for a devaluation to 30 shillings per U.S. dollar). The Government made a further devaluation by 26 per cent in 1984. In my view, there was less of an economic, but much more of a political case for these devaluations. It indicated to the bilateral donors and the international aid community that Tanzania was not opposed to a devaluation as a matter of political principle, but rather had extremely serious pragmatic and empirical objections to the IMF programme.

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RESUME

L'objectif principal de ce papier est d'analyser la nature des déséquilibres auxquels l'économie tanzanienne est confrontée et d'examiner si oui ou non la solution adéquate aux difficultés que traverse le pays se trouve dans la dévaluation importante de la monnaie, prescrite par le FMI. Cette étude prend davantage d'intérêt face à la situation internationale actuelle. La crise économique mondiale des quatre dernières années, qui a eu des retombées négatives sur la plupart des pays, qu'ils soient en développement ou développés, a eu des effets particulièrement dévastateurs sur les économies des pays africains. Un grand nombre de ceux-ci se sont vus dans l'obligation de demander de l'aide et de conclure, avec le FMI, des accords assortis de conditions, aux fins de faire face aux problèmes aigus de balances de paiements, nés de la crise. Comme toujours, une dévaluation importante de la monnaie locale des pays africains figurait, entre autres, *au programme d'adjustement préconisé par le FMI. Une analyse du problème de la dévaluation dans le cadre d'une économie telle que celle de la Tanzanie – pays essentiellement exportateur de produits de base (café, coton etc...) et importateur de produits manufacturés – devrait s'appliquer également à d'autres pays africains ayant une structure économique largement semblable.*

Dans sa conclusion, cette communication indique que des faits importants militent contre toute dévaluation – et encore davantage contre les dévaluations considérables que propose le FMI en Afrique – dans un pays exportateur de produits de base et notamment dans une économie à caractère dirigiste, où c'est la Banque Centrale qui assure la répartition des

devises à partir des priorités sociales établies. Mais cela ne signifie en aucun cas qu'un pays tel que la Tanzanie à économie dirigiste et exportateur de produits de base, ne devrait pas pratiquer la dévaluation. Ce pays devrait plutôt examiner attentivement (a) la portée et (b) les conséquences de toute proposition de dévaluation en demandant au FMI de donner des réponses empiriques à toutes les questions énumérées dans la page 31 ; autrement, il y a de fortes chances que la dévaluation, au lieu d'améliorer la situation économique, ne la rende plus catastrophique. Par ailleurs, le pays devrait également étudier les mérites relatifs d'une dévaluation générale par rapport à ceux d'une action plus sélective et orientée vers des buts plus précis, en adoptant divers taux de change qui pourraient être imposés sous forme de subventions et de tarifs. L'argument principal qui milite contre la dévaluation très substantielle que le FMI demande à la Tanzanie d'appliquer, parmi ses conditions, est que les retombées positives sur la balance des paiements et sur la production seront infimes et fort peu probables à court et moyen termes. Cependant il est certain que cette dévaluation aura de nombreuses incidences négatives sur l'inflation et la répartition des revenus.