THE SOFT BUDGET CONSTRAINT

The Emergence, Persistence and Logic of an Institution

The Case of Tanzania
1967-1992

Gun Eriksson Skoog

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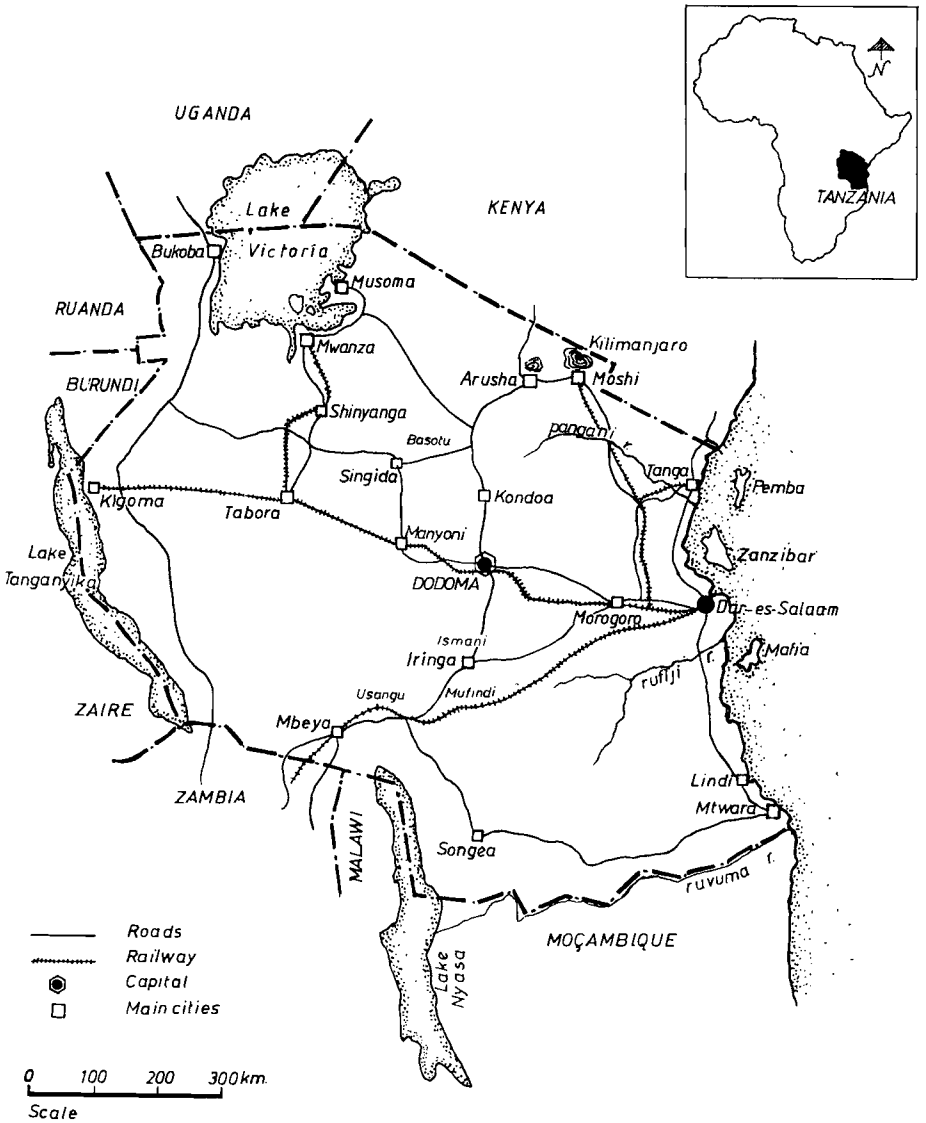
Map 1: Tanzania: Roads, Railways and Main Cities



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CHAPTER I

INTRODUCTION

This is a story of the soft budget constraint. It seeks an answer to a paradox: the prevalence of the soft budget constraint in spite of the tremendous inefficiencies that it gives rise to, and its persistence in spite of reform of the system of which it is an integral part. The story aims at increasing our understanding of why the phenomenon exists. By studying the case of state-owned enterprises in Tanzania before, during and after socialism, an explanation of the emergence, persistence and logic of the soft budget constraint is suggested. This introductory chapter presents an argument showing why this story is worth telling. It discusses the research topic and how the problem it presents is attacked.

THE SOFT BUDGET CONSTRAINT

The soft budget constraint is today a popular metaphor. Originally it was seen as a characteristic of the socialist system. It refers to the tendency of primarily state-owned enterprises to have their liquidity gaps or losses accommodated by the state, or some other external funding body, and to the resulting expectations of such bail-out. The concept was coined by the Hungarian economist János Kornai.[1] He distinguishes between four major forms of external financial assistance that contribute to the soft budget constraint: soft subsidies, soft taxation, soft credit and soft administrative pricing.[2] Discretion, and hence negotiability and the tendency for this type of

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1 See Kornai (1979), (1980) and (1986c), whose idea of various aspects of the concept is discussed in more detail in Chapter II.

2 Kornai (1990b), pp. 22-23, and (1992), pp. 140-142.

external assistance to be adjusted to the financing gap of the enterprises, characterises soft finance.

The soft budget constraint is a major source of inefficiency. Expectations of bail-out in case of financial trouble weaken incentives to economise on costs, and thus generate resource waste and rigidity within the enterprises. These inefficiencies, in turn, tend to spill over into inefficient resource allocation, shortages, over-investment and macro-economic imbalances. The soft budget constraint may thus have severe consequences for the functioning and development of the economy that incorporates it. Its contribution to the poor performance of the socialist system has become conventional wisdom, although there has only been a limited empirical examination of this wisdom.

While considered a characteristic of the socialist system, the concept has attracted increased attention and become widely used primarily *after* the collapse of socialism in Eastern Europe and the former Soviet Union. This is reflected in the growth of the literature on the soft budget constraint in the 1990s. One reason may be that the phenomenon appears to have become particularly problematic for economies trying to move away from socialism, pursuing a transition towards market economy, private enterprise and political pluralism. Given the previous central role and poor performance of public enterprises in these economies, eliminating the soft budget constraint has become an important task for economic reform.

Results in this regard appear, at best, to be mixed. Observations that suggest at least partial failure to get rid of the soft budget constraint are confirmed in empirical studies. In fact, persistence of the soft budget constraint appears to constitute a major obstacle to the very transition process itself. Studies by Claudia M. Buch *et al.* and Martin Raiser suggest that it has hampered both the sustainability of reform and economic performance in the Eastern European transition economies.[3]

The soft budget constraint appears to exist and create problems in other economies also, and not only in traditional and reforming centrally planned economies. Kornai recognises that it may also prevail within the public sector of mixed economies.[4] Buch *et al.* and Raiser further found that it may have existed and prevented reform in a number of developing countries, socialist and non-socialist alike.[5] Tanzania is a case in point. After independence in the early 1960s, the country embarked on a development strategy under the leadership of Julius K. Nyerere, based on the official ideology of socialism and self-reliance, popularly known as *ujamaa*.

Under the supreme power of a single revolutionary party, a socialist economic and political system with state ownership and extensive regulation of economic activity was created in the 1970s. The strategy involved rapid expansion of state-owned enterprises, so-called parastatals, into all economic sectors. With generous financial support from the international donor

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[3] Buch *et al.* (1994) and Raiser (1992), (1993) and (1997).

[4] Kornai (1990b), pp. 36-41.

[5] Buch *et al.* (1994) and Raiser (1994) and (1997).

community, an enormous parastatal sector was created. The parastatals faced tremendous performance problems, however, and incurred huge financial losses. Over-investment, under-performance and the concomitant budgetary support contributed to slumping output, pervasive shortages and macro-economic imbalances that culminated in an economic crisis in the late 1970s. The problems of the socialist system forced the leadership to initiate market-oriented reform in the mid-1980s, not least in order to improve parastatal performance. Losses incurred by parastatals worsened, however, as the enterprises failed to adapt to the changing environment. Their rigidity hampered structural adjustment, efforts at macro-economic stabilisation and economic recovery.

Buch *et al.* rank Tanzania among those developing countries that due to a high degree of budget softness experienced low output growth, a relatively high rate of inflation and collapsed reform efforts during the period 1977-1989.[6] Preliminary observations reported in country-specific studies further suggest that Tanzanian parastatals may have faced soft budget constraints during both socialism and market-oriented reform, and that these contributed to the partial failure of the latter.[7]

The very existence of the soft budget constraint is a paradox. The soft budget constraint prevails within the socialist system despite the tremendous inefficiencies that it gives rise to and the poor performance of the system that results. In addition, it tends to persist during the transition period, in spite of the fact that the system of which it is an integral part is reformed, and thereby appears to hamper the process of reform itself. This paradox leads us to the purpose of the present study: to increase our understanding of why the soft budget constraint exists. Let us begin by examining how the problem has been tackled in the literature.

EXPLAINING THE SOFT BUDGET CONSTRAINT

Two traditions can be distinguished in the literature on the soft budget constraint, one more neo-classically oriented and another strand working in the tradition of Kornai. Several theoretical attempts have been made to explain the soft budget constraint.[8] Within the neo-classical tradition, the focus is on the identification of the determinants of the soft budget constraint. Reference is made either to the non-profit objectives of the state - for instance, concern for employment or social surplus - or to different institutional conditions, such as centralised credit allocation. Several recent studies try to explain why banks continue to refinance payment-

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6 Buch *et al.* (1994), pp. 49-61, *passim,* who nonetheless warn about other than qualitative interpretations of their results (p. 56, footnote 64).

7 Eriksson (1991), pp. 26-32, and (1992), pp. 13-15 and 22-33, *passim.*

8 These attempts are surveyed in Chapter II.

defaulting and loss-making state-owned enterprises after a decentralising reform.

A number of partial explanations for the soft budget constraint are thereby suggested. They may all provide useful insights, but their partial nature runs the risk of painting an illusively simplifying picture of the causes of the soft budget constraint - and of how it can be successfully eliminated.[9] This is illustrated by the experience of the transition economies in Eastern Europe. Decentralised credit allocation through bank privatisation does not seem to have eliminated the soft budget constraint.[10] By focusing on partial explanations for partial expressions of the soft budget constraint, what appears to be one of its central characteristics is disregarded in the analysis: its complexity. Certain aspects of this complexity are, however, recognised by Buch *et al.*:

> It turned out that only the *combination* of our [macro-economic] indicators [of the soft budget constraint] in an aggregate index performed well, when correlated to a set of performance variables. This confirmed both our preference for *broadly based* shock programs and supported the usefulness of viewing the subsidization of loss makers as a *complex* phenomenon.[11]

The soft budget constraint does not just have a multitude of expressions. It is not unlikely that all the factors presented in the literature contribute to explaining its existence - in combination. If the soft budget constraint is a consequence of a broad combination of factors, the recognition of the complexity as such, as well as of the links between the different explanatory factors, is important for understanding its existence and for its successful elimination.

There is a possible second characteristic of the soft budget constraint that is overlooked in much of the partial analysis. By focusing on the *identification* of its determinants, many studies are based on the implicit assumption that the causal relationship is uni-directional. There are, however, indications that the causal relationship between the soft budget constraint and its determinants may be bi-directional, or circular. While some studies argue that the soft budget constraint is the result of certain institutional factors, other studies suggest that it renders the reform of institutions partly ineffective, thus contributing to their persistence. It is possible that the soft budget constraint and its determinants interact and influence each other. If such interdependence is a characteristic of the soft budget constraint, it can be seen as a link, not in a simple causal chain, but in a complex network. A deeper analysis than a mere identification of individual determinants then becomes important for understanding its existence. We would want to investigate the entire network: the relationship between the soft budget constraint and its different determinants and the complex process of interaction between them.

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[9] Qian and Roland (1994) represent an exception. They examine the effect of five different aspects of decentralisation - of government authority and control rights - on the soft budget constraint of different public enterprises such as in China.

[10] See Meyendorff and Snyder (1997) for the bank-privatisation experience. Additional references are provided by Berglöf and Roland (1994), p. 2.

[11] Buch *et al.* (1994), p. 148; emphases and comments added.

Except in its use of Kornai's concept, this branch of the literature diverges from the Kornaian tradition in several respects. Many of the neo-classically oriented studies try to explain the soft budget constraint during the transition from socialism, largely without searching for answers in the former socialist system. However, if we want to understand why the soft budget constraint persists during the reform of the socialist system, we may, first of all, want to know more about why it existed in the past - in particular if complexity and interdependence are important.

Kornai initially emphasised the paternalistic relationship between the state and state-owned enterprises as the immediate cause of the soft budget constraint in the socialist system.[12] Later, he extended his explanation, by placing the phenomenon in a broader context and tracing its causes to the fundamental elements of this system: the power of the party, the socialist ideology, state ownership and bureaucratic co-ordination.[13] Kornai stresses the affinity between these systemic elements and the fact that, as a consequence, causal relationships are multi-directional. He thereby implicitly recognises the complexity of the soft budget constraint and - in a footnote - its interdependence:

> Micro regulation ... is one of the *causes* of the softening of the budget constraint, because it precludes a total decentralization of responsibility and gives the superior organization a motive for glossing over the mistakes. But it is at the same time a *consequence* of the soft budget constraint...[14]

The soft budget constraint thus appears to be an integral part of the socialist system, mutually influencing and depending on the other elements within this complex structure. Buch *et al.* note that it 'contains a characterization of the institutional infrastructure of an economy and its underlying rationale'.[15] This suggests that the soft budget constraint may perform a function within the socialist system and thus have beneficial, and not only negative, consequences. Piotr Jasinski argues that under central planning, the soft budget constraint solves the problem of information, incentive and inflexibility.[16] His focus is at the system level. However, the links to the level of the actors, and a discussion of the beneficial consequences and logic of the soft budget constraint for their behaviour, are missing. A theoretical framework for an analysis of the relationships and interaction between the institutional system, the soft budget constraint and the actors is provided by Kornai's model of the socialist system. Hence the Kornaian tradition involves a broader contextual approach to explaining the soft budget constraint, and at least implicitly recognises complexity and interdependence. Kornai does not pursue the exercise, however, since his focus is on explaining the nature and functioning of the socialist system as a whole.

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12 Kornai (1986b), p. 59.

13 Kornai (1992), pp. 493-495; Kornai's model of the socialist system is described in Chapter II.

14 Ibid., footnote 37, p. 495; emphases added.

15 Buch *et al.* (1994), p. 39.

16 Jasinski (1993), p. 11; his argument is elaborated in Chapter II.

If the logic of the soft budget constraint is found in the socialist system, why does it persist when the system is altered, in spite of reform of the complex of which it is an integral part? This paradox has puzzled many researchers. Most studies have sought explanations in the role of formal institutions and incentive schemes. But is the persistence of the soft budget constraint merely a consequence of insufficient formal institutional reform, or does it possess some inherent stabilising characteristics that make it survive for other reasons also? Donald Hay *et al.* note that the soft budget constraint 'exists within, and may well reflect, strong political and cultural considerations'.[17] Any formal institutional system is complemented by informal behavioural rules that are in part inherited from the past and culturally determined. They tend to change slowly.[18] However, the potential influence of informal behavioural rules, relationships and incentives has largely been disregarded in the analysis of the soft budget constraint.[19]

Jasinski maintains that even though the soft budget constraint tends to persist, its nature and dynamics change during transition.[20] Empirical studies reveal that its expressions to some extent take new forms.[21] Does the persistence-cum-change of the soft budget constraint imply that it performed a function not only under socialism, but also during transition away from socialism? If so, what is the nature of this function?

Establishing the function of the soft budget constraint is, however, insufficient if we want to explain why it exists. Purely functionalist explanations may be criticised for explaining a phenomenon by its consequences, which is to reverse the order of cause and effect. A phenomenon cannot be assumed to emerge just because it has some beneficial consequences.[22] Similarly, arguing that it exists simply because somebody wants it to be there is insufficient as a causal explanation.[23] Hence the attempts to explain the soft budget constraint by exclusively referring to actors' objectives run the risk of being functionalist. Within both traditions, the existing literature simply takes the existence of the soft budget constraint for granted, by assuming that function implies existence. Although the soft budget constraint may be functional once established, explaining why it exists also requires an explanation of how it first emerged and a specification of the mechanism that links its function to its maintenance. The origin of the soft budget constraint still remains unexplored.

Hence, while several attempts have been made, existing studies cannot explain why the soft budget constraint exists. The literature within the Kornaian tradition provides possibilities for

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17 Hay *et al.* (1994), p. 327.

18 In Chapter II, institutions are discussed in some detail.

19 Winiecki (1992) is an exception.

20 Jasinski (1993), pp. 19-21.

21 Zhang and Sjöberg (1992), pp. 33-34, offer an example.

22 For a discussion and criticism of functionalist explanations, see Hargreaves Heap (1989), pp. 130-140, Knudsen (1993), pp. 275-285, and Rowe (1989), pp. 15-21 and Chapter 5, pp. 85-102. We shall return to the topic in the next chapter.

23 Besides, as Popper (1969), p. 96, notes, 'An action which proceeds precisely according to intention does not create a problem for social science'.

such an explanation, since it allows for a more contextual analysis, but the work remains to be done. These important shortcomings notwithstanding, the existing attempts to explain the soft budget constraint may well provide useful insights into the matter. The problem is that we know very little about the extent to which they do so. Their empirical relevance remains largely unknown. Not a single study examining the suggested theoretical explanations empirically has been reported as yet. The research questions of the present study are posed against this background.

In order to contribute to our understanding of why the soft budget constraint exists, we must answer questions about the emergence, persistence and logic of the soft budget constraint. More specifically, the research questions that the present study examines are the following. How did the soft budget constraint emerge? How and why was it maintained? Why did it persist? Answering these questions involves tracing the origin of the soft budget constraint; examining its functions and the mechanisms that link these to its maintenance within the socialist system; and finally, explaining its persistence during the transition from the socialist system to a more market-oriented order.

AN EMPIRICAL CASE STUDY

This study pursues its task by exploring a case: the case of parastatal enterprises in Tanzania. An important reason for choosing this particular case is the country's merits as a former, relatively open, socialist economy with a young and dynamic history, which enables an empirical examination of all the research questions.

The empirical literature on the soft budget constraint in relation to market-oriented reform has grown in the 1990s, but the origin of the soft budget constraint has not been examined at all. Nor has its prevalence during socialism been thoroughly studied empirically. The most immediate reasons for this lack of attention are probably the tremendous inherent information problems and the political repression preventing critical research in centrally planned economies. Study of the emergence, prevalence and persistence of the soft budget constraint in these economies is further complicated by the long time period that by necessity has to be covered, given their history.

As a former socialist economy, Tanzania offers better possibilities for such research. First of all, the country was never a full-fledged centrally planned economy. It did not experience the same repression and informational secrecy. Although riddled with information problems, to be discussed below, the Tanzanian economic - and political - system has been subjected to scientific scrutiny throughout its socialist history. Secondly, Tanzania has a relatively young history that can be separated into fairly distinct phases. Over a period of less than 25 years, it has passed from a pre- to a post-socialist system, which provides unique opportunities for an empirical examination of the soft budget constraint before, or rather during the establishment of,

under and after socialism. A second reason for selecting this case is given by the preliminary indications that Tanzanian parastatals may have faced soft budget constraints, during both the socialist and the reform period. However, there has still been no thorough study of the prevalence of the phenomenon in Tanzania.

In order to be able to study why the soft budget constraint exists in Tanzania we must establish its existence in this particular case. This is an implicit purpose of the present study. Establishing its existence involves an examination of the different expressions that the phenomenon takes, its significance and characteristics. This in turn requires a clear definition of the concept and the availability of relevant data; a similar definition is necessary in order to answer the research questions above, tracing for instance the functions of the soft budget constraint.

The literature includes certain attempts to establish whether, and the extent to which, the soft budget constraint has prevailed, but empirical study of the phenomenon is limited also in this very basic regard.[24] The concept is referred to in several studies, but systematic and in-depth analyses are few.[25] As pointed out by Örjan Sjöberg and Zhang Gang, some of the existing handful of studies are 'explorative and tentative rather than fully developed and conclusive'.[26] One reason, they note, may be the difficulty researchers have met in collecting the necessary sectoral or firm level data for a thorough analysis of, in particular, the different forms of soft external finance. Some researchers resort to macro-economic data, which are blunt and fail to reflect the multitude of expressions and thus the prevalence of the soft budget constraint with any degree of precision.[27] Other studies are based on a limited number of in-depth enterprise interviews which, however illuminating, are of narrow scope.[28]

A second reason for the scant empirical examination of the soft budget constraint may be that although intuitively attractive and increasingly used, the concept more and more assumes the form of a metaphor. Zhang notes that the vague and broad definition of the soft budget constraint makes it difficult to operationalise.[29] Lack of clarity also adds to ambiguities in the interpretation of observations and research findings.[30] Limited empirical analysis implies that the prevalence of the soft budget constraint, its true nature, importance and consequences largely

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24 China is the economy where the soft budget constraint has been most subjected to empirical examination. See, for instance, Sjöberg and Zhang (1995) and Zhang (1997), who also survey this literature. Kornai (1992), footnote 25, p. 489, lists examples of studies 'confirming' the prevalence of the soft budget constraint among public firms during market socialism in additional countries.

25 Hay *et al.* (1994), Kornai and Matits (1984), Sjöberg and Zhang (1995), Whiting (1996) and Zhang (1997) are noteworthy exceptions.

26 Sjöberg and Zhang (1995), p. 2.

27 Buch *et al.* (1994), pp. 42-49, who discuss the weaknesses of their own macro-economic indicators of the soft budget constraint, constitute an example.

28 Notably Whiting (1996).

29 Zhang (1997), p. 29. The definition of the soft budget constraint is further discussed in Chapter II.

30 For instance, as regards the extent of budget softness in Chinese public enterprises. (Sjöberg and Zhang, 1995, pp. 1-4, *passim.*)

remain unexplored. Whereas theoretical studies take its different expressions for granted, we know little about their empirical relevance, any change in their relative importance over time or the possible replacement of old forms of soft finance by new ones.

In order to overcome some of these shortcomings, the present study suggests a more clear definition of the soft budget constraint and uses data that are less aggregated than macro-economic data, but with a wider coverage at the sectoral or firm level than a limited number of interviews.

AN INSTITUTIONAL APPROACH

The study of the soft budget constraint is a study of human behaviour. When we seek to understand why the soft budget constraint exists, we want to know why humans behave in such a manner that the soft budget constraint is produced and maintained. We want to identify the circumstances under which the soft budget constraint is created by the actors as a logical consequence of those circumstances: tracing the logic of the situation according to which their behaviour is rational.[31]

What determines the situation of the actors? The institutional structure does. In every situation, the prevailing formal and informal institutions impose constraints on and provide opportunities for human behaviour. By thus shaping incentives, institutions guide the behaviour of individual actors and co-ordinate their interaction. Hence, in order to trace the logic of the situation, we shall examine the different institutional structures within which the soft budget constraint emerges, prevails and persists. This is consistent with much of the literature. Kornai, not least, suggests institutional explanations for the soft budget constraint. And, regarded as a characteristic feature of the socialist system, this is really what it amounts to, since economic and political systems are made up of institutions.

The approach adopted here is consequently institutional, first and foremost because it focuses on the role of institutions in shaping the behaviour of actors. This does not imply that the actors' objectives are considered unimportant for their behaviour.[32] However, the institutional structure constitutes the framework of behavioural rules within which humans act and interact. It thereby defines the conditions for how actors can pursue their aims and the expressions which their efforts take.[33] Thus the situational logic and institutional focus mean that detailed and

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[31] Cf. Popper (1969), p. 97.

[32] Cf. the discussion on functionalist explanations above.

[33] Many of what are referred to as objectives of the state, suggested as explanations for the soft budget constraint in the literature, to a large extent reflect the institutional structure and the incentives it creates. The wish of the state to maintain the level of public enterprise employment, for instance, can be seen as the expression that its more general taste for power takes under certain institutional conditions: monopoly granted to state enterprises

specific assumptions about actors' objectives are unnecessary.[34] Their behaviour can largely be understood if we manage to characterise the context in which they operate.

In the same way, the institutional approach does not imply that other constraints, imposed in particular by resources, are unimportant for actors' behaviour or are disregarded in our analysis. On the contrary, the role of institutions is crucial in this regard also. Via their influence on actors' behaviour, institutions affect the use and generation of resources within the economy. Hence, not only the manner in which actors can pursue their aims, but also the extent to which they can achieve them, are influenced by the institutional structure.

In order to identify the relevant institutions for actors within the Tanzanian state apparatus and its parastatals, this study takes Kornai's model of the socialist system as a point of departure. Although Tanzania was not a classical centrally planned economy, it featured the central elements of a socialist system. No system corresponds in practice to a theoretical model and, besides, a host of informal rules complements any formal system. Tanzanian socialism, both in theory and in practice, was characterised by a strong African identity. The formal socialist system was permeated by a set of informal institutions, related to features that the country shares with other Sub-Saharan African economies. The pre-capitalist peasant mode of production in these largely agrarian societies gives rise to what Göran Hydén has labelled the economy of affection:[35] informal networks for social interaction, largely based on kinship, and characterised by certain values and behavioural rules. Recognition of the informal institutions of the economy of affection is important for understanding the behaviour of Tanzanian actors before, during and after socialism. In this study they will be explicitly considered. Another important circumstance in the Tanzanian case is the role of foreign aid donors, who influence resource constraints as well as the institutional environment in which local actors operate.

The approach of this study is institutional, not only in seeing the soft budget constraint as an outcome of actors' behaviour and interaction given the institutional structure. The soft budget constraint itself is defined as an informal institution: a behavioural rule for interaction in recurrent situations of parastatal financing gaps. As will be argued, this definition extends, clarifies and unifies Kornai's descriptions of the concept, and is compatible both with his perception of it and with the complexity and interdependence as two of its major characteristics. Hence, what we want to explain is the endogenous creation of the soft budget constraint as a result of actors' behaviour and interaction within the system, combining formal and informal rules. This study in effect portrays the evolution of an institution.

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created by trade regulation.

[34] We do not, for instance, have to assume that actors within the state sector, in Tanzania or socialist economies in general, have objectives that in any major way differ from those of other human beings. Neither do we have to know much about them. In the example of the previous footnote, for instance, it is sufficient to assume that power is one element in the objective function of state actors, once we know the institutional context in which they operate.

[35] Hydén (1980).

We thus need an approach that allows for the study of the sequence of events, and their causal relationship, which make the soft budget constraint evolve - emerge, prevail and persist or change - over time. We want a framework within which we can study dynamic processes of interaction: first of all, between actors within the state bureaucracy and the parastatals; secondly, between the soft budget constraint and its 'determinants', i.e. other institutions; and, thirdly, between the soft budget constraint and its effects, remembering that it is a link in a causal network.

The institutional approach adopted in this study, which is in the tradition of the new institutional economics, offers a framework for such an evolutionary analysis of processes through which institutions are created.[36] This approach, which is largely inspired by Richard N. Langlois,[37] involves a broadened rationality assumption, recognising humans' bounded rationality and their ability to learn from experience and to gradually adapt to the environment. It includes an examination of the logic of the situation, where institutions enter exogenously, define the situation of the actors and thereby influence their behaviour. Thereafter the method of invisible-hand explanation, as inspired by Edna Ullmann-Margalit,[38] is applied. This suggests an explanation of how and why actors' behaviour gives rise to and maintains the soft budget constraint in the case of Tanzanian parastatals.

THE EMPIRICAL METHOD AND DATA

The research questions and the theoretical approach have implications for the empirical method of the present study. Institutional change is characterised by path dependence, which implies that existing institutions, and other prevailing conditions, determine the evolution of new ones. If we want to understand the emergence and persistence of the soft budget constraint in Tanzanian parastatals, we shall have to examine the initial and evolving conditions that prevailed in this particular case. Path dependence is thus a good reason for making a case study of an institution.

Similarly, a conceptual clarification of what kind of phenomenon the soft budget constraint is facilitates not only our choice of theoretical approach but also the empirical study of the phenomenon and its causes. Although institutions can only be observed indirectly, our definition of the soft budget constraint as an informal behavioural rule tells us what to look for: actors' behaviour in the situations in which the rule is expected to apply and the behavioural patterns

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36 By evolutionary, we hence mean a study of the very process of change; of its different stages, and the causal and sequential links between them. Implicitly, our approach is also evolutionary in a more specific sense, involving the study of change through a process driven by variation generation and selection, as defined for instance by Nyberg (1998), p. 10.

37 Langlois (1986c).

38 Ullmann-Margalit (1978).

that result from actors' adherence to the rule. Establishing the existence of the soft budget constraint thus includes a study of how actors bargain for and discretionarily allocate financial resources from the state when parastatals are in financial trouble. This partly corresponds to Kornai's four means of budget softening. However, the author's method of defining the soft budget constraint means that the phenomenon can be observed with better precision, which in turn implies that any additional expressions of the soft budget constraint can be incorporated.

The Data Material

Data have been collected on the application of the soft budget constraint, on the four major and a number of additional forms of external resource transfers to parastatals and their soft character, and on the financial performance of parastatals. This data material is unique, because of its wide coverage at the parastatal and sectoral level, and because it reflects the multitude of expressions that the soft budget constraint takes. Whereas most empirical studies of the soft budget constraint have focused on a selection of enterprises, this study spans over the entire parastatal sector in Tanzania. This implies that a picture of its general prevalence can be painted, and its role for the institutional system and its performance in the Tanzanian case can be grasped. The comprehensive material also enables the study of variations and innovation in the application of the soft budget constraint, which reveals information about its nature. In addition, the data allow us to make observations that would be partly disguised by macro-economic data.

For the preparation of the present study, two pre-studies were made.[39] Hence part of the data material on which our analysis is based has been accounted for earlier. Most of these data were collected in late 1992, and thereby set a natural limit to the time period studied here. The starting point for our analysis is the Arusha Declaration of 1967, in which the official socialist ideology was formulated and a process of institutional development towards a socialist system was initiated. The availability of data is not equally good over the whole period studied, 1967-1992, but generally improves with time. This implies that the best coverage of the different expressions and thus the prevalence of the soft budget constraint is obtained during the second half of the 1980s and the early 1990s. While systemic change in Tanzania is a process that continues up to the present day, the reform period studied spans over eight years. In spite of the fact that such a change tends to take time, this is long enough to enable us to distinguish certain tendencies.

The merits of the data notwithstanding, these are impaired by a number of weaknesses. First of all, the data on the application of the soft budget constraint emanate from a number of different sources with different standards for classification and compilation and details etc.

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[39] Eriksson (1993) and (1995).

Furthermore, the available data are often incomplete. There are many missing observations in the data-sets and much of the desired information is simply not available or would require unfeasible collection, compilation and calculation. Consequently, some of the data consist of broadly collected pieces of information. This is reflected, for instance, in some of the tables presented, which by necessity have to be based on data from different sources. It further implies that the relationship between soft resource transfers and loss-making parastatals cannot be systematically established through statistical methods.

In addition to data which establish the existence of the soft budget constraint, an explanation of its existence involves the use of a wide range of information. The broad approach with its focus on complexity and interaction makes such a wide collection of data necessary, but again, information is not always available in the desired form or quality.

The availability and quality of statistical information in Tanzania is limited in general, for at least two reasons. First of all, in developing countries, methods for data collection, processing and presentation tend to be unsophisticated and much economic activity takes place outside the formal economy, and therefore to a great extent remains unrecorded in official figures. Although Tanzania appears to have a relatively well-functioning organisation for the production of economic statistics, figures are still subject to serious deficiencies.

Amit Bhaduri *et al.* account for weaknesses in the official statistics on output, investment and foreign transactions in Tanzania.[40] Apart from inherent inconsistencies and calculations based on out-dated assumptions, common tendencies appear to be that output, trade and investment are underestimated, due to poor coverage, while the foreign deficit is overestimated. Estimates of value added and capital formation have largely been based on data for the parastatal sector, whereas small-scale, private and informal activities have only been included to a limited extent. When the Tanzanian economy was gradually deregulated from the mid-1980s onwards, small-scale, private and informal activity grew while parastatal activity declined. Consequently, the biases reported here can be expected to have grown over time.

In 1995, after the collection and compilation of most of the data presented in this study, the national accounts of Tanzania for the period 1976-1990 were revised in order to correct for some of these weaknesses. According to the revised figures, official gross domestic product (GDP) and gross capital formation (GCF) grew considerably faster during the period 1989-1990 than had been indicated by the earlier figures. As a result, the revised estimate of GDP at factor cost in 1990 was 62 per cent higher than the old estimate, GDP at market prices was 46 per cent higher and GCF at current prices was 30 per cent higher.[41]

Apart from reflecting overall growth, the official GDP is sometimes referred to in this study in order to illustrate the relative magnitude of various quantities. However, the earlier figures have not been replaced by the revised ones, for two reasons. First of all, the revised time series

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[40] Bhaduri *et al.* (1993), pp. 105-128.

[41] Bureau of Statistics (1995b), pp. 2 and 5-4.

are not sufficiently long to allow for a consistent replacement throughout the material, but would introduce unnecessary inconsistencies and would complicate comparisons of the data. The revision begins with data from 1976, and although the revised nominal output series has been extended to 1994, data on real output have only been revised up to 1990.[42] Secondly, the marginal returns from such a recalculation and substitution exercise are likely to be small in relation to the associated costs. The only major differences between the old and the new series occur from 1989 onwards, while changes during the period 1976-1988 are marginal. The biases in the unrevised output (and investment) data reported here must instead be borne in mind when reading and assessing the material that refers to the late reform period presented in this study.

A second type of information problem is related to the fact that Tanzania used to be a socialist economy, where the 'dubious quality and the limited availability of statistical data is a well known feature'.[43] These problems are in part related to the often vastly distorted relative prices caused by comprehensive price control. Moreover, the discrepancy between the socialist ambitions and the actual economic performance of the system creates incentives for actors to disguise the true picture, for instance by hiding information or dressing the figures. In addition, the importance of financial data tends to be neglected, due to the condemnation of the profit motive and the resulting weak financial criteria for performance. Even the prevalence of the soft budget constraint contributes to distorting information, not least on the financial performance of parastatals, as will be argued in this study. These system-related information problems are all relevant to the Tanzanian case, and will be highlighted in the text. However, during the reform period, some of the information distortions were reduced as a result of price deregulation, while others remained due to the heritage of socialist practices.

The information problems imply that we sometimes have to make do with data of dubious or unknown quality. Nonetheless, any information should be treated with care and interpreted with caution. Data that are central for the analysis and make a significant contribution to existing knowledge should be subjected to particularly critical scrutiny. In our study, this applies primarily to data on the application of the soft budget constraint and on parastatal performance, the character of which is discussed in relation to their presentation in the text. Other information by necessity has to be subjected to a more superficial scrutiny, and explicit reference cannot be made to all its weaknesses. Where a weakness has been specifically identified, this must be borne in mind while reading the text. This applies, for instance, to macro-economic data, where exact figures may be particularly misleading as to actual values, while they may better reflect relative magnitudes and changes in these. As suggested above, biases in official statistics tend to be systematic.

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[42] Bureau of Statistics (1995a), p. 1. Later revisions, that have been unavailable to me, may also have eliminated the latter limitation.

[43] Román (1995), p. 14 ('statistical data' is emphasised in the original), making further reference to Nove (1986) and de Vylder and Fforde (1988).

Story Telling

The character of the data material at our disposal - its complexity and the fact that the information partly comes in bits and pieces - suggests a method for its presentation. While individual pieces of information may be difficult to interpret and may appear to be of limited use, they can nevertheless prove useful and be assigned a meaning if they are incorporated into a wider context. Taken together, they contribute to painting a coherent picture of the soft budget constraint and its causes. Hence, the means by which we shall present this comprehensive material is by telling the story of the soft budget constraint.

There are other reasons for applying the method of story telling. Since the task of this study is to trace the origin of the soft budget constraint, answering the question of why it exists also requires an answer as to how it came about. This amounts to accounting for its history. According to Karl R. Popper, 'this agrees entirely with the popular idea that to explain a thing causally is to explain how and why it happened, that is to say, to tell its "story"'.[44] Hence, story telling is the method by which we approach our research problem. Telling a story also appears to be the most appropriate way to apply the invisible-hand approach to the empirical world, since it implies that we study the proceeding of processes - events in causal and chronological sequential stages over time.[45]

Story telling is, however, more than a popular perception of causal explanation. Although seldom recognised by economists, according to Donald N. McCloskey, it is often and should be an important part of the scientific method which we and other researchers employ.[46] McCloskey argues that as scientists, we use rhetoric in a conversation with our audience, in order to persuade them that the points we make are valid, and telling stories is one of the tools we use. The other tools are fact, logic and metaphor.[47] Economists do often not take their story telling seriously. They 'concentrate on making their metaphors - "models" - meet rigorous standards of logic, and far less on making their stories - "stylized facts" - meet equally rigorous standards of fact'.[48] All tools are, however, important and complement one another. 'Metaphors and stories, models and histories, subject to the discipline of fact and logic, are the two ways of answering "why".'[49]

This work forwards a rhetorical argument in the spirit of McCloskey. On the basis of our facts: the vast data material; our metaphors: the definition of the soft budget constraint, the institutional approach and the invisible-hand explanation; and logic reasoning, it tells the story

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44 Popper (1964), p. 144.

45 Cf. Nelson (1986), pp. 136-137, also referring to Nelson and Winter (1982).

46 See for instance McCloskey (1990), pp. 1-23, *passim.*

47 McCloskey (1986), (1990) and (1994). For a discussion of the 'rhetorical tetrad', see for instance McCloskey (1994), pp. 61-63.

48 Lundius and Lundahl (forthcoming), p. 8, referring to McCloskey (1990), p. 23.

49 McCloskey (1990), p. 10.

of the soft budget constraint and why it exists. It thereby attempts to persuade the reader that this is a plausible story. This does not imply a rejection of the possibility that the data presented here can be interpreted differently. Certain pieces of information probably lend themselves to alternative interpretations more easily than others. However, rhetoric is the art of speaking and we try to persuade the reader that our interpretation of the data makes sense, given the metaphors we use, the logic of our reasoning and the story we tell. This implies that not every possible qualification can or should be highlighted. Then there would be no story. Certainly, persuasion also involves making appropriate comments on relevant weaknesses of the available facts and making reservations about interpretations when this is called for. In the end, it is the reader who decides whether or not we have succeeded.

CONTRIBUTIONS

By applying an institutional approach to the study of the soft budget constraint in the case of Tanzania, the present work relates to three major fields of economic inquiry, to which it aspires to make a contribution. The most immediate ambition is to answer our research questions in this particular case: to examine the emergence, persistence and logic of the soft budget constraint within the parastatal sector in Tanzania.

In the pursuit of this exercise, the study also provides new insights into related issues, pertaining to the problems experienced by the Tanzanian economy: the poor performance of parastatals and the socialist system and the problems associated with the slow, painful and partly ineffective transition of the system and the parastatals within it. By studying the behaviour of individual actors while stressing complexity and interdependence within the institutional structure, this study combines and links a micro-economic perspective with an analysis at the system level. It claims to thereby make a contribution to the literature on the Tanzanian economy which will deepen our understanding of its functioning, performance and development during socialism, crisis and transition in general, and of the parastatal sector in particular.

The study also contributes to the economic analysis of the subject matter: the soft budget constraint. It complements the scanty empirical literature, in three major respects. First of all, it adds to the few attempts to thoroughly establish the existence of the soft budget constraint, by operationalising the concept and applying it to a unique set of data. Secondly, the study is exceptional in constituting the first known empirical examination of a suggested explanation of the soft budget constraint. In particular, and thirdly, it is unique in studying the emergence, persistence and logic of the soft budget constraint by spanning over the three periods of socialism: rise, height and decline.

By examining a case, the ambition of the study is to enhance our understanding of the soft budget constraint and why it exists in general. It generates fresh knowledge about the nature, expressions, emergence, functions, consequences, maintenance mechanisms, stability and

change of the soft budget constraint. Our case study thereby offers suggestions for more generally valid answers to the questions posed here, with implications for the theory on the soft budget constraint. In this regard, the study also claims some originality and novelty. By defining the soft budget constraint as an informal institution and suggesting an invisible-hand explanation of its emergence, persistence and logic, it complements the existing theoretical literature. The study elaborates the theory of the soft budget constraint and adds to the method of studying it.

Institutional analysis is the third major field of economic inquiry to which the present study relates. The role of institutions is increasingly recognised, but most contributions in this area appear again to be theoretical. As pointed out by Robin C.O. Matthews, the quantitative measurement of institutions is not a straightforward exercise.[50] The concept is complex and often vaguely defined, and relevant data are not routinely collected. Empirical institutional analysis is nonetheless becoming increasingly common. The present study offers an example of this, and represents an attempt to operationalise an informal institution. More specifically, it studies the evolution of an institution, a field where empirical studies are particularly scarce.

The study may thus have implications for our knowledge about institutions, their role and change at a more general level, for instance by providing insights about the character and problems of transition from socialism to capitalism. In addition, it is hoped that a contribution will be made to our understanding of the role of informal rules, including those that are culturally determined.[51] This study may have wider implications than initially appears. To the extent that it succeeds in its endeavour, it sheds light on the soft budget constraint and the role of institutions not only in current or former socialist economies, but also in other Sub-Saharan African economies, where informal behavioural rules of the economy-of-affection type prevail.

THE STRUCTURE

Our metaphors - the conceptual, theoretical and methodological foundations for this study - are established in Chapter II. The chapter first discusses the subject matter, the soft budget constraint, as presented and explained in the literature. Thereafter, an account is given of the theory and methodology used in the present study. We discuss what institutions are and how they evolve, and present the approach adopted: our definition of the soft budget constraint, the method of situational analysis, our basic assumptions and the elements of an invisible-hand explanation. Once this analytical framework is established, metaphor and logic can be combined with facts - into a story.

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[50] Matthews (1986), p. 917, quoted by Zhang (1997), p. 30.

[51] The works of Fukuyama (1995) and Putnam (1993) represent the increased recognition of the role of culture for economic performance and the functioning of formal rules.

The story of the soft budget constraint begins in Chapter III, which studies its origin within the Tanzanian parastatal sector. The chapter takes the historical, cultural and ideological setting as a point of departure, and examines how the situation of parastatal managers and state bureaucrats was influenced by the changing institutional environment implied by the gradual development of the socialist system in the 1970s. By studying the behaviour of the actors and their interaction, a story is told of how the soft budget constraint gradually and spontaneously emerged as an informal behavioural rule, without being intended by anyone.

Chapter IV shows that the soft budget constraint prevailed within the socialist system during the economic crisis in the late 1970s and early 1980s, and that it generated inefficiencies. It contributed to poor parastatal performance and to the macro-economic problems, even to the crisis itself. So what was its *raison d'être?* the chapter asks. Why was it maintained, and how? As the story proceeds, it tells about the functions that the soft budget constraint performed for the actors, by influencing the organisational structure and the institutional system, and how these functions contributed to a cumulative process through which it was self-maintained, and even reinforced, during this period.

The poor performance of the system eventually forced the political leadership to initiate economic reform programmes that involved systemic change and efforts to improve parastatal performance and reduce the problems related to the soft budget constraint. Chapter V tells the story of what happened to the soft budget constraint during the transition period 1984-1992. It examines how the reform process, as well as the past, influenced the behavioural situation of the actors, the problems they faced, their options for dealing with these and their responses. The story tells about the extent to which the soft budget constraint persisted in spite of reform and efforts to eliminate it, how it was effectively eliminated or changed, and why it evolved the way it did. This is where the story ends.

Chapter VI summarises the findings and draws conclusions about the lessons that can be learnt from the Tanzanian experience. The chapter brings the study to a close by discussing its implications for our knowledge about Tanzanian developments, the soft budget constraint and institutional evolution and by making suggestions for further economic analysis.

CHAPTER II

AN INSTITUTIONAL APPROACH TO THE SOFT BUDGET CONSTRAINT

Before the story of the soft budget constraint can be told, the analytical framework which gives structure to this story must be established. The soft budget constraint is our central metaphor. Institutions form another, which is almost as crucial. We shall define the soft budget constraint as an institution and thereafter use a third metaphor - an invisible-hand explanation - to tell the story of the emergence, persistence and logic of the soft budget constraint.

This chapter gives an account of these metaphors and their inherent logic. It begins, however, with a discussion of the soft budget constraint and its causes as analysed in the literature; this in turn is what motivates the research questions and the approach adopted in this study. The second part of the chapter presents this approach: first the institutional theory and then the analytical method.

THE OBJECT OF THE STUDY

This section offers a presentation of how the soft budget constraint has been perceived by other scholars and how they have tried to explain it, in order to better acquaint us with the phenomenon behind the metaphor, while serving as a point of departure for the present study. The presentation includes an account of Kornai's model of the socialist system.

The Phenomenon and its Characteristics

What is the Soft Budget Constraint?

In his study of socialist economies, Kornai identified the soft budget constraint facing enterprises as a characteristic feature within the state sector.[1] However, despite the fact that the concept is by now widely used in the literature, there exists no clear and precise definition. Kornai himself uses a variety of definitions and provides lengthy explanations. To begin with, according to Kornai a *budget constraint* is neither 'a book-keeping identity nor a technical relation, but a rational planning postulate'. It is a *'behavioural characteristic* of the decision maker: he is used to covering his expenses from the income generated by selling his output and/or by earning return on his assets. Therefore, he adjusts his expenditures to his financial resources.'[2] Based on expectations about the firm's future financial position, the budget constraint imposes an *ex ante* constraint on his behaviour. However, if the state, or some other external organisation, compensates the firm for losses incurred, the expenditure of the firm is not limited by the revenues generated from its own commercial activities. In this respect, a *soft* budget constraint is a *non-binding* constraint on the firm's behaviour:

> The 'softening' of the budget constraint appears when the strict relationship between expenditure and earnings has been relaxed, because excess expenditure over earnings will be paid by some other institution, typically by the state. A further condition of 'softening' is that the decision-maker expects such external financial assistance with high probability and this probability is firmly built into his behaviour.[3]

By stressing the requirement that for a firm's budget constraint to be soft, the firm must *expect* future bail-out, Kornai emphasises the dynamic character of the phenomenon. This suggests that an occasional compensation for a loss does not produce a soft budget constraint. It is rather when the firm's budget is regularly adjusted to permit repeated overspending, so that such external assistance can be expected to be forthcoming, that its budget constraint becomes softened. Hence, for a firm's budget constraint to be soft, it must also be perceived as such by the firm.[4]

Expectations of external finance may vary, however, and '[t]he higher the subjective probability that excess expenditure will be covered by external assistance, the softer the budget constraint'.[5] Thus the degree of budget softness may also vary. Kornai regards the soft budget constraint as a theoretical extreme point on a continuous scale. The other extreme point is

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1 As noted by Jasinski (1993), footnote 3, p. 3, 'A full bibliography of what Kornai wrote on the soft budget constraint would have to include almost everything he published since 1979'.

2 Kornai (1990b), p. 21; emphasis added.

3 Ibid.

4 See, for instance, Kornai (1979), p. 807, and (1986c), pp. 44-45.

5 Kornai (1990b), p. 21.

represented by a completely hard budget constraint: the budget of the firm is an effective constraint on its expenditure.[6] In the real world, budget constraints are soft or hard to varying degrees.[7]

The importance attached to the expectations of external assistance is related to the incentives for behaviour that the soft budget constraint thereby creates for the firm. In particular, incentives to economise on costs are weakened and incentives to overspend are created. In theoretical inquiries, it has become increasingly common to consider these incentive problems as arising because the state is unable to credibly threaten to enforce a hard budget constraint on the firm. The soft budget constraint is thus described as a *dynamic commitment problem* for the state.[8] *Ex ante,* the state wants to threaten not to bail out the firm in case of loss, in order to prevent the firm from making such a loss. However, *ex post,* the state faces incentives to bail out the firm, for one reason or another, and the firm's anticipation of this result renders the state's threat non-credible.[9]

Thus the phenomenon has been vividly described, but the literature has not yet provided an unambiguous definition of what the soft budget constraint is. It has been referred to as a behavioural characteristic, a non-binding constraint and expectations of future bail-out by the firm, and as a dynamic commitment problem on behalf of the state. Kornai offers additional elaborations on what the soft budget constraint is, but 'deliberately refrains from an overtly pedantic definition ... The concept, however, must not be interpreted too literally, but more as a metaphor',[10] he argues.

How are Budget Constraints Softened?

Kornai mentions four major means by which budget constraints are softened: *soft subsidies* via the budget, *soft taxation, soft credit* via the banking system and *soft administrative pricing.*[11] These budget-softening transfers are discretionary and therefore negotiable. This implies that the firm can influence its access to the funding, the amount of assistance and the conditions on

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6 Kornai (1979), p. 808, footnote 7, and (1990b), pp. 24-25.

7 The degree of softness may, for instance, be relatively higher in sectors to which the state attaches particular priority. Davis (1989) has shown that the medical system, which was given relatively low priority in the former Soviet Union, faced fairly hard budget constraints, while Ericson (1988) suggests that they were relatively soft in the highly prioritised military sector. Kornai (1992), p. 143, footnote 20, notes that large firms tend to face softer budget constraints than small firms. See also Qian and Roland (1994). For further discussion on the degree of budget softness, see for instance Gomulka (1985) and Scott (1990).

8 This literature is largely inspired by Dewatripont and Maskin (1989), and later versions, eventually published in a revised form (1995); it includes, for instance, Berglöf and Roland (1994), Hardy (1992), Qian (1994) and Qian and Roland (1994). See also Lindbeck and Weibull (1988).

9 As pointed out by and Qian and Roland (1994), p. 1, 'Time inconsistency is at the heart of the soft budget constraint problem'.

10 Kornai (1990b), p. 25.

11 See, for instance, Kornai (1990b), pp. 22-23, or (1992), pp. 140-142.

which it is granted and/or repaid, through the use of bargaining, lobbying and political pressure.[12] The assistance is adjusted to the financial situation of the firm; it is 'tailor-made', granted in order to compensate for cost increases, overspending or losses so as to help the firm out of even chronic financial trouble.[13]

The soft budget constraint is hence the outcome of a bargaining process between the state and the firm. The firm typically lobbies with state bureaucrats for a subsidy, tax exemption, renewed credit (despite previous payment default) or an increase in its output price according to the cost-plus principle. Officials at the Treasury, the tax office, the state bank, or the price authority allocate the funds at their own discretion. Thus external assistance is not normally forthcoming automatically, but some effort by the firm is needed.[14] According to Chris Scott, budget softness should be viewed as an outcome of rent-seeking activities undertaken by the firm in the *control sphere,* while incurring opportunity costs in the *real sphere.*[15] He refers to Kornai's terminology, where action in the real sphere involves change in real variables, affecting production. Action in the control sphere amounts to efforts to change financial variables, to influence prices or to receive external assistance through manipulation and bargaining in the offices of ministries, authorities and banks.[16]

According to Kornai, the two parties engaged in the budget-softening process are involved in a social relationship: that between a 'paternalistic patron' and a 'patronized organization'.[17] The paternalistic relationship implies that the state assumes some of the responsibility for the firm, its performance and survival, as expressed *inter alia* by the softening of its budget constraint. The degree of paternalism may vary. A moderate degree implies that the firm manages basically on its own until struck by financial difficulties. It then turns for assistance to the state, which helps it out of trouble and ultimately guarantees its continued survival. A higher degree of paternalism implies that the state more actively assumes responsibility for the firm, by more or less automatically accommodating its financing needs. Then a lesser bargaining effort (less intense and sophisticated) is needed by the firm to get the external assistance.[18]

However, such bargaining and relationships do not always seem to prevail when budgets are softened. Kornai recognises the existence of other forms of soft finance, and mentions specifically *inter-firm* or *forced credit* between state- or public-owned firms in reformed or market-socialist economies.[19] In order to solve their liquidity problems, firms may refrain from

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12 Kornai (1985), p. 50.

13 Kornai (1990b), pp. 22-23. For a more detailed discussion of the budget-softening characteristics of external assistance, see also Eriksson (1993), pp. 19-21.

14 Kornai (1990b), p. 24.

15 Scott (1990).

16 See Kornai (1986c), p. 43, and (1980), p. 308. Scott (1990), pp. 120-122, notes that action in the control sphere is identical to rent-seeking or directly unproductive profit-seeking activity.

17 Kornai (1990b), endnote 21, pp. 43-44.

18 See Kornai (1986b) and Scott (1990) on the degree of paternalism and its relationship with the soft budget constraint.

19 See Kornai (1990b), p. 35, and (1992), pp. 501-502, which also refers to several empirical studies on the

honouring their payment obligations to their suppliers, i.e. other firms, which thus find themselves forced to grant credit.

This form of soft finance reveals that Kornai is not entirely clear and consistent as to how budget constraints are softened. First of all, it suggests that soft finance does not necessarily have to be bargained for. Firms can just default on their payments - as long as such behaviour is tolerated by the creditor.[20] Secondly, budget softness cannot always be the outcome of a paternalistic relationship between the parties, if they are two firms engaged in horizontal trade. Finally, financial assistance does not have to be granted intendedly, or with the explicit purpose of accommodating financing gaps, but may have this impact anyway.

Why is the Soft Budget Constraint a Problem?

The problems of the soft budget constraint are related to the incentives that it gives rise to, primarily at the level of the firm, and also to the implications of firm behaviour at the macro-economic level. The major negative effects are the following.[21] First of all, the soft budget constraint weakens the firm's incentives to economise on costs. A firm which expects the state to compensate for its cost overruns has little reason to be restrictive on the expenditure side so as to make do with its initial budget or the resources generated from its own commercial activity. The soft budget constraint may even create incentives to raise expenditure, or spend all the available resources, since overspending can be expected to generate additional funding. This may apply in both profitable and loss-making firms.[22] The basic negative effect of the soft budget constraint on the behaviour of the firm is weak financial discipline, which in turn has a number of consequences. The most immediate effect is inefficient use of resources.

As a result, the firm's price responsiveness tends to be weak, particularly on the input side. Weak response to changing relative prices gives rise to allocative inefficiency as input-output combinations are not adjusted. Such inefficiency becomes particularly marked when price structures change significantly. By protecting firms from bankruptcy and liquidation, the soft budget constraint contributes to the preservation of inefficient and rigid production structures. Reallocation of resources is hampered, both within and between existing firms, and this is turn hampers dynamic adjustment through the exit of old firms and the entry of new ones.

Another important consequence of the soft budget constraint emphasised by Kornai is its tendency to fuel demand and generate shortages. Kornai contends that most objectives of the

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subject.

20 Admittedly, Kornai does not deny this possibility, but he consistently stresses the role of bargaining.

21 See Kornai (1990b), pp. 26-29, or (1992), pp. 146-147, for a survey.

22 Besides, when losses are compensated for, profits are often taxed away in a discretionary manner. On the 'levelling' of profits between Hungarian state-owned enterprises, see Kornai and Matits (1984). When the firm is unable to benefit from its profits, incentives to spend all available resources are reinforced. Cf. Hare (1989), pp. 56-57, Kornai (1992), p. 146, and Nagaoka and Atiyas (1990), p. 15.

firm (profit, sales, growth, firm size, discretion, power) are associated with expansion, which in turn tends to continuously increase the firm's demand for both recurrent inputs and investment.[23] With a soft budget constraint, there are weak limitations on expenditure, or none at all, which is why the demand of the firm tends to 'run away'[24] to the extent of becoming 'almost insatiable'.[25] Hence, in combination with what Kornai calls the quantity and expansion drives in socialist economies, the soft budget constraint breeds excess demand for inputs and investment. According to Kornai, this excess demand cannot be eliminated by pure price adjustment, since firms are more or less unresponsive to prices.[26] Instead it results in persistent shortages which tend to become self-reinforcing.[27] Firms will hoard inputs unlimitedly in order to ensure their access to them.[28] Combined with investment hunger, the soft budget constraint may thus lead to over-investment as well as to investment in technology of inferior quality, which further contributes to hampering innovation and development.[29]

One implication of the soft budget constraint is that money plays a rather passive role for the firm:[30] financial resources accommodate - instead of constrain - its activity. The prevalence of soft budget constraints may therefore render macro-economic stabilisation efforts ineffective. Tight monetary and fiscal policy cannot be pursued if firms are unresponsive to price signals, such as the interest rate, and as long as funding is guaranteed for poorly performing firms. Demand management only works if budget constraints are hard.[31] The soft budget constraint thus contributes to the generation of inflationary pressure.[32] Certainly, the magnitude of this as well as the other macro-economic consequences depend on the prevalence of the phenomenon.

Thus the soft budget constraint hampers not only economic development, but also the effectiveness of various government policy and reform measures. By worsening macro-economic imbalances and retarding structural adjustment, the soft budget constraint becomes a

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23 Kornai (1990b), p. 27.

24 Kornai (1992), p. 147.

25 Kornai (1979), p. 809.

26 Qian (1994) takes a different position.

27 Kornai (1979). A debate on the character and interpretation of shortages or excess demand in socialist economies has taken place between Kornai and adherents of the so-called disequilibrium school. For a survey of the debate, see van Brabant (1990) and a conference volume edited by Davis and Charemza (1989). A related debate concerns the relevance of the soft budget constraint for the prevalence of shortages in socialist economies. Kornai introduced the concept of the soft budget constraint to explain these persistent shortages. However, other factors have been forwarded as explanations. See Gomulka (1985), Kornai (1985), Hare (1989), Bajt (1991) and Jasinski (1993). Besides, certain authors, notably Gomulka (1985), consider efficiency loss rather than shortages to be the main consequence of the soft budget constraint.

28 Magee and Quandt (1994) explore theoretically how the soft budget constraint may lead to a higher than normal demand for inputs. Cf. Qian (1994).

29 See Xu and Qian (1992) for a theoretical examination of the relationships between the soft budget constraint, investment and innovation.

30 Kornai (1992), p. 147.

31 Kornai (1990b), pp. 28-29, and (1992), pp. 147-148.

32 A thorough discussion of shortages and inflation, their causes, including the soft budget constraint, and the relationship between them in the socialist system is provided by Kornai (1992), Chapters 11-12, pp. 228-301.

major obstacle to the market oriented transition of former socialist economies, and to economic reform programmes in developing countries.[33] An additional negative consequence of the soft budget constraint, which acts as a major obstacle to reform, has been identified by Hay *et al.*: 'the political and bureaucratic ... methods through which the soft budget constraint operates provide a fertile area for both petty and major corruption, using financial relaxation as a lever to pursue personal goals, reward associates etc.'[34] This suggests an explanation for the soft budget constraint, the subject to which we now turn.

Explanations of the Soft Budget Constraint

Several explanations of the soft budget constraint have been forwarded. Explicit attempts to trace its causes are becoming more and more frequent at the theoretical level, but as mentioned earlier, none of the suggested explanations has been examined empirically. This sub-section surveys the different types of explanation presented in the literature.

Objectives versus Institutions as Partial Determinants

A number of studies, particularly those that regard the soft budget constraint as a dynamic commitment problem, focus on the question of why the *state* faces incentives to bail out loss-making firms and thereby softens their budget constraints. Answers are usually sought *either* in the objectives of the state *or* in institutional factors which shape its incentives.

Budget softness is sometimes perceived as a result of the divergence of the state's objectives from the profit motive and, hence, from the assumed objectives of the firm.[35] Despite operating at a loss, the survival and continued operation of a firm may fulfil some of the goals of the state. The state may therefore be willing to pay with budget softness for the benefit thus achieved. If the state is a benevolent social guardian, it may try to enhance social surplus,[36] which is likely to diverge from the firm's profit, in particular if market structures are monopolistic, the exchange rate is overvalued and prices are controlled.[37] However, since the soft budget constraint seems to result in socially inefficient rather than efficient outcomes, the state may have other goals than social efficiency. Several authors suggest that it may want to keep even an inefficient firm going

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33 As suggested by empirical studies, discussed in the previous chapter.

34 Hay *et al.* (1994), pp. 325-326.

35 For instance, by Boycko *et al.* (1992) and Segal (1993), as noted by Qian and Roland (1994), p. 3, footnote 4.

36 As suggested by Nagaoka and Atiyas (1990), p. 10; and by Shleifer and Vishny (1994), referred to by Qian and Roland (1994), p. 3, footnote 4.

37 Nagaoka and Atiyas (1990), p. 11.

in order to maintain the output or employment level, particularly if the firm is large or holds a monopolistic position, so that a closure would have substantial social consequences.[38] Such consideration may reflect power motives, or what has been referred to as political constraints.[39] Assar Lindbeck and Jörgen W. Weibull show that if the state is altruistic, in the sense that it is concerned about and derives utility from the welfare of the recipient firm, a soft budget constraint may result because such common concerns give rise to the non-credible commitment problem.[40]

This type of explanation for the soft budget constraint identifies its major cause as lying within the objectives of the state. However, the form that objectives take depends largely on the institutional system. Some researchers even suggest that the soft budget constraint may be compatible with a profit-maximising state, or with a state that maximises the firm's profit, while they trace its explanation to incentives created by institutional factors. Mathias Dewatripont and Eric Maskin, and several followers,[41] argue that once resources have been invested in a bad project, it may be optimal for the state, or any other creditor, to refinance it in order to ensure some returns on the investment. When the state only gradually gains information about the quality of the project, the prevalence of sunk costs may motivate it to bail out loss makers.[42]

Dewatripont and Maskin argue that this is the general state of affairs, while it is the hard budget constraint that is the exception.[43] The so-called sunk-cost trap[44] is particularly severe if the extension of finance is centralised, as when the banking system is state owned. The resulting size enables the refinancing of bad projects. If, however, credit is decentralised, incentives to bail out loss makers are weakened. Individual creditors are too small to afford such refinancing, and new creditors are needed. The new creditors are less informed about the project and have to pay an informational rent to the old creditor, and thus do not capture all the returns from refinancing.[45]

Another institutional condition that has been referred to as an explanation of why the state bails out loss makers is centralised decision making. If the autonomy of the firm is weak because of extensive state regulation and intervention, the state may find it difficult to hold the firm responsible for its financial performance. Even if autonomy is increased at a certain stage, present losses may reflect government imposed restrictions in the past. The state may thus bail

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38 See, for instance, Boycko *et al.* (1992), Hardy (1992) and Staehr (1993).

39 By Dewatripont and Maskin (1989) and (1995).

40 Lindbeck and Weibull (1988).

41 See Berglöf and Roland (1994), Dewatripont and Maskin (1989) and (1995), Nagaoka and Atiyas (1990), pp. 11-12, Qian (1994) and Xu and Qian (1992).

42 Compare this proposition with the case of perfect information. If the state knew in advance that refinancing of a bad project would not be worthwhile, sunk costs would be genuinely sunk, which according to theory implies that they would have no opportunity value and therefore no bearing on refinancing decisions.

43 Dewatripont and Maskin (1995), p. 543.

44 Nagaoka and Atiyas (1990), p. 11.

45 Dewatripont and Maskin (1989).

out the firm as 'compensation for past limited autonomy'.[46] This explanation corresponds to the paternalistic relationship between the state and the firm, to which we shall soon return. The effect of different aspects of regional decentralisation of authorities and control rights, from higher- to lower-level governments, on the degree of budget softness of public firms is examined by Yingyi Qian and Gérard Roland.[47] They suggest that fiscal centralisation (lack of competition for capital), easy access to credit for the local government, decentralised monetary authority, large employment rents or quasi-rents received by employees, a large number of employees per firm, a concentrated population and a large number of firms under one jurisdiction all tend to soften the budget constraint.

However illuminating, most of these studies offer only partial explanations of the soft budget constraint. They focus on the role of either objectives or institutions, as if these were unrelated, and almost exclusively try to explain the behaviour of the state, while ignoring that of the firm. In general, they disregard any more complex causal relationships and interactions. The focus is on generally valid explanations of the soft budget constraint, while little attention is devoted to seeking answers within the socialist system. However, there is another tradition also in the literature.

Under Socialism: Within the Classical System

Kornai's research has been directed towards understanding the nature of the socialist system, in both its classical and its reformed form. The soft budget constraint is considered to be a characteristic trait of this system mainly because of the paternalistic relationship between the state and the state-owned firms. Hence, according to Kornai, paternalism is the 'direct explanation for the softening of the budget constraint'.[48] The higher the degree of paternalism, the greater the state's responsibility for the firm, the weaker the bargaining effort needed for external finance, the stronger the firm's expectations of assistance and the softer the budget constraint.

Jasinski finds this explanation of the soft budget constraint unsatisfactory, partly because it only forces us to reformulate the question. 'We should ask ... why the state is paternalistic.'[49] Kornai does not answer this question explicitly, but in a more recent contribution he synthesises his previous arguments by offering a more complete and coherent picture of the socialist system.[50] He traces the causal linkages between the major elements of the system, so that different systemic phenomena receive a more comprehensive explanation. Kornai distinguishes

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46 Nagaoka and Atiyas (1990), p. 10.

47 Qian and Roland (1994).

48 Kornai (1986b), p. 59.

49 Jasinski (1993), p. 6.

50 Kornai (1992).

between the classical and the reformed socialist system.

The classical socialist system consists of five elements.[51] The key to understanding the system is the *political structure.* This element combines the undivided *power of the communist party* with the dominant influence of the *official socialist ideology.* The party is imbued with its ideology, which legitimises its power and paternalistic nature. As the vanguard of the working class, the party knows best what is in its interest and is destined to lead the whole of society. The party decides on all major appointments, promotions and dismissals within the state. The two penetrate one another and their officials, together with functionaries in mass-organisations and managers in state-owned firms, form a bureaucratic hierarchy.

The political structure is the underlying factor explaining all the other elements of the system. It brings about the property form which 'it deems desirable'.[52] The second element of the classical system is thus the dominant position of *state and quasi-state ownership* of at least the so-called commanding heights of the economy. Ideology rationalises state ownership which vests economic control with the party. The right of disposal of the residual income of state-owned firms belongs to the state - 'to all and to none'[53] - or effectively, to the bureaucracy, which also exercises control rights over the firm.

Political power, socialist ideology and state ownership jointly determine the co-ordination mechanism. Under classical socialism, there is a preponderance of *bureaucratic co-ordination,* which is the third element of the system.[54] Bureaucratic co-ordination allocates resources administratively, channels information and co-ordinates human activity within a bureaucratic hierarchy with vertical relationships. The bureaucracy actively interferes in the co-ordination process, including the daily operation of firms, by using commands, both in the form of planning and as *ad hoc* interventions. There is *direct* bureaucratic control of the economy. Subordinates are dependent on superiors, although certain vertical bargaining takes place, which implies that effort to win superiors' approval through command execution is the overriding success criterion.

These three elements, which form the ideology and the political and economic systems, are the central features of the classical socialist system and the underlying factors that explain the other elements. First of all, they influence a fourth element: a set of system specific characteristics related to the *interests, motives* and *behaviour* of and *relationships* between the individuals. Here Kornai groups together such phenomena as paternalism, plan bargaining, the quantity drive, the soft budget constraint and weak price responsiveness. These traits, in turn, together with the initial ones, influence a fifth element, what Kornai refers to as *'typical lasting economic phenomena'.*[55] These include forced growth, chronic shortage, unemployment on the job etc., and are hence expressions of the problems and performance of the system.

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[51] The following presentation is based on Kornai (1992), Chapters 3-7 and 15.

[52] Ibid., p. 362.

[53] Ibid., p. 75.

[54] The other co-ordination mechanisms that Kornai (ibid.), Chapter 6, refers to - market, self-governing, ethical and family co-ordination - play subordinate roles.

[55] Ibid., p. 363.

Kornai is keen to stress that despite the main direction in the causal chain thus outlined, the line of causality between the system-specific phenomena, which interact, may also run in the opposite direction. The soft budget constraint is assigned a central role in the system, since it provides an explanation for much of its *modus operandi,* but it is regarded as a link in a causal chain rather than as a basic determinant. There is an affinity between the elements of the system, which 'attract and require each other',[56] because as the system evolves, coherence and consistency develop between its elements. Over time, the system consolidates itself as there is an organic growth of institutions and behavioural patterns within it.[57] 'A curious "natural selection" comes to apply: new institutions, regulations, customs, and moral and legal norms that are easily reconciled with the nature of the system survive and take root; those alien to it are discarded.'[58]

Kornai seems to retain his idea about the relationship between paternalism and the soft budget constraint, but he now provides a framework which could offer a richer explanation of the causes of the soft budget constraint *and* of paternalism. However, as mentioned in the previous chapter, he does not explicitly perform the analysis, since his focus is on explaining the system as a whole. This implies that he is unclear about the role of paternalism versus the other systemic causes of the soft budget constraint. In the model of classical socialism, he places paternalism and the soft budget constraint in the same category (the fourth element), and says that they are caused by the same overall systemic factors. In spite of the other systemic explanations suggested by his framework, his adherence to paternalism has been criticised. Jasinski holds that by singling out paternalism, Kornai implicitly assumes that the state could be anything but paternalistic and thus that the soft budget constraint could be eliminated under classical socialism.[59] Jasinski agrees that the soft budget constraint is a systemic feature, but for a different reason: because planning is an imperfect substitute for 'an all-embracing market self-regulatory mechanism'.[60] He regards the soft budget constraint as a 'logical necessity: under central planning ... budget constraints had to be soft'.[61] The logic of the soft budget constraint under central planning can be described as follows.[62]

Central planning is difficult. Due to the complexity of society, it is extremely troublesome to pursue any major exercise where planned quantities of inputs and outputs are to be matched. Hence, more often than not, state-owned enterprises fail to live up to the plan, by not reaching the planned output target with the resources available. Nonetheless, plan fulfilment is the primary success criterion; other goals are subordinated. Financial profit is even irrelevant, since controlled prices do not reflect relative scarcities. When both quantities and prices are controlled, costs and profits contain no information about the efficiency of a firm. There is thus

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56 Ibid., p. 366.

57 The term *organic* is explained below.

58 Ibid., p. 366.

59 Jasinski (1993), p. 6. Kornai (1992), p. 495, footnote 38, denies that this is what he means.

60 Jasinski (1993), p. 8.

61 Ibid., p. 14.

62 Inspired by Jasinski (ibid.), pp. 8-14.

no objective criterion by which to evaluate performance and thereafter to reorganise the physical assets.

Under those circumstances, the post-correction of plans may be right. When a firm fails to fulfil the plan, additional funding provided by the state is necessary to ensure an output that is as close as possible to the plan. With state enterprises as the major or only production units, they must be kept alive for any production to take place, in order to keep the entire production and planning machinery intact and the central plan inherently consistent. Softening of the budget constraint thus provides a means by which to adjust the plans underway, whereby the extremely rigid planning system gains some flexibility. Given the plans and the numerous constraints facing a firm when all 'variables' are fixed, offering budget softness also provides incentives for the firm to make an effort to fulfil the plan targets. If budget constraints were also binding, the firm would have no scope left at all for manoeuvre.

As a logic of central planning, the soft budget constraint thus had a function to perform, which Jasinski describes in the following manner:

> ... the soft budget constraint can be looked at as a relatively cheap and fair way of overcoming the problems caused not only by difficulties with writing consistent plans and monitoring their fulfilment, but also by unforeseen circumstances like, for example, a change in the terms of trade. In other words, the soft budget constraint seems to be an economical answer to the problems of *incentive, information, and insufficient flexibility* inherently present in centrally planned economies.[63]

The soft budget constraint may thus not only have negative effects, but also some beneficial consequences, as noted by Hay *et al.* Firstly, it works 'as a supplementary tool in a planned economy used to adjust the allocation of resources so that resources can be used more efficiently. In the second case, it gives a sense of security to the work-force so that social stability can be maintained.'[64]

Under Socialism: Within the Reformed System

Despite the coherence of classical socialism, the system is ridden with inner conflicts and tensions that accumulate over time. It is dysfunctional, has internal problems and performs poorly, which eventually leads either to reform or to collapse of the system.[65] According to Kornai, the accumulation of economic difficulties, public dissatisfaction with these and with political repression, loss of confidence in the system by those in power and the outside example

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[63] Ibid., p. 11; emphasis added.

[64] Hay *et al.* (1994), p. 55.

[65] See, for instance, Verdery (1993) for an analysis of the fall of the socialist system. Kornai (1992), p. 384, footnote 1, provides references on the tensions within the system.

of other reforming socialist economies are the major sources of change within the system.[66] *Reform* of the classical system refers to a major and persistent change in at least one of its first three elements: political structure, ownership form or co-ordination mechanism. However, the systemic traits remain basically intact. *Post-socialist transition,* by contrast, involves radical change in the first element. It ends the political monopoly of the communist party, which in turn brings fundamental changes in the other elements towards a capitalist market economy.[67]

Reforming socialist economies have experimented with a multitude of measures to make the system perform better.[68] Most of them eventually resorted to various forms and degrees of deregulation. In particular, the role of central planning was reduced and direct bureaucratic control was thereby replaced by elements of market co-ordination and indirect bureaucratic control. Decision making was partly decentralised, which gave state firms increased autonomy. However, the bureaucracy continued to control the firms, in particular their entry and exit and the appointment of managers, through informal orders, interventions and micro-regulation of a more *ad hoc* and discretionary nature. Bargaining became more widespread and increasingly concerned with prices, wages, taxes, subsidies, credits, licences etc., and the bargaining power of subordinates grew stronger. Hence, state-owned firms came to operate under what Kornai refers to as dual dependence: vertically on the bureaucracy and horizontally on their buyers and sellers.[69]

The fact that the soft budget constraint remained a characteristic feature of the reformed socialist system has been recognised by many observers.[70] Jasinski even suggests that, while caused by basically the same factors as in the classical system, it became more widespread and its consequences more damaging.[71] Decentralisation and bargaining increased the scope of manoeuvre for firm managers while state monitoring and control decreased. In combination with eased political pressure, implying milder consequences for managers in case of disobedience, this weakened the financial discipline in the firms. Maxim Boycko *et al.* similarly suggest that when there is a mere transfer of control rights to the firm, increasing its autonomy in management, the budget constraint tends to become softer. When, however, cash-flow rights are also transferred through privatisation, it should become harder,[72] which in turn hints at what could be expected from the eventual post-socialist transition.

Kornai examines why state bureaucrats continue to soften the budget constraint of state-owned firms under reformed socialism. He now makes use of his system framework, seeking answers in political power, ideology, property and bureaucratic co-ordination.[73] First of all, firm

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66 Kornai (1992), pp. 383-386.

67 Ibid., pp. 388-389.

68 Kornai (ibid.), Chapters 17-22, surveys the various categories of change.

69 See Kornai (ibid.), p. 482.

70 Kornai (ibid.), p. 489, footnote 25, provides several references.

71 Jasinski (1993), pp. 17-18.

72 Boycko *et al.* (1992).

73 See Kornai (1992), pp. 493-495.

managers are appointed by and depend on higher level bureaucrats, who in turn partly need the managers' support for their own positions. Individuals within the bureaucracy also tend to identify themselves with other members, and are therefore willing to help an ally in trouble. Liquidation of firms might also reduce the 'mass basis' for their power, in terms of the workers, and thus threaten their legitimacy. Secondly, the bureaucrats' motives for bail-out can be traced to socialist values, which favour solidarity with the weak and poor, worker security and social equality through the levelling of earnings. New conflicting ideas of profit maximisation were introduced, but traditional values were stronger. For the individual state and party bureaucrat, 'paternalism is his bounden duty'.[74]

Furthermore, state ownership implies that there is a lack of separation of functions within the state, which is simultaneously the owner and the manager of the firm. This contributes to an unclear division of responsibilities and weakens incentives for the owner, the state, to financially discipline the manager, also the state. Another source of bureaucrats' interest in the survival of firms managed by their appointees and related to state ownership has been pointed out by Jan Winiecki.[75] The dependence of the firm managers on the benevolence of state and party bureaucrats for financial support enables the latter to extract various forms of rent, notably in the form of goods and services in scarce supply which are produced by the firm.[76] The bureaucracy thereby manages to capture some informal rights to the state-owned property. Finally, returning to Kornai, continued regulation and intervention by bureaucrats in the management of a firm still implies that it cannot be held fully responsible for its loss. The failure of the firm is partly of the bureaucrats' own making, so that they have an interest in disguising it.

The explanations for the soft budget constraint under both classical and reformed socialism offered by Kornai and Jasinski are quite comprehensive and complement one another fairly well. Kornai focuses on how both objectives and incentives shaped by the system influence the behaviour of state bureaucrats, while Jasinski performs an analysis of the function of the soft budget constraint at the system level. Nonetheless, the link between the two levels is weak and only implicit. The relationship between the soft budget constraint and the other systemic elements as well as its significance for the actors within this system has not been clarified. The dynamic interaction between the institutional system, the soft budget constraint and the actors is missing.

A major strength of the classical system is accounted for by its coherence, but in the coherence lies also its vulnerability. The affinity between state ownership and bureaucratic co-ordination implies that the linkages between them are strong. They reinforce and stabilise each other. Changes in single elements bring inconsistency, which destroys the system's inner

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[74] Ibid., p. 493.

[75] Winiecki (1992).

[76] Winiecki (ibid.) holds that these rents are most important in large industrial enterprises. This is why such firms are prioritised by the bureaucracy when allocating resources, and why their budget constraints tend to be particularly soft. Cf. footnote 7 above.

coherence, rather than replacing the old system with a new coherent one. Reformed socialism involves efforts to combine mutually inconsistent and repelling elements with weak linkages between them, state ownership and market co-ordination, and is therefore inherently unstable.[77]

Under Post-Socialist Transition

As described above, reform did not improve the performance of the socialist system. The system eventually collapsed and embarked on a transition process towards private enterprise, market economy and political democracy. Surprisingly, despite comprehensive systemic change, involving for instance the privatisation of state-owned firms and banks, extensive budget softness appears to have remained during transition.[78] The duration of the soft budget constraint might in part be due to the fact that systemic change tends to proceed slowly, so that the factors that once gave rise to it are only gradually dismantled, but certain new characteristics have been observed.

Jasinski maintains that the nature and dynamics of the soft budget constraint are changing, that its effects are even more severe than before and that it is more difficult to get rid of.[79] The scale of the problem seems to have increased. Given the dominance of the state sector, the mere size of the group of insolvent firms implies that the political reasons for not eliminating the soft budget constraint are substantial. Recession in many post-socialist economies aggravates the problem by increasing the aggregate losses, while the institutional inheritance slows down the development of the administrative and legal systems which are needed to handle liquidations. Further decentralisation and reduction of controls create what Jasinski refers to as new opportunities for firms with liquidity problems. The position of the firms has been strengthened, since they no longer have to bargain for external finance. Many firms simply refuse to honour their payment obligations. Non-payment is no problem of theirs but of their creditors, who are faced with a *fait accompli.* As a result, huge arrears in, for instance, tax and credit payments have accumulated. And inter-firm credit, while present under reformed socialism, appears to have grown as a source of soft external finance.[80]

Several authors draw attention to the perverse incentives to enforce credit contracts within the financial sector. Explanations are sought for why banks - now with decentralised power to allocate credit - continue to bail out repayment-defaulting state-owned loss makers.[81] David

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[77] On the affinity between ownership forms and co-ordination mechanisms, see Kornai (1990a) and (1992), pp. 447-450 and 497-500.

[78] See Chapter I for references.

[79] Jasinski (1993), pp. 19-28.

[80] See, for instance, Begg and Portes (1992), p. 8, Raiser (1992), pp. 35-36, and (1993), pp. 266-267, and Zhang and Sjöberg (1992), pp. 33-34. Buch *et al.* (1994), p. 43, provide additional references.

[81] See, for instance, Berglöf and Roland (1994). Nagaoka and Atiyas (1990), pp. 12-16, provide several arguments, but their focus is on the pre-transition period.

Begg and Richard Portes point to the fact that the value of a debtor's assets may be less than the cost of enforcing bankruptcy, and that creditors may want to wait and see if the fortune of the debtor improves over time.[82] The latter point suggests that uncertainty about the outcome of bail-out versus non-bail-out seems to make creditors renew finance as in the past, instead of refusing. Begg and Portes further note that action against defaulters may signal the poor status of the bank's own credit portfolio, while passivity may be expected to generate bail-out from the government. If banks are severely under-capitalised, have large non-performing loans and face pressure to support ailing state-owned firms, this may also result in passivity. Passivity of the banks contributes to creditor passivity with respect to inter-enterprise credit, which creates an interlocking network that is 'too big to fail'.[83]

In Market Economies and Governments

Kornai maintains that the soft budget constraint may prevail also in market ('mixed') economies, notably within the public sector.[84] Although empirical studies are largely lacking,[85] the possibility exists. The causes, he argues, are found in the increasing tendency of the state to become a protector of welfare and national interests and in the 'self-reinforcing tendency of bureaucratization'.[86]

It has also been suggested that the government itself may face budget softness. This research is directed towards the problem of budget deficits and the tendency to delay the stabilisation of these.[87] Incentives for the state to overspend may arise, at least in the short run, if there is co-operation between and limited control over several government decision makers: for instance, if ministries or local authorities compete for fiscal resources and if the central bank is weak, monetising their demand.[88] A similar situation may occur if external resources are available, for instance, from another country in the form of foreign aid.[89] A continuously overspending government may thus be thought of as being bailed out by the central bank, through inflationary financing, or by foreign donors or creditors. However, running budget deficits are only considered to be beneficial up to a certain point, when the negative consequences, notably in terms of inflation, have grown to the extent that it is no longer worthwhile for the government to overspend.[90]

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82 Besides, given the accumulated debts, it may be difficult to assess a firm's future profitability potential.

83 Begg and Portes (1992), pp. 7-12 (quotation from p. 11), partly referring to Mitchell (1992).

84 See Kornai (1986c), pp. 46-47, and (1990b), pp. 36-41.

85 As shown in Chapter I, there are studies suggesting that soft budget constraints prevail in developing countries.

86 Kornai (1990b), p. 41.

87 See Velasco (1993) for references.

88 Aizenman (1990).

89 Aizenman and Isard (1990).

90 See Velasco (1993) and Aizenman (1990).

Some authors hold that the budget softness of firms may be related to that of the government or, more specifically, to its money printing authority. David Granick, for instance, argues that Chinese publicly-owned enterprises at the provincial level ought to face harder budget constraints than their counterparts at the central level, since only the central government could finance bail-out by printing money.[91] However, as shown by Zhang, empirically, there are indications that this is not necessarily the case.[92]

This survey of the literature on the soft budget constraint and its causes underpins what was argued in Chapter I. In spite of the important contributions, a clear and unambiguous definition of the soft budget constraint is yet to be provided. Several partial explanations have been offered, but they risk painting an over-simplified picture of causal relationships. In general, complexities, linkages, interactions and interdependencies are disregarded, even though they appear to be important for understanding the characteristics, causes and logic of the soft budget constraint. As shown, the work of Kornai and Jasinski goes a long way towards a more complex explanation, but unclarities and gaps remain and links are missing.

The aim of the present study is to complement the existing literature so as to increase our understanding of the emergence, persistence and logic of the soft budget constraint. It suggests a definition and explanation of the phenomenon that focuses on complexity and interdependence and thereby claims to fill parts of the gaps, while linking some of the earlier attempts at explanation. Let us now, therefore, turn to our second major metaphor: institutions.

INSTITUTIONS

Institutional economics is by no means a homogeneous school of thought. It combines a variety of theories and traditions. Since several attempts have been made to categorise the different strands of institutional economics,[93] this section will not provide yet another survey. The focus is instead on concepts, assumptions and approaches which are of central importance for our particular inquiry. The first four sub-sections explore the nature of institutions and their functions, while the final one discusses how institutions evolve.

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[91] Granick (1990), referred to by Hay *et al.* (1994), p. 324. See also McKinnon (1994), referred to by Zhang (1997), p. 25, and Qian and Roland (1994).

[92] Zhang (1997), pp. 75-109, found that collective - as opposed to non-collective - rural enterprises under local government ownership in China faced basically soft budget constraints despite the hard budget constraints of the local governments, partly because the firms were able to seek soft funding elsewhere.

[93] See, for instance, Bardhan (1989), Eggertsson (1990), Gunnarsson (1991), Knudsen (1993), Langlois (1986c) and Raaschou-Nielsen (1988).

The Institutional Structure

What is an Institution?

The definitions of an institution vary and are often vague. Having surveyed the literature, Agnete Raaschou-Nielsen concludes that a common definition can only be formulated in the broadest sense: institutions are '"restrictions on behaviour" affecting human beings as economic agents'.[94] A frequently quoted definition that is more specific has been formulated by Andrew Schotter, and will serve as a point of departure for our discussion of what an institution is:

> A social institution is a regularity in social behavior that is agreed to by all members of society, specifies behavior in specific recurrent situations, and is either self-policed or policed by some external authority.[95]

This definition includes several important aspects of an institution; however, as pointed out by Uskali Mäki, it also illustrates a problem. Sometimes an institution is defined as 'a *regularity* of behaviour', whereas in other cases, institutions are referred to as 'normative *rules* underlying such behaviour'.[96] Schotter here incorporates both meanings.[97] However, for our purposes, for instance in the study of how institutions emerge,[98] a distinction between behavioural rules and behavioural regularities is useful. We shall take the position that *an institution is a behavioural rule:* it is the rule and not the regularity that prescribes behaviour. Regularities in behaviour are seen as a reflection of individuals adhering to rules.[99] *An institution is a social rule,* as opposed to a personal rule, in that it prescribes individual behaviour in situations of interaction with other human beings, thus providing solutions to recurrent interaction problems.[100]

There are different types of institutions. Douglass C. North makes a distinction between formal and informal institutions, which usually complement each other.[101] Others distinguish between pragmatic and organic institutions, following the terminology of Carl Menger.[102] Formal or pragmatic institutions are consciously designed by human beings and often take the form of written constitutions, laws, regulations and contracts. Informal or organic rules evolve spontaneously and unintendedly over time from human behaviour and interaction in the form of

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94 Raaschou-Nielsen (1988), p. viii; free translation from the Danish.

95 Schotter (1981), p. 11.

96 Mäki (1993), p. 13; emphases added.

97 Later, Schotter (1986), pp. 118-119, makes a distinction between the two views on institutions, by letting them represent two basically different approaches within institutional economics, and he finally defines social institutions as sets of rules.

98 To be clarified below.

99 Cf. Hayek (1973), p. 43, according to whom a 'regularity, of course, means simply that the elements behave according to rules'.

100 Knudsen (1993), p. 269. See also Vanberg (1994), pp. 19-20.

101 See North (1990), p. 4 and Chapters 5-6.

102 See Menger (1963), Book 3, Chapters 1-2, pp. 129-159.

conventions, codes of conduct and behavioural norms. In this section we are primarily concerned with organic institutions.

Institutions are enforced or policed in different ways, as suggested by Schotter in the quotation above. Formal rules are often enforced by some external authority. The police and the courts, for instance, enforce the rule of law. Contracts may be policed by one party retaliating (or threatening to retaliate) against the other party's contract default. The reason why rule enforcement may be necessary is that individuals may face incentives to diverge from the rules, although this is not always the case. Conventions are often self-enforced, because it is beneficial for all parties to adhere to the rule (as long as the others do), for instance to honour promises or to speak Swedish in Sweden. Institutions, particularly formal ones, that are not enforced are ineffective and may be considered non-existent in terms of their influence on human behaviour. They may in some cases have been effectively replaced by certain parallel informal rules, which suggests that behavioural rules for social interaction are related - but how?

How are Institutions Related?

Society may be described as a set of institutions. They include all formal and informal rules for social interaction, as represented by economic, political and cultural rules. An institution is not, however, an isolated or autonomous rule. It 'fits into the system of institutions' that are related to one another.[103] Several authors recognise this relationship, which according to Walter C. Neale is functional. The function of each rule is to govern activities not governed by other ones, so that one institution takes over where other institutions cease to apply.[104] Paul D. Bush takes a similar position:

> 'Society' may be thought of as a set of institutional systems. An 'institutional system', in turn, may be thought of as a set of institutions. And an 'institution' may be defined as *a set of socially prescribed patterns of correlated behavior.* In each of the above sentences, the term 'set' refers to functionally interrelated elements.[105]

Hence, within an institution, different behaviours are correlated into a pattern, while the behavioural patterns of different institutions are correlated into an institutional system. According to Bush, this functional inter-relatedness is provided by the value system. Values function as standards of judgement, and therefore as correlators of behaviour. Institutions contain social prescriptions (rules) for behaviour, and what are prescribed are the values to be applied as correlators.[106] Hence, the characteristic of an institutional structure is the value system that correlates behaviour within it. The central role attached by Kornai to ideology for the

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[103] Neale (1988), p. 245.

[104] Ibid.

[105] Bush (1988), p. 126.

[106] Ibid., pp. 126-128.

socialist system illustrates this point.

The functional relationships between institutions imply that if not necessarily inter*dependent,* many of them are interrelated and mutually reinforcing. This gives a certain amount of coherence, inherent consistency and stability to an institutional system.[107] Viktor J. Vanberg refers to institutions as 'systems or networks of interrelated and mutually stabilizing routines'.[108] A similar position is taken by Herbert A. Simon, who refers to institutions or roles as 'mosaics of programmed behaviour that constitute social systems', and to society as a 'whole system of *interlocking* roles' or institutions.[109]

Thus in order to form a system in this regard, an institutional structure seems to require a certain amount of inner coherence. Kornai's definition of classical socialism, for instance, would then qualify, whereas market socialism, with its inherent contradictions and inconsistencies, or the system under post-socialist transition would not. Institutions are certainly not always consistent, particularly during periods of dramatic institutional change. When formal rules are altered, for instance, inconsistencies are likely to arise in relation to informal rules, which have not yet been adapted.[110] Besides, partial formal reform may also produce inconsistencies between formal rules. While institutional change appears to be an on-going process,[111] a system experiences certain periods of relative coherence and stability, and others characterised by change and contradictions. Within this system human beings act.

Uncertainty, Abstraction and Rationality

According to North, institutions provide a 'framework within which human interaction takes place'. [112] Their major role 'is to reduce uncertainty by establishing a stable (but not necessarily efficient) structure' to this interaction.[113] As pointed out by Langlois,[114] for the individual actor this implies that institutions contribute to determining the situation in which he finds himself, by

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[107] We shall return to these issues below.

[108] Vanberg (1993), p. 189.

[109] Simon (1982b), p. 390; emphasis added. Cf. the position, common within the study of comparative economic systems, that an economic system consists of a set of interdependent, mutually consistent and reinforcing parts (Grosfeld, 1990, p. 7), and Kornai's affinity between ownership forms and co-ordination mechanisms discussed above.

[110] Such institutional 'disequilibrium' is, according to North (1990), pp. 87-90, *passim,* characterised by tensions between formal and informal rules. However, in other cases, change in formal rules involves an adaptation to already prevailing formal rules, and thus brings consistency between them.

[111] Institutional evolution is discussed below.

[112] Ibid., p. 4.

[113] Ibid., p. 6.

[114] Langlois (1986b), p. 247.

constituting, in the words of Neale, 'the arenas in which people try to accomplish their aims'.[115] Humans act on purpose, they plan, design, calculate and respond, and motives are the reasons why people act. They are the driving forces behind human behaviour. However, as discussed in Chapter I, motives alone cannot determine specific acts or behaviour. Human behaviour - the ways in which humans go about fulfilling their aims - is determined by the institutional structure.[116] Hence, we must understand this institutional context, so that we can explain 'why, in pursuit of their purposes, men employ certain practices and strategies rather than others'.[117] Let us therefore explore the decision-making situation of the individual.

Uncertainty and Bounded Rationality

Numerous scholars acknowledge that the decision maker is neither perfectly informed nor has the perfect computational abilities in order always to be 'able to determine with perfect reliability what, in particular situations, is the maximizing choice'.[118] Friedrich A. Hayek recognises the problem of knowledge: we cannot possibly know all the facts upon which the success of our actions depends, but are necessarily partly ignorant. Our ignorance implies that there are limits to our reason, which is 'insufficient to master the full detail of complex reality'.[119] According to Simon,[120] the limits to perfect rationality may first of all be due to incomplete information, and thus uncertainty about the consequences of different choices, as well as about all the possible alternatives that we may choose between.[121] The complexity of the information about environmental constraints further limits our ability to calculate the consequences of our choices.[122]

The sources of our uncertainty are not merely found in imperfect information, but also in imperfect choice. The actor may be unable to maximise because his decision-making competence is limited in relation to the difficulty and complexity of the decision problem; there is what Ronald A. Heiner calls a competence-difficulty (C-D) gap.[123] This C-D gap introduces 'uncertainty in distinguishing preferred from less-preferred behavior',[124] which prevents perfectly

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115 Neale (1988), p. 229.

116 Cf. Neale (ibid.), pp. 229-231 and 242-244.

117 Vanberg (1993), p. 184.

118 Ibid., p. 177.

119 Hayek (1960), p. 66, quoted by Vanberg (1993), p. 181.

120 Simon (1972), pp. 163-164 and 169.

121 The first type of uncertainty, about 'which pregiven state will obtain', is referred to by Langlois (1986b), p. 228, as *parametric,* while he calls the latter type, uncertainty about 'which states are possible', *structural.*

122 Heiner (1986), p. 60, quotes Hey (1979), p. 232, to illustrate the problem. Often 'the optimization problems that ... agents are supposed to be solving ... are so complicated that the economic theorist ... probably spent several months finding the solution'.

123 Heiner (1983).

124 Ibid., p. 561.

rational choices from being made. Due to the uncertainty caused by these restrictions on the individual's information and computational capabilities, humans are, in the words of Simon, *boundedly rational.*[125] The decision maker intends to be rational, but is only limitedly so.[126]

Abstraction and Procedural Rationality

To the extent that humans are boundedly rational, unable to maximise, how do they go about pursuing their aims? First of all, according to North, the problem of the individual becomes one of 'deciphering the environment'.[127] Simon considers 'human beings [to] handle this difficulty by attending to only a small part of the complexity about them', basing their decisions on 'a highly simplified model of the world'.[128] Hayek recognises that due to our inescapable ignorance, we must believe what we cannot know; we use abstraction as a basis for our decision making. Abstractions are 'the indispensable means of the mind which enable it to deal with a reality it cannot fully comprehend'. We always act 'by singling out as relevant only some aspects' of a particular situation.[129]

If humans are unable to maximise on the basis of all relevant information then they must rely on a simplified version of reality. Simon holds that

> If ... we accept the proposition that both the knowledge and the computational power of the decisionmaker are severely limited, then we must distinguish between the real world and the actor's perception of it and reasoning about it. That is to say, we must construct a theory (and test it empirically) of the processes of decision.[130]

Such a theory must account for both how the individual abstracts from reality and how he makes his decisions on the basis of this abstraction. The decision-making situation of the individual is thus determined by his perception of the context in which he finds himself, which in turn may be a function of his past experience and the prevailing value system. North recognises that the actor's subjective perceptions and theories are in part influenced by normative views, such as ideology.[131] Ideologies provide models of how the world is as well as values about how the world should be, and an individual's perception of his context is determined by both 'ideas of cause and effect and of decency and morality'.[132]

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125 Simon (1972), p. 162. See also Simon (1964).

126 Simon (1962), p. xxiv, referred to by Williamson (1986), p. 173.

127 North (1990), p. 22 ff.

128 Simon (1984), p. 48.

129 Hayek (1973), p 30.

130 Simon (1986), pp. S210-S211, quoted by North (1990), p. 23.

131 North (1990), p. 23.

132 Neale (1988), p. 234.

In an ambitious attempt to incorporate the moral dimension into economic theory, Amitai Etzioni discusses how morality, values and beliefs, or 'normative-affective factors', influence our decision making in various ways. He holds that these factors affect our reasoning, cognitive frameworks and our search for solutions. They 'shape to a significant extent the information that is gathered, the ways it is processed, the inferences that are drawn, the options that are being considered, and the options that are finally chosen'.[133] Hence, the value system of society helps us to interpret the world by contributing to shaping simplified models of it, and thereby influences the very process of decision making.

Recognition of humans' bounded rationality has drawn attention to the very processes of decision making, focusing on *how* individuals make decisions, rather than on *what* decisions they make.[134] Such a perspective has implications for the rationality assumptions. We want to define rationality in terms of how efficiently humans handle different problem situations.

Simon introduced the concept of *procedural rationality,* which is concerned with how decisions are made: with the means that actors use to cope with uncertainty and cognitive complexity. Behaviour is procedurally rational if the procedures used to choose actions are efficient, given the limitations of the actor. Simon contrasts this rationality concept with 'substantive rationality', which is concerned with what decisions are made, in other words, with the efficiency of the actions chosen.[135]

Nicholas Rowe suggests a similar replacement of what he calls act-individualism, where rationality is considered to pertain to actions, with rule-individualism, where rules of action are the unit of rationality.[136] However, a procedural concept of rationality must explicitly incorporate the procedural elements of the decision-making process in which choices are made by the individual.[137]

Experience, Rule Following and Adaptation

What then are the procedures adopted by boundedly rational humans in order to cope with uncertainty in their decision making?

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[133] Etzioni (1988), p. 94.

[134] It remains controversial whether humans should be assumed to maximise within the constraints of the C-D gap on the basis of their subjective models of the world, or to apply some other simplified decision-making procedure.

[135] For his definitions, see Simon (1976), pp. 130-131, (1978a), p. 494, and (1978b), pp. 8-9.

[136] 'A rule of action is rational if, by following that rule, an agent maximizes his expected utility.' (Rowe, 1989, pp. 4-5.)

[137] Cf. Knudsen (1993), p. 287.

Experience and Expectations

Our perceptions of the world may well be altered when confronted with reality, which implies that our subjective models are influenced by experience.[138] Hence, we also draw on our past experience when abstracting about reality in order to form a basis for our decision making. Simon does not introduce morality or ideology, but regards the mechanisms by which the individual selects the information on which to base his decisions as a function of his past experience and his ability to learn from that experience. He thereby adopts a rationality concept that is procedural and specifies the decision-making procedures. When actors are unable to identify a maximum in complex situations, they employ a simplified decision-making procedure where search and satisficing are central elements.

When an individual faces a new decision-making situation, he uses his experience to characterise that situation and to associate it with the success or failure of actions taken in similar previous situations. If past behaviour was successful, then in a similar situation he is likely to take the same action again. If, on the other hand, his past behaviour was a failure, he is likely to search for a behaviour that is better - but not necessarily the best - compared to his past experience. Simon holds that instead of maximising, individuals tend to *satisfice.* This implies that they set 'aspiration levels', and terminate the search when they find an alternative that satisfies the aspiration-level criterion. These aspiration levels are themselves determined by and adjusted to changes in past experience.[139]

According to Popper, problem solving 'always proceeds by the method of trial and error: new reactions, new forms, new organs, new modes of behavior, new hypotheses, are tentatively put forward and controlled by error elimination'.[140] However, as pointed out by Vanberg:

> In order for trial-and-error learning to work, the behaving organism must somehow, explicitly or tacitly, *classify* problem-situations into categories of situations which are, in some relevant sense, 'similar'.[141]
>
> This is in fact an assumption which seems to be necessarily implied in the very notion that a person's behaviour is influenced by past experience. Because, it is difficult to see how past experience can be utilized in any other way than by classifying particular instances along generalized categories of 'types of situations' and 'types of behaviour'.[142]

Classifying situations on the basis of experience is thus a way to abstract about reality, in that certain - but not all - characteristics of situations are recognised. Classifications determine what

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[138] Cf. Vanberg (1994), pp. 23-24.

[139] 'Aspirations are expectations - adjusted in the long run to realities - of the result that can reasonably be attained.' (Simon, 1982b, p. 399.) For details, see Simon (1972), p. 168, (1976), pp. 133 and 136, (1978b), p. 10 ff., and (1979), pp. 502-503.

[140] Popper (1972), p. 255, quoted by Vanberg (1993), p. 185.

[141] Vanberg (1993), p. 186.

[142] Ibid., p. 176.

the individual perceives as recurrent situations. By associating recurrent situations with the success or failure of past behaviour, humans draw on their experience to form expectations about the future outcome of similar behaviour in the present situation. As Vanberg notes, actions cannot be motivated by their factual consequences, only by the individual's expectations of their outcome, and it is his previous experience that shapes his expectations.[143]

Expectations can also be influenced by experience other than the personal one, for example through observation of other people's experience. Hayek holds the view that learning from experience is 'a process not primarily of reasoning but of the observance, spreading, transmission and development of practices which have prevailed because they were successful', recognising that 'men can learn from each other ... rules of conduct by example and imitation'.[144]

Rational Rule-Following Behaviour

When successful behaviour is repeated in recurrent situations, behavioural regularities can be observed. With a case-by-case maximisation approach, such regularities are interpreted as a series of actions resulting from individual maximising choices where each situation is assessed separately.[145] Vanberg, by contrast, holds that 'actors do not respond to particular situations as unique events but, instead, tend to form categories of situations which they perceive as similar, in some behaviourally relevant sense'.[146] Behavioural regularities are interpreted as the result of *rule-following* behaviour: a certain behaviour is regularly shown because when the agent identifies certain situations as belonging to a particular class in which this behaviour has been found to be a useful strategy in the past, that behaviour is repeated. The classification of situations constitutes 'the roots of all rule-following behaviour ... Behavioural rules are, in this sense, standard recipes for how to deal with certain types of situations. They are conjectural solutions for certain types of recurring problems.'[147]

Heiner similarly holds that predictable and regular behaviour is not an expression of optimising individuals, but 'will evolve only to the extent that uncertainty prevents agents from successfully maximizing'.[148] He thus considers uncertainty caused by the C-D gap to be the main cause of rule-governed behaviour. When we are unable to distinguish between preferred and non-preferred behaviour, we limit our flexibility in using information, choosing action and adjusting to different situations. We restrict our behavioural repertoire, by ignoring 'actions which are appropriate for only "rare" or "unusual" situations', although they might be preferred

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[143] Ibid., p. 184.

[144] Hayek (1973), pp. 18-19. See also Alchian (1950), pp. 217-220, on individual adaptation through trial-and-error elimination and imitation.

[145] Vanberg (1993), especially pp. 175-176.

[146] Ibid., p. 176.

[147] Ibid., p. 187.

[148] Heiner (1983), p. 561.

under certain circumstances. The problem is that we cannot reliably determine when to choose those actions, and therefore run the risk of making mistakes. Instead we adhere to behavioural patterns or rules that are 'adapted only to relatively likely or "recurrent" situations', because we can determine their outcome with better reliability.[149] Hayek takes a similar position. 'Man does not so much choose between alternative actions according to their known consequences as prefer those the consequences of which are predictable over those the consequences of which are unknown.'[150] Hence, uncertainty generates behavioural regularities (rule following) and therefore predictable behaviour.

Rule following may thus be a way for boundedly rational individuals to handle the uncertainty they face due to the C-D gap through a fairly simple procedure. And it may be a rational procedure: rule-following individuals may be procedurally rational. Although deviation from a rule might in certain cases be preferred, it may nevertheless be better to ignore it and stick to the rule, because of the uncertainty in reliably interpreting information about when to deviate. According to Heiner, rule following may (or may not) be superior to case-by-case maximisation, depending on the complexity of the problem, the competence of the agent and the nature of the rule.[151]

The individual's benefit from rule following is not necessarily material. It may also be moral. By following a rule saying that 'you shall not steal', uncertainty about how to behave (buy or steal?) in situations where goods are displayed in a shop is reduced, and we may benefit in terms of a social respectability and good conscience. Neale, who includes 'folk-views' in his definition of institutions, holds that folk-views provide justifications and explanations for people about why they behave according to rules.[152] North holds that ideological commitment is a means by which institutions are self-enforced.[153] Hence, rule-following behaviour may also be influenced by ideological or moral conviction.[154]

Adaptive Rationality and Learning

Rational rule-following behaviour does not imply a rigid adherence to pre-determined rules. Rules are under constant review by the actors, who learn through trial and error to adapt to new situations in a process of adaptive learning. A procedural rationality concept is particularly important when we are interested in 'the explanation of how the behavioural repertoires of

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149 Ibid., p. 567. See also Heiner (1990).

150 Hayek (1967), p. 80.

151 Case-by-case maximisation entails the risk of making the wrong choice, as noted by Vanberg (1993), pp. 177-178, referring to Heiner (1983), (1987) and (1990), whereas rule following entails the risk of missing preferred exceptions.

152 Neale (1988), pp. 232-233.

153 North (1990), p. 55.

154 See also Etzioni (1988), pp. 90-94 and 114 ff.

persons are shaped and change over time'.[155] Christian Knudsen, among others, holds that in order to understand processes of social change, we must allow for 'the occurrence of essentially new and consequently unforeseeable contingencies'. Therefore, the rationality concept must include a 'constructive element'.[156]

Successful behaviour is repeated in recurrent situations, but when past behaviour has proved unsuccessful, innovation, or constructive behaviour, is required. Such situations are particularly likely to occur when the environment of the actors is changing, so that the outcome of a certain behaviour no longer remains what it used to be. According to Simon, behavioural innovation is initiated when current behavioural 'programmes' no longer satisfy the individual's aspiration levels. The individual starts searching for and experimenting with new modes of behaviour, routines etc., which is not a matter of finding the best programme, but of finding one that is good enough.[157]

Both rule following and innovative behaviour are thus based on the individual's experience, and through a learning process of trial-and-error elimination behaviour is adjusted to new experiences. Learning becomes a process of experience-guided adaptation to the environment. A relevant behavioural assumption in this context, one which recognises the bounded rationality of humans and at the same time constitutes a procedural concept, is *adaptive rationality.* Vanberg adopts the concept, which he considers to correspond more or less to that of *adaptive learning,* the theory of which

> seeks to explain how individual's behavioural repertoires change over time in response to experiences undergone. The repertoire of behavioural dispositions, routines, habits etc., which determine a person's behaviour at any point in time, is viewed as the (provisional) outcome of a process of trial-and-error. Individuals are not assumed to be capable reliably to determine which course of action will serve them best in any given situation. They are, however, assumed to be able to systematically learn from experience - what kind of behaviour is more likely to be successful in certain kinds of situations. And they are assumed to be able to develop over time a repertoire of behavioural routines which are functionally adapted to the kind of environment in which they live.[158]

Although boundedly rational because of the C-D gap, *adaptively rational humans* can thus be defined as those who are able to learn systematically from experience so as to pursue their aims: to repeat successful behaviour (follow rules) and modify unsuccessful behaviour (innovate) - hence, they are adapting to changes in the environment.

Adaptive rationality is thus consistent both with rule following and innovative behaviour, as well as with actors' rational case-by-case handling of rare or unique problems. Rule following can only be applied in (what are perceived as) recurrent situations. Much of our activity is

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155 Vanberg (1993), p. 185; emphasis added.

156 Knudsen (1993), p. 286.

157 Simon (1982b), p. 397.

158 Vanberg (1993), p. 188.

devoted to a number of common, familiar situations presenting problems of moderate importance which face us.[159] Schotter maintains that

> the societal rules of thumb that we have called social institutions are really satisfactory rules that solve recurrent problems once and for all but might not always lead to optimal results. Their major benefit is that by solving unimportant problems quickly, they allow the agents in the economy to allocate their effort elsewhere to solve more important problems.[160]

Occasionally, we face rare or unique situations when, for instance, major economic decisions have to be made.[161] In those situations, there are no rules to rely on, so actors have to search for a satisfactory behavioural alternative, involving most certainly an examination of expected costs and benefits associated with different alternatives. However, as stressed by Simon, whether actors search for a new behavioural rule to be applied in recurrent situations or for a behavioural solution to a rare problem, search is always selective,[162] guided by past experience. As mentioned, actors terminate their search when they have reached their aspiration levels, which in turn are adapted to their previous achievements. Hence, the satisficing behaviour of boundedly rational individuals is backward-looking behaviour that involves adaptive learning, which is based on past, realised consequences.[163]

The Function of Institutions

Institutions facilitate both individual behaviour and the interaction between individuals within an institutional system. They thus perform both a social function and a function for the individual actors.[164]

Facilitating Individual Behaviour

When actors are confronted with recurrent problems, institutions facilitate their decision making and behaviour by shaping expectations about how to behave successfully in those situations. The reason institutions do so is that they contain and convey information[165] - about how to behave in

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159 Cf. North (1990), p. 83.

160 Schotter (1981), p. 149.

161 Compare, for instance, the purchase of a car with our daily food shopping.

162 Simon (1959), p. 271, referred to by Vromen (1995), p. 117.

163 Vromen (1995), pp. 116-118.

164 Cf. Vanberg (1993), p. 172, who distinguishes between rule following as 'an attribute of individual human behaviour' and 'the role of rules in coordinating human social interaction'.

165 Langlois (1986b), p. 237, recognises that 'institutions have an informational-support function'. Cf. Nelson and

specific situations and about the likely success of such behaviour. More specifically, institutions communicate values and are expressions of what we and others have learnt from past experience. 'From repetition arise habits and customs which conserve the lessons of past experience and provide a basis for future expectations.'[166] Thus despite the uncertainty we face due to the C-D gap, we may use and benefit from the knowledge contained in institutions by following behavioural rules. They 'serve as behavioral guides that reduce the knowledge and cognitive skills necessary for successful action'.[167] They reduce our behavioural uncertainty and facilitate our decision making and behaviour in complex situations.[168]

By guiding human action in specific situations, institutions offer behavioural solutions to recurrent problems facing individual actors. As pointed out by Schotter, every institution solves a particular problem.[169] This implies, furthermore, that institutions also facilitate our decision making and behaviour in situations other than the specific ones in which they apply. This is implicitly suggested by the last quotation in the previous sub-section, which implied that institutions enable actors to focus their attention on decisions of major importance. In addition, we argue that given the functional relationship between many institutions, a given institution will also facilitate actors' adherence to the other ones, which it complements and is consistent with.

A second reason for individuals to follow rules has been put forward, in addition to the first one of facilitating actors' decision making and behaviour.[170] According to Rowe, it may be beneficial for an individual to follow rules because he thereby contributes to shaping other actors' expectations of his own future behaviour, and he may therefore be able to influence their behaviour to his own advantage.[171] However, any rule following is likely to make others expect similar behaviour from us in the future, which may influence their behaviour regardless of whether this was our intention or not. Rule following facilitates not only our own decision making but also that of other actors, which points at the intrinsically social character of institutions.

Winter (1982), referred to by Knudsen (1993), p. 293. '*Routines* are repositories of knowledge concerning how a firm can "do" different things.' See also Schotter (1981), p. 109.

166 Mitchell (1935), p. 640, referred to by Vanberg (1993), p. 173.

167 Langlois (1986b), p. 247.

168 The uncertainty facing decision makers due to the C-D gap can also be seen as a reflection of high costs of information (and computation), and rule following is then a solution to this problem. Hence, rules reduce information costs. Cf. transaction cost economics: it is costly to transact essentially because information is costly. See Eggertsson (1990), p. 15, according to whom the resulting transaction costs include search and bargaining costs, costs associated with the making, monitoring and enforcement of contracts and with the protection of property rights. Román (1995), pp. 33-36, distinguishes between co-ordination costs (for acquiring, processing and exchanging information) and motivation costs (for specification, observation, verification and enforcement of an agreement), and briefly surveys transaction cost economics (pp. 25-26.) See also North (1990), pp. 27-35.

169 Schotter (1981), pp. 1-2.

170 For instance, by Schelling (1960), referred to by Knudsen (1993), p. 287.

171 Rowe (1989), pp. 22-23.

Co-ordination of Social Activity

Actors involved in social interaction face uncertainty not only about their own behaviour but also about the behaviour of others. Since the outcome of human behaviour largely depends on how fellow humans behave, the complexity of an actor's environment largely concerns interdependencies in human interaction.[172] Thus an important reason why institutions reduce our uncertainty and facilitate behaviour in complex situations is that they shape expectations about the behaviour of others:

> Institutions ... allow people to act with a high degree of confidence in their expectations of how other people will respond to their actions, and ... allow other people to interpret actions and to respond intelligently. Institutions give meaning and continuity to actions and assure that each action fits with some of the actions of other people to maintain ongoing processes.[173]

> Social institutions ... reduce the social uncertainty in the system by making the actions of the agents more predictable and stabilizing their expectations as to what strategies the other agents may choose.[174]

Simon stresses the importance of stable expectations for the 'stability of the patterns of behaviour in groups of interacting persons' and, hence, for the stability of the institutional system. 'Any one member of the group is acting rationally in maintaining his pattern of behavior so long as the others do likewise.'[175] This is not always the case,[176] but the interdependence of actors' rule following implies that institutions, by stabilising expectations, facilitate co-ordinated activity in society.

However, institutions do not co-ordinate activity and stabilise the system only by stabilising expectations. They apply in situations of social interaction. As stressed by Shaun Hargreaves Heap, institutions are *shared,* and therefore function as devices for communication and co-ordination of activity between individuals.[177] The recurrent problems, to which institutions offer behavioural solutions, are not personal problems. Institutions solve co-ordination problems between humans.[178] They provide, in the words of Vanberg, 'standard solutions to recurring social interaction problems of various sorts'.[179]

Human interaction thus gains stability, because institutions correlate and stabilise behaviour over time, between actors, situations and institutions. Institutions enable different actors to co-

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172 Cf. Heiner (1983), p. 573.

173 Neale (1988), pp. 229-230.

174 Knudsen (1993), p. 269.

175 Simon (1982b), pp. 391.

176 There may also be situations when an individual faces incentives to deviate from a rule as long as all the others adhere to it, for instance, a rule devised to prevent over-exploitation of a common good.

177 Hargreaves Heap (1989), pp. 4 and 116-119.

178 North (1990), p. 41.

179 Vanberg (1993), p. 190. Cf. Knudsen (1993), p. 269.

ordinate their behaviour with each other, so that their actions fit. They also make it easier for individuals to correlate their own behaviour in different situations: the solution of specific problems facilitates the handling of other problems too; adherence to one institution facilitates adherence also to other institutions. Finally, since institutions store and transmit knowledge about behaviour, 'connecting the past with the present and the future',[180] they bring stability to our behaviour over time. Does the fact that institutions perform a function imply that they are beneficial for society?

Institutions and Economic Performance

Institutions are important for the economic performance and development of societies. As behavioural rules, institutions guide human action and interaction by imposing constraints on and/or providing options for behaviour. They promote and facilitate certain types of behaviour and discourage others, by affecting their relative costs and benefits,[181] and thus influence the incentive structure facing individuals. The incentives created, together with other incentives, determine the economic activities of individuals and influence economic performance via the resulting resource allocation.[182]

Rule following may be rational for individuals, but the institutional system is not necessarily conducive to economic development and prosperity. If, as pointed out by North, the institutional structure rewards productive activity, behaviour that stimulates economic growth will enable individuals to fulfil their aims. However, if redistributive and non-productive activity is rewarded, economic growth will suffer.[183] Hence, even if the institutional structure creates incentives for counter-productive behaviour, it may be rational for individuals to follow those rules, given the institutional system in which they operate. However, an institutional system may consist of a combination of such productive and counter-productive institutions.[184] Counter-

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[180] North (1993), p. 259.

[181] Within the production sphere, for instance, institutions affect, according to North (1990), pp. 64-66, both transaction costs and traditional production costs - the latter by influencing the technology employed.

[182] For examples on how the ownership structure of firms may influence economic outcomes, see Eggertsson (1990), Chapter 5.

[183] North (1993), pp. 242-243. See further North (1990), Chapter 8.

[184] Cf. North (1990), p. 9, who talks about efficient and inefficient institutions. In North (1993), p. 252, he defines inefficient institutions (property rights) 'simply as rules which do not produce increases in output'. This example reflects the problem associated with the meaning and use of these concepts once institutions are introduced into economic analysis. For a brief presentation of the arguments and a discussion, see Eggertsson (1990), pp. 20-25. Demsetz (1969), referred to by Eggertsson (1990), p. 21, for instance, argues that talking about inefficiency and similar concepts is 'misleading and ambiguous unless the outcome that they describe can be improved upon'. Given institutional interdependence, *ceteris paribus* assumptions thus make little sense. Cf. Vromen's (1995, p. 174) interpretation of Menger (1985). 'The welfare effects of some institution thus cannot be judged in isolation. The effects depend crucially on the other institutions that exists in society ... the whole of which they are part.'

productive institutions, as well as institutional systems, may not only emerge, but may persist during long periods. Their survival is related to the character of institutional evolution.

The Evolution of Institutions

Just as human behaviour is influenced by the institutional structure, so institutions themselves are the creation of human beings. Let us therefore explore how human behaviour shapes the evolution of institutions by contributing to their emergence, maintenance and change.

The Process of Emergence

An institution does not exist just because it performs a function. Identifying this function is thus insufficient for explaining its origin,[185] since 'the fact that an institution has "beneficial consequences" does not necessarily mean that it will emerge'.[186] An institution has a history. And, as pointed out by Schotter, 'if one is to study institutions, one must study them in a historical-evolutionary context'.[187] We want to account for the evolutionary process through which they emerge.

The distinction between formal and informal, or pragmatic and organic, institutions is not only one of classification. It may also represent different approaches within institutional economics, primarily as to the explanation of how institutions are created. According to Schotter, one approach views institutions as the result of plan and conscious design, whereas the other regards them as unplanned regularities of social behaviour, emerging spontaneously as the unintended outcome of individual behaviour and interaction.[188] Menger refers to the two approaches as the pragmatic and organic understanding of social phenomena.[189] He emphasises, however, that none of them can claim to be universal, since different types of institution are created and changed in different ways.[190] For the purpose of the present study - in line with the view of institutions presented here - our focus is on the emergence of organic institutions.

An explanation of how an institution emerges organically is a kind of invisible-hand

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185 As argued in Chapter I, this would amount to a purely functionalist explanation. The issue will be further discussed in the following section.

186 Knudsen (1993), p. 288, referring to Elster, without specifying the source further.

187 Schotter (1981), p. 2.

188 See, for instance, Schotter (1986), pp. 117-118.

189 Menger (1963), Book 3, Chapters 1-2, pp. 129-159.

190 The distinction between formal and informal institutions is partly arbitrary. A formal institution may, in fact, be a reflection of how an informal institution, spontaneously evolved in society, at a certain point in time gains official recognition by being formalised, for instance, into a law. Cf. Sugden (1986), p. 5.

explanation.[191] It involves accounting for the stages whereby the interaction of individuals in pursuit of their self-interest gives rise to the institution, although its emergence was not the intention of anyone. As pointed out by Schotter, institutions emerge to solve recurrent problems:

> Economic and social systems evolve ... To ensure their survival and growth, they must solve a whole set of problems that arise as the system evolves. Each problem creates the need for some adaptive feature, that is, a social institution.[192]

An analysis of *how* an institution emerges spontaneously and unintendedly as a solution to a recurrent problem has to take as its point of departure the decision-making situation of the individual actor: the problem he faces, his behavioural uncertainty, perceptional legacy and the institutional context in which he operates. Since uncertainty is the basic source of predictable regular behaviour, it also conditions the evolutionary processes through which rules evolve.[193] Our previous discussion suggests how such a process might proceed.

When facing uncertainty about how to handle a new problem, the adaptively rational individual uses his experience and subjective perceptions to classify the situation and associate it with past behaviour and the related outcomes. On this basis, he forms expectations about the outcome of different behaviour, makes trials, eliminates errors and repeats previously successful behaviour in similar situations. Over time, successful repetition in recurrent situations gradually strengthens his expectations of success. He learns from experience how to behave and handle these problems, while his uncertainty about how to do so successfully declines. Gradually, he develops a behavioural rule - regardless of whether he is aware of this fact or not - to be applied as a solution to the specific recurrent problem.

The rule is not a personal, but a social rule. It prescribes behaviour in situations of human interaction. Once the individual's behaviour has been repeated sufficiently often to become a regularity, this type of behaviour is likely to be exactly what other humans expect from him in similar situations. When a certain behaviour is regular enough to be anticipated by others, then it has given rise to not only a behavioural rule for our individual, but a social institution.[194] It is not the behaviour itself that constitutes the institution, nor its regularity, but rather the fact that the behaviour has become regular enough to shape expectations about similar behaviour in the future. In summary, repeated behaviour in recurrent situations eventually results in behavioural regularities, which by shaping expectations give rise to behavioural rules - institutions.

While 'economic and social institutions emerge in society in response to a set of recurrent societal problems',[195] different institutions may be able to solve the same specific problem. This is another reason for studying the process of emergence itself, in order to establish what

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[191] To be further discussed below.

[192] Schotter (1981), pp. 1-2.

[193] Heiner (1983), p. 585.

[194] Cf. Rowe (1989), p. 5, according to whom 'social institutions are in fact nothing more than agents rationally following rules of action, and being believed by other agents to do so'.

[195] Schotter (1981), p. 17.

institution will emerge as a solution to a specific problem, or why a particular institution and not another one emerged.[196] The reason why we cannot *a priori* determine which institution will evolve is that the process is path dependent. Path dependence implies that the process and the institutions that emerge in this process are determined by the initial conditions, in terms of the historical context and specific circumstances, as well as by exogenous influences and endogenous developments during the course of the process.[197] In particular, path dependence implies that the emergence of any specific institution is in part determined by the already prevailing institutional structure, by the problems this structure creates and by the behaviour of the individuals that it promotes. We will return to the issue of path dependence shortly.

Mechanisms of Maintenance

As discussed above, informal institutions do not require any explicit formal or external enforcement mechanism. Once an institution that has evolved spontaneously is established, it tends to be maintained through some self-reinforcing mechanism. To the extent that people follow rules because such behaviour proved successful in the past, institutions seem to be maintained through the functions they perform. However, in order to show that this is the case, the maintenance mechanism must be specified.[198]

There are two major types of maintenance mechanisms referred to in the literature as explanations for why institutions persist: natural selection and reinforcement. A natural-selection mechanism implies that a certain rule prevails because the individuals who behave according to it turn out to be more successful than others. It is the (economic) system that selects this behaviour as successful, for instance through competition in the market.[199] Natural selection takes place at the population level. Reinforcement mechanisms, on the other hand, operate at the level of the individual,[200] which is the perspective taken here. According to Knudsen, this implies

> that behaviour that is rewarded is reinforced, while behaviour that is punished is discouraged. The individual 'becomes aware' of the relationship between a certain behaviour and its 'beneficial consequences', and works out a rule from this 'learning process'.[201]

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196 Cf. Knudsen (1993), p. 289, and Schotter (1981), pp. 2-3.

197 Classical references on path dependence (of technological change) are, for instance, Arthur (1988) and David (1985). For brief presentations, see Knudsen (1993), pp. 290-291, and North (1990), Chapter 11, *passim.*

198 This is stressed not least by Elster (1979), to whom we shall return.

199 Alchian (1950) is a classical reference. Others are Hayek (1978) and (1988), and Nelson and Winter (1982).

200 Knudsen (1993), p. 278. See Vromen (1995), pp. 119-121, for a discussion of the dissimilarities between natural selection and adaptive learning.

201 Knudsen (1993), p. 278.

Hence it is through the individual's ability to learn from experience that he recognises the beneficial consequences of rule following and repeats the successful behaviour. The institution is hereby reinforced.[202] According to Philippe van Parijs, such reinforcement is a general feedback mechanism in the social world.[203]

North elaborates on this type of reinforcement of (formal and informal) institutions by drawing parallels to the literature on technological change. He argues that once an institution has been established, the interdependencies within the institutional system give rise to increasing returns to the institution, because of a number of self-reinforcing mechanisms.[204] First of all, establishing an institution is associated with considerable set-up costs. This clearly applies to formal institutions such as laws, but also to spontaneously emerging institutions, not least in terms of actors' trials and errors. It is easier, and therefore in some sense cheaper, to adhere to an already established institution than to search for other solutions and establish another rule. Secondly, these costs are also associated with significant learning effects for the individuals, who acquire skills and knowledge that do not simply enable them to survive and pursue their aims within the system. Over time, they also learn to adhere better to the rules, and to increase their benefit from the institutional structure. Thus a certain rule-following behaviour (productive or non-productive) is not only rewarded, but also gradually reinforced.

Thirdly, there are co-ordination effects, for at least two reasons.[205] Since all individuals act within the same institutional structure, adhering to a rule is beneficial because others do so. In addition, institutions are reinforced because of the interdependence and functional complementarity between them. Just as the new rule is adapted to, or a consequence of, the other surrounding formal and informal institutions, so they in turn are likely to be modified so as to be consistent with the new rule. Finally, adaptive expectations arise because increased adherence to the institution strengthens the beliefs about its prevalence and reduces uncertainties about its permanence. Each time that individuals behave according to the rule they confirm and strengthen their own and others' expectations of its validity. Institutions are thus reinforced by their very application.

Once a certain institution has become established, its self-reinforcing mechanisms account for its maintenance. This implies that the institution may be difficult to change or get rid of - there is a 'lock-in' in the institutional system[206] - even if it performs its function less well than some alternative institution would have done. It is these mechanisms that make the process of institutional evolution path dependent, influencing the character of institutional change.

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[202] Cf. Vromen (1995), p. 107, who distinguishes between natural selection and *adaptive learning* as two 'evolutionary "feedback" mechanisms'.

[203] van Parijs (1981) and (1982), referred to by Hargreaves Heap (1989), p. 135.

[204] North (1990), pp. 93-95, drawing largely on Arthur (1988).

[205] Cf. the discussion above.

[206] North (1990), p. 7.

Because of their inter-relatedness and self-reinforcement and the resulting lock-in - and because they contain experience and shape expectations - institutions tend to be stable. Nonetheless, institutions do change. Societies, in fact, go through a constant process of institutional evolution, although its pace, range and direction may vary. The 'stability characteristics' of institutions are important to understand,[207] however, because they determine the character of the process of institutional change.

Institutional change can be set off by random events:[208] for instance, an exogenous price shock. North considers the major sources of institutional development to be changes in either preferences, for instance moral attitudes, or relative prices, including factor-price ratios, information costs and technology.[209] Hence, competition for scarce resources is the key to institutional change, he argues.[210] The role of technological change is recognised by several authors. Bush, for instance, contends that the driving force behind institutional change is growth in the fund of human knowledge, 'generated by the community-wide problem-solving processes'.[211]

This suggests that many - if not most - impulses for institutional change emanate from within the institutional system itself - not least through its consequences for economic outcomes. The incentives shaped by institutions have implications for the kinds of knowledge, skills and learning that develop, the resulting technology employed, the costs and benefits of different types of economic activity and, eventually, for the relative scarcity of resources.[212] If incentives that favour non-productive activity are created, society's economic performance is likely to decline over time, due to the increasing returns of the institutional structure and its self-reinforcing tendencies. At a certain point, relative pay-offs may have changed to the extent that rule-following behaviour no longer produces the benefits that it used to, which may initiate a process of institutional change. Finally, a discrete change in a formal institution, or in the form or effectiveness of its enforcement, may give an impulse to change or modify some of the other institutions within the structure, notably the informal ones.[213]

Consider a random event, exogenous or endogenous to the institutional system. This event involves a change in the environment of the individuals which becomes increasingly uncertain. According to Heiner, our inability to decipher the complex environment, particularly if it is changing, implies that we are non-alert to and tend to ignore potential, even costlessly available,

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[207] North (1993), p. 253.

[208] Cf. Sugden (1986) and (1989), referred to by Knudsen (1993), p. 289.

[209] North (1990), pp. 84-86.

[210] North (1997), p. 8.

[211] Bush (1988), p. 153, who notes that the direction of causality may also be the opposite: institutional change accelerating the process of technological development.

[212] Cf. North (1990), pp. 74-78.

[213] Ibid., p. 6.

information that would lead us to deviate from our behavioural rules.[214] Since we abstract from reality, and hence disregard certain relevant information, we may at first not even recognise that our situation has changed and requires an adjustment of behaviour. Furthermore, when uncertainty increases, our chances of choosing the preferred action are reduced. Greater uncertainty will therefore make us even less prone to deviate from our rules, which is why it will 'cause rule-governed behavior to exhibit increasingly predictable regularities'.[215] An individual's initial reaction to change may therefore be to adhere even more strictly to the behavioural rules he is used to.

North recognises that once people have adapted their behaviour to the institutional structure, they face incentives to maintain it intact.[216] They have learnt to take advantage of the opportunities provided, within the constraints imposed, and thus depend on the existing institutions for their well-being. At least they may believe that they do, while fearing that they would do worse in a new institutional set-up. In any case, their uncertainty as to how to behave successfully increases, and learning to benefit from new rules takes time. Actors may consequently try to prevent change of, in particular, formal institutions from taking place or becoming effectively implemented. Besides, changes in formal rules may be ambiguous, and hence produce inconsistencies between them as well as between formal and prevailing informal rules. This may create uncertainty about the validity of a formal change, hence about which rules apply (old or new?), and thus add to the actors' slow adaptation.

The institutional structure thus creates interest groups with a stake in its existence. The subjective perceptions of the individual actors within these groups 'will evolve an ideology that not only rationalizes the society's structure but accounts for its poor performance'.[217] Consequently, ideas and values may contribute to delaying the process of institutional change. Etzioni argues that due to the influence of morality on our decision-making process, it tends to make learning, adaptation and adjustment slow and behaviour reluctant to change and relatively 'stickier' than would otherwise have been the case.[218]

The old behavioural rules that were adapted to specific circumstances, and which were therefore appropriate, are not necessarily equally functional in a new and different context.[219] Since uncertainty, in particular, limits our flexibility, dysfunctional behaviour may thus persist for quite some time, before we adapt and develop new adequate behavioural rules. To the extent that an old rule is inappropriate in a new context, the benefits accruing to the individual who adheres to it will decline, as argued. When behavioural outcomes are a failure, compared to his past experience, the actor will eventually recognise this relationship. When the outcome has

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[214] Heiner (1990), p. 20.

[215] Heiner (1983), p. 570.

[216] North (1990), p. 99.

[217] Ibid.

[218] Etzioni (1988), pp. 68-69.

[219] Cf., for instance, Schotter (1981), p. 2; and Vromen (1995), p. 174, interpreting Menger (1985).

deteriorated sufficiently far below a certain aspiration level, he faces incentives to modify his behaviour. Note that this does not necessarily happen instantly, as soon as he becomes aware of the declining outcome. As pointed out by Simon, changes in the environment and our experience make us adapt our aspiration levels.[220] This implies that if the actor's pay-off from adherence to the old rule falls, he may adjust his aspirations, with respect to what he can achieve, downwards.[221] Nonetheless if, at a certain point, he perceives that he can do better than by maintaining the *status quo,* he will begin searching for a new behaviour that is more appropriate to the new situation.[222] He will innovate. Given his ability to learn from experience, he will eventually develop a new behavioural rule, thus adapting his behaviour to the new context.[223]

As shown above, our modification and adaptation of behaviour and thus institutional change tends to be slow and gradual. In the words of North, it is 'incremental' and path dependent, because of the 'symbiotic relationship' between the institutional set-up and the individuals' behaviour which produces a lock-in.[224] People modify behaviour at the margin, reluctantly, under uncertainty, within the constraints and opportunities provided by the existing institutional structure. The way they change, experiment with behaviour and innovate is guided by their past experience and their subjective interpretation of the world, influenced by prevailing ideas and values. Thus both the pace and direction of institutional change are largely determined by behavioural uncertainty and institutional inter-relatedness.

THE APPROACH AND METHOD

Now that we are familiar with the two central metaphors that will be used in this study, the soft budget constraint and institutions, it is time to look at the theoretical approach and analytical method. This section begins by defining the study object, the soft budget constraint, as an institution. It proceeds by discussing how this institution can be observed. Thereafter, the institutional framework for our analysis is presented, including our basic assumptions, the method of situational analysis and an invisible-hand explanation. We also discuss who the central actors are in this study.

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220 See, for instance, Simon (1982b), pp. 393-399.

221 Hence, he satisfies himself with less. Similarly, if he achieves or surpasses his aspiration levels, he may adjust them upwards. He learns. And he wants more.

222 Vanberg (1993), p. 174, refers to Commons' view, noted by Biddle (1990), p. 37, that when we experience changes in the environment, our habits tend to be adjusted only after some delay.

223 Innovative behaviour leading to institutional change may also involve deliberate action, through lobbying for instance, to alter formal rules or renegotiation of contracts. Cf. North (1990), pp. 86-87.

224 Ibid., p. 7 and Chapters 10-11.

Definition of the Soft Budget Constraint

By defining the soft budget constraint as an institution - a behavioural rule for social interaction, guiding humans' behaviour by shaping their expectations and informing them about what behaviour to expect from others in particular recurrent situations - this study seeks to bring more clarity and consistence to the concept. Although such a definition has not previously been made, it is compatible with much of the literature. In particular, we argue, this definition is an extension, clarification and unification of Kornai's different descriptions of the concept and corresponds to the way in which he himself appears to perceive the soft budget constraint. This is suggested, first of all, by the significance he attaches to the role of the firm's expectations of bail-out for its budget constraint to be soft. Secondly, rather than as a simply financial matter,[225] he considers the degree of softness of the budget constraint to be a 'rule of behaviour, and human behaviour is shaped by much experience, long observation and "ingrained habit"'.[226] Kornai here comes as close as one may to defining the soft budget constraint as an institution, without explicitly doing so.[227]

We shall define the soft budget constraint as *the prevalence of expectations that one party will accommodate the financing gap of another party.*[228] This is an institution, a behavioural rule for social interaction. It applies in specific recurrent situations: when one of the parties is in financial trouble, and it applies to both parties when faced with this interaction problem: how to handle the financing gap. This is clearly a deviation from the perception, held by Kornai and his followers, that the soft budget constraint only applies to and shapes incentives for the party with a financing gap. It also departs from the other tradition in the literature, which focuses on the soft budget constraint as an expression of the incentives facing the financing party. Our position is that it forms expectations of, shapes incentives for and thus guides the behaviour of both parties involved in its application.

The soft budget constraint does not, however, specify who the two actors are. They may be the state and a state-owned firm, as is common in socialist economies, but this is not necessarily the case. The soft budget constraint may apply to the interaction between any other economic entities, for instance, two state-owned firms as in the case of inter-firm credit. This definition of the soft budget constraint is thus consistent *both* with Kornai's view that budget softness is the outcome of a paternalistic relationship, and with more horizontal trade relationships between fellow firms. A possible weakness of this definition is, however, that it does not specify who is expected to accommodate the financing gap of whom, although in practice, there should be little

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[225] Kornai (1990b), p. 25.

[226] Kornai (1986c), p. 48.

[227] On other occasions, he refers to the budget constraint as a behavioural regularity or a behavioural characteristic of the decision maker (the firm), and to the degree of softness of the budget constraint as a behavioural pattern. See Kornai (1986c), p. 36, Kornai (1990b), p. 21, and Kornai and Matits (1984), p. 225.

[228] Cf. Kornai (1985), Figure 1, p. 50, where he defines the soft budget constraint as 'expectation of external assistance in case of financial trouble'.

doubt about the direction of the financial assistance.[229]

It is the *prevalence of expectations* of financial accommodation that constitutes the behavioural rule, not financial accommodation *per se,* which is an application of the rule. It is by shaping the expectations of the actors - about each others' behaviour, the behaviour that others expect from them, and the success of their own behaviour - that the soft budget constraint guides their actions. The rule suggests that they should both behave so that the financing gap of the party in trouble is accommodated by the other party. However, since an institution consists of a set of socially prescribed patterns of correlated behaviour, adherence to the soft budget constraint does not imply the same behaviour for both actors. Their interaction is also sequential. The expectation of financial accommodation may, first of all, induce a firm in financial trouble to apply the soft budget constraint by turning to the state and bargaining for finance. It may thereafter induce the state, confronted with such a firm, to apply the soft budget constraint by providing funding. The assistance is usually financial, but it may also be material, for instance, inputs provided in kind.[230]

The soft budget constraint does not, however, prescribe any specific way of applying it. It allows the actors to adhere to it in a variety of ways. In this regard, the definition is non-pedantic, as suggested by Kornai. The forms its application takes may vary with the available sources of finance and with the behavioural constraints and opportunities provided by the surrounding institutional structure. In the socialist system, adherence to the soft budget constraint often involves lobbying and bargaining with various state organs on behalf of the firm, negotiations between the parties and discretionary allocation of resources by the state. However, such behaviour is not the only way of adhering to it, as illustrated by inter-firm credit. For the firm, it may also imply non-negotiated (as well as negotiated) payment default of, for instance, loans or taxes. Similarly, the state may adhere to the soft budget constraint not only by channelling new financial resources to the firm, but also by not enforcing payments due or by approving payment delay. Actors do not even have to behave actively, but may interact and apply the soft budget constraint passively: by defaulting on and refraining from enforcement of payments. Our definition thus brings consistency and unity between the different means of budget softening, and thereby extends the applicability of the soft budget constraint.

It further implies that adherence to the soft budget constraint may also occur unintendedly. A state, or a fellow firm for that matter, which refrains from enforcing payments from a firm in financial trouble does not have to do so with the explicit purpose, suggested by Kornai, of accommodating the firm's financing gap. Actors do not even have to be aware of the fact that they adhere to the rule, or about the extent to which they do so, as long as their behaviour is expected by others. This does not imply that all beneficiaries of, say, non-enforced tax payment perceive such state behaviour as adherence to the soft budget constraint. Private firms used to a

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[229] In addition, the definition allows for the possibility of reciprocal accommodation - an issue that remains unexplored in the present study.

[230] See, for instance, Kornai (1986b), pp. 54 and 60.

hard budget constraint, for instance, may simply perceive the benefit as a windfall gain. In that case, there is no soft budget constraint, because the behaviour of the state does not generate any expectations of bail-out.

The soft budget constraint is thus not a formal institution. It has not been established by any explicit decision; it is not formulated in any written law or regulation; it may not even be recognised as a behavioural rule by the actors. According to our definition, the soft budget constraint is an informal, or organic, institution that has emerged spontaneously and unintendedly through the behaviour and interaction of the parties involved. This process is one of the issues to be examined in the present study.

Finally, a few words on the degree of softness of the budget constraint, which may vary, for instance between sectors and over time. This study is not specifically concerned with the degree of softness and its variation. Nonetheless, we are confronted with the difficulty of establishing the critical point which distinguishes a basically soft budget constraint from a basically hard one. By defining the soft budget constraint as an institution, we shall apply a criterion for determining whether or not the budget constraint is soft; although this criterion is simple and admittedly rather blunt, it serves our purpose. Kornai offers guidance by letting the strength of the actors' subjective expectations define the degree of budget softness.[231] When the accommodation by one party of the financing gap of another party becomes a *regular behavioural pattern,* so that this behaviour is what (at least one of) the parties *expect* from each other in similar situations, then it has given rise to a rule of behaviour, the soft budget constraint,[232] regardless of the degree of softness.[233] The soft budget constraint may spread and gain general recognition. 'If an event occurs frequently enough which gives the impression of a soft budget constraint, and if its frequency goes beyond some *critical value,* a climate of "public opinion" will develop that regards the constraint as soft.'[234]

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[231] The strength of these expectations may vary with, for instance, the ease and speed by which financial accommodation occurs. Cf. Scott (1990) and Gomulka (1985).

[232] Cf. Kornai (1979), p. 807, according to whom the soft budget constraint does not result from a single event of bail-out, but when this behaviour becomes frequent and widespread, the firm's expectations are strengthened and its budget constraint becomes soft.

[233] The two parties involved in the repeated interaction are allowed to vary to some extent, for instance within the categories 'the state' and 'the state-owned firms'. For instance, various state agencies may grant assistance to one state-owned firm, which repeatedly receives external finance, or one state agency may repeatedly grant assistance to a number of different state-owned firms.

[234] Kornai (1986c), p. 45.

Observing the Soft Budget Constraint

An institution, even a formal one, cannot be directly observed. A behavioural rule may be codified into a law and the law may be documented, but it is rendered ineffective, and thus non-existent, unless actors expect it to apply and behave according to it. Similarly, we cannot observe actors' expectations of the validity of a certain rule. Instead we have to study the behaviour that results from such expectations, in particular the behavioural patterns produced by rule adherence in specific recurrent situations. By this means, the application of an institution can be observed. Since the definition of the soft budget constraint as an institution is an elaboration and extension of Kornai's definitions, its application is consistent both with the four major ways in which budget constraints are softened, referred to by him, and with other ways such as inter-firm credit. Thus the observation of actors' adherence to the soft budget constraint involves studying their behaviour when firms are in financial trouble, and the patterns that result from such behaviour.

There may be additional expressions of actors' expectations of the validity or applicability of a behavioural rule, for instance oral and written statements, which can be observed: folk-views or ideological explanations for and rationalisations of actors' behaviour, such as the reasons they give for following a certain rule in a certain situation.[235] Kornai stresses two other major indicators of the soft budget constraint that result from its regular application. One is the *survival* of chronically loss-making firms; the other, when 'the growth of the firm is not tied to its present and future financial situation', is the *expansion* of loss makers.[236] He also notes that in order to observe budget softness, several indicators have to be studied together.[237] In this study, we will examine the different ways in which the soft budget constraint is applied and the survival of chronic loss makers that results from the application of this rule. These are strong and important indicators. They will be complemented by other ones, when data are readily available.

The Institutional Framework

The relationship between human behaviour and institutions is two-sided. Institutions influence human behaviour, by constraining or promoting action, and institutions are in their turn created and changed by human behaviour. Although much of institutional economics is devoted to

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[235] Cf. Neale (1988), pp. 231-236, and Vanberg (1994), p. 29.

[236] Kornai (1979), p. 807.

[237] Just as he notes that the degree of budget softness can only be measured ordinally, not cardinally. (Kornai, 1986c, p. 45.) A theoretical discussion on how to measure the degree of budget softness is provided by Gomulka (1985) and Scott (1990). For an example of how the soft budget constraint can be 'observed', see Kornai and Matits (1984), who examined financial data for Hungarian state enterprises for the period 1975-1980. A number of indicators were defined, related to different measures of profit, subsidies and investment.

either one or the other of these relationships, several scholars advocate an institutional analysis that incorporates institutions both as exogenously given and as endogenously generated. According to Bruno S. Frey, 'An adequate general analysis considers the impact of institutions on individuals (through its effects on the opportunity set, or relative prices, costs and income), as well as the influence of individuals on the emergence and conscious design of institutions'.[238]

Langlois goes a step further, and sketches an outline for what he calls the New Institutional Economics. This includes seeing institutions both as exogenously determining the situation facing the actors and as an endogenous outcome of an invisible-hand process.[239] This outline, which includes the method of invisible-hand explanation as forwarded by Ullmann-Margalit, has inspired the approach adopted in this study of the emergence, persistence and logic of the soft budget constraint.

Assumptions, Situational Analysis and Actors

First of all, Langlois broadens the *rationality assumption,* by abandoning the maximisation rationality and replacing it with 'a kind of bounded rationality assumption', which 'does not grant the agent unreasonable cognitive powers or an inappropriate level of information'. He assumes that the individual is rational in the sense of possessing 'the ability to act reasonably, to act appropriately to one's circumstances, to adapt'.[240] We shall take a similar position by assuming that although humans are boundedly rational due to the competence-difficulty gap, they are rational in a procedural sense. Humans are adaptively rational, as defined earlier. They are able to learn systematically from experience and can therefore adapt their behaviour to a changing environment, so as to achieve their aims. Successful behaviour is repeated in recurrent situations. Thus they follow rules, and unsuccessful behaviour is modified. They innovate. Behaviour, even in rare situations, is largely guided by experience.

We shall assume that actors are so-called satisficers who strive towards achieving their aspirations.[241] The levels of these aspirations are set and adjusted on the basis of past experience, their own as well as that of others. This assumption is consistent with the institutional approach adopted here, which involves a largely backward-looking perspective.[242] We want to direct attention towards the role of the past - experience as well as perceptions based on ideas and values - for the behaviour of adaptively learning individuals. Apart from being useful for our overall purpose, this assumption improves our understanding of the behaviour of the actors

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[238] Frey (1990), p. 445. See also O'Driscoll (1986), p. 155.

[239] Langlois (1986b).

[240] Ibid., p. 230.

[241] Our reasons are pragmatic, motivated by this particular inquiry. We do not take a stand on principle in the controversy between advocates of satisficing versus optimising assumptions. For a presentation of the arguments and a discussion, see for instance Langlois (1986b), pp. 225-230.

[242] Cf. Vanberg (1993), p. 186, and Vromen (1995), p. 118.

involved in the budget-softening process. While assumptions by necessity are and should be abstractions from reality, a more 'realistic' assumption, in this sense, is therefore a merit.[243] Satisficing, bounded and adaptive rationality are less stringent, and thus weaker and broader behavioural assumptions than maximising rationality.[244] They relax the demands upon the individual, as will be discussed below. A weak rationality-assumption is made possible, and further motivated, by the method of situational analysis.[245]

On the basis of his weak rationality assumption, Langlois advocates the method of *situational analysis,*[246] where institutions enter exogenously. In the present study, this means institutions other than the soft budget constraint. The existing institutions thereby define the decision-making and behavioural situation of the individuals. This study examines the evolution of the soft budget constraint in the Tanzanian parastatal sector during the development, stability and reform of socialism. Hence, it is largely this system that determines the conditions under which humans act and interact. Our characterisation of the Tanzanian socialist system will take Kornai's model, presented above, as a point of departure, while recognising the specific Tanzanian features. In addition to the official socialist ideology, the political monopoly of the ruling party and the central role of state ownership and bureaucratic co-ordination, consideration will also be given to informal values and behavioural rules related, in particular, to the economy of affection. However, the individual is exposed not only to the situational constraints of his immediate exogenous environment, but also to what Langlois and László Csontos refer to as the system constraints of the larger environment. These include the feedbacks of the individual's own actions, as he interacts with others and thereby influences the environment.[247] Defining the situation of the actors also involves the identification of other constraints, for instance in terms of resources and demand, and relative prices.

To a large extent, the socialist system also determines who are the central actors within or related to the parastatal sector in Tanzania. *Parastatals,* to begin with, are majority-owned state enterprises or other organisations, with a budget and accounting system of their own. They are hence not directly integrated with the government (central or local) budget.[248] The vast majority of parastatals are *commercial,*[249] here also referred to as parastatal *enterprises.* Besides performing their operative functions, such as producing or marketing commodities or services, these parastatals are to be self-financing on the basis of such activity and to generate revenue for

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[243] Langlois and Csontos (1993), p. 115.

[244] Cf. Langlois (1986b), p. 252, Vanberg (1994), p. 26, and Williamson (1986), pp. 173-175.

[245] Langlois and Csontos (1993) argue that this method eliminates part of the controversy between 'neoclassical optimizers' and 'boundedly rational satisficers' (p. 114).

[246] See also Langlois and Csontos (1993).

[247] Langlois (1986b), pp. 235-241, and Langlois and Csontos (1993), p. 119.

[248] Cf. the United Republic of Tanzania (1988), p. iv.

[249] As reflected in various Annual Reports by the Tanzania Audit Corporation (TAC), whose definition of commercial parastatals is, however, more narrow than ours. The TAC definition excludes, among other firms, many agricultural parastatals. See, for instance, Tanzania Audit Corporation (1992), pp. 26-55, *passim.*

the government from dividends on profits.[250] In addition, there are *non-commercial* parastatals. These are also referred to as parastatal *organisations,* and include, for instance, universities and hospitals. In this study, as well as in the data we use and the sources we refer to, no distinction is usually made between parastatal enterprises and parastatals in general, since the former dominate the latter. When the distinction between different types of parastatals is important, we specify. Parastatals are thus part of the state organisational structure, headed by the president and with the government, ministries and other organs following below. A hierarchy can also be observed among the parastatals themselves. There are regulatory parastatals and financial ones, the state-owned banks, holding corporations and their subsidiaries as well as independent parastatals.

Within the parastatals, the *managers* are the central decision makers, to be distinguished, for instance, from the boards of directors and the employees. They are part of a huge bureaucracy that consists not only of the state officials, but also of party officials. The state and party organisational structures, although formally separate, in practice largely overlap. Many officials, particularly those in leading positions, belong to both. Parastatal managers interact with a large number of individuals, but their major counterparts are those within the state and party bureaucracy - the *bureaucrats.* Relationships within the bureaucratic structure are complex, but nonetheless essentially hierarchical. This implies that most bureaucrats are both subordinates and superiors. At the apex of the state-cum-party is the *political leadership.* In this study, a distinction is sometimes made between the (political) leadership and (other) bureaucrats, but most of the time, they are lumped together in the term bureaucrats.[251] It is thus the behaviour of and interaction between parastatal managers, on the one hand, and bureaucrats (including the political leadership), on the other, that we want to examine. Other actors - foreign donors, for instance - enter exogenously. Our situational analysis hence focuses on the examination of the institutional and economic context of these actors.

The method of situational analysis has implications not only for our behavioural assumptions but also for our assumptions about the preferences of the actors. It shifts the emphasis away from objectives towards the role of institutions and other contextual circumstances in explaining behaviour and economic outcomes. A certain action can be determined by analysing the logic of the situation,[252] without a detailed knowledge or specification of the individual's preferences. The reason is that the constraints of the situation and the system reduce the individual's options to the extent that 'a light postulate of reasonable conduct is adequate to secure a determinate outcome'.[253] Under these circumstances, behavioural assumptions carry relatively little explanatory weight.[254] Hence, knowledge about the individual's environment replaces and

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250 Cf. Ndulu (1984), p. 15, and Ngowi (1990), p. 18.

251 The organisational structure, and the relationships within the bureaucracy, of the state, the party and the parastatals will be discussed in greater detail in Chapter III.

252 Cf., for instance, Popper (1964) and (1969).

253 Langlois (1986b), p. 231.

254 Langlois and Csontos (1993), p. 117.

reduces the need for detailed knowledge about the individual's objectives.[255] By treating the situation as exogenous, we also limit the requirements on the individual. The existing institutions function as information carriers, and thereby 'serve to restrict at once the dimensions of the agent's problem-situation and the extent of the cognitive demands placed upon the agent'.[256] Hence, much of the individuals' motives and interests can be derived from the incentives, opportunities and constraints given by the institutional framework. We shall, nonetheless, make some assumptions about the basic objectives of the actors.

The most basic aim, acting as a driving force for all individuals, should to be to ensure the survival of themselves and their immediate families, and to do so well.[257] The context largely determines how well people can survive, and we assume that success, or utility, can be obtained from both material and moral rewards and from power. We thereby also adopt a broad motivational assumption. *Material rewards,* on the job for instance, may include formal pay and fringe benefits as well as informal rewards. *Moral rewards* imply that people have preferences for ethics and morality; they want to survive with dignity, by achieving both social prestige and self-esteem.[258] Finally, we assume that our actors aim for power. Our assumptions about the objectives of parastatal managers and bureaucrats thus resemble those suggested by William A. Niskanen's theory of the bureaucracy: pay, prestige and power.[259] Kornai stresses that the role of power is an important motivating factor within the socialist state and party bureaucracy. 'The members of the bureaucracy ... are bound together by their resolve to retain power. The bureaucracy constitutes the power elite ...'[260] He further notes that although not all people want it, those that accept leading positions are attracted by and want to increase their power.[261] The suggestion that power may be an important motivating force within African bureaucracies also is made by Robert H. Bates. He criticises the new institutionalism for exclusively focusing on economic factors while failing to recognise the centrality of political variables - the political power of the actors and the political setting in which they operate - for the creation of new institutions and their outcomes, not the least in the African context.[262]

Even if our actors all strive for material and moral rewards and power, the relative importance attached to them will differ. 'Adaptively learning individuals ...', Jack J. Vromen

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[255] According to Alchian (1950), a certain kind of behavioural pattern may prevail regardless of the actors' intentions, because the economic system acts as a mechanism that selects this behaviour as successful. For a discussion of attempts in the literature 'to show that economic phenomena can be explained without *any* reference to preferences', see Langlois (1986b), pp. 230-241 (quotation from p. 232).

[256] Ibid., p. 237.

[257] Cf. North (1990), p. 25, who notes that in a strict socio-biological model, what motivates human action is maximisation of the survival potential.

[258] As recognised not least by Etzioni (1988). See also, for instance, North (1990), pp. 20-22, and Williamson (1986), pp. 177-178.

[259] Niskanen (1971) suggests that bureaucrats strive for budget maximisation because larger budgets increase these 'three Ps'. (Godana, 1991, p. 30.)

[260] Kornai (1992), p. 41.

[261] Ibid., p. 119.

[262] Bates (1995), pp. 39-47, *passim*. See also Bates (1981), p. 2, referred to by Eggertsson (1990), p. 330.

notes, 'may all have different aspiration levels. They may have different motives and targets.'[263] In addition, the institutional conditions will determine how to behave in order to achieve these aims, how well the actors will achieve them and whether they will be relatively more successful in achieving, for instance, their power ambitions in relation to their economic aspirations or *vice versa.*

An Invisible-Hand Explanation

Once behavioural assumptions have been made and the initial situation of the actors has been established, Langlois argues that an *invisible-hand explanation* for economic phenomena, such as institutions, should be provided. The approach implies, in the present context, that the soft budget constraint should be explained as the unintended consequence of an evolutionary process of individual action and interaction.[264]

The idea and method of invisible-hand explanations has been developed, for instance, by Ullmann-Margalit. She distinguishes between two different types or moulds of invisible-hand explanations: *aggregate-mould explanations* and *functional evolutionary explanations.*[265] The aggregate mould tries to explain how a phenomenon did (or could have) come about. It focuses on 'the causal-genetic process by which individual action brings about the aggregate pattern to be explained',[266] and thus provides *'a chronicle of* (a particular mode of) *emergence'.*[267] The functional evolutionary mould asks why an institution - once it has been established - exists. It emphasises the institution's *raison d'être,* how and why it is maintained, and 'how mechanisms that maintain the pattern relate to those that brought it about in the first place'.[268] Hence, aggregate-mould explanations focus on the process through which an institution emerges, while functional evolutionary explanations focus on the process by which it is maintained.

Both Ullmann-Margalit and Langlois stress that an invisible-hand explanation of an institution involves an analysis of what problem the institution solves or what function it has. As discussed above, this does not imply that an institution can be explained by simply establishing what function it serves. This would amount to a purely functionalist explanation.[269] According to Ullmann-Margalit, it is rather the combination of functional and evolutionary analysis that

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263 Vromen (1995), p. 120.

264 Langlois (1986b), p. 236, adheres to the view held by both Popper (1965), p. 342, and Hayek (1979), pp. 146-147, that it is precisely the unintended or undesigned social repercussions as an outcome of human action that the social sciences should aim at explaining.

265 Ullmann-Margalit (1978), especially pp. 282-286.

266 Langlois (1986b), p. 242.

267 Ullmann-Margalit (1978), p. 284.

268 Langlois (1986b), p. 242.

269 Ibid., p. 248.

constitutes an invisible-hand explanation of an institution.[270] Jon Elster specifies conditions for valid functional explanations within the social sciences. An institution or behavioural pattern X is explained by its function Y for the group Z if and only if:

1. The function Y is an *effect* of the institution X;
2. The function Y is *beneficial* for the group Z;
3. The function Y is *unintended* by the actors producing the institution X;
4. The function Y (or at least the causal relationship between the institution X and its function Y) is *unrecognised* by the actors in the group Z; and
5. The function Y maintains the institution X by a causal *feedback* loop passing through the group Z.[271]

Criteria three and four require that the beneficial consequences (functions) of an institution should account for its maintenance without the actors maintaining it either intending this or being aware of their doing so. How is this possible? Ullmann-Margalit suggests an answer, by drawing a distinction between the *individual* and *aggregate* effects of actors' behaviour.[272] The third criterion implies that although actors producing the institution X may be striving for some goal, this goal must not be its function Y. However, actors may intend to bring about beneficial individual consequences without intending to produce the aggregate functions of the institution.[273] The same applies to actors' awareness of the consequences of their behaviour, raised in Elster's fourth criterion: actors may recognise the individual but not the aggregate effects. The fourth criterion - and as it appears, also the third - is relaxed by Langlois. Even explanations where actors gradually become aware of the function served by the institution, and therefore eventually maintain it consciously and intendedly, qualify as an invisible-hand explanation. In these cases, 'the institution is created organically but maintained pragmatically'.[274] We shall take the same position.

The fifth criterion distinguishes between the functional evolutionary mould and functionalism. It requires that the mechanism by which the institution is reproduced and maintained - the feedback loop - is specified. Otherwise, we 'would leave the crucial question unanswered: how can a behavioural pattern X be reproduced through its beneficial effects Y if these effects are not even recognized by their beneficiaries?'[275] As discussed above, maintenance of an institution may be accomplished through natural selection or a reinforcement mechanism. In this study we shall rely on reinforcement through actors' adaptive learning.

According to Langlois, explaining an institution requires that both its origin and its maintenance are accounted for, since the mechanisms that gave rise to the institution may be

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270 Ullmann-Margalit (1978), p. 282.

271 Elster (1979), p. 28, or (1983), p. 57. (This is not a quotation.)

272 As pointed out by Vromen (1995), pp. 99 and 103.

273 Ullmann-Margalit (1978), p. 267.

274 Langlois (1986b), p. 248, footnote 31.

275 Vromen (1995), p. 100.

different from those that maintain it.[276] Ullmann-Margalit describes how the two explanations may be superimposed:

> Suppose a certain existent social pattern or institution is up for explanation. The attempt may first be made to subject it to the first, aggregate, mold so that - if successful - an invisible-hand account of how it (could have) emerged is obtained. It may then be pointed out that this item is functional, that it contributes to the well-being and proper working order of the society incorporating it. So, it may now be subjected to the second, functional-evolutionary, mold, yielding an invisible-hand account of its durability and prevalence ... This superimposition of the two explanatory molds may be expected to yield a rather satisfying answer to the question concerning the existence of this institution, since it is capable of yielding an account of its emergence and inherent stability as well as its continued existence and prevalence.[277]

An invisible-hand explanation for the emergence of the soft budget constraint in the Tanzanian parastatal sector will be pursued here. We intend to explain how the institution emerged spontaneously as an outcome of human interaction. We shall show how the individual behaviour of and interaction between parastatal managers and bureaucrats - through the success of their behaviour, the experiences they gain, the formation of their expectations and the repercussions of their behaviour - gradually produce the soft budget constraint as a behaviour rule, without this ever being foreseen or intended by any of the actors.

The first explanation is hence concerned with the endogenous origination of the soft budget constraint. The next step is to provide an invisible-hand explanation for why, and by what mechanisms, it is maintained. Both explanations are evolutionary: the emergence and maintenance of the soft budget constraint are seen as processes evolving in causal and sequential stages over time. Explaining the processes involves accounting for the feedbacks that give rise to and maintain the soft budget constraint. The second part of the analysis, but not the first, is also functional. We shall explore what functions the soft budget constraint fulfils, once established, and how these functions relate to the feedback mechanisms that contribute to its maintenance. While functions and mechanisms are also involved in the initial generation of the soft budget constraint, it is conceptually difficult to talk about the functions of a phenomenon and pursue an analysis of its self-maintaining mechanisms prior to its establishment.

Finally, the stability characteristics of the soft budget constraint will be studied, as we examine its possible persistence and change in a partly altering institutional environment. This includes a study of whether its reinforcement mechanisms and functions are different from those in the past.

Now that our conceptual tools have been defined, our basic assumptions accounted for and the analytical framework outlined, we are ready to combine the metaphors and their inherent logic with our facts into the story of the soft budget constraint in Tanzanian parastatals.

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[276] Langlois (1986b), pp. 247 and 251.

[277] Ullmann-Margalit (1978), pp. 285-286.

CHAPTER III

EMERGENCE DURING THE ESTABLISHMENT OF SOCIALISM

The story begins by telling about how the soft budget constraint first emerged within the parastatal sector in Tanzania. It takes off in the late 1960s, when the newly independent East African nation took its first major steps on the road to socialism. Comprehensive ideological, institutional and organisational change initiated a process of gradual creation of a new economic and political system. These developments had tremendous consequences for the parastatal sector, which gained a central position within the system, and for the actors within it. As the system evolved, problems arose that parastatal managers and their counterparts in the state and party bureaucracy had to handle within the new and changing environment. By studying the establishment of the socialist system and the consequences for the parastatal sector during the late 1960s and the 1970s, this chapter examines how the soft budget constraint arose in the process. It characterises the institutional structure and other contextual circumstances under which the actors operated, the problems they faced, the opportunities and constraints for dealing with those and the behavioural outcomes of the incentives thus created. Let us first consider the historical, cultural and ideological setting in which these developments occurred.

HISTORICAL, CULTURAL AND IDEOLOGICAL SETTING

Prior to Socialism

Tanganyika gained independence from British rule in 1961. Three years later, it formed a union with Zanzibar, which had become independent in 1963. The United Republic of Tanzania was created. The nationalist movement in colonial Tanganyika had been led by the Tanganyika African National Union (TANU), which became the ruling political party in the new

independent state. Nyerere was chairman of TANU and became the nation's first president. He would remain in both positions for about 25 years.

The new independent state inherited an economic system characterised by private enterprise and certain state regulation. The economy was almost entirely agrarian, with a dual production structure of African peasant smallholdings and large plantations owned by Europeans. The industrial sector was small and undeveloped, and was managed by Asians or Britons. It was based on the processing of agricultural products and other raw materials for exports, and there was also some import-substituting production for the home market. The economy was open, being dependent on crop exports. During the colonial period, government regulation both restricted and favoured agriculture. By-laws restricted local production, while price guarantees were offered for food crops and compulsory marketing orders were granted to co-operatives. The co-operatives, which grew rapidly in the 1950s, were supported in order to promote commercialisation of the peasant smallholders and Africanisation - staffing with indigenous Africans - of trade and marketing, previously dominated by the Asian minority.[1]

Parastatals were set up to promote agricultural production and exports. The British established the Tanganyika Agricultural Corporation, which operated farms and ranches and acted as a government marketing agent, and five agricultural marketing boards. Parastatals for mineral exploitation, livestock development, transport and other infrastructure were also created. At independence, Tanganyika inherited some 15-20 parastatals.[2] The colonial parastatal policy implied substantial state participation in the economy. In 1960, one-third of the total capital formation was accounted for by the public sector. However, state interference was limited, since parastatal management was largely left to agents or government partners. The parastatals were expected and forced to operate according to market principles. Altogether, the parastatal policy of the government was rather *ad hoc* in nature.[3]

The first years after independence were characterised by relatively moderate policy changes. There was rather a continuation of policies introduced during the colonial period, focused on modernisation of the economy. Agriculture would be the leading sector in development, and it was through agriculture's ability to increase demand that industrialisation would be stimulated. From 1965, import substituting manufacturing enjoyed tariff protection, as certain import restrictions were introduced to support infant industries. The government continued to promote foreign investment, and economic growth was largely to be based on private enterprises, which were supported with industrial sites and even finance.[4] Despite the establishment of certain parastatals, no major organisational or institutional changes related to the role of the state sector took place until 1967. In the financial sphere, however, Tanzania, which was previously part of

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1 Hanak (1985), pp. 7-9, and Havnevik (1993), pp. 31-33.

2 See Mukandala (1988), pp. 10-11 and 421.

3 Ibid., pp. 11-12.

4 Kimei (1987), p. 44.

the British common currency area, cut the link between its monetary supply and sterling and established a central bank, the Bank of Tanzania, in 1966.[5]

The economy performed relatively well during the early years of independence.[6] The economy was expanding without any major macro-economic imbalances, so that the Tanzanian leadership could focus its attention on forming and consolidating the new independent state. The state had to reinforce its power and maintain the political unity achieved during TANU's fight for independence, and it had to gain control of economic power in order to be able to meet the aspirations of the population. First of all, political 'control had to be asserted over all levels of state power', especially the military forces, the police, the civil service and the legal system,[7] but also over rural trade. This required that the public administration should be staffed with indigenous Africans. Independence had been the common goal of the nationalist movement during the colonial period, but once independence had been gained, it gave way to the specific interests of different social groups. They made various demands directed at the state leadership.[8] Thus while ensuring its own political power, the TANU government also had to balance and unite the interests of groups both inside and outside the nationalist movement. Some of these groups were important for its ability to meet people's expectations, such as financial organisations, European settlers and Asian traders.[9]

As part of the power consolidation efforts, monopsony buying power was granted to co-operatives in order to get rid of Asian middlemen in crop trading. The co-operatives grew in number and their activities expanded beyond cash (export) crop trade into food marketing and several other activities.[10] In 1962, the 34 co-operative unions were brought together in the state-supported Cooperative Union of Tanganyika.[11] A three-tier system was established as the only legal agricultural marketing system, consisting of local co-operative societies, regional co-operative unions and parastatal marketing boards at the national level. Government regulation and control of agricultural marketing was strengthened, and by late 1966 there were 12 national agricultural boards with regulatory, advisory or monopolistic marketing functions.[12]

Despite the relatively favourable economic situation, the TANU government eventually faced both economic and political problems. Its control over the economy remained limited as the modernisation policy still relied largely on the private sector in agriculture and industry, and depended on the British for management and investments. However, foreign investment and

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5 Ibid., pp. 57-68.

6 See Tables 3.9 and 3.10 below.

7 Mukandala (1988), p. 12.

8 Kiondo (1989), p. 42.

9 Mukandala (1988), pp. 12-15.

10 Crops which are mainly grown for exports, such as coffee and cotton, are usually referred to as cash crops, whereas food crops are those grown mainly for domestic consumption, typically maize.

11 Ibid., p. 18.

12 Havnevik (1993), p. 37.

financial assistance was not forthcoming to the extent that had been expected.[13] As a result, there was a growing distrust of the role that the private sector and foreign investment could play in Tanzania's economic development. Moreover, Africanisation of the civil service took time. Popular demands were voiced, in particular by the autonomous and well organised labour movement. Improvements in social services, employment opportunities, education and incomes etc. did not materialise as hoped during the first years of independence, when the government's social profile was low.[14] The failure to satisfy people's expectations threatened the unity within the new state as well as the legitimacy and position of the TANU leadership.

The leadership responded by strengthening its political power. It incorporated groups within civil society into its domain of control. In particular the labour movement was attacked. In 1964, the previously independent labour union was taken over, and a single union under TANU control was created.[15] In 1966, operational problems within the co-operatives were identified by a government committee, which led to increased government interference and control of the co-operative movement. Most important was perhaps the adoption of a new constitution in 1965. It established the single-party political system, stressed the consensus-generating and care-taking role of the state,[16] and implied that political activities outside the state and the party were banned. However, the regime's continued survival also depended on its ability to deliver economic and social progress to the population. Hence it needed to gain control over the economy as well.

According to Andrew S.Z. Kiondo, these requirements which the regime faced in order to survive explain the logic of the 'statism' that eventually developed in Tanzania. By statism he means 'that the state intervenes systematically in economic activities while at the same time closing avenues for popular participation'.[17] Rwekaza S. Mukandala stresses the central role of parastatals. They were used to resolve and meet the conflicting goals of different social groups, and were critical for enabling the regime to hold its promises to the nationalist movement and for keeping the ruling coalition intact. They therefore served as a tool for the regime to secure its hold on state power.[18] Hence, the leadership eventually participated more actively in the parastatal sector. The establishment of the National Development Corporation, a parastatal holding company, in 1965 initiated the development of the industrial parastatal sector,[19] which would expand rapidly in the years to come. This tremendous parastatal expansion was legitimised and set off by the Tanzanian socialist ideology.

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13 Ibid., pp. 37-38.

14 Ibid., pp. 38-41.

15 Ibid., p. 39.

16 Ibid., pp. 37-39.

17 Kiondo (1989), p. 10.

18 See Mukandala (1988), pp. 15-22.

19 Skarstein and Wangwe (1986), p. 17.

The Tanzanian Socialist Ideology

1967 marked the starting point for Tanzanian socialism. In this year, the National Executive Committee of TANU adopted the so-called Arusha Declaration. The Arusha Declaration set the scene for the famous Tanzanian socialist development model.

The Arusha Declaration

Nyerere was the prime Tanzanian leader, not only by virtue of being the president of the nation and of TANU. The main official ideological speeches and writings were also formulated by him. This applied to the Arusha Declaration, which became the major blue-print for the official Tanzanian ideology.

The two major elements of this ideology were socialism and self-reliance. The primary task of TANU was to build a socialist society, where 'no person exploits another' and where 'the incomes derived from different types of work are not grossly divergent'. The individual's rights would be guaranteed by the state. It therefore had the responsibility to intervene actively in economic activity. Moreover, 'in order to ensure economic justice the state must have effective control over the principal means of production' and must 'facilitate the way to collective ownership of the resources of this country'.[20] The state as portrayed by this ideology had strong paternalistic traits.[21] It was seen as a unifying agent of the people, and a provider of material welfare to all in a fair and equal manner, ensuring the freedom and justice of the poor and protecting the people from exploitation and capitalist domination. This position was authoritarian rather than democratic and reflected the idea that development can be achieved through social engineering.

The ideology was not only distribution but also development oriented.[22] Socialism was seen as one of the means to develop the country; self-reliance was the other. Nyerere recognised the failure of the previous policy stance, by stating that there had been too much emphasis and reliance on the industrial sector, on foreign investment and aid - and on money. The country was so poor that it was at 'war against poverty and oppression',[23] but this war was not to be fought with money that the poor country neither possessed nor could expect to receive. Foreign assistance would endanger the newly gained independence by having conditions attached, and foreign private investors would repatriate their profits. Moreover, the previous attempt to promote the industrial sector involved the risk of an urban bias and was wrongly based on finance and know-how that Tanzania did not possess. Besides, gifts and loans might weaken the

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[20] Nyerere (1968b), pp. 14-16.

[21] As pointed out, for instance, by Kiondo (1989), p. 12.

[22] Hedlund and Lundahl (1989), p. 13.

[23] Nyerere (1968b), pp. 17-18.

people's own effort to work for development. Tanzania could not rely on any outside support, but should instead be self-reliant to ensure independence and bring about development. The major weapon against poverty should thus be hard work by the population. The country had plenty of land and people, which is why agriculture was seen as the basis for development.

The last part of the Arusha Declaration includes the so-called Leadership Code.[24] Tanzanian leaders were not only to embrace the socialist ideology, but should also serve as good examples to the rest of the population. This implied, for instance, that they were not allowed to own shares in any company, hold a directorship in a private enterprise, own houses rented to others or receive more than one salary. This code, together with the virtue of hard work and the vice of money, suggests that Tanzanian socialism had strong moral overtones, as pointed out by Stefan Hedlund and Mats Lundahl.[25] Nyerere criticised leaders and public officials for being too concerned with money - always asking for more money as a solution to their problems[26] - when hard devoted work was the solution. Although society should look after its individuals, he stressed that 'it is necessary for everybody to work to the maximum of his ability' for the nation.[27] Society had obligations towards the individual, but the individual had obligations too.

Ujamaa and African Socialism

The strong moral appeal is reflected in the final aspect of the Tanzanian socialist ideology: the perception of an African type of socialism. By drawing parallels to the traditional African society and its values, Nyerere employed the concept of *ujamaa,* which was given a strong symbolic value in the official ideology as well as in practical politics. *Ujamaa* is a Swahili word that can be literally translated as 'familyhood', and refers to traditional rules of rights and obligations within the household, the extended family and its guests. Every member of the extended family has an obligation to contribute to supporting the rest of the group with his own work, income, wealth etc., while this obligation grants him the right to be supported by the other members of the group according to the same conditions. Hence, all members share the responsibility for the survival of the group and can rely on the group for their own survival.[28] The title of a political document published in 1962, *Ujamaa - The Basis of African Socialism,* mirrors the fundamental meaning that Nyerere attached to the concept:

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[24] Ibid., pp. 35-36. Leaders are all high or middle level state officials and appointed or elected party members.

[25] Hedlund and Lundahl (1989), p. 18. See also Hanak (1985), p. 11.

[26] Nyerere (1968b), pp. 18-21.

[27] Ibid., p. 34. These ideas are further developed in a TANU pamphlet written by Nyerere (1968d), first published in 1962.

[28] See Hydén (1980), pp. 98-99.

> For when a society is so organized that it cares about its individuals, then, provided he is willing to work, no individual within that society should worry about what will happen to him tomorrow if he does not hoard wealth today. Society itself should look after him, or his widow, or his orphans. That is exactly what traditional African society succeeded in doing. Both the 'rich' and the 'poor' individual were completely secure in African society. ... Nobody starved, either of food or of human dignity, because he lacked personal wealth; he could depend on the wealth possessed by the community of which he was a member. That was socialism. That *is* socialism.[29]

Nyerere held that the traditional values of *ujamaa* had partly been lost during the colonial period. Capitalist and individualistic attitudes, greed, individual wealth seeking and land ownership, landlord-tenant and employer-employee relations and the exploitation of man by man had diverted people's minds from the African socialist principles. Therefore, these had to be regained. Besides, the traditional system had its own weaknesses, mainly in terms of tolerating inequalities and different income levels. A new socialist man had therefore to be developed and re-educated, by drawing on the traditional heritage, but at the same time extending the *ujamaa* concept to apply beyond the extended family: within the nation as a whole.[30] As pointed out by Hydén, *ujamaa* does not traditionally apply between households in a larger community. For mutual aid - but not ownership - between households, for instance during harvest or in case of emergency, there is another concept: *ujima.* Consequently,

> What Nyerere was asking of the peasants ... was to go beyond *ujima* and adopt *ujamaa* as the guiding principle of life and work, not only within the household but also in the relations between households in their community.[31]

Tanzanian socialism thus incorporated central traditional values. It would affect the systemic and economic developments in Tanzania in several ways. By presenting a model of the world and values about how it should be, it both influenced actors' perceptions and shaped incentives for their behaviour. The strong moral flavour of the Tanzanian socialist ideology led, first of all, to a 'heavy reliance on moral exhortation and non-material incentives'.[32] Attempts were made to replace material incentives with moral incentives to work, traced to the traditional values of *ujamaa.* The ideology also provided explanations and justifications for the system that would eventually become established. It legitimised the political leadership's policy and institutional changes, in particular expansion of the state sector and extensive economic regulation, as noted by several observers. Kiondo holds that it 'would provide logic to statism and mould it to a national policy'.[33] Kjell J. Havnevik stresses its consensus-generating role and sees the emphasis on self-reliance, equity and extended state control and ownership as an attempt to close the

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29 Nyerere (1968d), pp. 3-4.

30 Ibid. and Nyerere (1968a), pp. 108-118.

31 Hydén (1980), p. 99.

32 Hedlund and Lundahl (1989), p. 7.

33 Kiondo (1989), pp. 50-51.

emerging gap between the leadership and its social base.[34] Ellen Hanak, finally, recognises that the official ideology legitimised institutional changes, notably nationalisations, by disguising African nationalist aspirations behind socialist rhetoric.[35]

Apart from formal rules, informal rules are important for the incentive structure facing individuals in a society. Nyerere's reference to *ujamaa* suggests the prevalence of a culturally based set of informal institutions, legitimised and co-ordinated by the traditional value system, which guide behaviour and interaction within the Tanzanian society. These are the rules of the economy of affection.

The Economy of Affection

According to Hydén, agricultural production in much of traditional African society is characterised by a 'peasant mode of production'.[36] This mode of production is pre-capitalist, with free small-scale land ownership and communal land property based on kinship, and may exist in parallel with a socialist or a capitalist system. It is characterised by its rudimentary division of labour, small production units, little product specification, and therefore little exchange between fairly autonomous production units. In societies where the peasant mode of production prevails, it gives rise to what Hydén calls the 'economy of affection'.[37] The economy of affection is characterised by social networks and the communication and interaction that takes place between groups within these networks, tied to each other on the basis of kinship, friendship, a common place of birth or residence etc. It relates a number of otherwise autonomous units to each other in informal and often irregular communally organised activity.

In African societies with poorly developed formal social security systems and with high dependence on rain-fed agriculture, the vulnerability of many households means that they would be unable to survive or to fulfil their obligations towards their members without access to the support mechanisms offered by the economy of affection. The economy of affection implies that social groups take responsibility for the welfare of their members, notably within the household or extended family, but in severe situations, such as natural catastrophes, larger social networks - often related to the tribe - can be relied upon.[38] Individuals identify themselves primarily with the particular social group to which they belong, such as the clan or other social network, rather than with society as a nation. The rules and norms within these networks guide human behaviour

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[34] Havnevik (1993), pp. 42-43.

[35] Hanak (1985), pp. 36-37 and 54.

[36] Hydén (1980), pp. 13-16, and (1985), pp. 21-23.

[37] Hydén (1980), p. 18, and (1985), pp. 24-25.

[38] Cf. the discussion on *ujamaa* and *ujima* above. See Hydén (1985), pp. 29-36, for additional examples of the functions provided by the economy of affection.

by imposing obligations on the individuals which restrict their ability and willingness to support concerns of a more general character or interest beyond their own social group. They tend to maintain a local-patriotic perspective, expressed for instance in nepotism and positive discrimination of members of their own tribe in relation to employment and appointments.

Jean-Philippe Platteau provides insights that are of relevance for the economy of affection, by focusing on the central role of trust for all kinds of human interaction. Exchange in the modern market economy takes place at an impersonal level, where the problem of trust is solved by the prevalence of norms of a generalised morality in society. In pre-capitalist or traditional societies, however, a general morality is often lacking and moral behaviour is restricted to interaction within the people's own, primarily kinship-based, network. Hence, obligations to behave morally only apply within a person's own group, whereas there are no such obligations towards individuals outside that group. By contrast, behaviour that favours a person's own group may be considered moral even if it takes place at the expense of others or society as a whole, such as cheating an outsider. 'Procedural norms, when they exist, and codes of moral behaviour are particularistic.'[39] In these societies, the problem of trust is instead solved through strong and lasting relationships of inter-personal dependence. The establishment of trust is essentially based on the exchange of gifts, where gift giving 'serves to *create* small groups of trustworthy agents among whom repeated interactions take place'.[40] Reciprocal gift giving creates and reinforces trust, which enables economic transactions in the absence of a general morality or other enforcement mechanisms, by binding humans together in mutual obligations and dependence, restricting the individuals' freedom to act. A gift puts the recipient in debt to the giver, which is actually its purpose.[41] Within the economy of affection in rural Africa, the opposite may also apply:

> dispersion of favours or services, not related to reproductive needs of the local communities, leave the recipients with a hold on the patron. The expensive patronage practices of African election candidates is only one example of how clients may control patrons.[42]

In a country such as Tanzania, where the economy of affection prevails, it tends to permeate the whole of society. Individual behaviour is to a significant extent guided by its rules and moral norms. Consequently, the economy of affection has implications for the functioning of the state and its organisations. According to Hydén, the public sector is choked by a myriad of informal social networks, which limit the state's power and its efficient operation.[43] Under these circumstances, extraction of resources from the public sector for the purpose of benefiting one's own social group is not only morally correct, but an obligation. People expect their local leaders

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39 Platteau (1991), p. 56.

40 Ibid., p. 16.

41 Cf. Gurevitj (1970), p. 77 ff., on the 'gift-institute' of pre- and early feudal Teutonic Europe.

42 Hydén (1980), p. 19.

43 Hydén (1985), pp. 39 and 41.

to make use of their official positions to ensure benefits and resources to their own group, be it a clan or a group based on other ties.[44] In Tanzania, the tendency of leaders within the growing public sector to 'distribute patronage through the allocation of lower level positions to relatives, friends and others from their home areas' has been referred to as the '"godfather" syndrome'.[45]

Hence, within the economy of affection, there is a set-up of informal behavioural rules - both constraining and providing opportunities for the actors involved - that correspond to the traditional values of *ujamaa:* the *obligations* to support members of their own group and the *rights* to rely on their support in case of need.

Hydén interprets the Arusha Declaration as an expression of Nyerere's attempt to limit the influence of the economy of affection, 'by reducing the private economic base of the political leaders which had been used to support the economy of affection, and by centralizing the control of societal resources to the state'.[46] However, Nyerere did not only try to limit its role. By appealing to the traditional rights and obligations of *ujamaa,* in combination with a strong moral touch, he tried to elevate the morality of the economy of affection to the national level - to shape a generalised morality - so as to eliminate its particularistic character and the associated divisive forces.

EARLY SOCIALIST DEVELOPMENTS

The formulation of the official Tanzanian socialist ideology in the Arusha Declaration in 1967 set off a process of institutional and organisational development that would substantially change Tanzanian society. It initiated and influenced the shaping of the socialist economic and political system. The process by which this system evolved, the form that it took and the way it performed were also influenced by factors that could be traced to the country's historical and cultural location, such as the political struggles and the economy of affection discussed above.

This section accounts for the early socialist developments in Tanzania, with particular focus on the implications for the parastatal sector. It begins by showing the effects of the new ideology on the development of the sector and on the mode of policy making in the country. It goes on to examine rules and relationships within and the organisational structure of the growing public sphere - the state, party and parastatals - where our major actors, parastatal managers and bureaucrats, operated.

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44 Hydén (1980), pp. 26-28.

45 Hanak (1985), p. 54.

46 Hydén (1980), p. 97.

Parastatal Expansion and the Mode of Policy Making

With the official ideology as a point of departure, the Tanzanian leaders saw extended state ownership and control of the economy as the means by which to pursue socialist transformation and economic development. On this voyage, parastatals were the main vehicle.[47] The most immediate consequence of the Arusha Declaration was thus a dramatic expansion of the parastatal sector.

Expansion of the Parastatal Sector

According to the Arusha Declaration, the principal means of production and exchange were to be owned and controlled by the peasants and the workers through the state. The so-called commanding heights of the economy included the following:

> land; forests; minerals; water; oil and electricity; news media; communications; banks, insurance, import and export trade, wholesale trade; iron and steel, machine-tools, arms, motor-car, cement, fertilizer, and textile industries; and any big factory on which a large section of the people depend for their living, or which provides essential components of other industries; large plantations, and especially those which provide raw materials essential to important industries.[48]

Those parts of the commanding heights that were not already controlled or owned by the government were thus to be nationalised. Immediately after the Arusha Declaration a massive nationalisation exercise was initiated. To begin with, the commercial banks, firms engaged in food processing and milling activities, insurance businesses and enterprises within external and wholesale trade were nationalised. The government secured majority share-holdings in major industries under the National Development Corporation, such as beer breweries, a tobacco company, a shoe producing firm and a cement factory.[49]

The value of assets nationalised during the period 1967-1971 is displayed in *Table 3.1,* which shows that the major nationalisations were executed in the first year, notably within agriculture and manufacturing. However, in 1971, major nationalisations in commerce occurred, mostly in terms of the acquisition of real estate,[50] which is why over the period, commerce and manufacturing dominated the total value of nationalised assets.

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[47] Cf. Ndulu (1984), p. 19.

[48] Nyerere (1968b), p. 16.

[49] Kiondo (1989), p. 63, and Ndulu (1984), p. 22.

[50] World Bank (1988a), p. 4.

Table 3.1: Value of Nationalised Assets in Tanzania, 1967-1971 (Million TSh)*

Sector**	1967	1968	1969	1970	1971	Total	*% of Total*
Agriculture	120	-	-	-	-	120	*14*
Commerce	11	-	-	86	250	347	*39*
Finance	96	-	-	-	-	96	*11*
Manufacturing	134	102	86	2	-	324	*36*
Tourism	1	-	-	-	-	1	*<1*
Total	362	102	86	88	250	888	*100*
% of Total	*41*	*11*	*10*	*10*	*28*	*100*	

Notes: * TSh = Tanzanian shillings. ** During the period there were no nationalisations within the construction, electricity, mining or transport sectors.
Source: Kiondo (1989), Table 2.1, p. 65, and own calculations based on this source.

The nationalisations were complemented with investments in existing parastatals and the establishment of new ones. In the year of the Arusha Declaration, investment in new parastatals grew to almost five times the previous year level.[51] *Table 3.2* shows that nationalisations, the creation of new parastatals and expansion of existing parastatals accounted for about one-third each of parastatal-sector growth during the period 1964-1971. Whereas in 1964, parastatals in mining and electricity accounted for almost 80 per cent of the asset value, by 1971 parastatals had expanded in all sectors of the economy, with manufacturing taking the lead, accounting for about 30 per cent of the asset value.

Table 3.2: Different Forms of Parastatal-Sector Expansion in Tanzania, 1964-1971 (Million TSh)

Sector	Asset Value 1964	*Relative Share (%)*	Natio-nali-sation	New Para-statals	Investment Existing Parastatals	Asset Value 1971	*Relative Share (%)*
Manufacturing	25	*4*	324	549	211	1,109	*31*
Mining	241	*40*	-	-	70	311	*9*
Construction	25	*4*	-	-	137	162	*5*
Electricity	231	*38*	-	-	294	525	*15*
Transport	-	-	-	288	80	368	*10*
Tourism	15	*2*	1	128	13	157	*4*
Commerce	13	*2*	347	12	142	514	*14*
Agriculture	56	*9*	120	14	60	250	*7*
Finance	4	*1*	96	16	67	183	*5*
Total	610	*100*	888	1,007	1,074	3,579	*100*
Rel. Share (%)	*17*		*25*	*28*	*30*	*100*	

Source: Kiondo (1989), Table 2.3, p. 67, and own calculations based on this source.

Table 3.3 shows that between 1966 and 1971, the value of parastatal assets had more than quadrupled. The most rapid parastatal expansion took place in 1967, when the asset value increased by as much as 81 per cent.

[51] Kiondo (1989), Table 2.2, p. 66.

Table 3.3: Overall Growth of Parastatal Assets in Tanzania, 1964-1971

Year	Total Parastatal Asset Value (Million TSh)	Annual Growth (%)	Index
1964	610	-	100
1965	716	17	117
1966	852	19	139
1967	1,542	81	252
1968	1,930	25	316
1969	2,253	17	369
1970	2,712	20	444
1971	3,456	27	566

Source: Kiondo (1989), Table 2.4, p. 68.

However, the parastatal sector did not only expand in terms of its asset value. Moreover, this process did not come to a halt at the end of 1971. Parastatal expansion is also reflected in the number of parastatals, listed in *Table 3.4*. The table draws on several different sources, and figures for several years are missing, which illustrates the difficulty of establishing the actual number of parastatals. Nonetheless, the available data indicate that the number of parastatals more than doubled between 1966 and 1971. Considering the quadrupling of the asset value, this suggests that the average parastatal size also increased during this period. The expansion continued, and the most rapid increase in the number of parastatals appears to have taken place in the late 1970s: from 159 to 380 in a mere two years.

Table 3.4: Number of Parastatals in Tanzania, 1966-1979

Year	Number
1966	46
1967	64
1968	73
1969	78
1970	85
1971	99
1972	104
1973	117
1974	139
1975	142
1976	-
1977	159
1978	-
1979	380

Source: Table A.1 in the appendix.

The relative importance of the parastatal and total public sectors in the Tanzanian economy is suggested by *Table 3.5*. The table reflects the sectors' role in the production of goods and services, in employment generation and in capital accumulation during the period 1966-1980. The growth of parastatal assets through investment described above is reflected in the sector's share of monetary fixed capital formation, which doubled (from 22 to 45 per cent) between 1969 and 1970, and peaked at 60 per cent in 1972. Parastatal investment remained substantial during

most of the 1970s, but dropped sharply in 1978 in relation to both public and total capital formation. Consequently, parastatal investment accounted for most of the growth in the public sector's share of total investment between 1969 and 1972, which reached 78 per cent, but thereafter gradually declined to around 50 per cent in the late 1970s.

Table 3.5: Share of the Public and Parastatal Sectors in the Tanzanian Economy, 1966-1980 (Percentages)

Year	Public Sector % of Official GDP (o/w parast. %)		*Parastatal % of Official GDP*	Public Sector % of Total Employment (o/w parast. %)		*Parastatal % of Total Employ-ment*	Public Sector % of Monet. Fixed Capital Formation (o/w parast. %)		*Parastatal % of Monetary Fixed Capital Formation*
1966	14.7	(45.0)	*6.6*	34.0	-	-	46.8	(43.4)	*20.3*
1967	18.7	-	-	-	(21.1)	-	-	-	-
1968	-	-	-	53.0	-	-	-	-	-
1969	-	-	-	-	-	-	60.7	(36.5)	*22.2*
1970	21.4	(57.4)	*12.3*	58.0	(29.4)	*17.1*	72.4	(62.6)	*45.3*
1971	-	-	-	-	-	-	76.1	(72.8)	*55.4*
1972	23.7	(57.4)	*13.6*	-	-	-	78.1	(76.7)	*59.9*
1973	-	(59.5)	-	-	-	-	76.6	(71.6)	*54.8*
1974	26.0	(57.4)	*14.9*	66.0	(35.9)	*23.7*	73.7	(62.7)	*46.2*
1975	-	-	-	-	-	-	67.2	(58.2)	*39.1*
1976	23.3	-	-	65.0	-	-	53.6	(51.6)	*27.7*
1977	-	-	-	-	-	-	49.7	(89.5)	*44.5*
1978	23.3	(56.9)	*13.3*	72.0	(46.0)	*33.1*	49.3	(37.6)	*18.5*
1979	-	-	-	-	-	-	51.2	(34.3)	*17.6*
1980	21.5	(55.7)	*12.0*	-	-	-	57.0	(41.1)	*23.4*

Note: A dash (-) indicates that data are not available.
Source: Ndulu (1984), pp. 24-25, 27-28 and 31-33, and calculations based on this source.

Public and parastatal contribution to employment also appears to have grown constantly, although data are available only for selected years. Public-sector employment as a share of total employment increased from 34 per cent in 1966 to 72 in 1978. The ratio of parastatal to public employment also grew, which implies that the contribution of the parastatal sector to total employment grew even faster. It almost doubled (from 17 to 33 per cent) between 1970 and 1978. Finally, both the parastatal and the entire public sector saw their shares of official GDP increase between 1966 and 1974. Parastatal output grew most rapidly as its share more than doubled, reaching 15 per cent in 1974. From then onwards, the public and parastatal sectors' share of official GDP declined slightly, although it remains uncertain when the actual turning point occurred, because of missing data. However, the sectors' contribution to the production of goods and services never matched their contributions to investment and employment. According to the table, the public sector never contributed more than 26 per cent to the official GDP.

Hence, the process of parastatal and state sector expansion initiated by the Arusha Declaration was both rapid and increased the sectors' relative size tremendously. In terms of investment, nationalisations and output growth, the major parastatal expansion occurred in the late 1960s and early 1970s, whereas the number of parastatals increased dramatically in the late 1970s. Parastatal employment continued to grow throughout the decade.

Policy Making: We Must Run While Others Walk

Whereas parastatal expansion was one of the major expressions of the new socialist policies, its rapid pace in part reflects the mode of policy making. Hydén identifies the development of a certain policy making strategy in socialist Tanzania, which he refers to as the 'we must run while others walk' strategy.[52] As discussed above, the Arusha Declaration stressed Tanzania's poverty and the hard work needed to develop the country, which implied that a substantial effort was necessary. 'By adopting the notion that "we must run while others walk," the impression of a revolutionary atmosphere ... [was] created', which aimed 'partly at holding expectations back, partly at enforcing the need for discipline and restraint.'[53] This strategy was intended to create a sense of participation in the socialist transformation of society, as part of the effort to reinforce the moral incentives.

Four elements characterise the strategy. First of all, it created an urge to do everything at once. Secondly, to provide this sense of rapid advance, policy decisions were announced under dramatised circumstances, even before detailed information about the possible consequences had been obtained. The ends justified the means, since the ends were judged so important that they should be achieved at any cost. The third characteristic was an unwillingness to use past experience as a guide to policy making. The past was considered irrelevant because it was associated with colonial rule. One had to break with the past, and instead move into the unknown future. Finally, and as a consequence, employees in the public sector constantly had to work in a context where expectations exceeded what could possibly be attained, which created a sense of anxiety.[54]

This mode of policy making came to constitute an informal behavioural rule within the public sector, that by influencing actors' expectations, guided their behaviour in the design and execution of different measures. The notion of 'we must run while others walk' suggests that there were tendencies of both over-ambition and poor planning in Tanzanian policy making. The implications for the implementation and outcome of different measures adopted by the political leadership were severe. As will be discussed, the rapid parastatal expansion was to have a negative effect on the sector's operational and financial performance. Not only did the state-led development strategy imply that the parastatal sector expanded in size and relative importance, but parastatals ventured into all sectors of the economy. To begin with, however, the official policy focused on development of the agricultural sector, which experienced particularly dramatic changes as a result of government policy inspired by the Arusha Declaration.

The launching of the so-called *ujamaa* programme illustrates how ideology influenced policy making, characterised by the 'we must run while others walk' strategy.[55] The African

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[52] The phrase was first used by Nyerere, but Hydén articulated it as a strategy. (Hanak, 1985, p. 22, footnote 2.)

[53] Hydén (1979), p. 5.

[54] Ibid., p. 6.

[55] The essence of the programme was formulated by Nyerere (1968a).

socialist concept was to be applied in agricultural production. The rural population would first be resettled into so-called *ujamaa* villages, where they were thereafter to engage in collective production. Hedlund and Lundahl show how that within this programme, 'living together, working together and sharing the proceeds' were expected to be achieved voluntarily, on moral grounds and without resort to individualistic material incentives.[56] These were rejected as capitalist methods, as was individual land ownership.

Actual implementation proceeded slowly, as peasants were reluctant to respond to the moral incentives to resettle themselves, and the campaign was intensified. In 1967, a hunt of *kulak* farmers - medium-sized farmers who employed permanent labour, thus exploiting others - had begun. As a result, most 'capitalist' farming in the country came to an end in 1971 and 1972, through nationalisation or other collectivisation of estates, farms and plantations.[57] These changes notwithstanding, the programme was a failure in terms of communal farming. It remained negligible whereas an overwhelming amount of agricultural production continued to take place on individual plots.[58] 'Virtually all studies of *ujamaa* production conclude that productivity on the communal farm was considerably below that on the private farms.'[59] Hence, although the *ujamaa* programme managed to replace private large-scale farming with state-owned and collective farms, it never altered the basic production principles of peasant smallholders, who maintained their dominant role in agricultural production.

Structure and Relationships within the Public Sector

The initial rapid expansion of the parastatal sector had implications for the sector's future evolution. Let us examine the relationships and interactions within the public sphere and see how they gave rise to parastatal expansion dynamics: changes in behavioural rules and in the organisational structure of parastatal control.

To begin with, the parastatal sector appears to have performed fairly well. Table 3.5 above reveals no indication of any major performance problems during the first post-Arusha Declaration years. Parastatal investment, as a share of total monetary fixed capital formation, grew by slightly more than 50 per cent between 1966 and 1970, while the sector's contribution to official GDP almost doubled. This suggests that the performance of the parastatal sector was more or less at par with its expansion. Parastatals in general also appear to have done well financially.[60] The nationalisations meant that in certain cases profits from private enterprises

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56 Hedlund and Lundahl (1989), p. 35.

57 Hydén (1980), p. 104.

58 See Amani *et al.* (1987), p. 16, and Hedlund and Lundahl (1989), p. 38.

59 Hydén (1980), p. 119.

60 Moshi (1990), p. 14, and Mukandala (1988), pp. 407-408.

were transferred to the parastatal sector. The financial surplus of the National Development Corporation (NDC), for instance, increased four-fold between 1966 and 1967, and within the financial sector, the gains were even greater.[61] The NDC return on investment averaged almost ten per cent during the period 1965-1969, although five companies alone accounted for 80 per cent of the holding corporation's profits, and the major part of the profits were made by associate rather than subsidiary companies.[62]

Similarly, the institutional environment facing parastatal managers appears to have been relatively favourable in spite of the dramatic changes that took place. The nationalisations, in particular, implied considerable change for the former private firms, not only in terms of ownership. They created uncertainty about what behavioural rules and other conditions for operation would prevail under the new regime. However, no major change as regards the organisation and management of the newly nationalised enterprises appears to have taken place during the first years after the Arusha Declaration. 'Capitalist principles of operation' remained in many parastatals for a few years and foreign managements were often retained, or management contracts were signed with the former owners or with new partners.[63] For instance, after the Arusha Declaration the NDC saw its number of subsidiary companies grow rapidly, but most senior personnel at the headquarters were expatriates. In 1969, 25 of its 35 subsidiaries had expatriate managements and/or management agreements.[64]

One reason for the initial reliance on expatriates was the lack of a sufficiently large and experienced African group that could manage the expanding parastatal sector. This circumstance should have contributed to the relative autonomy of parastatal managers, and to begin with operation of the parastatals - whether old or new - continued without much government interference. Many parastatals were formally put under the administration of holding corporations - parastatals themselves - such as the NDC. This system created a buffer between the individual parastatals and the government, loosening the ties between them. The position of parastatal managers was thereby strengthened. According to Mukandala, 'The operational environment for parastatals in Tanzania was a dream come true for chief executives at both the holding corporation and subsidiary company levels'.[65]

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61 Hydén (1980), p. 157.

62 Associate companies were those in which the state only held minority shares and which the National Development Corporation had no formal responsibility to manage. (Mukandala, 1988, pp. 317, 319-320 and 330.)

63 Hydén (1980), pp. 156-157.

64 Mukandala (1988), p. 318.

65 Ibid., p. 115.

The autonomy initially enjoyed by parastatal managers was gradually eroded as the state and the party increased their political and economic control over the sector. The process of parastatal formation and functioning contributed to the shaping of different interest groups within the public sector and led to conflicts between them. Parastatals provided a new route to economic power. They soon constituted a large and strategic branch of the state sector which consumed a large part of state funds and therefore became lucrative for those who controlled them.[66]

Mukandala distinguishes between different strata within the Tanzanian state which were fighting for control over the parastatal sector: the political, administrative and the managerial strata.[67] The *political stratum* consisted of all those holding political positions within the state and the party, either through election or appointment. The most important and influential group within it was the political leadership, consisting of the government and the party leaders.

In Tanzania the executive power was strong. It was supreme over the legislative and the judiciary powers and was vested in the president, Nyerere. He also had strong legislative rights, whereas those of the parliament were often reduced to formally rubber-stamping decisions already made *in camera.*[68] The president had the power to appoint a large number of members of parliament and officials within the judiciary, thereby ensuring their loyalty. The jurisdiction of the courts was further narrowed by the executive's tendency to set up administrative and statutory tribunals with extensive powers replacing the courts of law.[69]

The president was also chairman of the party, responsible for appointing all party, government and parastatal top officials. He elevated the status of the National Executive Committee of the party instead of using the formal executive, the cabinet, whose role was hence largely taken over by the party and the presidency. Their strong powers meant that the party had supreme authority over all other state organs - 'laws simply are overridden if Party policy so dictates'[70] - and that the procedures for official appointments resembled the *nomenklatura* mode in centrally planned economies.[71] *Nomenklatura* here refers to the right of all levels of the party 'to "recommend" and "approve" appointments for all managerial positions in the economic (and public) administration and all managerial positions in enterprises'.[72] As a result of the presidential and party appointments, loyalty to the political leadership and the official ideology became important success criteria within the public sector.

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66 Ibid., pp. 23-26.

67 Ibid., pp. 27-28.

68 See, for instance, Hanak (1985), p. 68, and Mihyo (1994), pp. 44-45.

69 Kiondo (1989), pp. 43-44.

70 See Hanak (1985), pp. 59 and 67-70 (quotation from p. 70), and Mukandala (1988), pp. 107-109.

71 Cf. Mukandala (1995), p. 55.

72 Winiecki (1990), p. 198. Under socialism in the Soviet Union, *nomenklatura* referred to the body of regulations of the party for the filling of its various positions. (Kornai, 1992, p. 37.) Similar formal party rules were established in Tanzania, applying, for instance, to the appointment of senior positions in the party-controlled workers' union. (Masanja, 1990, p. 216.)

The president was also directly involved in the running of parastatals. While all parastatals had so far been established through parliamentary legislation, the 1969 Public Corporations Act empowered the president to establish and abolish any parastatal by discretionary order. Presidential involvement reflected the importance attached to political considerations and objectives - in the name of ideology and at the expense of economic and business considerations - and his discretionary power to judge when such considerations should be made.[73] Parastatal holding corporations and individual enterprises were assigned to parent ministries according to the industrial sector, partly in order to ensure compliance with government and party policies. The ministers' control of parastatal investment programmes and projects appears to have been one of their most important tasks. It legitimised detailed involvement in the management and operation of parastatals.

However, the ministries' actual power over parastatals was at least partly circumscribed by the presidential appointment of parastatal managers. Managers thus gained a strong power position vis-à-vis other superiors. They 'routinely ignored ministers of their parent ministries', and were able to promote anything in the name of the president. 'To oppose them was to oppose the president, the party, and so on.'[74] The ministers appointed most of the chairmen of the boards of directors of parastatals to ensure political control. However, the boards of directors were generally weak vis-à-vis the parastatal managers, who as presidential appointees could largely ignore the boards of directors. The boards focused on minor issues instead of meeting regularly and discussing performance related matters.[75]

The *managerial stratum* emerged in the process of parastatal creation and consisted of chief executives of both holding corporations, subsidiary and independent parastatals. They were supervisors of production, highly educated in the west. Their ranks increased with the growing number of parastatals; many were close to the president and they had considerable resources at their disposal.

The *administrative stratum,* finally, consisted of the top level of the state bureaucracy, such as principal secretaries, directors, commissioners and other high professionals in the service of the state. According to Mukandala, 'They were subordinate to the political stratum, at whose pleasure they served'.[76] As indicated, the demarcation between the presidency and the top party leadership was blurred, as was that between state and party officials at lower levels. There was a close identity between the functionaries within the bureaucracy, many of whom occupied senior positions in both the party, the government and other public organisation.[77] Besides, because of the supreme power of the party, even its lower-level functionaries could draw on government employees in the decentralised administration. An important consequence of party supremacy

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[73] See Mukandala (1988), pp. 103-107, and Sayore (1989), pp. 5-6.

[74] Mukandala (1988), pp. 107 (quotation) and 116. See also Sayore (1989), pp. 15-16.

[75] Mukandala (1988), pp. 107 and 111, and World Bank (1988a), p. 28.

[76] Mukandala (1988), p. 28.

[77] Mukandala (1995), p. 57.

was the politicisation of the civil service, which implied, for instance, that ideological considerations always ranked higher than technical ones in policy implementation.[78]

Increased Political Control over the Parastatals

The expansion of the parastatal sector and the relative autonomy of its managers eventually threatened the political leadership's control over the sector and its development. The sector's size and rapid growth made it increasingly difficult to manage and control. The emerging managerial stratum began to question and oppose 'the political stratum's policies and knowledge of commercial principles, which they insisted were necessary if parastatals were to function well'.[79] In order to increase its control over the growing parastatal sector and the managerial stratum, on which the socialist strategy and its own legitimacy largely depended, the leadership adopted a number of regulatory measures. Steps were taken to ensure central and political control over the parastatal sector, by extending the presidential powers mentioned above. The president further declared that parastatals should execute the policies laid down by the TANU government. In 1970 he ordered the formation of workers' councils in every enterprise. This was not a response to worker demands but rather a means by which the political stratum used the workers to gain control over the parastatal managements. This also applied to the *Mwongozo.*[80]

The formation of workers' councils had been limited and criticism was increasingly raised against the prevalence of capitalist principles and practices in the parastatal sector. In 1971 the party launched the TANU Guidelines, the *Mwongozo.* Its overall stance was a warning of the neo-colonial threat to the Tanzanian and African revolution. The ideological mobilisation was stepped up. Capitalist thinking and methods were to be eliminated, people should take action to solve their own problems and leaders should not distance themselves from the masses with privileges. According to Hydén, the *Mwongozo*

> warned that no Tanzanian leader should be allowed to be arrogant, extravagant, contemptuous or oppressive. It went one step further in arguing that nobody should any longer be forced to accept orders from superiors simply because they had the authority to give such orders.
>
> ... By claiming to be on the side of the workers, the party leadership were in the position of forcing the managers to obey political instructions or otherwise be exposed and forced to quit. ... No leader could any longer claim autonomy from the party control. All were part of a large 'fraternity' guided by the party principles.[81]

The political leadership used the *Mwongozo* to reduce the autonomy of the parastatal managers and to increase their own control over the sector. Party branches were set up in all national

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[78] Hanak (1985), p. 70.

[79] Mukandala (1988), p. 408.

[80] Ibid., p. 30.

[81] Hydén (1980), pp. 157-159 (quotation from p. 159).

organisations, including the parastatals, and any political intervention in parastatal operations and management was legitimised. The loyalty of the managerial stratum to the political leadership, ensuring adherence to political directives, was strengthened. By condemning capitalist principles and emphasising the role of worker participation, the official ideology both translated into and legitimised these formal institutional changes. As a perhaps unintended result, the workers' position was simultaneously strengthened, which further weakened the managers' autonomy.

In addition to political control, a number of measures were taken to both regulate and supervise the parastatals, through legal acts and the establishment of new parastatals, other organisations and committees with controlling functions. Regulatory parastatals such as the Presidential Standing Committee on Parastatal Organizations were created. Its formal function was to regulate parastatal wage and salary setting and other activities related to staffing and discipline, but in practice it was a 'watchdog',[82] ensuring that parastatals operated in a socialist manner.[83]

Power Struggles and Expansion Dynamics

The struggle over power between the political and managerial strata, the growing difficulty of managing the parastatal sector and operational problems in some parastatals resulted in a policy of 'rationalisation' in 1969. The leadership split up large holding corporations into smaller, more manageable and efficient units. The National Development Corporation (NDC) had been in charge of both the state's investment in and management of industrial parastatals and had seen its number of subsidiaries double in 1967, Now in 1969 it was split up, and only retained parastatals within manufacturing, processing and mining. It was divided several times and gave birth to at least 19 different holding corporations or parastatal companies between 1969 and 1980. Another giant that was split up was the State Trading Corporation.[84]

The initial parastatal expansion thus set in motion forces that, through the interaction between the political and the managerial strata in their struggle for control over the parastatals, gave rise to certain state sector expansion dynamics. The political leadership's efforts to increase its control over the growing sector increased the number of parastatals, through the establishment of regulatory ones and the split up of existing ones. However, the managerial stratum responded by trying to regain or expand its own domain of control, power position and autonomy, which came to 'result in the creation of yet more parastatals'.[85]

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82 Mukandala (1988), p. 120, in turn quoting a parastatal manager.

83 See Kiondo (1989), pp. 69-70, and Mukandala (1988), pp. 29-36, 115 and 118-121, for a survey of the measures adopted for parastatal control.

84 See Kiondo (1989), pp. 70-71, and Mukandala (1988), pp. 31, 313, 315-316 and 326-327.

85 Mukandala (1988), pp. 29-30. See also Kiondo (1989), p. 69.

The most important response was to establish new parastatals, for instance under the NDC and the National Housing Corporation, in order to compensate for those that the holding corporations had been deprived of by the state. Over two-thirds of the NDC investments during the period 1966-1969 were used for the creation of new parastatals, and its three-year plan for 1973-75 reserved 140 million TSh for 'expansion and new projects partly through the take-over of private concerns'.[86] The more subsidiary parastatals the holding corporations had, the larger and more important they became, the more resources were allocated to them from the government budget, the stronger their bargaining power grew, for instance when negotiating about higher managerial salaries, and the more successful they became in mobilising external finance on their own. 'Going international', for instance, was a useful strategy, because once foreign finance was obtained, 'it assured approval for the projects from the Treasury, the Bank of Tanzania and the Ministry of Development Planning. The need of foreign capital to invest in new projects rather than expanding or rehabilitating old ones reinforced this trend.'[87]

As the holding corporations 'hatched' more subsidiaries, the managerial stratum once again threatened the political leadership, and a second round of control measures and rationalisation was introduced. Whether this struggle for control of the parastatal sector is the major explanation for its phenomenal expansion or not, there ought to be little doubt that the growing parastatal sector created groups within it, as well as within the state and the party, who acquired an interest in its further expansion. By affecting power relationships, expansion itself shaped behavioural incentives for the actors involved in the process to alter the organisational and institutional structures, which in turn reinforced incentives for further expansion.

Organisational Structure: A Byzantine Spaghetti Maze

The official socialist ideology, the one-party political system, the power struggles within the public sector and the resulting expansion dynamics eventually gave rise to an organisational structure for control of the parastatal sector, illustrated by *Figure 3.1.* Although formally part of the state sector, parastatals were also controlled by a large number of political organs at various levels. Apart from the different party organs, there were those of the parliament and the politically installed workers' councils. As a result, not only was a huge parastatal sector created, but also a complex and intricate organisational control structure, the full details of which are lacking in the figure. What formally may have looked like and initially was intended as a neat structure with clear hierarchical relationships soon resembled what Mukandala refers to as a Byzantine spaghetti maze.[88]

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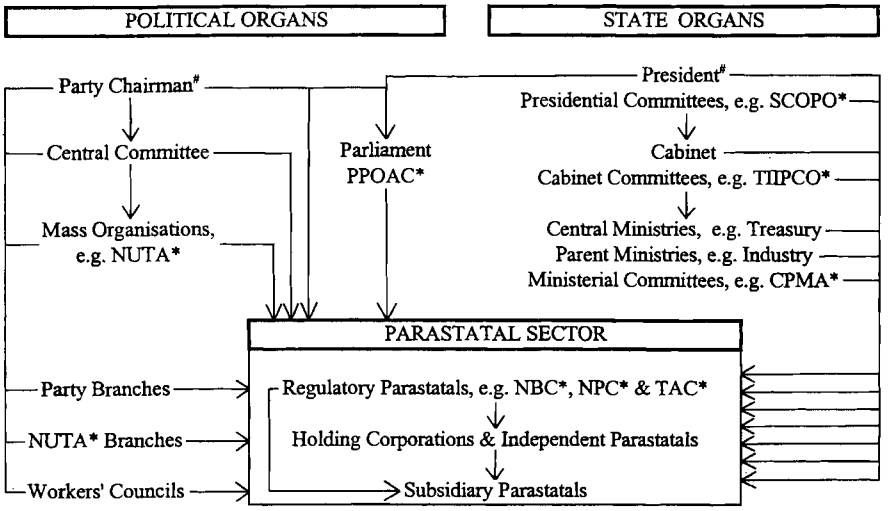
[86] See Mukandala (1988), pp. 32, 233-234, 321 and 328-337 (quotation from p. 333).

[87] Ibid., p. 32.

[88] Ibid., p. 409.

Figure 3.1: Organisational Structure for Control of the Tanzanian Parastatal Sector



Notes: This organisational control structure applied during the period 1969-1986. # Nyerere held positions both as president of the state and chairman of the party. * PPOAC = Parliamentary Parastatal Organization Accounts Committee, SCOPO = Presidential Standing Committee on Parastatal Organizations, TIIPCO = Tanzania Investment and Industrial Promotions Committee, NUTA = Union of Tanzania Workers, CPMA = Committee on Parastatal Management Agreements, NBC = National Bank of Commerce, NPC = National Price Commission, TAC = Tanzania Audit Corporation.

Source: Adapted from Mukandala (1988), Chart 3, p. 108, and pp. 101-124.

A central characteristic of the complex structure was the diffuse relationships between different organisations and actors. This diffusion meant that the division and demarcation of powers and responsibilities, for instance between parastatals and their holding corporations and between the holding corporations and the parent ministries, were poorly defined and therefore unclear. There was no uniform hierarchy of authority, but several overlapping layers of responsibility and control.[89] Formal areas of responsibility were defined and assigned to different bodies, but the multitude of agencies, their overlapping functions and the coexistence of parallel state and party hierarchies meant that, in practice, the relationships between the different organs were utterly confused.[90] Within the highly centralised formal structure, with the party at the apex, commands were meant to flow downwards and obedience upwards.[91] Although the orders of superiors and the loyalty of subordinates were important, inter-personal relationships and dependencies were hence more complex than indicated by the formal hierarchy.

The early socialist developments in the late 1960s and early 1970s were characterised by ideological formation, expansion of the parastatal sector, forced policy making ('we must run

[89] Moshi (1990), p. 3, Mukandala (1983), pp. 2 and 15, and (1988), pp. 125-126.

[90] Table A.4 in the appendix represents an attempt to associate different organs with the formal responsibilities for parastatal decision making and supervision.

[91] Mukandala (1995), p. 57.

while others walk') and by increased political control of the parastatals. Apart from creating a huge organisational structure, these developments altered the institutional set-up, with consequences for the behavioural opportunities and constraints facing actors within the parastatal sector, including the state-*cum*-party bureaucracy. In particular, parastatal expansion and increased political control of the sector defined the property rights associated with state ownership of the means of production.

EMERGING PARASTATAL FINANCIAL PROBLEMS

The early socialist developments had implications for the performance of the parastatals. As the 1970s came along, the major vehicle on the road to socialism began to face both operational and financial problems, largely as a result of its rapid growth, the policy-making style and the *Mwongozo*. By influencing the institutional set-up, these changes also affected actors' ability to handle the problems. This section shows how the early socialist developments contributed to the emergence of financial problems for parastatals. It discusses how these problems were initially perceived and dealt with by the actors, and concludes by showing that they were not isolated phenomena, but problems of a more general character.

Problems Created by the Early Socialist Developments

Capitalist Principles Replaced by Mwongozo

Slackness in parastatal performance became increasingly apparent after 1971, partly as a consequence of the introduction of the *Mwongozo*.[92] The *Mwongozo* can, just like the incorporation of the traditional concept of *ujamaa* into the official ideology, partly be seen as an attempt by the political leadership to establish a generalised morality in order to curb the particularised morality of the economy of affection. In practice, however, it turned out to have the opposite effect. The *Mwongozo* increased the scope for the interests of the economy of affection to articulate themselves, which had severe implications for the performance of the parastatal sector.[93]

Previously prevailing capitalist work and organisation principles, such as management control, command over workers and the profit motive, were condemned. The state was to ensure that they were abolished. There was an 'inveterate hatred' against capitalist principles such as

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[92] As argued, for instance, by Hydén (1980), p. 169.

[93] Ibid., pp. 169 and 160-167.

striving for profit, which was considered an 'evil'.[94] The implications of these values are reflected in the experience of the manager of the Mpwapwa District Development Corporation, who in 1974 was 'summoned by district heads and accused of being profit minded'.[95] Workers, managers and bureaucrats were still largely involved in the economy of affection, retaining strong links to their rural home areas and being oriented primarily to the needs of their extended families. When the capitalist principles - which constituted a set of rules of behaviour based on a generalised morality - were abolished, or their relative importance was at least reduced, the validity of the rules of the economy of affection and its particularised morality were correspondingly strengthened. 'Many workers ... interpreted the new political directive as an invitation to ignore the obligations to the public realm',[96] and were quick to respond by raising demands:

> requests for time off to visit sick relatives, or loans for emergency needs in the family, were made with less constraint, because many workers expected such favours to be granted now that the capitalist concern for profit had been officially condemned. ... Their sense of socialism was that they would have more time for themselves and their families.[97]

The introduction of the *Mwongozo* substantially weakened the position of the parastatal management vis-à-vis the labour force, whose main organ for forwarding demands was the new party branches. Since few managers were willing to challenge the supremacy of the party, their scope for manoeuvre was severely circumscribed, and thus also their autonomy and authority to manage the parastatals, as discussed above. *Mwongozo* in fact

> made organizational management virtually impossible because demands were often raised that could not possibly be accommodated within the principle of productivity. Workers demanded rights to autonomy that in many cases made them immune to any use of organizational authority. Managers, in response to demands made through the economy of affection, often made decisions that satisfied such demands but which went contrary to the interest of the organization. In short, both workers and managers acted in such a way that the public institutions were the prime victims.[98]

Incentives to behave so as to promote the financial and operational performance of parastatals at all levels was undermined. The diluted managerial authority contributed to the deterioration of the working morale of not only parastatal employees but also the managers. The *Mwongozo* enabled them also to adhere to the rules of affection. A final quotation from Hydén illustrates their position:

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[94] Bishagazi (1993), p. 9 (first quotation), and Moshi (1980), p. 7 (second quotation).

[95] Moshi (1980), p. 7.

[96] Hydén (1980), p. 167.

[97] Ibid., p. 161.

[98] Ibid., p. 163.

> Those Tanzanian managers who were committed to building a modern socialist society grew increasingly disappointed with the behaviour of the workers. The more unscrupulous members of the bureaucratic bourgeoisie, on the other hand, did not hesitate to take advantage of the new situation. The frequency with which accusations of nepotism and favouritism were made against managers, is evidence that the economy of affection was at least as well nursed after *Mwongozo* as it was before. A third category of managers reacted by keeping a low profile. They did not take management decisions that could land them in political trouble. Management of the public sector was, if not paralysed, at least considerably weakened after *Mwongozo*.[99]

The *Mwongozo* introduced institutional changes that appear to have contributed to deteriorating parastatal performance through the incentives thus created in a number of ways: by condemning capitalist principles such as the profit motive; by diluting the authority and autonomy of parastatal managers in executing their management functions; by facilitating the articulation of particularised interests within the economy of affection, legitimising the extraction of parastatal resources for private uses; and by undermining the working morale of both managers and employees. The *Mwongozo* illustrates how the formal rules, when interpreted according to the prevailing social values, enabled and led to the application of the informal rules of the economy of affection within the parastatal sector.

Under-Capitalised Parastatals Over-Loaded with Tasks

Many emerging parastatal problems were directly related to the size and rapid growth of the sector. The policy-making style of 'we must run while others walk' had negative consequences for the planning and financing of parastatals, many of which faced problems from the outset. Expansion of the parastatal sector required considerable resources to finance the investments, which implied that over time, investment finance grew increasingly scarce. High equity-debt ratios, which had initially been preferred by the government, could no longer be sustained.[100] Many parastatals were established without adequate equity finance, and were thus under-capitalised right from their formation. They therefore had to resort to credit financing to a large extent, not only for recurrent but also for investment purposes, which resulted in high indebtedness, large interest payments and often persistent liquidity problems.

For instance, several parastatals under the National Development Corporation faced frequent liquidity problems due to their initial under-capitalisation.[101] Another example is provided by the National Road Haulage Company (NRHC), a parastatal established in 1972 to handle road-freight transport services. The NRHC was plagued by financial problems right from its inception.[102] The equity capital provided by the government was in the form of trucks and other

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[99] Ibid., p. 165. See also Moshi (1990), p. 5.

[100] Mukandala (1988), p. 409.

[101] Kimei (1987), p. 163.

[102] In the remainder of this sub-section, reference is frequently made to three different parastatal cases. In order to avoid an excessive number of footnotes, only quotations are directly traced to the source. Throughout, the parts

transport vehicles, whereas all other costs, for both operation of the fleet and any other investment needs, had to be raised by the parastatal itself. During the first three years of operation, only 26 per cent of its investments were financed by equity capital. The NRHC was forced to rely on suppliers' credit plus loans on a deferred-payment basis from the holding corporation for its trunk-route operations.

In other cases, only a minor proportion of the nominal equity value was actually paid to the parastatal by the government, or other forms of finance did not materialise as expected. The National Housing Corporation (NHC), established as early as 1962, provides an example, because 'at no time did the corporation receive funding in the promised amounts'.[103] During 1964-1969, it only received 25 per cent of the projected finance from the government and abroad; between 1969 and 1974, only 46 per cent; and during the rest of the 1970s, a mere 25 per cent again.

Insufficient initial capital undermined many parastatals' ability to perform their operative functions as expected. In addition, they were often over-loaded with tasks, incompatible both with the available finance and with their limited administrative capacity. The NHC was assigned enormous tasks. It was to provide - and even to build itself - houses and other buildings; lend or grant finance for house construction to individuals, groups and local authorities; start a savings bank for housing; invest such bank deposits; be an estate manager of its stock of rental houses; hold subsidiary companies; and inquire into, advise and assist in the preparation of housing schemes. The ambitious expansion of the parastatal sector and its over-loading with tasks reflects the over-optimism of 'we must run while others walk' and the importance attached to political and ideological considerations at the expense of technical and financial concerns. Inadequate planning of the role and financing of parastatals led to the creation of unrealistic projects.

The NRHC illustrates the poor planning of finance and operations. The vehicles provided for the parastatal, mentioned above, were largely granted by foreign aid agencies. Although simpler vehicles would have been more appropriate, the government ordered the acquisition of Scania trucks and trailers because they were granted by the Swedish government. These vehicles were too sophisticated for both the unskilled drivers and the poor roads, which led to frequent breakdowns, high fuel consumption and at least 10 out of 18 tonnes of unutilised capacity per trailer. More than 100 such vehicles were provided although the NRHC had neither the capacity nor the resources to run them. In addition, the receipt of this grant carried with it import duties and body-building costs that further weakened the financial position of the NRHC.

Many parastatals were neither operationally nor financially viable in the first place. They were established without any reasonable chance to fulfil their tasks in a satisfactory manner, let alone to finance their own operations through revenue generated from their business activities.

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on the National Road Haulage Company (NRHC) draw on Mwaze (1983), pp. 43-44 and 50-54; those on the National Housing Corporation (NHC) are based on Mukandala (1988), pp. 186, 201-204, 210, 212 and 214-239; and the parts on the District Development Corporations (DDCs) are fetched from Moshi (1980), pp. 12-20.

[103] Mukandala (1988), p. 236.

This applied to the NRHC, at least to its so-called hire-pool operations, handling short-distance freight transport, and was recognised by the parent ministry already in the year of establishment. A year later, the holding corporation concluded that the hire-pool activities would incur huge deficits, unlikely to be covered by its other operations. When the NRHC applied for a loan from the National Bank of Commerce in 1975, the bank remarked that 'the limit of this deficit is the sky! It is obvious that the company relies solely on borrowed money without capital of its own. Such a company can hardly survive!'[104]

These circumstances were detrimental for the performance of the parastatals. Financial problems, related to under-capitalisation and poor planning, that faced parastatals in the early 1970s, appear to have been particularly pronounced among District Development Corporations (DDCs). In 1969, local governments were urged to establish their own economic wings - DDCs - to reduce their dependence on central government subventions. When local authorities were abolished in 1972, the DDCs came under the control of the districts,[105] and by 1974, as many as 67 DDCs had been established, engaged in production, commerce and service activities.

The DDCs were highly under-capitalised from the beginning. They relied mainly on finance from the banks, primarily the Tanzania Rural Development Bank, and were consequently highly indebted and suffered severe liquidity problems. The Kilimanjaro Development Corporation (KIDECO) is a case in point. Established in 1970, it was instructed to take over the butcheries from private businessmen in the Moshi area. In 1973, it embarked on town bus services and the following year it was assigned the task of managing two nationalised farms. KIDECO's liquidity problems meant that its transport business could meet only nine per cent of its outstanding liabilities and was consistently unable to service its loans to the financial organisations.

The DDCs were generally poorly planned. Projects were speedily initiated by political leaders without commercial experience and motivation, and lacked thorough analysis of both 'economic viability and financial feasibility. Project appraisals are either not done at all or, at least, are not done thoroughly or accurately.'[106] Many of the DDC projects would probably never have managed to bear their own costs because they were so small. They often took over petty, even family, businesses, such as butcheries and petrol stations. Many such projects saw their costs increase immediately after the take-over. The DDCs soon became over-staffed, as a large number of positions were established for even tiny projects. The Mbozi DDC, for instance, 'employed twelve bar-maids, an accountant and a cashier in its bar business despite the fact that sales did not exceed three cases of beer per day!'[107]

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[104] Subramanin (1977), p. 2, quoted by Mwaze (1983), p. 52.

[105] Regions and districts and their centrally appointed top officials, the development directors, were part of the decentralised state administration that effectively replaced the previous, fairly autonomous, local governments with powers to tax, headed by elected politicians. On decentralisation within the growing public sectors in Tanzania and other African economies in the late 1960s and 1970s, see for instance Hydén (1985), pp. 118-150.

[106] Moshi (1980), p. 17.

[107] Ibid.

The financial performance of the DDCs consequently appears to have been particularly poor. Each year during the period 1974/75-1976/77, the number of loss-making DDCs exceeded that of the profit-making ones, and aggregate net losses were consistently reported. Although KIDECO's management tried to give the impression of success by reporting either sales or gross profit instead of net profit, it was eventually revealed that by 1975 the DDC had accumulated losses to the magnitude of more than one million TSh.

The tendency of DDCs to become over-staffed may in part be a reflection of the economy of affection taking its toll, which required public officials to make use of their position to favour members of their social networks, for instance by offering employment. The NHC was also over-staffed, since 'work had to be sought for its idle workforce'.[108] The probability that the economy of affection may also have induced the extraction of resources from parastatals in terms of theft, embezzlement of funds and corruption is suggested by the cases of the NHC, the NRHC and the DDCs, all of which were accused of engaging in such practices.

Hence, over-ambitious, hasty and poorly planned parastatal expansion created financial problems for many parastatals from the very beginning. The introduction of the *Mwongozo* reinforced political and ideological control and adherence to the rules of the economy of affection, which worsened the problems in the early 1970s. Soon, many parastatals found themselves in financial difficulties. The evolving system created problems. These problems had to be dealt with.

Actors' Initial Perception and Response

The early socialist developments also influenced actors' perception of and response to parastatal financial problems. This sub-section discusses how parastatal managers and their counterparts within the bureaucracy interpreted and handled the problems when confronted with them for the first time.

Parastatal Managers: Uncertainty and Limited Experience

When managers found the parastatals in financial trouble in the early 1970s, their background, the institutional context in which they operated and the prevailing ideas and values influenced how they perceived the situation - the problems and their own options to deal with them - and hence how they behaved. When the problems first occurred, they created uncertainty, because the situation was new to parastatal managers in several respects. Many managers lacked business experience. The rapid expansion of the sector and the ambition to fill all leading public positions

[108] Mukandala (1988), p. 217.

with Africans made it difficult to recruit competent managers to all parastatals.[109] Besides, the appointment procedures implied that political and ideological loyalty, and possibly social network ties, ranked higher than professional management skills. Parastatal managers were therefore often recruited from the public administration, within the former civil service of the colonial state or the top ranks of the new government and the party.[110]

Managers with some previous business experience also faced uncertainty about how to behave. Managers of nationalised former private firms, for instance, found themselves operating under new ownership, and were unfamiliar with the behavioural implications of public property rights. Although it initially meant little change in practice, the period of establishment of the socialist system was characterised by 'institutional instability',[111] and thus by tremendous uncertainty. In particular the introduction of the *Mwongozo* fundamentally altered the rules and created behavioural uncertainty for many parastatal managers, as testified by their low profile.

The official ideology and new rules stated that capitalist principles should be abolished. Parastatals should promote socialism and adopt socialist principles, but this major goal was vaguely defined and created confusion. What did it imply, for instance, in the present situation, when parastatals were in financial trouble? Now that the profit motive was condemned, would it be wrong to try to make parastatals' ends and means meet? Formal parastatal objectives were unclear, ambiguous, multiple and contradictory. Apart from fulfilling the multitude of tasks formulated in their statutes,[112] parastatals had to perform a number of general and poorly specified functions, such as 'to act in the public interest'.[113] And despite the official ban of the profit motive, parastatals were 'to provide services at minimum cost'.[114] As commercial entities, they were normally expected to be self-financing,[115] *and* to generate a surplus so as to contribute to capital accumulation.[116]

What was a manager to do when the parastatal was in financial trouble? Although he lacked experience of the present situation and had to search for behavioural solutions, he had some experience that he could perhaps rely on. An enterprise manager from the pre-*Mwongozo* period was used to capitalist principles and the behavioural rules of the market. When recognising the situation of a firm in financial trouble, he may have perceived himself as responsible for solving the problem; thus he would expect that behaviour adapted to a commercial and competitive environment, such as cost cutting and sales promotion, would be appropriate and successful in the present context also. Experience had not yet taught him otherwise; he did not know what else

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[109] Makoba (1993), pp. 42 and 46.

[110] Ibid., p. 42.

[111] Lipumba (1995), pp. 26-27.

[112] The statutes of the Tanzania Fertilizer Company (1968), for instance, list 30 purposes for which the parastatal was established, without ranking their relative importance.

[113] Sayore (1989), p. 19.

[114] Ibid.

[115] Cf. the definition of parastatal enterprises in Chapter II.

[116] Cf. Ndulu (1984), p. 29.

to do and besides, how would the parastatal otherwise survive?

Managers with experience from public administration, used to bargaining over the administrative allocation of resources, may instead have perceived the financial problems as budgetary accounting imbalances, and would thus expect that administrative solutions would be appropriate ways of responding. Uncertain parastatal managers could also find behavioural guidance in the informal rules of the economy of affection. They implied that a member of a social network who was in financial trouble was entitled to assistance from other members. Seeking finance from the state and party bureaucrats - not least from those who appointed the managers - may have been perceived as a natural response. Many managers could rely on already established personal relationships within the bureaucracy. Such behaviour was consistent with the official ideology and the rules introduced after the *Mwongozo,* which prescribed that within the parastatals, 'all matters that are regarded important must have the blessing of the Party'.[117]

Given their varying experience and subjective perceptions, parastatal managers in similar situations may have judged their situation differently, and therefore tried to solve their financial problems in different ways. A manager who considered laying off workers, refused to meet their requests for costly benefits, or demanded stricter discipline faced difficulties in the new institutional setting, however. Once the *Mwongozo* was in place, such measures are unlikely to have been approved by the party organs. A manager who tried to secure the parastatal profit ran the risk of being accused of adhering to capitalist principles. This happened to the manager of the Mpwapwa District Development Corporation.

Other managers turned to the bureaucracy for financial assistance, as illustrated by the case of the National Road Haulage Company, related above. It sought finance from its holding corporation and the National Bank of Commerce. This may to have been the most common response to the initial parastatal financial problems in the early 1970s, as suggested by the managers' background. Within the National Development Corporation (NDC), two-thirds of the parastatals were managed by Tanzanian nationals in the early 1970s, as revealed by *Table 3.6.* The other parastatals had foreign management.

Table 3.6: Financial Performance and Management of the National Development Corporation Parastatals in Tanzania, 1969-1980 (Selected Years, Percentages)

Year	Number of Parastatals	o/w Loss Making (%)	Foreign Managed			Managed by Tanzanian Nationals		
			% of No	*o/w Loss*	*% of Loss*	*% of No*	*o/w Loss*	*% of Loss*
1969	33	64	36	42	24	64	76	76
1970	35	69	34	50	25	66	78	75
1971	33	70	33	55	26	67	77	74
1980	18	39	33	0	0	67	58	100

Source: Makoba (1993), Table 1, p. 43, based on various National Development Corporation Annual Reports and National Development Corporation (1985), p. 21, and own calculations.

[117] Katunzi (1984), p. 148.

The limited business experience of Tanzanian managers, their administrative background and their linkages to the economy of affection suggest that they were more inclined to seek external assistance when in financial trouble. As shown in the table, it was also these parastatals that experienced the major financial problems. 77 per cent of the parastatals managed by Tanzanians made losses and they included 75 per cent of all the loss-making NDC parastatals.

The success of the managers' behavioural attempts depended, however, on how the bureaucrats responded. Let us consider the situation of an official within the bureaucracy who was approached by the manager of a parastatal in financial problem, pleading for assistance. How did he perceive the situation and behave?

Bureaucrats: Information Problems and Optimism

When a bureaucrat in a holding corporation, parent ministry or state-owned bank was first confronted with a parastatal in financial trouble, he also faced uncertainty about how to interpret and handle the situation. It was, first of all, difficult to know what the character and causes of the parastatal's financial problems were. Were they due to the manager's under-performance or factors beyond his control, and were they temporary or of a more fundamental character?

Financial performance data were often missing. Many parastatals did not submit accounts to the relevant controlling bodies. If they did, the accounts were often delayed several years, or they were not audited, or the audited accounts were improper and not approved. 19 District Development Corporations (DDCs), for instance, did not submit any reports to the Prime Minister's Office in 1969/70 and 1970/71, and the Mbozi DDC did not keep any accounts at all during the whole period 1972-1975.[118] Between 1975/76 and 1978/79, the accounts of a quarter of around 300 clients of the Tanzania Audit Corporation (almost exclusively parastatals) were in arrears and a massive two-thirds of the accounts audited did not receive clean audit reports.[119]

Financial performance data for parastatals were of a conspicuously poor quality, which created uncertainty about the accuracy of the information. Concealment and distortion of information was common within the parastatal system in Tanzania.[120] The Kilimanjaro Development Corporation manager, who reported sales or gross profit instead of net profit, illustrates the practice. In addition, a bureaucrat with little commercial competence did not know how to interpret financial information or what the relevant information was.[121] Besides, why should he be concerned with such information, when political and ideological goals took

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[118] Moshi (1980), p. 14.

[119] Table A.10 in the appendix.

[120] As reported, for instance, by Hydén (1979), pp. 8-9.

[121] The Tanzania Association of Parastatal Organisations (1989), p. 36, reports that civil servants in the parent ministries were unable to interpret financial reports - as were parastatal managers.

precedence over the profit motive? Financial and economic performance indicators were subordinated,[122] if at all relevant. Performance evaluation focused instead on shifts in the relative importance of the public sector, or on quantitative and physical achievements. '*Output* became the major focus ... Although no clear output indicators were singled out, services, goods and financial contribution to development resources featured prominently.'[123] A parastatal that was producing and expanding its operations and market shares was perceived as efficient and successful. Hence, bureaucrats could not use - and did not need - their experience to interpret and evaluate parastatal performance. They made use of ideology.

As pointed out by Paschal Mihyo, public sector expansion took place in a 'climate of social and economic optimism created by the country's socialist policy'.[124] There were strong expectations about what the parastatals could achieve,[125] of benefits to be reaped in the future. And the process had just begun.

> Researchers and policy makers during this period [the early 1970s] took for granted that the model of public enterprise applicable in Tanzania was the most appropriate and that the main problem was a general lack of experience. They also assumed that the poor performance of these enterprises arose from market factors, aggravated by organizational problems. They assumed that most problems were externally stimulated, either by multinationals or by fluctuations in prices on the international market, and that if prices and linkages stabilized, equilibrium would be restored.[126]

Hence, given the bureaucrats' difficulties of properly assessing parastatal financial problems, the strong ideological stance and the optimistic climate influenced their interpretation of the situation. The problems were largely perceived as temporary infancy problems, partly caused by a hostile outside world, that would be overcome once operations had been fully developed. It may thus have seemed a good idea to provide financial assistance to trouble-ridden parastatals during the formative years. And since many parastatals were under-capitalised, granting additional finance could be seen as a means by which to correct this initial mistake, to enable them to pursue their tasks and earn future returns.

The first time a bureaucrat received a parastatal manager seeking financial assistance, he did not know how to behave successfully. Many parastatals were new and, given the rapid growth of the control structure that paralleled parastatal expansion, this was also the position of many bureaucrats. The behavioural rules were new and therefore uncertain, and the division of authorities and responsibilities was unclear. The politicisation of decision making added uncertainty, not least about controversial decisions. As a result, bureaucrats at various levels, 'wary of doing anything out of step, and with the higher ups breathing down their necks, ...

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[122] Makoba (1993), pp. 45-47.

[123] Mihyo (1994), p. 3; emphasis added.

[124] Ibid.

[125] The crucial and far-reaching role that parastatals were expected to play in directing societal developments in the planned and desired manner is discussed by Ndulu (1984), pp. 18-23.

[126] Mihyo (1994), p. 3.

[became] reluctant to take any big decisions without the blessings from the higher ups'.[127]

Just as for managers, the experience and subjective perceptions of individual bureaucrats varied. Some may thus have tried to refuse to assist a parastatal in trouble, but would probably have faced difficulties in the politicised environment. Since such a drastic decision may have threatened the survival of the parastatal, lower-level bureaucrats might have thought that it was better left to the superior bureaucrats, so as to avoid risking their own positions. How else could bureaucrats behave? Could they rely on past experience? Possibly, but they were unwilling to use the past, associated with colonialism and capitalism, as guidance. Ideology was a better guide. Socialism assigned a protective, paternalistic and care-taking role to the state. The weak ones had to be looked after, and resources would be redistributed from those who had to those who had not. Similar behaviour, although within informal social networks, was prescribed by the rules of the economy of affection. Hence, when parastatal managers in financial trouble asked for assistance, bureaucrats - not least the superior ones who had appointed the managers - may have perceived themselves as obliged, not only to support the parastatals but also to assist the managers.

Given the uncertainty which the actors faced when parastatal financial problems first emerged during the early years of the formation of socialism, their behavioural trials varied. The success of these trials was largely to determined by the institutional structure. As will be shown in the remainder of this chapter, neither parastatal financial problems nor their behavioural solutions, in terms of seeking and granting external financial assistance, were isolated phenomena, but emerged at a general level in the 1970s.

Parastatal Problems on a Large Scale

It has long been widely recognised that Tanzanian parastatals faced both operational and financial problems, which eventually became severe and widespread, but this is not entirely easy to establish. The rapid expansion of the parastatal sector meant that it had to finance both investments and operations. The financing requirements of the public sector, its principal composition and financing sources are displayed in *Table 3.7.* Charles S. Kimei calculated the total public sector financing requirement (TPSFR) as the sum of the deficits on the current and capital accounts *less,* and hence *after,* capital transfers to the sector. The TPSFR is in turn separated into the budgetary financing requirement of the government (BFR) and the parastatal financing requirement (PFR).[128]

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[127] Mukandala (1983), p. 15.

[128] The TPSFR, BFR and PFR thus differ from, and understate, the actual budget deficits by the amount of external capital transfers. In the government budget, such capital transfers consisted mainly of foreign grants, and reduced the BFR by about 25 per cent during 1973-1980. (Kimei, 1987, pp. 188-189.)

Table 3.7: Trends in Total Public, Government and Parastatal Financing Requirements in Tanzania, 1963/64-1979/80 (Selected Years, Percentages)

FINANCING REQUIREMENT	1963/64	1966/67	1969/70	1972/73	1976/77	1979/80
In Relation to Monetary GDP						
Total Public Sector (TPSFR)	2.3	9.2	25.4	28.6	37.6	-
- Government Budgetary (BFR)	1.4	4.1	10.5	9.2	13.1	23.5
- Parastatal (PFR)	0.9	5.1	14.9	19.4	24.5	-
In Relation to Total Public Sector (TPSFR)						
Government Budgetary (BFR)	59.1	44.8	41.3	31.8	34.8	-
Parastatal (PFR)	40.9	55.2	58.7	68.2	65.2	-
Sources of Financing of TPSFR						
Domestic	41.7	64.3	89.1	73.0	73.3	-
Foreign	58.3	35.7	10.9	27.0	26.7	-

Notes: A dash (-) indicates that data are unavailable. TPSFR = Total public sector financing requirement, BFR = Budgetary financing requirement of the government, PFR = Parastatal financing requirement.

Source: Kimei (1987), Tables 8.4-8.5, pp. 185-186, based on and adapted from various issues of the National Accounts published by the Government of Tanzania.

The table shows that the financing requirement of the total public sector grew rapidly to substantial levels in the post-Arusha Declaration years. This applied particularly to the parastatal deficit (PFR), which increased almost five times in relation to the monetary GDP between 1966/67 and 1976/77. By that time, it had reached 25 per cent, whereas the total public sector financing requirement (TPSFR) amounted to 38 per cent of the monetary GDP. The more rapid growth of the PFR meant that it accounted for an increasing share of the TPSFR - 65 per cent in 1976/77. As regards the sources for financing the total public sector financing requirement, domestic sources dominated over the foreign ones.

As discussed above, under-capitalisation forced many parastatals to rely excessively on external finance for both recurrent expenditure and investment purposes, notably in terms of borrowing. *Table 3.8* displays the sources of financing of the parastatal sector deficit, which for the sector as a whole was mostly for capital formation.[129] The table shows that parastatals relied mainly on their own resources, for instance in terms of retained profits, in the early post-Arusha Declaration years. The situation changed, however, and even deteriorated dramatically, in the 1970s. Even during the period 1970-1973, parastatal reliance on external finance had increased to no less than 89 percent, compared to 41 per cent in the previous period. In the following four years, the sector depended exclusively on external financing of its deficit. Caution must be observed, however, in these interpretations. The table is partly based on data from the Analysis of Accounts of Parastatals, published by the Bureau of Statistics, which are known for their poor reliability.[130] In particular the absolute values reported are uncertain, but the figures may indicate the true trends in the variables.

[129] Ibid., p. 186.

[130] See Eriksson (1993), pp. 13-15, Mukandala (1988), p. 92, and the World Bank (1988a), p. 65, on the quality of these data.

Table 3.8: Sources of Parastatal Financing in Tanzania, 1966-1977
(Average Annual Percentages)

SOURCES OF PARASTATAL FINANCING	1966-69	1970-73	1974-77
Total Financing	*100.0*	*100.0*	*100.0*
- o/w Own Sources*	59.3	10.8	-15.7**
- o/w Outside Sources	40.7	89.2	115.7
- Government Loans and Grants	16.6	21.6	24.8
- Domestic Financial Borrowing	13.3	49.4	81.7
- Foreign Loans and Grants	10.9	18.2	9.3
Outside Financing	*100.0*	*100.0*	*100.0*
- o/w Government Loans and Grants	40.7	24.2	21.4
- o/w Domestic Financial Borrowing	32.6	55.4	70.6
- o/w Foreign Loans and Grants	26.7	20.4	8.0

Notes: * Including retained profits, depreciation and use of cash balances. ** The negative figure implies that the sector was accumulating financial assets/cash at the expense of outside sources of finance, i.e. obtained outside resources above the financing requirement, which may be explained by the inclusion of financial organisations in the parastatal sector.

Source: Kimei (1987), Table 8.6, p. 187, based on and adapted from the National Accounts of Tanzania, 1964-72, and the Analysis of Accounts of Parastatals, 1966-77, published by the Bureau of Statistics.

Financial resources from outside the parastatal sector itself were thus readily available. As its ability to finance its own expansion dropped sharply in the early 1970s, all external sources of finance - government and foreign loans and grants and domestic financial borrowing - increased their share of financing the parastatal deficit. While all external sources contributed significant financing shares in the late 1960s, the growing external financing needs in the 1970s were mainly accommodated by domestic financial borrowing. It was the source of parastatal financing that grew most rapidly, to the extent that during the period 1974-1977, it accounted - according to these data - for 82 per cent of the parastatal deficit.

The dependence of parastatals on borrowing thus appears to have grown in the 1970s as their ability to generate their own sources of finance declined. This may suggest that their financial and operational performance deteriorated over time, which is in fact indicated by some of the data previously presented. According to Table 3.5 above, the contribution of the parastatals to official GDP only appears to have grown up to 1974, despite the sector's continued expansion. During the period 1970-1974, parastatal investment grew to such an extent that it accounted for more than half of the monetary fixed capital formation. These enormous investments notwithstanding, parastatal output as a share of official GDP declined slightly in the subsequent period, from 15 per cent in 1974 to a mere 12 per cent in 1980. This reflects the problems of managing the parastatal investments efficiently.

The observations that many parastatals faced problems due to the introduction of the *Mwongozo,* as reflected for instance in over-staffing, is also supported by Table 3.5. While the contribution of parastatals to official GDP remained more or less constant between 1970 and 1978, employment in the sector increased so rapidly that its share of total employment almost doubled over the same period, from 17 to 33 per cent. Hence, not only the productivity of capital, but also that of labour dropped. Besides, throughout the period 1966-1980, parastatal performance was worse than the rest of the public and the private sector together, since its contribution to official GDP was constantly smaller than its contribution to both employment

and investment. A comparison of parastatal and private industrial firms reveals the relative inefficiency of parastatals. During the period 1975-1979, output per worker in parastatal industrial firms was approximately half the output per worker in the private firms, despite the fact that output per unit of capital was the same, suggesting 'the existence of substantial redundant labour in the parastatal sector'.[131]

The deteriorating operational performance of the parastatals, in terms of productivity, supports the picture that they became increasingly unable to generate their own finance, but it does not explicitly tell us what happened to the financial performance. However, although the accounting standard was generally low and financial data were often lacking or unreliable, the data that do exist suggest declining performance in this regard also. Mboya S.D. Bagachwa and S. Chandrasekhar calculated the *gross* rate of return on capital in the parastatal manufacturing sector, and found that it declined between 1970 and 1980, from 29 to 12 per cent.[132] Their data also emanate from the Analysis of Accounts of Parastatals. This implies that in particular the level of the reported return on capital is uncertain, while the negative trend may reflect the true trend.[133] Besides, *net* rates of return must have been even lower.

Data from the Tanzania Audit Corporation (TAC) further reveal that in 1976/77 and 1978/79, one-third (35 and 32 per cent) of more than 200 parastatal accounts audited by the TAC disclosed losses.[134] The number and share of manufacturing parastatals under the National Development Corporation (NDC) that made losses during the period 1969-1980 are shown in Table 3.6 above. It reveals that during 1969-1970, two-thirds of some 30 odd NDC parastatals made losses. In 1980, the share had dropped to 39 per cent (of a reduced number of total NDC parastatals). Although these data do not suggest a deteriorating performance on average, they indicate widespread financial problems.

Operational and financial problems within the parastatal sector thus spread in the 1970s to the extent that they applied not only to individual parastatals but to the entire sector. Hence, contrary to what was believed initially, the problems were not temporary. They persisted, and in many cases even worsened. Let us see why parastatal performance and financial problems continued to deteriorate and examine more closely how they were handled, by first considering the macro-economic developments in the early 1970s and the response of the political leadership to these.

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131 World Bank (1988a), p. 19.

132 Bagachwa and Chandrasekhar (1984), Table 6, p. 66.

133 Cf. footnote 130 above.

134 Mukandala (1983), Table 3, p. 13.

CONSOLIDATION OF THE SYSTEM

The process of forming a socialist society continued throughout the 1970s. This section examines the impact of the early developments on the performance of the Tanzanian economy, and describes how the government and the party dealt with emerging macro-economic and other problems. It concludes by characterising the socialist system that took shape in the process.

Emerging Macro-Economic Problems

Partly as a consequence of the expansion of the parastatal sector and the problems within it, macro-economic imbalances emerged in the early 1970s. *Table 3.9* shows that whereas overall economic growth was fairly high during most of the period, it declined slightly in the early 1970s. This decline can in part be traced to agricultural output, which saw its share of total GDP drop throughout the 1960s to its lowest level in the period 1971-1975. Despite the central role assigned to agriculture in the official ideology and development policy, the sector faced problems in the post-Arusha Declaration period that, given its relative importance in the economy, had severe macro-economic consequences.

Table 3.9: Economic Structure and Growth in Tanzania, 1961-1981
(Average Annual Percentages)

	1961-65	1966-69	1970-73	1974-77	1978-81
Real GDP Growth Rate	5.8	6.0	5.0	5.3	2.6
Sectoral Share of GDP	1961-65	1966-69	1971-75	1976-80	
- Agriculture	53.9	43.3	38.7	40.3	
- Industry*	11.5	16.2	17.0	14.2	
- Services**	34.6	40.5	44.3	45.5	

Notes: * Including mining, processing, construction and public utilities. ** Including commerce, transport, finance and public administration.

Source: Kimei (1987), Tables 2.1 and 2.3, pp. 47-48, based on various issues of the National Accounts and Statistical Abstract published by the Government of Tanzania.

In 1973, the failed *ujamaa* programme was replaced by the so-called villagisation policy. It made resettlement of all Tanzanians in rural areas into registered villages by the end of 1976 compulsory. Because of the rural population's slow response to the associated moral incentives, the resettlement was finally completed by military force. It was 'the largest resettlement effort in the history of Africa' and, according to Hydén, 'the strongest blow to peasant autonomy after independence' in Tanzania.[135] The launching of the villagisation policy coincided with a drought

[135] Hydén (1980), pp. 129 (second quotation) and 130 (first quotation). For brief accounts of the *ujamaa* and villagisation policies, see also Hedlund and Lundahl (1989), pp. 34-44, and van Cranenburgh (1990), pp. 139-143.

in 1973, which severely hit agriculture. Official purchases of food dropped to an extent that necessitated large imports of staple grains in 1973/74.[136]

The official reliance on moral as opposed to material incentives was reflected in a neglect of the role of relative prices in stimulating the production and marketing of crops. Within the official agricultural marketing system, producer prices for major crops were administratively set at low levels, partly in order to provide the urban population with cheap food.[137] Consequently, the relative price of agricultural products declined during most of the 1970s. Cash crops were neglected, with the result that their price relative to that of food crops dropped during much of the period.[138]

Weak incentives for agricultural production and marketing had a negative effect on the country's export performance. *Table 3.10* shows that the share of agricultural products, which dominated Tanzanian exports, declined after the Arusha Declaration, reaching its lowest level during the period 1970-1973. In those years, exports fell short of imports for the first time since independence. This resulted in a trade deficit of nine per cent of monetary GDP. The current account also turned negative, and from then on the country experienced recurrent balance-of-payments problems.

Table 3.10: Trade and Balance of Payments in Tanzania, 1961-1981
(Average Annual Percentages)

	1961-65	1966-69	1970-73	1974-77	1978-81
Trade to Monetary GDP (%)					
Exports	43.0	36.8	32.5	26.9	27.8
Imports	42.0	35.7	41.2	43.9	50.6
Trade Account Balance	1.0	1.1	-8.7	-17.0	-23.8
Current Account Balance	2.1	0.3	-7.9	-9.9	-18.5
Capital Account Balance	1.2	1.6	10.3	8.7	11.0
Change in Reserves	-0.1	1.6	1.4	-0.5	-3.9
Composition of Exports (%)					
Primary Exports	94.0	86.7	80.6	87.7	84.9
- o/w Minerals	13.2	12.5	8.9	5.2	6.6
- o/w Agriculture	80.8	74.2	71.7	82.5	78.3
Manufactures	6.0	13.3	19.4	12.3	15.1

Source: Kimei (1987), Tables 2.4-2.5, pp. 49 and 51, based on and adapted from Bank of Tanzania data.

In 1974 and 1975, Tanzania faced a minor balance-of-payments crisis. The crisis was triggered by external shocks, such as the drought and the first oil crisis in 1973, but it was also a result of the failed government policy, notably towards agriculture. In combination with a quadrupling world-market price for oil, food imports in 1974 and 1975 made import expenditure rise to almost twice the level of export earnings,[139] while simultaneously imposing constraints on the

[136] See Skarstein and Wangwe (1986), p. 247.

[137] Lundahl and Ndulu (1987), p. 196.

[138] Ellis (1982a), which is a classical reference as regards price developments in Tanzanian agriculture.

[139] Skarstein and Wangwe (1986), p. 196.

importation of both consumer, intermediate and capital goods. As a consequence, the country faced not only widespread food shortages but also scarcities of other basic commodities.[140]

The emerging macro-economic imbalances are also indicated by the savings and investment performance displayed in *Table 3.11.* Investment increased dramatically in the late 1960s and early 1970s, particularly public sector net investment. However, monetary savings remained fairly constant, which implied that the country experienced large and growing net financial deficits from the early 1970s onwards. These were financed from foreign sources, as reflected in large surpluses in the capital account.[141] The difference between savings and investments was due exclusively to the net borrowing of the public sector (except in the late 1970s), which increased rapidly in the early 1970s and then remained high. Hence, public sector investment was largely foreign financed. Together with the trade deficit, this suggests that already in the early 1970s, Tanzania was highly dependent on foreign finance for both imports and public sector expansion. This circumstance stands in sharp contrast to the official ideology and policy of striving for self-reliance.

Table 3.11: Ratios of Savings and Investments to Monetary GDP in Tanzania, 1964-1981 (Average Annual Percentages)

	1964-65	1966-69	1970-73	1974-77	1978-81
Total Monetary Savings	*8.2*	*8.7*	*9.9*	*9.9*	*8.2*
- o/w Private Sector	6.6	5.7	7.0	8.6	6.4
- o/w Public Sector	1.6	3.0	2.9	1.3	1.8
*Gross Investment**	*16.5*	*21.9*	*32.9*	*31.5*	*37.8*
*Net Investment**	*7.0*	*10.3*	*18.8*	*20.7*	*27.5*
- o/w Private Sector	4.7	4.7	2.9	7.3	12.9
- o/w Public Sector	2.3	5.6	15.9	13.4	14.6
Total Net Lending	*1.2*	*-1.6*	*-8.9*	*-10.8*	*-19.3*
- o/w Private Sector	1.9	1.0	4.1	1.3	-6.5
- o/w Public Sector	-0.7	-2.6	-13.0	-12.1	-12.8

Note: * In the monetary economy.
Source: Kimei (1987), Tables 2.6-2.7, p. 52, based on and adapted from various issues of the National Accounts published by the Government of Tanzania.

The expansion of the parastatal sector also led to problems in terms of its macro-economic implications. The sector was running large deficits, and so was the government, and part of these deficits stemmed from financing the parastatal growth. Table 3.8 above shows that the government share in the financing of the parastatal deficit grew from 17 per cent in the late 1960s to 25 per cent during 1974-77. These loans and grants constituted a substantial financial burden for the government itself, accounting for about one-third of its budgetary financing requirement (BFR), which tripled during the period 1966-1977.[142] In addition, the large food imports and the oil price increase put pressure on recurrent government expenditure. As a result,

[140] Kiondo (1989), p. 72.

[141] See Table 3.10 above.

[142] Kimei (1987), p. 187, and Table 3.7 above.

the budget deficit doubled in nominal terms in 1974/75.[143]

The financing of the government budget deficit created problems. Although an important share was financed by foreign grants and loans, domestic borrowing remained the dominant source of government deficit financing in the late 1960s and throughout the 1970s. It increased rapidly, by on average 34 per cent annually in real terms.[144] The sources of domestic government borrowing are shown in *Table 3.12.* Having initially borrowed primarily from non-bank sources, the government shifted to borrowing mainly from the state-owned banking system in the mid-1970s. In particular borrowing from the central bank increased.

Table 3.12: Government Domestic Borrowing, Bank Lending and Rate of Inflation in Tanzania, 1966-1981 (Average Annual Percentages)

	1966-69	1970-73	1974-77	1978-81
Total Government Domestic Borrowing (%)	*100.0*	*100.0*	*100.0*	*100.0*
- o/w Central Bank	2.3	19.4	29.3	39.1
- o/w Commercial Banks	37.1	19.4	24.5	26.3
- o/w Total Banking System	39.4	38.8	53.8	65.4
- o/w Non-Bank Organisations	60.6	61.2	46.3	34.6
Total Outstanding Bank Credit to Domestic Sectors (%)	*100.0*	*100.0*	*100.0*	*100.0*
- o/w Public Sector	5.2	69.3	87.9	92.2
- o/w Private Sector	74.8	30.7	12.1	7.8
Rate of Inflation (%)	*3.4*	*6.6*	*16.0*	*20.3*

Source: Kimei (1987), Table 2.8, p. 53, based on various issues of the Statistical Abstract published by the Government of Tanzania, on various issues of the Economic and Operations Report of the Bank of Tanzania, and on Tables 8.9-8.10, p. 190, based on and adapted from Bank of Tanzania data.

Simultaneously, as shown in Table 3.8 above, also the parastatal sector relied to a large and growing extent on domestic bank borrowing. The combination of parastatal and government deficit financing requirements put the financial system under considerable and increasing pressure for loanable funds. The implications for the monetary system and the Tanzanian economy as a whole were severe. As one consequence, the public sector more or less completely crowded out the private sector from access to domestic credit. Table 3.12 shows that the public sector share of total bank credit increased from 25 per cent in the late 1960s to 69 per cent already in the early 1970s, and further, to 92 per cent, at the turn of the decade.

The increase in the public sector deficit - which up to 1977 was mainly due to parastatal sector expansion - and its financing requirement, mainly accommodated by domestic bank borrowing, were the prime cause of monetary expansion in Tanzania in the 1970s. From 1974 there was a shift in the main source of the money supply, from net foreign assets in the previous period to government deficits, which had a higher inflationary impact.[145] Consequently, as shown in Table 3.12 above, the rate of inflation grew rapidly throughout the 1970s, signalling

[143] See also Kimei (ibid.), pp. 187-188.

[144] Between 1966/67 and 1980/81. (Ibid., pp. 188-189.)

[145] Ibid., pp. 191-192 and 194-197.

problems already in the early years of the decade. The growing rate of inflation led to an increasing overvaluation of the Tanzanian currency.[146]

Response: Increased Regulation

Problems thus emerged within both the parastatal sector and the entire economy in the early 1970s. Simultaneously, the struggles between the political and managerial strata for power and control over the parastatals continued, and the economy of affection increasingly penetrated the sector. This sub-section examines how the government and the party responded to these problems with policy and institutional changes.

As suggested above, the government handled the emerging internal and external macro-economic imbalances largely by resorting to domestic borrowing and foreign aid. Certain efforts to stabilise the situation were made, however. But, as pointed out by Arne Bigsten, when imbalances and shortages emerged in the 1970s, the government developed a tendency to respond to these with administrative solutions.[147] Thus when addressing the balance-of-payments problems in 1974 and 1975, it tried to limit the importation of consumer goods through systems of import licensing and the administrative allocation of foreign exchange to goods considered as essential. In response to the domestic imbalances, the government introduced credit restrictions. These efforts would prove ineffective, however, given the way the financial system functioned.[148]

The Financial System[149]

The ability of the government to rely on domestic bank borrowing partly reflects the policy of self-reliance, and was related to the nationalisation of the financial system in 1967. To begin with, the system operated without direct government interference. The central bank, the Bank of Tanzania (BoT), conducted traditional monetary policy fairly autonomously. As the public sector expanded and its financing needs grew, however, the role and functioning of the system changed. In 1970/71, financial planning was introduced. The central bank became directly subordinated to the government planners and thereby obtained a new role. The purpose of financial planning was to mobilise finance for the public sector and its emerging deficits. On the

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146 See Ndulu (1988), Table 8, p. 52.

147 Bigsten (1988), p. 430.

148 See for instance Sarris and van den Brink (1993), pp. 12-13, for a brief account of the measures introduced to counter the emerging imbalances.

149 This sub-section draws on Kimei (1987), pp. 97-172.

basis of the desired growth in money supply, credit to the government for deficit financing was first planned. Thereafter, credit to other sectors emerged as a residual. Hence, once the financial system was nationalised, regulation of credit allocation provided the government with an easy access to bank borrowing and with a means to handle its growing budget deficits.

As a basis for conducting monetary policy, however, the system was highly inefficient, partly because there was no mechanism that ensured adherence to the financial plan. The budget deficits, particularly the current deficits, were on average much larger than planned. So were public sector domestic bank borrowing and growth in money supply. Instead of using traditional instruments of monetary control, the BoT resorted to directives on credit allocation and to administratively determined interest rates.[150] From the early 1970s onwards, however, its real interest rates were negative, due to ceilings on nominal rates when inflation was high.

The function of the BoT as a government banker was complemented by the National Bank of Commerce (NBC). When the lending of the BoT to the government approached its legal limits, the NBC took on the role as major government lender. The lending of the NBC, in turn, was accommodated by the BoT. The NBC also operated autonomously, more or less as a normal commercial bank, immediately after its nationalisation, when it was granted a monopoly in the allocation of short term credit, predominantly overdrafts, on the Tanzanian mainland. However, its character and role changed from 1971 onwards. The interaction that emerged between the BoT, the Treasury and the NBC made it impossible for the NBC to fulfil its intermediation function efficiently and independently as well as to operate 'in a profit maximizing manner'.[151] By fixing interest rates, mostly at negative real levels, constraints were imposed on deposit mobilisation. Lending, in turn, was restricted by the priority given to the government and by the planned allocation of credit among sectors.

It was initially stipulated that the NBC was to operate on strictly commercial principles. Creditworthiness was meant to be the major lending criterion. Although political pressure was not to be used in lending to particular groups of borrowers, it was soon stressed that the NBC 'should offer maximum possible assistance to the public sector'.[152] Besides, political interference in individual allocation decisions became common. Hence, the role of the NBC also became to accommodate the financial needs of the public sector, the parastatals and the government, as reflected in the sector's rapidly growing and dominating access to bank credit.[153]

Development banks - the Tanzania Investment Bank, the Tanzania Rural Development Bank and the Tanzania Housing Bank - were also established in the early 1970s. They enabled the government to influence the allocation of investment finance, notably foreign aid loans, but also

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[150] Given the institutional structure, traditional instruments of monetary policy would probably not have been effective anyway, as argued by the Bank of Tanzania (1991c), pp. 47-50, itself. Collier and Gunning (1991), p. 533, show that 'given the Tanzania financial system, raising nominal interest rates does not achieve any of the gains associated with liberalization and is indeed counterproductive'.

[151] Kimei (1987), p. 126.

[152] Ibid., p. 137.

[153] Cf. Table 3.12 above.

government loans and grants. Priority was to be given to the financing of public sector projects, although the banks were supposed to apply conventional lending criteria. However, these requirements were largely incompatible, considering the poor viability and performance of many parastatal projects. The state-owned banks were therefore forced to 'reconcile profitability with social criteria',[154] which resulted in poor loan recovery for the investment and rural-development banks.

Besides promoting development in different business sectors and managing their parastatals, the holding corporations also performed financial intermediation functions similar to those of the development banks. They also re-lent or invested government and foreign loans and grants in parastatal companies. The National Development Corporation, whose reliance on external funds was contrary to the intention that it should be self-financing, disposed of funds to an extent that far exceeded the amounts of any one of the development banks.

The state-owned financial system that developed in Tanzania in the 1970s was characterised by political intervention in credit allocation and other aspects of bank operations. Lending was 'determined by government priorities rather than market criteria', as noted by Paul Collier and Jan W. Gunning.[155] As a result, the whole system of formally independent organisations, with little autonomy in practice, was geared and adapted towards accommodating government and parastatal financing needs, thus enabling the ambitious government policies and parastatal expansion.

Agricultural Marketing

The tendency to respond to economic problems with increased control and regulation was obvious within agriculture. The villagisation policy, for instance, was accompanied by an extended use of by-laws, regulating agriculture and rural life in several ways.[156] In addition, the whole agricultural marketing system went through dramatic changes.

Up to 1973, most marketing was handled by the co-operatives and the parastatal marketing boards. So-called scheduled crops - most cash crops and the major food crops - had to be marketed through this system according to law, and their prices were administratively determined by the government. In 1974/75, the number of scheduled crops was extended to include drought resistant crops and the pricing method was changed. Producer prices were now fixed according to the so-called pan-territorial principle. They were set nation-wide, disregarding regional differences in transport costs. Producer prices for cash crops were residually determined at levels where marketing costs and government taxes had been deducted from the export prices.

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[154] Kimei (1987), p. 159.

[155] Collier and Gunning (1991), p. 533.

[156] Farmers in the Rufiji District, for instance, were compelled according to by-laws to weed the cashew nut fields, and were banned from engaging in petty business such as charcoal burning and selling, fishing and transportation of fish outside the district. (Havnevik, 1993, pp. 224-225 and 227.)

In the case of food crops, consumer and producer prices were set independently. Low consumer prices were unable to cover the marketing costs and relatively high producer prices, whereby consumer prices of food were implicitly subsidised.[157]

From 1973 onwards, the marketing boards were gradually replaced by or transformed into so-called crop authorities. The National Milling Corporation (NMC) was put in charge of the marketing of all major food crops. In the case of cash crops, one authority was created for each major crop. In addition to marketing, the new crop authorities were to perform a vast number of functions, such as research, production expansion, extension services, processing and fertiliser distribution. The NMC, for instance, was also to market minor crops and to handle the long-term strategic storage of food crops, the importation and distribution of imported food, as well as the producing wheat and maize flour, canned products, livestock feed and wine.[158]

The forced villagisation meant that by the end of 1975, almost the entire rural population had moved into villages.[159] Once the villages had been established, the government decided to dissolve the co-operatives. Co-operative societies were abolished in 1975 and co-operative unions in 1976. The official reasons were formulated in economic and ideological terms. Inefficiency and corruption within the co-operatives was referred to and they were accused of serving the interests of rich and capitalist farmers who exploited the peasant smallholders.[160] Several observers contend that the major reason was rather the fact that some co-operatives had become strong power centres, perceived as potential threats to the hegemony of the political leadership.[161]

The marketing functions of the co-operatives were thereafter taken over by the crop authorities, and by the villages that collected the marketed supply from the peasants. This constituted an enormous task for the authorities, adding to their other functions, to which they were to prove poorly suited. Under the previous system, co-operative unions collected all the produce in a certain region. Now each crop specific authority was responsible for collecting its own crop in villages throughout the country. This required an elaborate organisation of local branches and considerable staff, while each crop season was usually restricted to a limited number of months. This left much of the huge staff idle for long periods. Similarly, all other resources were under-utilised during off-season periods, and there was duplication of, for instance, trained personnel, research and extension services.[162] At the same time, several crop authorities, notably those handling cash crops, saw the production of their specific crops decline, and therefore handled ever smaller volumes.

The combined effect of these factors was a drastic decline in labour productivity and a

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[157] Sarris and van den Brink (1993), pp. 117-118, Schyberger (1987), p. 134, and Skarstein and Wangwe (1986), pp. 237-239, offer more detailed presentations of the pricing systems.

[158] Mtango (1981), pp. 24-25, and Skarstein and Wangwe (1986), p. 238.

[159] Hedlund and Lundahl (1989), p. 43.

[160] Schyberger (1987), pp. 75-76.

[161] See, for instance, Hanak (1985), pp. 51-52, and Hydén (1980), p. 133.

[162] Skarstein and Wangwe (1986), p. 241.

corresponding increase in the unit cost of crop marketing. A branch office of the Tobacco Authority of Tanzania employed 15 permanent employees for the purchase of 13 tonnes of tobacco, which only required one annual collection by a single truck. The overhead costs of the Cashewnut Authority of Tanzania almost doubled between 1974 and 1979, while its marketed output decreased from 145 to 57 thousand tonnes. As a result, its unit cost increased by almost 400 percent. The cases of tobacco and cashew-nut marketing are illustrative, but not unique. During the period 1974/75-1977/78, the labour productivity of the seven cash-crop authorities and the Sugar Development Corporation declined by on average 38 per cent. For six of the seven cash-crop authorities, the share of overhead costs, mainly in terms of wages for the permanent staff, grew from 26 to 37 per cent of the final sales value between 1970/72 and 1978/80.[163]

One consequence of the growing marketing costs and margins was a drop in the producers' share of the sales value, particularly for cash crops. Hence, the decline in real producer prices of cash crops in the 1970s was not caused by falling real prices on the export markets. It was due to the combination of the rules for administrative pricing and the deteriorating financial performance of the crop authorities. While under the previous marketing system, restrictions on cost increases had been inherent in the price setting mechanism, no such constraints were provided by the rules of the new system. The residual determination of producer prices implied that the crop authorities were allowed to cover cost increases simply by reducing the relative share of the producer price to that of the sales price. In this way, incentives for such cost increases were also created.[164]

The immense task to be carried out by the National Milling Corporation (NMC) was far beyond its planning, organisational and financial capacity. By 1981, its accounts had not been audited since 1973, 'its internal accounts were four years in arrears, and it had become virtually impossible to disentangle its operating costs between different lines of activity'.[165] Frank Ellis nonetheless tried to estimate developments in the NMC gross marketing margin for major food crops. He found that it grew by 49 per cent in real terms between 1970-72 and 1978-80. By the end of the period, actual sales revenue only covered 70 per cent of the costs. The remainder of the NMC cost of selling grain had to be subsidised. To enable the continued operation of the parastatal, in spite of its 'spiralling operating costs', it was allowed to accumulate a growing overdraft with the National Bank of Commerce (NBC). 'This accumulated overdraft had reached ... T.Shs. 2 800 mill. by December 1980 ... equivalent to five times the producer value of all NMC purchases from peasants in 1980.'[166]

The dramatic cost increases of the crop authorities had severe implications for the entire economy, one being reflected in their demands on the financial system. In particular, the

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[163] Schyberger (1987), p. 113, referring to Ellis (1983); and Skarstein and Wangwe (1986), pp. 237 and 242-243, referring to Ellis (1982b), p. 70, and (1983), pp. 222 and 234, and to the World Bank (1982), p. 77.

[164] See Skarstein and Wangwe (1986), pp. 235, 237-238 and 243.

[165] Mtango (1981), p. 48, and Skarstein and Wangwe (1986), p. 238 (quotation).

[166] Ellis (1983), pp. 224-225, referred to by Skarstein and Wangwe (1986), pp. 238-239 (quotation from p. 239).

financial deficits of the NMC turned out to be a burden, crowding out other bank borrowers. Between 1973 and 1980, the share of NBC lending for domestic marketing of agricultural crops, which was almost exclusively dominated by the NMC, increased from 31 to 63 per cent of total NBC non-government lending.[167] However, the cash-crop authorities also faced liquidity problems, despite their privileged option to cover cost increases by decreasing the producer share of the sales value. They accumulated overdrafts with the NBC that by December 1980 almost totalled the level of those of the NMC.[168]

Regulation of Trade

State participation in and control of domestic as well as foreign trade was gradually increased in the 1970s. The State Trading Corporation (STC) was to take over importation and wholesale in Tanzania by replacing about 400 private importers and a large number of national wholesalers in 1970. However, these tasks proved too extensive for the STC, which in 1973 was replaced by the Board of Internal Trade (BIT), under which six national importing parastatals and 19 regional trading companies (RTCs) were established.[169]

As the importing parastatals faced problems, notably in terms of competition from other importers, monopolistic powers were granted to them in buying and selling imported goods. This was done through the policy of confinement, which implied that the parastatals were designated confinees in trade. Confinement also applied to trade in those domestically produced goods that were classified as essential commodities, which were in high demand and limited supply. Industrial parastatals were, however, allowed to import directly from overseas sellers, but all imports required both import and foreign exchange licences.[170] The Bank of Tanzania was entrusted with import licensing, which was meant to ensure the use of scarce foreign exchange according to national priorities. The granting of import licences was related to the availability of foreign exchange and complemented with a system of administrative foreign exchange allocation. Export trade was also regulated, for instance through licensing, and only the crop authorities were allowed to export cash crops.[171]

Domestic trade became equally regulated, with trading parastatals and their agents marketing both domestically produced and imported goods. The RTCs operated in the regions created under the reorganisation of the state administration in 1972. They were wholesale traders, and all trade in essential commodities was confined to them, while in their distribution they prioritised

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[167] Kimei (1987), Table 6.7, p. 140. Total NBC lending here appears to refer to total non-central government NBC lending.

[168] Skarstein and Wangwe (1986), p. 245, referring to Ellis (1983), p. 230. Table A.9 in the appendix reveals that the National Milling Corporation and several other parastatals made losses in the late 1970s.

[169] Kiondo (1989), pp. 71-72, and Schyberger (1987), p. 53.

[170] Kiondo (1989), pp. 71-72, and Schyberger (1987), pp. 59 and 135.

[171] Kimei (1987), pp. 105 and 197, and Ndulu (1984), p. 21.

public and semi-public retailers or their own outlets. Any domestic trader required a trade licence, which had to be renewed annually.[172]

Prior to the mid-1970s, direct state intervention in retail trade was limited. But after the balance-of-payments crisis in 1974-75, which resulted in widespread food shortages and scarcities of other basic commodities, the government directed more attention to the distribution system. Its response was to increase state regulation, control and direct involvement. In 1976, the so-called Operation *Maduka* (shops) was launched. State or co-operative retail services were not only extended to the villages, but were to take over the retail market from private traders. Government and party leaders at various levels commanded more or less immediate closure of private shops in the villages, even before alternative state or co-operative shops had been established. The resulting shortages of goods in rural areas led, however, to a modification of the campaign, stipulating that no private shop should be closed until public substitutes had been established. Public retail shops mushroomed. By 1980, 7,800 retail shops had been established by village governments, District Development Corporations and other parastatals, and through individual co-operative efforts.[173]

In periods of acute commodity shortages, direct rationing was used for the distribution of basic necessities. The confinement system was closely related to the system of commodity allocation. The latter was intended to ensure regional equality in the distribution of and access to goods in scarce supply, executed by the Board of Internal Trade and allocation committees in the regions and districts.[174]

Price Control

The increased regulation of trade was closely related to the expansion of administrative pricing. Although price control in Tanzania dates back to the colonial period, it was pursued on an *ad hoc* basis and only a limited number of consumer goods were price controlled. In response to rapidly growing excess demand and subsequent price increases, comprehensive price controls were introduced in 1973, when the National Price Commission (NPC) was also established.[175] The NPC was to determine and control price levels, ensure reasonable trade margins to producers and traders and guarantee the pan-territorial pricing principle.[176] However, not all administratively determined prices were controlled and set by the NPC. Producer prices for most agricultural products, retail prices for basic foodstuffs and charges for public utilities, for instance, were determined by other government agencies.

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[172] Schyberger (1987), pp. 55 and 134.

[173] Kiondo (1989), pp. 73-74. See also Hydén (1980), p. 132.

[174] Schyberger (1987), pp. 135-136.

[175] Kimei (1987), p. 45, and Maliyamkono and Bagachwa (1990), pp. 84-85.

[176] Ndulu (1984), p. 21.

Price controls were in general imposed on any food and intermediate inputs that were considered essential to consumers and producers. The majority of consumer goods produced locally by large and medium sized firms were also price controlled by the NPC. Prices were administratively determined at the ex-factory, importer, wholesale, sub-wholesale and retail levels.[177] *Table 3.13* shows the number of price-controlled goods, which appears to have more than doubled with the establishment of the NPC in 1973. As early as in 1974, more than 1,000 product categories were price controlled, including both domestically produced and imported ones. The data in the table are incomplete, however, and uncertain, being based on several different sources.[178] They nonetheless suggest that although the number of categories was reduced towards the end of the decade, the number of price-controlled individual items amounted to several thousands.

Table 3.13: Number of Price-Controlled Goods in Tanzania, 1973-1980

Year	*Product Categories*	o/w Domestic	o/w Imported	*Individual Items*	o/w Domestic	o/w Imported
Early 1973	-	-	-	*400*	-	-
1973	-	-	-	*1,000*	-	-
March 1974	*1,066*	602	464	-	-	-
-	-	-	-	-	-	-
1978	-	-	-	*3,000*	-	-
1979	*325*	154	171	*1,031*	456	575
1980	-	-	-	*2,000*	-	-

Note: A dash (-) indicates that data are not available.
Source: Table A.2 in the appendix.

Administrative prices of both imported and locally produced goods were set according to a cost-plus system. The importer or producer presented his cost calculations to the NPC, which would scrutinise and accept the costs before allowing for a certain mark-up as a percentage of the costs and fixing the maximum price.[179] The system consequently implied that if the cost increases were accepted by NPC, they were more or less automatically accommodated by the output price.

As recognised by Robert C. Rice, the price-control system created unintended incentives for importers 'to import goods with higher import duties and to purchase from higher cost suppliers and over-value the CIF prices of goods imported'.[180] Correspondingly, when setting prices of locally produced goods, the cost-plus principle implied that there was 'little or no incentive to manufacturers to cut costs; in fact they ... [could] even report non-existent costs that ... [could

[177] Rice (1979), p. 96.

[178] Besides, it remains uncertain whether some of the figures in the table include goods that were price controlled by other agencies than the National Price Commission. My impression is, however, that in general they do not.

[179] A thorough account of the cost-plus pricing system was given by Rice (1979), pp. 96-98 and 108. For more brief presentations, see Maliyamkono and Bagachwa (1990), pp. 85-86, or the International Monetary Fund (1986), p. 16.

[180] Rice (1979), p. 108.

not] be easily traced by the limited staff of NPC'.[181] The NPC was, at least in the mid-1970s, unable to effectively check the accuracy, particularly of the operating costs of manufacturers. Similarly, there was no mechanism to ensure that producers had tried to economise on costs before applying for compensating price increases. The NPC appears to have accepted the producers' suggested margins as long as they did not diverge too far from their historical levels.[182]

T.L. Maliyamkono and Bagachwa make the observation that there was an inherent incentive in the cost-plus pricing method, for public as well as private production managers, not only to inflate costs, but also to 'lobby directly or corrupt price-fixing officials so as to qualify for price increases'.[183] Interviews with senior officials in two parastatals subjected to price control, the Tanzania Fertilizer Company and the Tanzania Portland Cement Company - although conducted almost two decades later - confirm their use of both inflated costs and lobbying in this price setting process.[184]

According to Bo W:son Schyberger, the options for traders to influence the pricing decisions to their advantage were weaker than those for producers. By participating in direct negotiations with the NPC, submitting and arguing for their individual cost calculations, manufacturers were favoured. The situation for traders was different. They handled a larger number of goods and their prices were determined by a percentage mark-up, to be applied to large groups of commodities. The administrative price system focused on controlling wholesale and retail trade margins, while 'being virtually without any effect on the costs of the manufacturers'.[185]

Reinforced Political Power

Resource allocation increasingly took place through administrative means. This applied not only in the commodity and financial markets, but also in the labour market, through the regulation of wages and salaries, direct government control of rural-urban migration and full party control over the labour unions.[186] This reflects the fact that apart from economic problems, the early socialist developments created political problems for the political leadership. It was involved in a struggle for control over the parastatals with the growing and powerful managerial stratum. Besides, as the economy of affection penetrated the state sector, more traditional power structures, beyond the control of the state and party hierarchy, were supported. The leadership responded to these problems by gradually increasing its political power and control not only

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[181] Ibid., p. 97.

[182] Ibid., pp. 97 and 99.

[183] Maliyamkono and Bagachwa (1990), p. 44.

[184] Personal communication, November and December, 1992, Dar es Salaam.

[185] Schyberger (1987), pp. 137-138 (quotation from p. 138).

[186] Kimei (1987), p. 45.

over resource allocation and parastatals, but also over other potential or threatening power centres within civil society.[187]

As discussed earlier, this was a major reason for abolishing the co-operatives, as well as for controlling the labour movement. In 1977, the labour movement was finally wholly incorporated into the party. It became one of the party's so-called mass movements.[188] Several other civil organisations, such as those for women, parents, youth and peasants, were incorporated in a similar manner.[189] The power of the party was further strengthened when TANU was merged with the ruling party on Zanzibar (the Afro-*Shirazi* Party) to form *Chama cha Mapinduzi* (CCM) - the Revolutionary Party - in 1977. The supreme power of the party became constitutional, gaining formal legality.[190]

The gradually increased political control of parastatals through a huge and complex organisational structure was not only the result of struggles for power within the public sector. It also reflected efforts of the political leadership to handle the performance problems of the parastatals. However, instead of controlling results, and holding managers accountable for those, resort was made to the control of procedures,[191] as expressed in the frequent and detailed intervention in daily operations. The government and party response to both economic and political problems was thus characterised by extended regulation and control of the economy, including the parastatal sector, and civil society. Apart from initiating the numerous institutional changes accounted for here, the leadership shifted its sectoral policy, while the role of foreign aid in these developments increased.

Industrial Expansion and Foreign Aid

The government sectoral policies that developed during the second half of the 1970s were characterised by a change in emphasis, away from agriculture and towards the industrial sector. This was partly a response to the macro-economic problems experienced in the beginning of the decade, when shortages first emerged and revealed the country's as well as the manufacturing sector's dependence on imports.[192] This sub-section discusses the industrialisation strategy that was adopted, largely within the parastatal sector. Since the policy was supported by foreign donors, the role and impact of foreign aid for industrial and parastatal expansion is also examined.

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187 Kiondo (1989), pp. 50-61, provides a brief survey of the increased central control of civil society up to 1977.

188 The former National Union of Tanganyika Workers (NUTA) was replaced by the JUWATA, a party-controlled mass organisation to which all employees automatically belonged. (Masanja, 1990, p. 216.)

189 Kiondo (1989), p. 60.

190 See, for instance, Mwakyembe (1985), pp. 40-41 and 44-45.

191 Mihyo (1994), *passim*, for instance pp. 3-5.

192 Cf. Skarstein and Wangwe (1986), p. 10.

Industrial Policy

In spite of the ideological focus on agriculture and comprehensive sectoral policies, the 1970s were in several ways marked by discrimination against the agricultural sector in favour of industry. The bias is reflected, for instance, in the declining agricultural terms of trade, discussed above. It also shows in the government allocation of public resources. The proportion of development expenditure from the central government budget to the Ministry of Agriculture declined from 17 to 10 per cent between 1975/76 and 1978/79. The corresponding share allocated to the Ministry of Industries grew from 4 to 18 per cent.[193]

This shift of emphasis was partly a result of the so-called Basic Industry Strategy (BIS) adopted in the mid-1970s. This was an ambitious industrialisation strategy for the coming 20 years (1975-1995), reflecting the optimism among policy makers and advisors as to what planned industrialisation could achieve.[194] Industry was meant to produce primarily for the domestic market, while manufactured exports would emerge only as a residual and were thus neglected. Emphasis was laid on industrial activities meeting the so-called basic needs of the people, including food processing, textiles, clothing, footwear, building materials, education, health services, transportation and water supply. Most inputs would be domestically produced. The core industries would be iron and steel, metal-working and engineering, industrial chemicals, paper, textiles, leather, construction materials and electricity.[195]

The BIS was an enormous, inward-oriented investment project, which required huge resources, including foreign currency. It depended largely on a continued inflow of foreign aid, as well as on technical and manpower assistance from the donor countries, as will be further discussed below. The second half of the 1970s consequently saw a dramatic expansion of the industrial sector. Industrial investment grew by on average 31 per cent annually in real terms during the period 1975-1979, whereby the share of industrial to total investment jumped from 18 per cent in 1975 to 27 the following year, and grew further to 37 per cent in 1979.[196]

Much of the industrial sector expansion took place within the parastatal sector, in accordance with the official ideology. The parastatal share of manufacturing employment grew steadily throughout the decade, and reached 50 per cent in 1979. However, the contribution of parastatals to manufacturing value added seems only to have grown up to the mid-1970s, when it accounted for 39 per cent. Thereafter it declined slightly.[197] The role of parastatals in manufacturing varied between and within sub-sectors, depending on the relative importance attached to them by the BIS priorities. Within the metal-based industries, parastatals accounted for 99 per cent of the output of basic metals, such as iron and steel. Within the chemical industry, they dominated the

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[193] Schluter (1981), Part I, Table 13. A similar trend can be observed in the allocation of total public expenditure. (Ibid., Table 5.)

[194] Cf. de Valk (1992), p. 169.

[195] Skarstein and Wangwe (1986), pp. 8-9.

[196] Ibid., Table 1.4, p. 13, and calculations based on this source.

[197] Ibid., Table 1.8, p. 19.

manufacturing of tyres, fertiliser, starch and pharmaceuticals. Parastatals produced 83 per cent of all output of textiles, had a monopoly in leather tanning and accounted for 60 per cent of the output of shoes. Cement production was wholly publicly owned and parastatals produced 74 per cent of all paper products.[198]

Foreign Aid

The importance of foreign aid in these developments is noteworthy. Foreign donors were attracted by the Tanzanian egalitarian and welfare-oriented development model: an experiment in socialism that was independent of the communist bloc, based on local conditions and values. *Table 3.14* shows that total foreign aid from the OECD countries to Tanzania increased more than ten-fold in nominal US dollar terms between 1970 and 1980, from 51 to 666 million USD.[199]

Table 3.14: Disbursement of Foreign Aid to Tanzania, 1970-1980 (Million USD)

Year	Net Loans*	Total Grants	Total Aid	Grants % of Total Aid
1970	24	28	51	54
1971	32	31	62	49
1972	17	45	61	73
1973	35	65	100	65
1974	63	99	163	61
1975	114	188	302	62
1976	71	196	267	73
1977	125	215	340	63
1978	-33	457	424	108
1979	101	487	588	83
1980	9	658	666	99

Note: * Concessional loans less principal repayments.
Source: Table A.3 in the appendix.

Total aid (less technical co-operation grants) also increased in relation to the monetary GDP, from 3 to 17 per cent over the period.[200] The table shows that in particular the grant element increased at the expense of concessional loans. It averaged 97 per cent of total aid during the period 1978-1980. Tanzania received aid from a large number of multilateral and bilateral donors. During the period 1974/75-1978/79, the World Bank was the largest donor, accounting

[198] The figures appear to apply to conditions prevailing in the late 1970s. (Ndulu, 1984, pp. 25-26, and Skarstein and Wangwe, 1986, pp. 19-20.)

[199] Lipumba (1995), p. 23, remarks that the OECD figures on foreign aid to Tanzania have been estimated to be 'inflated' by some 20 per cent.

[200] Skarstein and Wangwe (1986), Table, 6.1, p. 195.

for 23 per cent of the funds, closely followed by Sweden, which alone provided 21 per cent of the total aid to Tanzania.[201]

Sweden has been perceived as a particularly friendly and so-called like-minded donor country, largely because of its generous and unconditional support. Tanzania became a favourite country, whose goals and priorities corresponded well to those of the Swedish donor. Political and economic independence was one of the official Swedish aid goals that gained particular focus in southern Africa. Sweden applied the method of country programming: the recipient country was guaranteed a certain amount of aid during the next few years, which enabled it to integrate aid into the planning of its development strategy. The relationship between donor and recipient as two equal and sovereign states was emphasised, and Sweden was strongly inclined to adapt the form and contents of aid to the wishes of the recipient country. Consequently, donor conditionality at the policy level was condemned by Sweden, because it was regarded as interference in the internal affairs of a sovereign state.[202]

The Role and Impact of Aid

The donors not only supported the Tanzanian development model in general. Much of the parastatal expansion and the Basic Industry Strategy was, in fact, enabled by the growth of foreign aid. In the 1970s, foreign aid was mostly geared towards investment projects, thus focusing on capacity building rather than capacity utilisation. Tanzania's development policy, especially during the second half of the decade, was largely an aid-funded investment strategy, as noted by Joshua Doriye *et al.*[203] Not only did foreign aid and investment boom, but aid financed a growing share of total investment. Total aid (less technical co-operation grants) in relation to monetary gross investment increased from 17 per cent in 1973 to 52 per cent in 1980.[204]

Public sector investment was highly aid dependent. During the period 1975/76-1980/81, foreign aid accounted for on average 60 per cent of new investments in terms of public development expenditure allocated to the ministries. Particularly aid dependent were, among others, the Ministry of Industries (on average 68 per cent) and the Ministry of Agriculture and Livestock (73 per cent). Agricultural parastatals in cotton production and processing received almost 100 per cent of their investment funds from foreign donors, the Sugar Development Corporation almost as much, and so did parastatals responsible for sisal (up to 1978/79) and cashew nuts (up to 1979/80). The parastatals handling food marketing, food production and the cash crops coffee, tea and tobacco received slightly smaller shares, but the majority of their

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201 Schluter (1981), Part III, p. 2.

202 Elgström (1992), pp. 41-79, *passim.*

203 Doriye *et al.* (1993), pp. 56 and 62.

204 Skarstein and Wangwe (1986), Table 6.1, p. 195.

investment funds still came in the form of foreign aid.[205]

As discussed above, parastatal expansion and the resulting power relationships created incentives for further expansion. The behavioural rules within the sector reinforced these tendencies. The de-emphasis of the profit motive, the lack of performance assessment based on productivity criteria, the high degree of monopolisation and the constraints on behaviour imposed by the highly regulated factor and product markets shaped incentives for parastatal managers to focus on *starting* projects. As noted by David Williams, parastatal expansion became the indication of managerial success and thus the way to survive and prosper.[206] This clearly applied within the National Development Corporation. Initiating new projects, mobilising finance and establishing new subsidiary parastatals was given more attention than the management of the existing ones, which was neglected.[207]

Given the institutional structure and the resulting incentives to initiate projects within the parastatal sector, the availability of foreign aid not only enabled, but also fuelled the parastatal expansion and influenced the direction of parastatal and industrial investments. The practice of planning and deciding on investments in Tanzania was based on the proposer's ability to raise non-government financing for the project, notably in terms of foreign aid, since government finance was scarce.[208] Hence parastatals and projects were established when and where there was finance, and donor investment finance was abundant in the 1970s. Regional trucking companies, for instance, were formed for the very purpose of utilising the available aid resources.[209]

Foreign aid appears to have been so abundant that the scrutiny, viability and quality of investment projects was neglected or at least suffered. Two of the donor-supported core industries under the Basic Industry Strategy, iron and steel and pulp and paper, involve such economies of scale that they are unlikely ever to have been able to financially sustain their own operations.[210] Donors faced large real increases in their disposable resources, 'which made it very hard for them to put a brake on the momentum of their project-generating bureaucracies'.[211] Sweden, for instance, had adopted the quantitative goal of spending one per cent of the country's GDP on foreign aid, and this goal was attained in 1975/76. However, the Swedish International Development Authority (SIDA) had problems spending all the funds available. This resulted in large unspent amounts being carried over from one year to another, particularly when the funds grew rapidly. These spending difficulties gave rise to an unofficial aid goal for SIDA: the so-called disbursement goal, which implied that its officials were successful if they managed to

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[205] Schluter (1981), Part III, Tables 15 and 18.

[206] Williams (1979), pp. 43-44.

[207] See Mukandala (1988), pp. 128 and 313.

[208] Williams (1979), p. 43.

[209] Hanak (1985), p. 78.

[210] Skarstein and Wangwe (1986), pp. 144 and 167.

[211] Hanak (1985), p. 83.

spend all the aid funds available.[212] The disbursement criterion had implications for the quality and character of Swedish aid:

> In order to spend more money, capital intensive technology choices have been made, and costly projects and 'hardware' (buildings, equipment) have been prioritized at the expense of 'software' (transfer of knowledge). Efforts to spread a more cost-conscious way of thinking have been stalled.[213]

Foreign aid thus largely determined the types of investments made in Tanzania, in particular the choice of technology, which was 'often merely a fallout from the chosen source of finance and related project inputs'.[214] The technology that was promoted under the industrialisation programme tended to be large scale and capital intensive. Because of their capital intensity, and contrary to the intention, most of the priority industries under growing state ownership became highly import dependent.[215] The choice of capital intensive technology was related not only to donor motives such as SIDA's disbursement goal, but also to the fact that donors often tied their aid to procurement in the donor country, even to specific suppliers. Aid tying had implications for project costs as competitive procedures in procurement were by-passed. The Musoma Textile Mill, a parastatal whose project costs amounted to about two and a half times those of a similar textile project, is a case in point.[216]

The state-led and aid-propelled investment boom in Tanzania had several implications for the performance of the economy in general and for manufacturing enterprises in particular. As noted by Joshua Doriye *et al.,* its focus on expanding the production capacity took little account of the strategy's recurrent implications.[217] The capacity expansion increased the demand for recurrent inputs to operate the new enterprises. Since manufacturing tended to be capital intensive and import dependent, the demand for imported inputs grew. However, the capacity expansion simultaneously tightened the constraints on recurrent imports, partly because the growing importation of capital goods tended to crowd out the importation of the recurrent inputs needed to operate the capital. The share of capital goods in total imports doubled between the mid-1960s and the late 1970s, from 20 to nearly 40 per cent.[218] Simultaneously, the discrimination of exports hampered the country's own import capacity. As a result, foreign

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212 Elgström (1992), pp. 42-43.

213 Ibid., p. 43.

214 Williams (1979), p. 43. Cf. Skarstein and Wangwe (1986), pp. 64-66.

215 Skarstein and Wangwe (1986), pp. 20, 64 and 74-75.

216 Ibid., pp. 64-65. On pp. 67-69, the authors discuss how the technological choices were influenced by the lack of managerial and technical skills. The tying of aid was partly a donor response to demands for promotion of domestic industries. Although the idea of strict separation between aid and business was strong within the Swedish aid community, such commercial considerations have clearly influenced Swedish aid. Swedish exporting companies and their labour unions also lobbied for participation in the country's aid projects, and SIDA support to the Basic Industry Strategy in Tanzania may partly reflect their success in doing so. (Elgström, 1992, pp. 43, 48 and 76-77, partly referring to Forss, 1985, pp. 219-220.)

217 As noted by Doriye *et al.* (1993), p. 56

218 Doriye and Wuyts (1992), p. 3.

exchange grew all the more scarce, particularly during the second half of the 1970s.

The large inflows of foreign aid thus contributed to tightening the constraints on recurrent imports. In a similar manner, aid contributed to tightening the constraints on domestic recurrent inputs, for instance in terms of public recurrent expenditure and, as discussed above, bank borrowing. As a consequence, the growth of production capacity was paralleled by and actually caused a decline in its own utilisation.[219] Assuming that the average rates of capacity utilisation in the manufacturing sector ranged between 70 and 90 per cent in 1970, Rune Skarstein and Samuel M. Wangwe estimated that they declined to between 34 and 38 per cent in 1981, most rapidly in the late 1970s.[220]

The decline in the utilisation of existing and newly installed production capacity is reflected in manufacturing output and productivity. The value added of manufacturing firms with at least ten employees stagnated, even declined slightly, in real terms between 1974 and 1981, whereas the firms' employment grew by 60 per cent. Consequently, over the period, labour productivity declined by over 40 per cent.[221] Parastatals appear to have performed worse than firms in general. Bagachwa and Chandrasekhar show that the rate of growth in value added declined relatively faster in parastatal manufacturing firms than in the manufacturing sector as a whole throughout the 1970s. However, their employment growth was relatively faster up to 1978, which suggests a more rapid decline in labour productivity. With a consistent rise in the capital-output ratio in manufacturing parastatals, their total factor productivity must have fallen.[222]

Concluding Remarks

We may conclude that the parastatal and industrial expansion in the 1970s was largely enabled by the growing amounts of foreign aid and influenced by the circumstances under which it was granted. Donor involvement thus had implications for the context of both parastatals and actors within the sector as well as for the performance of both parastatals and the economy at large. It contributed to the adoption of large scale, capital intensive and import dependent technology. The character of investment projects was similarly influenced, towards low quality, non-viability and high cost. Many of the prevailing values, behavioural rules and incentives within the parastatal sector were thereby reinforced. Most important were perhaps the lack of financial accountability that applied to aid recipients and the weak cost consciousness that resulted within the projects.

Foreign aid imposed behavioural opportunities and restrictions also by affecting resource

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219 See Doriye *et al.* (1993), pp. 56-63, Doriye and Wuyts (1992), and Wuyts (1994), for a more thorough presentation of the argument.

220 Skarstein and Wangwe (1986), Table 6.8, p. 208.

221 Ibid., Table 6.4, p. 202.

222 Bagachwa and Chandrasekhar (1984), Table 1, p. 55, and pp. 61-62.

constraints, easing those on investment finance while tightening those on recurrent domestic and imported inputs. Hence, while it facilitated their expansion, foreign aid contributed to and aggravated the problems facing parastatals, not least within the manufacturing sector. The scarcity of foreign exchange and other recurrent inputs led to low capacity utilisation which, together with the behavioural incentives, gave rise to inefficiencies as reflected in falling productivity. Through its contribution to shortages and poor parastatal and manufacturing performance, foreign aid was partly responsible for the macro-economic problems discussed in the beginning of this section.

The Outcome: Tanzanian Socialism

The early socialist developments - characterised by ideological formation, parastatal expansion, forced policy making and increased political control - initiated a process of institutional change towards a socialist system. These developments gave rise to performance problems, both within the parastatal sector and in the economy as a whole, as well as political problems, to which the leadership responded with administrative solutions. While the early developments led to partial institutional change, remnants of the old system were still in place, such as elements of the market mechanism and private enterprise. However, as the power of the party was gradually strengthened, the role of state ownership extended, and resource allocation and pricing were increasingly administratively determined, the socialist system gradually evolved and consolidated itself. The prevalence of large amounts of foreign aid influenced the shaping of this system. Towards the end of the 1970s, the Tanzanian socialist system was established. Its major formal features resembled those of the socialist system as defined by Kornai, presented in Chapter II.

Characteristic Features of the System

The socialist system consisted, first of all, of the political structure. It combined the official socialist ideology, as first expressed in the Arusha Declaration, with the political rules: a one-party system and party supremacy. The undivided power of the *Chama cha Mapinduzi* applied over the state as well as over any political activity in society. The party decided on all major appointments within the state sector. State and party penetrated one another to the extent that the officials formed one bureaucratic hierarchy.

Secondly, this political system made it possible to extend state ownership of the commanding heights of the economy through nationalisations and other means of parastatal expansion. The parastatal sector expanded in size and relative importance and parastatals ventured into all sectors of the economy. Ideology rationalised the dominant and privileged

position given to this ownership form, as well as the control over the parastatals by the bureaucracy within a complex organisational structure. Party supremacy implied that state property rights were vested in the party. In practice, they were largely delegated to and thus also exercised by state bureaucrats and, albeit to a lesser extent, by parastatal managers. However, the rules that defined relationships, responsibilities and authorities for the management and use of the property were many, complex and often unclear. The rights to the residual income from parastatals belonged to the state, hence formally to the public but in practice to the bureaucracy. Investment and divestiture decisions were centralised within the political leadership.

Just as suggested by Kornai's model, these systemic features brought about bureaucratic co-ordination. This became the predominant mechanism for allocation of resources, co-ordination of economic activity and exchange of information within the public bureaucracy and organisational structure - and, to a significant extent, also within the private sphere. Bureaucratic co-ordination was initiated during the early socialist developments, not least by the *Mwongozo,* as reflected in political and bureaucratic intervention into and control of parastatal operations.[223] This co-ordination mechanism was extended and became comprehensive during the 1970s when the government responded to the early performance problems with regulation and control. Resource allocation became administratively determined to an increasing extent. Similarly, more and more prices were set according to administrative principles, which meant that their functions as information carriers and allocative devices were destroyed.

Tanzanian socialism never involved central planning, in terms of detailed physical matching of inputs and outputs, like in the classical socialist economies. To use the terminology of Kornai, there was no direct bureaucratic control. Control was less rule-bound and more discretionary, often *ad hoc.* In this regard, Tanzanian socialism was closer to the reformed than to the classical system, as defined by Kornai. State ownership and bureaucratic co-ordination composed a set of formal behavioural rules that together constituted the formal economic institutions.

The system also consisted of informal rules, as reflected for instance in the policy-making style of 'we must run while others walk'. Furthermore, the development of the formal system took place within the country's specific historical and cultural context. It was marked by the colonial heritage, the power relationships from the independence movement and, as emphasised in this study, by the economy of affection resulting from the peasant mode of production. These factors influenced both the shaping and the operation of the Tanzanian system. The official ideology incorporated traditional social values as reflected in the catchword *ujamaa.* The informal rules of the economy of affection, based on these values, involved mutual rights and obligations of assistance within social networks, even at the expense of other networks or society at large, penetrating not least the public sphere. As a consequence, the formal rules, associated for instance with state ownership, were partly rendered ineffective by the informal rules of the economy of affection. In practice, part of the parastatal property was diverted for

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[223] The example of bureaucratic intervention in parastatal operations illustrates how in practice it may be difficult to distinguish between the application of party supremacy, state ownership and bureaucratic co-ordination.

private uses, by employees, managers and bureaucrats, as suggested above and further discussed in the following chapters.

The peasant mode of production also implies that much economic activity takes place outside the official channels and that the degree of subsistence production is high in Tanzania. During the period 1966-1980, subsistence GDP was estimated to be about one-third of total GDP.[224] Agricultural production had stayed essentially private, and so had parts of commerce, construction and manufacturing.[225] In addition, local peasant markets remained in place, although they operated under severe restrictions. Hence, elements of private ownership and market co-ordination existed side by side with the official system, which nonetheless dominated the entire economy. In particular, it applied within the parastatal sector and the public bureaucracy.

Systemic Problems

The early socialist developments created operational and financial problems for the parastatals, and the gradual consolidation of the system during the 1970s reproduced and often reinforced these problems. Increased regulation of trade, for instance, which granted parastatals monopolistic and monopsonistic market powers in broad activity areas, assigned even more overwhelming tasks to many parastatals. The all-encompassing and diverse functions of the exporting crop authorities and the National Milling Corporation (NMC) are a case in point. Towards the end of the decade, many of these parastatals faced financial problems and the NMC made huge losses. Other measures, such as increased price control according to the cost-plus principle, weakened incentives to economise on costs within the parastatal sector. The abundance of foreign aid contributed to a deteriorating cost consciousness in aid-supported parastatals and made it possible to start many financially unviable projects.

Particularly during the second half of the 1970s, additional problems emerged, as parastatals faced resource constraints that grew more and more severe. These problems were largely caused by the aid-supported investment boom in combination with price control. Shortages of foreign exchange for the importation of inputs developed. This had negative consequences for manufacturing parastatals, which saw their capacity utilisation decline drastically. Similarly, local recurrent resources were growing scarce. The capacity expansion required more and more domestic working capital, which many poorly performing parastatals were increasingly unable to raise themselves.

Besides, although foreign donors financed much of the parastatal investment, a common practice was to only finance the direct foreign exchange costs of the projects. Local costs had to be financed by the Tanzanian counterpart, in other words, by the government. Thus the

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[224] Kimei (1987), Table 2.1, p. 47.

[225] Cf. Table 3.5 above.

investment boom raised not only the domestic demand for recurrent finance, but also the demand for finance of the domestic investment costs.[226] The government was unable or unwilling to raise its share of investment finance, which meant that the desired low debt-equity ratios could not be maintained. Of some 5.3 billion TSh invested in agricultural parastatals in the late 1970s, only 8 per cent consisted of state equity and grants, while as much as 65 per cent was provided in the form of loans. Consequently, the problem of under-capitalisation that plagued many parastatals in the early 1970s worsened as the 'parastatization mania' continued, with severe implications for their financial performance.[227]

Hence, the socialist system in Tanzania did not just give rise to financial problems for parastatals in its initial stages. As the system evolved and gradually consolidated itself, the problems spread and recurred over and over again. These systemic problems had to be dealt with, not only once, but repeatedly. The system hence required some adaptive feature to take account of this inherent problem.

REPEATED HANDLING OF RECURRENT PROBLEMS

Not only parastatal financial problems but also the actors' ability to handle the problems were affected by the developing system in the 1970s. This section examines how the development of the institutional structure and other contextual circumstances influenced the behavioural options of parastatal managers and bureaucrats who were repeatedly confronted with parastatal financial problems. It shows how the actors gradually learnt to successfully handle the recurrent problems as their behaviour was adapted to the opportunities and constraints provided by the evolving system. Let us first consider the situation in which managers of parastatals in financial trouble found themselves.

Behavioural Options for Parastatal Managers

Constraints: Weak Autonomy and Growing Shortages

For parastatal managers, independent decision making and running of the enterprise was circumscribed already in the early 1970s. Over time, their opportunities to effectively manage the parastatals and influence, especially improve, financial performance deteriorated further, primarily because of the growing regulation of economic activity.

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[226] See Wuyts (1994), p. 11, and Doriye and Wuyts (1992), pp. 26-27.

[227] Mukandala (1988), p. 101.

Confinement of trade created market power and reduced the diversity of actors and thereby the number of alternative suppliers and customers to transact with. Managers could not choose suppliers, shift to cheaper ones and exert pressure on their prices, or select those who offered inputs of better quality. Many parastatals were forced to trade with particular suppliers and customers that were often other parastatals or public entities. Some parastatals saw their financial position deteriorate because their customers had financial problems. The National Housing Corporation (NHC), for instance, found it difficult to enforce the payments of loans granted for construction purposes and of rents from its tenants. 'The collection of rent and loan repayments was plagued by defaults', aggravated by the fact that many defaulters were parastatals and government ministries, which it was difficult to act against.[228]

As the scarcity of foreign exchange and recurrent finance gradually worsened during the decade, the role of administrative allocation of investment finance, working capital and foreign exchange grew. As a result, shortages of inputs and commodities also worsened and more goods became indirectly subjected to administrative allocation. Managers were increasingly unable to secure the inputs necessary to maintain high levels of capacity utilisation, which fell and thus raised unit costs. Increased price control restricted managers' ability to flexibly alter output prices or rates charged for services, just as input prices could not be freely negotiated with suppliers. Several parastatals faced financial problems partly because their output prices were fixed at levels below those that would have covered their costs. This was not generally the case, but applied to rents charged by the NHC and,[229] as shown, to consumer prices for food charged by the National Milling Corporation.

Managerial autonomy was further limited by the frequency of political intervention and because decisions had to be sanctioned by the party and a multitude of other superior organs, as discussed above. Major decisions on location, unit size and product line had to be initiated by the higher party organs. Interference was also common in daily operational decision making, in the form of commands that had to be implemented promptly.[230] Parastatals were obliged to execute government and party policy instructions, which were numerous, often contradictory and announced in an *ad hoc* manner.[231] Such orders became more frequent as the number of parastatal control agencies grew over time. Considering the lack of qualified manpower and the limited administrative capacity, the continued expansion of the sector and its frequent reorganisations added to these managerial difficulties. The wholesale trade in textiles, for instance, was reorganised at least every three years during the period 1967-1978.[232]

The regulatory system restricted the autonomy of parastatal managers in 'hiring, firing and

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228 Ibid., pp. 209 (quotation) and 216.

229 Ibid., p. 216.

230 Moshi (1990), pp. 5-6. See also Mukandala (1983), pp. 2 and 15, and World Bank (1988a), pp. 28-29.

231 Moshi (1990), pp. 5 and 17, Moshi and Shirima (1992), p. 17, and World Bank (1988a), p. 22.

232 Schyberger (1987), p. 56.

setting wages'.[233] Wages, as well as managerial salaries, were regulated by the Presidential Standing Committee on Parastatal Organizations. Employment security was high and with little understanding for dismissals, managers were largely prevented from reducing the labour force when production declined. Although formal procedures for laying off workers existed, these were cumbersome to apply and subject to political interference. Worker protection and generation of public sector employment were emphasised for ideological and political reasons.[234] The rules of the economy of affection imposed additional constraints on the adjustment of the workforce, given the demands on managers to provide relatives and friends with employment. Cutting employment may have implied social and moral disgrace, weakening their links with the social network on which they depended.

Management problems due to poor working morale, fostered already by the *Mwongozo,* may have been aggravated over time, as the nominal wages of employees did not keep pace with the growing rate of inflation.[235] In manufacturing firms with ten employees or more, real wages declined from 1973 throughout the decade, by on average seven per cent annually.[236] Falling real wages, employment security and more idle time on the job due to falling rates of capacity utilisation were detrimental for work incentives. Employees had to compensate their falling wages with alternative incomes. Reliance on social networks hence grew in importance. Diverting labour time to other income-generating activities and abusing or appropriating parastatal resources became more tempting, just as demands on managers to make use of public funds for personal and family needs are likely to have grown.

During the 1970s, parastatal managers thus faced sharpened resource and institutional constraints limiting their autonomy. Their scope for manoeuvre in directly influencing the variables that would cut costs, raise revenue, increase efficiency and thus improve parastatal financial performance was gradually reduced. Towards the end of the decade, the role of bureaucratic co-ordination had grown and controls under state ownership expanded to the extent that most decisions concerning major parastatal matters were made by state and party bureaucrats through administrative means.

Opportunities: Bargaining and Market Power

These institutional changes also provided opportunities for alternative behaviour. The fact that many decisions concerning parastatals were administratively determined and that interference from superior organs was the order of the day made decision making highly discretionary. This

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[233] World Bank (1988a), pp. 32-33.

[234] Moshi (1990), p. 16, and World Bank (1988a), pp. 96 and 100.

[235] Cf. the World Bank (1988a), pp. 32-34.

[236] Own calculations based on Skarstein and Wangwe (1986), Table 6.9, p. 210.

provided opportunities for managers to influence the decisions through bargaining with state and party bureaucrats.

When, for instance, pricing and the allocation of credit and foreign exchange was regulated, the scope for parastatal managers to bargain with bureaucrats for cost-compensating price increases and preferential access to these resources increased. The incentives to bargain for resources grew stronger the more scarce the resources became. In fact, given the tightening institutional and resource constraints, managers who found their parastatals in financial trouble had little option but to bargain for preferential access to scarce resources. Other avenues were more or less closed and they would otherwise have been left without any resources at all. In fact, bargaining became the major mode of decision making within the parastatal sector and the bureaucracy towards the end of the 1970s.

The behavioural opportunities for managers thus changed both form and location. Because areas of responsibility were largely undefined within the bureaucracy, the 'relationships between and within the parastatal sector and controlling bodies ... [were] a contested terrain',[237] and hence an arena for bargaining. The strength of the bargaining power of different actors was related to how influential their contacts were within both the formal hierarchy and informal networks. Most parastatal managers were directly appointed by the president, which gave them a strong bargaining position vis-à-vis lower-level superiors, for instance in the ministries. Hanak notes that the post-independence 'Africanized civil service was unquestionably dominated by the "coffee tribes"'.[238] Since nepotism and tribalism applied within the bureaucracy, this circumstance may contribute to explaining the strong position of the parastatals within agricultural marketing.

While parastatals were increasingly resource constrained, they were generally not facing any demand constraints. They may initially have been restricted by limited demand, but from the mid-1970s, limits on their output and sales diminished. In manufacturing, which previously had faced insufficient demand, these constraints virtually disappeared.[239] When shortages of consumer goods and producer inputs worsened, parastatals instead faced a growing excess demand for their products. This, in combination with strengthened monopolistic positions, implied that in the late 1970s, parastatals in general enjoyed a seller's market. Their market positions also strengthened the managers' bargaining power when negotiating with bureaucrats about finance or other matters.

Just as the *Mwongozo* allowed the rules of the economy of affection to be applied, so formal rules within the parastatal sector made it easier for people at all levels to follow informal rules, since decision making became discretionary, and relationships and responsibilities became uncertain. The informal rules partly complemented the formal ones, by taking over where the latter did not apply. They affected the way in which discretionary power was exercised in

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[237] Mukandala (1988), p. 125.

[238] Hanak (1985), p. 35.

[239] Skarstein and Wangwe (1986), p. 26.

practice, guiding, for instance, the decisions as to which particular parastatal would be assisted. In other instances, the informal rules of the economy of affection instead replaced the formal rules, rendering the latter partly ineffective. As we have already seen, this applied when parastatal property was diverted for the private benefit of network members.

Hence, just as the formal rules within the parastatal sector both constrained managers' behaviour, through intervention and regulation, and provided behavioural opportunities, through bargaining, so did the informal rules of the economy of affection. They made managers support and rely on personalised relationships. The two sets of rules provided incentives for action in the *control sphere*, as opposed to action in the *real sphere*.[240] Productive activity through the creation and reallocation of resources was discouraged and restricted. Behaviour that implied resource redistribution through bargaining within the bureaucracy, and hence rent seeking, was enabled and encouraged. In the 1970s, managers' scope for action in the real sphere gradually declined. But their scope for action in the control sphere increased correspondingly. Under these circumstances, parastatal managers faced incentives to turn to bureaucrats for external assistance when parastatals were in financial trouble.

Learning to Seek External Finance

It took some time for parastatal managers to become acquainted with the new and changing rules, and to adapt their behaviour accordingly. As discussed above, they could not know initially whether or not seeking external parastatal finance would be successful. However, the second time a manager found his parastatal in financial trouble, he already had some experience to draw on. Although he could not know all the incentives that bureaucrats faced and how they would respond, and therefore may still have been uncertain about how successful such behaviour would be, his uncertainty was reduced. To the extent that his first behavioural trial had been successful, this experience created certain expectations that similar behaviour would also be successful in the present situation.

As the parastatal sector grew while its financial problems mounted, the number of parastatal managers who bargained for and managed to secure external assistance from different state organs increased. They could observe the experience of other managers in similar situations, and see that many behaved in the same way and were successful in doing so. Over time, as a manager successfully repeated this behaviour when parastatal financial problems recurred and observed a growing number of similar experiences made by others, his expectations of external assistance in those situations were gradually reinforced.

As discussed above, neither all managers nor all superiors acted in the same way, partly because they all faced uncertainty as to how to behave successfully. If a bureaucrat refused to grant additional finance, so that the parastatal manager's trial was a failure, he had to search for a

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[240] Cf. the definitions of the terms in Chapter II.

behavioural alternative. However, there were few alternatives open for him, since action in the real sphere was tremendously constrained. The available alternative was to turn to another superior, and if this also proved unsuccessful, to approach a third one. Considering the experience of the parastatal sector as a whole, parastatal managers were in general successful. A few exceptions have been noted, however. The National Road Haulage Company, for instance, was forced into liquidation in 1977, and the Kilimanjaro Development Corporation was replaced by the Moshi Development Corporation in 1975.[241]

Managers who tried to handle the financial problems without seeking financial assistance from the bureaucracy are unlikely to have been equally successful, given the character of the problems and the institutional set-up. Over time, however, these managers also learnt gradually how to behave successfully, adapting their behaviour according to the prevailing incentive structure. Foreign managers were possibly more successful in solving parastatal financial trouble through action in the real sphere. This is suggested by the relatively better financial performance of the National Development Corporation parastatals under foreign management.[242] They had fewer social obligations to the local community and were less exposed to political interference, and thus enjoyed greater autonomy in operational and entrepreneurial matters than their Tanzanian counterparts. They were generally more competent and their remuneration was to a greater extent related to parastatal performance.[243]

Behavioural Options for Bureaucrats

Bureaucrats thus repeatedly faced managers of parastatals in financial trouble who were seeking external assistance. When first confronted, we argued, the situation was perceived as one of temporary start-up problems that motivated the provision of financial support. When the number of parastatals increased and the problems therefore recurred, granting finance to new parastatals with problems perceived to be similar could be justified on the same grounds. But when the same parastatal manager repeatedly returned for renewed finance, would not bureaucrats have suspected lax management due, perhaps, to the manager's expectation of external assistance? Besides, refinancing the parastatals became increasingly costly. Did not bureaucrats, under those circumstances, face incentives to refuse instead of renew finance to parastatals, holding managers accountable for the poor financial performance, so as to prevent under-performance and limit costly refinancing?

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241 Mwaze (1983), p. 56; Moshi (1980), note 18, p. 25.

242 Cf. Table 3.6 above.

243 Makoba (1993), pp. 47-48.

Constraints: Increased Contribution and Dependence

Denying parastatals renewed finance while holding managers financially accountable was difficult, not only for the perceptional and ideological reasons discussed earlier. The constraints on such behaviour grew increasingly severe as the socialist system evolved. It required, first of all, that parastatal performance and managers' contribution could be established, so as to serve as a basis for the decision on how to respond.

Such evaluation became more and more difficult. The politicised, contradictory and poorly specified parastatal objectives implied that operational performance criteria were largely lacking. In addition, the extent to which parastatal financial performance reflected economic performance was difficult to establish. As the number of goods under price control was extended while resource constraints developed, relative prices became gradually more distorted. Increased regulation and parastatal expansion added to the information problem by reducing the degree of competition. There were fewer producers and traders with whom parastatal performance could have been compared.

Financial data were thus an increasingly unreliable basis for socially desirable allocation decisions, and thus for bureaucrats' decisions about whether or not to grant finance to a parastatal in trouble. Formal allocation criteria usually stated that parastatals and other public entities should be given priority, for instance in the provision of credit. However, more detailed rules as to which parastatals resources should be allocated to, such as the creditworthiness criterion of the National Bank of Commerce, either conflicted with the preference for public recipients or were poorly specified.[244] However, much of the task of bureaucrats was to administer the allocation of resources. Given the information problem, the character of the allocation criteria and the growing parastatal problems, this task would have been difficult to accomplish if parastatals in financial 'need' had not been assisted.

Financial accountability would have implied that parastatal payment obligations were enforced, which required information about the parastatal service record. However, information systems were rudimentary throughout the public sector, not least within the banks, as will be illustrated in the following chapters. Administrative and legal enforcement mechanisms were also weak or absent, in terms of 'powers to summon, castigate, impose penalties or prosecute violations of ... regulations'.[245] This was partly a consequence of party supremacy over the legal system and the president's right to appoint the judiciary, which was deprived of its independence. Besides, controlling organs often lacked specialised units and expertise, and uncertainty prevailed among bureaucrats as to who had the authority and responsibility to take remedial action.[246]

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[244] This typically applied in the allocation of foreign exchange, in terms of donor commodity import support, as will be discussed in the following chapter.

[245] Mihyo (1994), p. 34.

[246] See Bishagazi (1993), pp. 11-12, Mihyo (1994), p. 34, Mukandala (1988), p. 125, and the World Bank (1988a), pp. 23-31, for details.

Bureaucratic co-ordination, in terms of administrative allocation and pricing as well as interference in parastatal operations, made it increasingly difficult for the bureaucracy to hold parastatal managers responsible for parastatal performance. Controlling procedures imposed constraints on controlling results. As argued, managers were largely prevented from improving parastatals' financial results, since most of the 'variables' on which they depended were fixed. Input and output prices were controlled, and resource constraints fixed input and thereby output quantities. Managers were further constrained by the political leadership's demands for implementation of socialist policies and by the bureaucracy's interventions. It was practically impossible for the managers to fulfil all the tasks required, with few variables at hand, and at the same time make revenue cover expenditure. The institutional, resource and political constraints were inconsistent with the financial one, which was also the least important constraint. It had to be relaxed if managers were to perform their different tasks.

In addition, bureaucratic co-ordination made it virtually impossible to distinguish the managers' contribution to, and thus responsibility for, the financial problems of the parastatals. Instead, the large and growing bureaucracy itself increasingly contributed to the poor performance, through its direct participation in the management of the parastatals and the constraints imposed by institutions and shortages created by the leadership. Managers could claim on good grounds that the state should assume its share of responsibility, by providing financial compensation for their limited autonomy. Arguments of this sort were often forwarded in negotiations with the bureaucracy. The National Development Corporation (NDC), for instance, argued strongly that many of its problems were not of its own making, but caused by factors such as the rapid rate of inflation and shortages of foreign exchange, raw materials and spare parts. It accused the political stratum of fostering the 'distorted and confused decisionmaking process', and its parent ministry of detailed management of all its parastatal activities.[247] Unless the bureaucracy assumed some responsibility for the consequences, it would have found it difficult to motivate managers to make parastatals execute its policies and commands.

Refusing to financially assist the parastatals would thereby have made it difficult for bureaucrats to perform their own tasks. At different levels within the administrative stratum, they were expected to implement the government and party policies and to manage and supervise the parastatals. Just as the managers, they were held *loyally* accountable to their superiors, the political leadership. However, it was not only lower-level bureaucrats who depended on the parastatals for the pursuit of their tasks. So did the political leadership. Although under the one-party system, the leadership was not accountable to an electorate, it was in some respect accountable to its followers. The paternalistic role of the state implied that in order to build up his credibility and authority, the president had to:

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[247] Mukandala (1988), pp. 328-329.

> provide services to the people. Those dependent on him for their power, must do the same. They [had] ... to prove their loyalty to the central authority. Political success is usually counted in terms of number of followers and in order to achieve as wide support as possible no limitation is applied on the use of material resources.[248]

As mentioned earlier, the political leadership thus needed control over large economic resources in order to be able to redistribute them in a manner that favoured its followers and legitimised its own position. Parastatals were the major tool. In addition, the strong market positions of many parastatals implied that unless financial assistance was provided, the performance of crucial economic functions - the provision of basic needs - would have been threatened. As the market powers of the parastatals grew, the leadership became increasingly dependent on a few enterprises. Here the agricultural crop authorities feature as the perhaps most prominent example. These dependencies imposed strong restrictions on not assisting parastatals in financial trouble.[249]

Apart from the large financial investments made, the leadership's tremendous ideological investments made in the parastatal sector escalated with its expansion during the 1970s. The more finance and prestige that was invested, the more difficult it became to refuse assistance. The so-called sunk-cost motive to provide additional finance, in order to secure future returns on previously made investments, was gradually reinforced. Similarly at lower levels, not least within the holding corporations and parent ministries, bureaucrats faced constraints on not assisting parastatals in financial trouble, since their own pay, power and prestige were related to the size of the parastatal sector under their domain of control.

Thus the formal economic and political institutions, supported by the official ideology, increased the bureaucracy's dependence on the parastatal sector in a number of ways. So did the informal rules of the economy of affection in combination with constraints imposed by the economic decline. While bureaucrats had moral obligations to assist parastatals and their managers when in trouble, they may have felt both obliged and tempted to increasingly use parastatals in their support of other members of their social networks. Besides, not only workers' wages but also 'top salaries' declined in real terms, by 1978 to less than one-third of their 1970 level.[250]Although public officials had their salaries complemented by substantial fringe benefits,[251] incentives to earn informal incomes also increased for bureaucrats. Incentives were thus created to grant parastatal finance in exchange for a personal or network favour or rent - for instance, parastatal employment of relatives or access to goods, produced or traded by parastatals, the supply of which grew scarce towards the end of the decade.

The continued parastatal sector expansion, increased bureaucratic intervention and regulation of economic activity, in combination with the informal rules of the economy of affection and the

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[248] Hydén (1979), p. 10.

[249] Cf. Mihyo (1994), p. 91.

[250] World Bank (1988a), Table, 1.6, p. 15.

[251] Hanak (1985), p. 54.

growing macro-economic problems that resulted, made it increasingly difficult for bureaucrats to hold parastatal managers financially accountable. Instead, incentives to provide financial assistance were created and gradually reinforced. Simultaneously, bureaucrats' opportunities to provide such finance were enhanced.

Opportunities: Discretionary Power and Available Finance

Increased regulation and control assigned extended discretionary powers to the bureaucracy. Its ability to decide on factors with a direct bearing on the possibility of parastatals' survival was tremendously enhanced. However, the investment boom made recurrent finance increasingly scarce. How did the bureaucracy manage to financially assist an ever larger parastatal sector with persistent financial problems? Where did they get the finance?

The circumstance that parastatals largely survived on external assistance does not imply that recurrent finance was always and automatically provided in the requested amounts. As the resources became more rare, they had to be spread more thinly. The fact that many parastatals faced recurrent, even permanent, liquidity problems suggests that although they got finance in one way or another, the amounts were in some respect insufficient.[252] Hence, other factors had to be adjusted. The drastic fall in the rate of capacity utilisation in manufacturing suggests that the output level is one factor that was accommodated. Another factor was the real wage level. Its dramatic decline more than matched the drop in labour productivity, at least in the manufacturing sector.[253]

The scarcity of recurrent resources implied that financial support sometimes came in the form of non-enforced payment dues. When the crop authorities, for instance, had liquidity problems, the banks refrained from enforcing loan repayment, as reported above. Besides, parastatals got new loans despite their failure to honour previous obligations. Maryjoyce E. Mtango reported in 1981 that the National Bank of Commerce (NBC) found it difficult to recover short-term loans from borrowers with performance problems.[254] It nonetheless continued to renew loans to defaulting parastatals such as its major borrower, the National Milling Corporation (NMC). The NMC outstanding liabilities to the bank were allowed to increase more than five-fold between 1973/74 and 1979/80, despite the fact that they were far from covered by the value of the NMC stocks. It even declined during the period, which implies that the NMC liabilities were covered by stocks to a decreasing - and appallingly low - extent. Whereas 38 per cent of the bank's outstanding credit to the NMC was covered in 1973/74, the share had dropped

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[252] For instance, in relation to the investment made or in terms of under-capitalisation, implying a disproportionate need to rely on credit financing.

[253] While value added per employee in Tanzanian manufacturing firms with ten or more employees declined by over 40 per cent over the period 1974-1981, the real wage declined by over 50 per cent. (Skarstein and Wangwe, 1986, Tables 6.4 and 6.9, pp. 202 and 210.)

[254] Mtango (1981), p. 17.

to a mere 4 per cent by 1979/80.[255]

The growing external financing of the parastatals imposed considerable constraints on the financing organs themselves. For instance, NBC lending to the NMC implied that much of the bank's assets were tied up and non-performing. This limited the ability of the bank to perform its functions and threatening to cause considerable credit losses. How was it possible for financing organs to refinance parastatals over and over again without completely draining themselves of resources? The answer is that these organs, which were often themselves parastatals, were able to either shift the financial burden on to other groups or reduce their access to the resources, or in their turn secure finance from some other state body.

When the NBC share of credit allocated to parastatals (and the government) and the failure of the latter to honour their debt obligations grew, the amount of credit available for other borrowers declined. As shown in Table 3.12 above, the public sector was allowed to crowd out private borrowers from access to credit. The private share dropped to extremely low levels in the late 1970s. Hence, when recurrent finance grew scarce, the parastatal share was increased at the expense of other sectors. As mentioned above, the NBC also had its lending accommodated by the central bank, in the form of direct borrowing and rediscounting of public securities.[256]

In addition, the government both guaranteed and took over bank loans to parastatals from the banks, and thereby ensured the repayment in case of default. It remains uncertain just how common such guarantees were in the 1970s, but data indicate the prevalence of the practice.[257] Perhaps the most important factor for the NBC was the take-over by the government of more than 2,000 million TSh of NMC overdraft liabilities to the bank in 1980/81, of which the government paid 250 million annually from then onwards.[258] This measure alone relieved the NBC of a considerable financial burden. The bank could thus successfully turn to both the government and the central bank for financial compensation, while shifting part of the burden of parastatal financing to the private sector.

Parastatal holding corporations similarly offered financial assistance to their subsidiary parastatals. This was increasingly made possible by their own resort to government finance. As shown in *Table 3.15,* between 1967 and 1980 a growing share of the funds of the National Development Corporation (NDC) was lent to its parastatals. The share rose from 10 to 36 per cent. Parastatals also received credit guarantees, of about the same magnitude and to an increasing extent. This support was made possible by the NDC's increased reliance on external

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[255] The outstanding liabilities of the National Milling Corporation to the National Bank of Commerce increased from 438 to 2,358 million TSh while the value of stocks dropped from 168 to 94 million TSh during the period. (Ibid., Table 1, p. 31.)

[256] Kimei (1987), p. 118.

[257] According to data on guarantees for loans that remained unpaid by June 1992, the government guaranteed a National Bank of Commerce overdraft of 12.4 million TSh to the Tanzania Railway Corporation in 1979 (Ministry of Finance, 1992b, p. 3), and three other loans in the following year. Cf. Tables A.16-A.17 in the appendix.

[258] Ministry of Finance (1990). These payments are reflected as government subsidies to the National Milling Corporation in Table A.11 in the appendix.

finance. Government grants to the holding corporation grew dramatically, so that by 1980 they accounted for 81 per cent of its sources of funds.

Table 3.15: Sources and Uses of National Development Corporation Funds, 1967-1980 (Selected Years, Million TSh, Per Cent of Total in Brackets)

SOURCES	1967		1970		1975		1980	
Capital Fund*	96.5	(38)	147.6	(37)	183.8	(42)	616.6	(82)
- o/w Govt Grants**	22.3	(9)	111.8	(28)	178.1	(41)	609.4	(81)
- % of Capital Fund	*23*		*76*		*97*		*99*	
Capital Reserves	12.0	(5)	19.8	(5)	-	(-)	-	(-)
Revenue Reserves	46.8	(19)	84.8	(21)	45.3	(10)	42.6	(6)
Borrowings & Other Short Term Credit***	97.3	(39)	142.5	(36)	208.5	(48)	94.1	(12)
Total Sources	*252.6*	*(100)*	*394.7*	*(100)*	*437.6*	*(100)*	*753.3*	*(100)*
USES								
Fixed Assets	8.6	(3)	10.9	(3)	3.6	(3)	14.4	(2)
Equity Investment	187.0	(74)	266.5	(68)	224.4	(51)	296.5	(39)
Loans****	26.0	(10)	112.2	(28)	173.6	(40)	268.4	(36)
Short Term Deposits	32.7	(13)	27.5	(7)	-	(-)	-	(-)
Other Assets	-1.7	(-1)	-22.4	(-6)	26.0	(6)	174.0	(23)
Total Uses	*252.6*	*(100)*	*394.7*	*(100)*	*437.6*	*(100)*	*753.3*	*(100)*
NDC Guarantees of Affiliate Loans	14.9	(6)	-	(-)	460.3	(105)	226.3	(30)

Notes: * Capital paid in by the government. ** Including profits from sale of investments. *** Mainly from the government and from external sources. **** Short and long-term credit and bridging finance.

Source: Kimei (1987), Table 7.8, p. 163, based on and adapted from various NDC annual reports, and own calculations.

Another source of finance that became important for more and more parastatals was administrative pricing. Cost-plus pricing, and residual producer pricing within agricultural marketing, offered bureaucrats a means by which to compensate parastatals for cost increases. By approving raised output prices, organs such as the National Price Commission shifted the financial burden to parastatal customers, i.e. to consumers and other producers or traders. Exporting crop authorities had their cost increases shifted to peasant suppliers, who received less for their crops when the parastatals' costs increased.[259] The exercise was facilitated by the strong market positions of the parastatals, which left suppliers and customers with few alternative traders. Hence, increased regulation raised not only the discretionary powers of the bureaucracy, but also the amount of resources under its domain of control that could be allocated to parastatals.

The government provided recurrent finance to liquidity constrained parastatals in a number of ways. Credit guarantees, debt take-over and the channelling of grants and loans via holding corporations were but a few means. It also offered direct subsidies, bridging-finance loans and

[259] However, towards the end of the 1970s, residual pricing did not fully compensate the cost increases of all exporting crop authorities. (Ödegaard, 1985, p. 112 ff.) This is reflected in the losses incurred by several of these crop authorities in the late 1970s. See Table A.9 in the appendix.

tax exemptions.[260] Discretionary tax exemptions were granted by ministerial order after application from the parastatal. Although the data are incomplete, the figures for the period 1966-1979 are shown in *Table 3.16.* According to the table, exemptions were most frequently granted on customs duty and sales tax. During the post-Arusha period, between 15 and 66 exemptions or more were granted each year. Although not shown in the table, the major recipients of these exemptions appear to be parastatals, including non-commercial ones. Parastatals also seem to dominate excise-duty exemptions.[261]

Table 3.16: Number of Tax Exemptions Granted by Ministerial Order in Tanzania, 1966-1979

Year	Customs Duty	Sales Tax	Excise Duty	Income Tax	Total Exemptions
1966	13	n.a.	n.a.	n.a.	n.a.
1967	3	n.a.	n.a.	n.a.	n.a.
1968	15	n.a.	n.a.	n.a.	n.a.
1969	12	5	1	n.a.	n.a.
1970	23	17	3	n.a.	n.a.
1971	22	22	3	n.a.	n.a.
1972	26	19	1	n.a.	n.a.
1973	31	21	1	n.a.	n.a.
1974	29	27	-	10	66
1975	30	22	2	12	66
1976	25	27	1	10	63
1977	23	18	2	7	50
1978	33	25	-	-	58
1979	10	10	-	3	23

Source: Table A.12 in the appendix.

By affecting both recurrent expenditure and revenue, the provision of parastatal finance had severe implications for the government's own financial position. While up to 1976/77, the growing budget deficits were mainly found in the capital account, the recurrent deficit grew rapidly to about 30 per cent of the total deficit in the period 1978/79-1980/81.[262] While foreign aid financed much of the budget deficits, this was mainly geared to investments, as discussed, and it contributed to the tightening of the recurrent constraints. However, significant amounts of commodity import support were provided to parastatals and other recipients by Sweden.[263] Recipients were expected to pay in local currency for the imports to the government, which

[260] Table A.11 in the appendix shows that apart from the National Milling Corporation (cf. footnote 258 above), the Tanzania Fertilizer Company received direct government subsidies from 1976/77 onwards. Bridging-finance loans from the government to parastatals that remained unpaid by November 1991 (and 1992) are shown in Tables A.25-A.26 in the appendix. However, it is not possible to establish when these loans were granted. Government subsidies and bridging-finance loans to parastatals will be studied in further detail in the following two chapters.

[261] Discretionary tax exemptions are also discussed more thoroughly in Chapters IV and V.

[262] Kimei (1987), pp. 187-188.

[263] As shown by Table A.13 in the appendix, it accounted for about 20 per cent of the so-called SIDA country frame for Tanzania during the second half of the 1970s.

would have earned public revenue. The extent to which they did so, however, remains unknown. Import support was not recorded in public accounts until the late 1970s. Otherwise, as will be discussed in the following chapters, import support did not become an avenue for recurrent finance on any major scale until the 1980s.

In the late 1970s, the budget deficits were instead mainly financed by domestic bank borrowing. As already mentioned, the role of lending from the National Bank of Commerce grew when that of the Bank of Tanzania (BoT) reached its legal limits. However, as the budget deficit continued to grow, the BoT Act was amended in 1978. Its limits on lending to the government were relaxed.[264] The government thus made legal adjustments to enable continued and growing deficit accommodation through money printing. The result was rapid monetary expansion and growth in the rate of inflation, which fuelled the macro-economic problems that erupted in an acute crisis.[265] The leadership ultimately let the Tanzanian people pay for its financing of the growing deficit of the parastatal sector. This development was facilitated by the one-party system and the leadership's increased political control, which implied that accountability to the population deteriorated.[266]

Learning to Provide Financial Assistance

State and party bureaucrats gradually learnt to handle parastatal financial problems in a successful manner. Just like the parastatal managers, they learnt to adapt their behaviour to the incentives created by the evolving socialist system. Every time a bureaucrat tried to provide external finance to a parastatal in trouble and found the behaviour successful, his initial uncertainty was reduced and his expectations of future success strengthened. As the situations recurred, experience accumulated and he observed a growing number of other bureaucrats with similar experience, he gradually learnt that granting assistance was a successful way to behave in those situations. Although this type of behaviour was successful in general, not all bureaucrats behaved in the same way. Some were more reluctant to grant or renew finance, and sometimes even refused it. This may have been successful in certain situations, but in many cases it was not. Those who took a more stern position towards parastatals often found that they had problems maintaining it.

Bank officials sometimes tried to refuse to renew finance to poorly performing parastatals. However, such behaviour did not prove to be particularly successful. It was overruled by the political leadership, which intervened in the allocation decisions of the banks by using political pressure. As early as 1972, the chairman and managing director of the National Bank of Commerce (NBC) 'complained of ministries which "plunge themselves into commanding or

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[264] See Kimei (ibid.), pp. 111-117, on public debt management and the Bank of Tanzania government lending.

[265] The crisis will be discussed in Chapter IV.

[266] Cf. Havnevik (1993), pp. 50-51, and Kiondo (1989), p. 76.

enticing the bank to give ... loans" to unqualified parastatals'.[267] According to Mtango, the bank was more reluctant to grant overdrafts to loss-making and repayment-defaulting parastatals towards the end of the decade. It even refused or cancelled overdraft facilities to certain parastatals with permanent problems.[268] However, as shown above, the NBC continued to grant credit to the crop authorities despite their accumulation of outstanding liabilities. In 1983, a subsequent chairman and managing director of the bank concluded that it had 'borne the brunt of poor management of our public sector. ... In order to preserve "the social objective"', the NBC had been compelled to lend to under-capitalised parastatals which relied on short term finance, were unable to adhere to the bank's repayment arrangements, and whose performance it was difficult to evaluate because of poor record keeping and cash management.[269] Thus bank officials making such experiences also learnt that refusing finance to parastatals was unsuccessful, and they appear to have eventually adapted their behaviour accordingly.

THE OUTCOME: THE SOFT BUDGET CONSTRAINT

This chapter has accounted for the evolution of the socialist system in Tanzania, from the early socialist developments initiated in 1967 to its consolidation in the 1970s. We discussed how the ideological formation, rapid parastatal expansion and extensive political control set in motion forces which, together with traditional behavioural rules and substantial amounts of foreign aid, led to the gradual establishment of a socialist system. The early developments gave rise to performance problems and power struggles to which the political leadership responded with increased regulation. Towards the end of the 1970s, a system was established that was characterised by the official socialist ideology, the supreme power of a single party, state ownership over a huge parastatal sector and bureaucratic co-ordination of economic activity, coupled with the informal rules and values of the economy of affection.

We showed that as the socialist system evolved, parastatal financial problems were constantly reproduced, and that over time, parastatal managers and state and party bureaucrats gradually learnt to handle those problems successfully. The condemnation of capitalist principles, pervasive political intervention, under-capitalisation and over-ambitious tasks for parastatals, and actors' obligations to support informal social networks, soon gave rise to financial difficulties. In the optimistic climate that prevailed, they were initially perceived as temporary infancy problems. Parastatal financial problems persisted, however, and even

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[267] Mukandala (1988), p. 127, quoting Mramba and Mwapachu (1972), p. 180. The Tanzania Housing Bank was also subjected to superiors' direct intervention in its allocation decisions. It was pressured by the government to grant loans to the National Housing Corporation. See Mukandala (1988), p. 238.

[268] Mtango (1981), pp. 17-19.

[269] Nsekela (1984), p. 6.

worsened with the continued expansion of the sector, the growing resource constraints and increased regulation.

When parastatals were in financial trouble, managers faced incentives to turn to the bureaucracy for external assistance, and bureaucrats faced incentives to provide such finance. As the problems recurred, the consolidation of the system gradually reinforced actors' incentives to behave in such a manner. The extended role of bureaucratic co-ordination gradually circumscribed managers' scope for manoeuvre. In combination with the growing shortages, this severely restricted the managers' options to solve the problems by adapting parastatal activities. By contrast, the opportunities to bargain with bureaucrats for access to scarce resources and different forms of financial assistance gradually increased, while the managers' bargaining power was reinforced by the monopolistic market positions of the parastatals. Bureaucrats, in turn, found it increasingly difficult to hold parastatal managers financially accountable. The systemic information problems worsened and the bureaucrats' own responsibility for parastatal financial problems increased with political intervention, administrative allocation and price control. Simultaneously, bureaucrats' dependence on parastatals for the execution of economic, political and social functions increased, while their discretionary powers over gradually increasing resources were expanded.

Although the actors were uncertain about how to behave successfully in the early and changing times of socialist development, they eventually became acquainted with the behavioural rules of the evolving system. In the process of trying to handle the recurrent parastatal financial problems in a successful manner, they gradually adapted their behaviour to the incentives created by the institutional set-up and other contextual circumstances. By drawing on their own experiences and the accumulated experience of others, the actors repeated the behaviour that they had found successful in the past. We argued that over time, managers and bureaucrats learnt that seeking and granting external assistance to parastatals in financial trouble was a successful way to handle the recurrent problems.

As a result, in parallel with the formal institutional developments, parastatal sector expansion and recurrent financial problems, a behavioural pattern was gradually taking shape. What may initially have been perceived as occasional instances of managers of individual parastatals in financial trouble seeking external assistance from bureaucrats, and their offering temporary emergency relief, became a regular way of dealing with systemic problems. By the end of the 1970s, when the socialist system approached its consummation, more than a third of over 200 parastatals were making losses and the huge sector relied heavily on external finance; a behavioural rule had become established: the *soft budget constraint.* The soft budget constraint had emerged gradually as a consequence of the repeated behaviour of and interaction between a large number of parastatal managers and bureaucrats in recurrent situations of parastatal financial problems. This aggregate outcome was never the intention of anyone. Each actor was only trying to behave successfully while minding his own business, given the options provided by the institutional set-up.

The soft budget constraint was an informal behavioural rule - it was not stipulated anywhere

- that applied in situations when parastatals had financial problems. It applied in general within the parastatal sector, in the sense that behaviour according to the rule was sufficiently common and widespread for the actors to expect it to be successful. This does not imply that the actors could be completely certain that such behaviour would prove successful. The strength of actors' expectations of its validity may have varied. Similarly, the ease with which external financial assistance was provided, how rapidly or in what form it came forth may have differed between parastatals. Discretionary powers between bureaucrats varied and so did the availability of finance. Certain parastatals may have ranked higher in priority, as suggested by the crop authorities' privileged access to credit from the National Bank of Commerce.

The present chapter has thus told the story about how the soft budget constraint emerged spontaneously and unintendedly within the parastatal sector, in the process of institutional and economic development that took place in Tanzania during the 1970s. The evolving socialist system created inherent problems and as the actors learnt to handle these, while adapting their behaviour according to the incentives created by the prevailing institutions, the new informal rule gradually emerged in the process. The soft budget constraint was hence a logical consequence of the socialist system. The story will now proceed by exploring in more depth the functions that the soft budget constraint performed and the mechanisms through which it was maintained within this system.

CHAPTER IV

MAINTENANCE AND REINFORCEMENT DURING THE CRISIS

The Tanzanian socialist system was plagued by inherent weaknesses. By the end of the 1970s, when the system was firmly established, its performance problems culminated in an acute economic crisis. However, in spite of the crisis, which lasted into the mid-1980s, the system remained remarkably stable throughout the period. As an informal institution, the soft budget constraint was now part of this system. The present chapter studies the development and operation of the soft budget constraint during the economic crisis, and the story continues by describing how and why the soft budget constraint prevailed within the socialist system.

The first part of the chapter establishes the prevalence of the soft budget constraint during this period. It begins with a sketch of the general expressions and consequences of the crisis, followed by an examination of the implications for the parastatals and the actors within the sector. An account is given of the financial performance of parastatals and the institutional context of managers and bureaucrats who had to deal with the problems. Once established, the soft budget constraint guided the actors' behaviour, and its application to different forms of external parastatal finance is studied.

The prevalence and application of the soft budget constraint had important implications for the parastatals and the actors. In order to trace the functions that it performed, the mechanisms through which it was maintained and hence the logic of its prevalence, the chapter continues by examining its consequences. Three sections inform us about the direct and indirect beneficial consequences of the soft budget constraint for parastatal managers and bureaucrats, through its influence on the institutional and organisational environment, and its negative consequences for parastatal performance. A subsequent section synthesises our findings into the argument that, once established as an informal institution, the soft budget constraint was maintained in a cumulative process of self-reinforcement. In this process, it contributed to both the stability and the crisis of the socialist system.

Chapter IV

THE ECONOMIC CRISIS

A Crisis of the Socialist System

The economic crisis was a crisis of the performance of the socialist system. The ambitious socialist strategy was based on a tremendous expansion of the parastatal sector and on political and bureaucratic control of economic activity. However, the parastatals faced severe operational constraints and financial problems, largely because of their rapid growth and extensive tasks, comprehensive regulation and political intervention. Parastatal financing deficits translated into expanding budget deficits, which together crowded out the private sector from access to credit while they increased the demands on monetary accommodation. Such accommodation was largely made possible by financial planning and by the functioning of the state-owned banking system.

The donor-supported investment boom within the manufacturing sector further sharpened the constraints on recurrent resources, while it fuelled the demand for imports. At the same time, agriculture was discriminated against. Incentives for agricultural production and much-needed exports were weak, partly because of the strong ideological stance, which implied that moral incentives were relied on, while the prices offered were poor. The enforced villagisation policy, effective import substitution, and a tremendously inefficient parastatal marketing system contributed to poor agricultural and export performance. As the system consolidated itself - as parastatal and industrial expansion continued, and political control and economic regulation intensified - the performance problems worsened.

Thus during the 1970s, macro-economic imbalances developed gradually. They did not emerge as suddenly as the crisis would seem to suggest. The previous chapter showed that the net borrowing of the public sector and the trade and current account deficits were large already in the early 1970s.[1] A favourable commodity boom in 1976-1977 partly disguised the problems, but by the time the system was established, its problems erupted into a crisis. Although systemic in character, the crisis was triggered by exogenous shocks. In 1978, the Tanzanian terms of trade deteriorated dramatically, mainly due to falling world-market prices for coffee and the second oil price shock.[2]

The effect of the exogenous shock was worsened by inappropriate response, caused by systemic inertia.[3] The government was slow in adopting adequate measures and continued overspending in spite of the supply constraints, which kept demand up. In addition, the highly regulated economy was rigid and therefore extremely vulnerable to exogenous shocks. With extensive price control and a fixed exchange rate, price signals were not transmitted effectively

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1 See Tables 3.9 and 3.10 in Chapter III.

2 Calculations by Ndulu (1988), p. 11, and Table 5, p. 49, reveal that the Tanzanian barter terms of trade deteriorated by 38 and the income terms of trade by 53 per cent between 1977 and 1982.

3 Cf. Ndulu (ibid.), pp. 3-17, who accounts for the systemic and other causes of the crisis.

through the economy. To this came the rigidity created by administrative resource allocation. As a result, adaptation to the new terms of trade was hampered. Within the parastatal sector, managerial autonomy was weak, which prevented flexible response. Macro-economic imbalances worsened dramatically and output stagnated. The country entered a period of severe economic recession that would continue into the mid-1980s, as indicated by *Table 4.1.*

Table 4.1: Selected Macro-Economic Indicators for Tanzania, 1977-1986 (Percentages)

Real Growth	*1977*	*1978*	*1979*	*1980*	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*
Total Official GDP	0.4	1.2	3.4	2.9	-0.5	0.6	-2.4	3.4	2.6	3.3
- Agriculture	1.1	-1.7	0.8	3.9	1.0	1.3	2.9	4.0	6.0	5.7
- Manufacturing	-6.0	3.4	3.3	-4.9	-11.2	-3.3	-8.7	2.7	-3.9	-4.0
External Balance										
- Exports % of Off. GDP	18	13	14	13	12	8	7	8	5	8
- Imports % of Off. GDP	24	31	28	27	23	20	14	17	16	24
- Exports % of Imports	76	42	49	47	50	40	47	46	33	32
Domestic Balance	*77/78*	*78/79*	*79/80*	*80/81*	*81/82*	*82/83*	*83/84*	*84/85*	*85/86*	*86/87*
Budget Deficit										
- % of Total Expenditure	-	-	-	42	46	34	34	35	31	39
- % of Official GDP	11	18	17	14	15	10	9	9	7	9
*Deficit Financing**										
- o/w Foreign Financing	66	35	39	43	71	54	31	49	36	76
- o/w Domest Bank Borr.	13	50	45	36	65	71	45	24	51	9
	1977	*1978*	*1979*	*1980*	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*
Monetary (M2) Expans.	20	13	47	27	18	19	18	4	29	29
Rate of Inflation	12	12	13	30	26	29	27	36	33	32

Note: A dash (-) indicates that data from compatible sources are unavailable. * Deficit sometimes over-financed, due partly to negative domestic bank borrowing and partly to negative domestic non-bank borrowing, not shown in the table.

Source: Table A.5 in the appendix.

The immediate expression of the crisis was an acute shortage of foreign exchange. Exports dropped from 18 to 8 per cent of official GDP between 1977 and 1982, and the trade deficits worsened dramatically. From 1978 onwards, exports financed less than half of the country's imports, which were instead increasingly financed by foreign aid. However, imports declined from 31 to 14 per cent of official GDP between 1978 and 1983. This severely hit the already input-constrained production. Manufacturing output virtually collapsed. It declined in real terms by on average 3.3 per cent annually over the period 1977-1986. Overall GDP growth was also poor. With an estimated annual population growth of 2.8 per cent,[4] real per capita growth was negative during most of the period 1977-1983.

Domestic imbalances worsened as public expenditure grew fast, partly due to the government's parastatal deficit financing, while poor output growth hampered revenue. In 1978/79, the government's own budget deficit grew from 11 to 18 per cent of official GDP. It doubled in relation to total public expenditure, from 24 to 47 per cent.[5] The deficit was

[4] Bureau of Statistics (1989), p. 21.

[5] Calculations based on Maliyamkono and Bagachwa (1990), Table 1.1, p. 139.

increasingly financed through domestic bank borrowing, which in turn speeded monetary expansion. This expansion far exceeded real growth. As a result, the rate of inflation jumped from 13 to 30 per cent in 1980, and thereafter remained high.[6]

Although the macro-economic imbalances and the decline in manufacturing output continued into the second half of the 1980s, 1984 is here considered to be the last year of the crisis proper. Major reform measures that implied important systemic change and had immediate positive economic effects were then initiated, and these marked the starting point for a new period in Tanzania's development.

The economic crisis hit actors at all levels. The ambitious tasks but poor finances of the government forced it to spread public resources thinly. This, in combination with the shortage of imported inputs and spares, contributed to deteriorating standards, not only in the production sector, but also in social and physical infrastructure. Shortages developed for most commodities, notably consumer goods, which were extremely scarce.[7] Apart from suffering from the general foreign-exchange scarcity, consumer goods saw their share of imports fall from 37 per cent in 1974 to 10 per cent in 1982.[8] The supply of consumer goods was also reduced indirectly by the input-constrained domestic manufacturing.

Hence, 'workers had to direct all their energies to searching and queuing for the scarce commodities'.[9] In addition, real wages and salaries declined dramatically, as shown in the previous chapter. People were thus less able to sustain themselves and their families on their official incomes. A frequently quoted study by David L. Bevan *et al.* suggests that urban per capita real income declined by more than 50 per cent between 1976/77 and 1984. Rural incomes also experienced 'a very substantial drop' between 1976/77 and 1979/80, and 'a very small, further drop' in 1982/83.[10] The official economy consequently proved unable to provide goods and services to the population, wages and salaries to survive on and decent prices for peasants producers.

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6 See Ndulu (1988), pp. 3-5 and 13-14, on the relationship between the budget deficit, money supply and the rate of inflation in Tanzania, and for references.

7 Bevan *et al.* (1987b), p. 41, illustrate the problem. Deliveries of imported Matsushita radios, for instance, dropped by 40 per cent between 1977 and 1982 in urban areas, and by 73 per cent in rural areas. In 1983, 90 per cent of peasant households in four regions reported that there had been times when they wanted to buy some 21 basic consumer goods, but were unable to so because the goods were not available in the market. (Bevan *et al.*, 1988b, pp. 12-14.)

8 Lipumba and Ndulu (1987), p. 17.

9 Maliyamkono and Bagachwa (1990), p. 93.

10 Bevan *et al.* (1988a), referred to by Sarris and van den Brink (1993), p. 146 (quotation).

Parallel Markets and Informal Survival

The Tanzanian socialist system not only failed to supply the basic needs of its citizens. It was also incapable of creating opportunities for the population to provide for its own survival within the formal system. This forced the actors at the grassroots level to seek alternative sources of income generation and consumption. The way for many consumers and producers to survive was to rely on so-called parallel markets and engage in informal activities.

Growing shortages in the late 1970s went hand in hand with increasingly distorted official - administratively determined - prices. An excess demand for virtually everything was created. This demand spilled over into growing parallel markets, where prices were considerably higher and large rents could be gained. Parallel markets for consumer goods exploded.[11] In rural areas, peasants sold much of their produce in parallel food markets, which expanded beyond their traditional levels. This was largely a result of the growing inefficiency of the official marketing parastatals and the low prices that they could offer, when their spiralling marketing costs had been deducted from the export price.[12] There was also significant illegal cross-border trade in agricultural products, and parallel markets for foreign exchange.[13] The official exchange rate was only moderately adjusted to the high rate of inflation. Hence the Tanzanian shilling became increasingly overvalued.[14]

Urban employees had to complement their official wage income with side-line activities, such as urban farming, food vending, repair and maintenance, tailoring and local beer brewing.[15] Others, not least public officials, engaged in more directly illegal activities, like rent seeking and embezzlement of public funds, bribery, tax and control evasion, under- and over invoicing.[16]

Several attempts have been made to estimate the size of the various forms of informal or parallel activities. A thorough study of the so-called second economy was carried out by Maliyamkono and Bagachwa.[17] A more recent and, according to the authors, improved estimation of the size and growth of the sector was made by Bagachwa and Alex Naho. This latter study suggests that the second economy expanded rapidly at the onset of the crisis, from 12 to 24 per cent of the official real GDP between 1977 and 1978. It remained at that level

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11 Although markets for consumer goods grew increasingly controlled during the 1970s, Bevan *et al.* (1988b), pp. 2, 9 and 11, consider the official prices to have been fairly close to the equilibrium levels prior to 1978, when shortages became acute.

12 Ödegaard (1985), pp. 156-157. Cf. the discussion on the marketing parastatals in Chapter III.

13 See Maliyamkono and Bagachwa (1990), pp. 98-108, on the 'second economy' in foreign trade.

14 According to Kiondo (1990), Table 3, p. 33, referring to Lofchie (1988), Table 1, p. 212, the parallel-market exchange rate (TSh/USD) increased from 1.6 times the official rate in 1978, to 10.1 times in 1984. However, data differ. Havnevik (1993), p. 10, calculated the parallel exchange rate to be 3.9 times the official rate in 1984.

15 See, for instance, a field survey by Tripp (1988), referred to by Kiondo (1989), pp. 223-224, for details on these types of activity and their characteristics in Dar es Salaam during 1987/88.

16 Some of these will be discussed later in this chapter.

17 Maliyamkono and Bagachwa (1990); who define the second economy as including informal (very small scale), parallel (due to price control) and black market (trade in illegal goods) activities.

during most of the 1980s, but peaked at 31 per cent in 1984.[18] However, the estimates of unrecorded economic activity in Tanzania vary radically with the method adopted. As shown by Alexander H. Sarris and Rogier van den Brink, the size of the sector may well have been considerably larger, both before, during and after the economic crisis.[19]

Thus in order to survive during the crisis, people made informal adjustments so as to compensate for the decline in incomes derived from formal employment, trade and production. Sarris and van den Brink show that among both poor, middle and rich households in rural as well as urban areas, the relative importance of formal employment declined between the late 1970s and the early 1980s. All groups increased their income shares from agriculture and, more pronouncedly, informal activities.[20] The authors further conclude - in stark contrast to the findings of Bevan *et al.*, referred to above - that urban households at the middle income levels were the only income group that experienced real drops in income during the economic crisis. All other groups, even the poor, managed to more or less compensate themselves for the declines in formal incomes.[21]

Hence, by the time the socialist system approached its consummation, the Tanzanian population had to struggle for survival. People managed to adjust to the crisis by shifting into informal activities when the official economy failed. As we shall see, the parastatals also suffered from commodity scarcities and severe financial problems during the crisis.

THE SITUATION OF THE PARASTATALS AND THE ACTORS

This section sets the stage for our examination of the prevalence of the soft budget constraint and the subsequent analysis of its consequences. It characterises the situation within the parastatal sector during the crisis, by first accounting for the financial performance of the parastatals. It then discusses the institutional context in which parastatal managers and public bureaucrats operated and the implications for their behaviour when dealing with the problems.

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[18] Bagachwa and Naho (1995), Table 1, p. 1394.

[19] Sarris and van den Brink (1993), pp. 48-57.

[20] Ibid., pp. 182-183.

[21] Ibid., pp. 154-190, *passim.*

Worsening Financial Problems for Parastatals

Since the crisis was in many respects a failure of the official system, one of its expressions was a poor and deteriorating financial performance of its main vehicle on the road to socialism: the parastatal sector. This is reflected in parastatal accounts audited by the Tanzania Audit Corporation (TAC). The TAC is the auditor of most parastatals and its clients are almost exclusively parastatals.[22] *Table 4.2* displays their overall audit record during the crisis. Although not all parastatals submitted their accounts for audit, the large number of accounts audited reveals much about the financial performance of the sector.

Table 4.2: Tanzania Audit Corporation Clients, their Audited Accounts and Financial Results, 1980/81-1985/86 (Million TSh)

Audit Year	No. of TAC Clients*	Accounts for Fin. Years	PROFITS		LOSSES			TOTAL**	
			No. of Accounts	*Total Value*	*No. of Accounts*	*% of Tot. No.*	*Total Value*	*No. of Accounts**	*Net Value*
1980/81	398	-	117	1,518.3	110	39	319.4	282	1,198.9
1981/82	433	1974-82	168	2,189.9	181	48	559.5	376	1,630.4
1982/83	448	1977-82	196	3,876.5	165	40	910.2	412	2,966.2
1983/84	460	1977-83	213	2,911.9	171	41	2,994.4	422	-82.5
1984/85	420	1973-84	189	3,811.4	165	42	1,853.0	394	1,958.4
1985/86	415	1977-85	190	5,927.0	203	47	2,386.9	431	3,540.2

Notes: A dash (-) indicates that data are unavailable. * The number of Tanzania Audit Corporation clients and the number of accounts audited differ, partly because many clients submit delayed accounts. ** The total number of accounts exceeds the sum of those disclosing profits and losses, since accounts breaking even are also included.
Source: Table A.6 in the appendix.

The general notion in Tanzania, that many parastatals were loss makers, is substantiated by the TAC data. The share of the accounts audited that disclosed losses grew rapidly at the onset of the crisis, from 32 per cent in 1978/79[23] - not shown in the table - to 48 per cent in 1981/82. Hence, almost half of the parastatals appear to have made losses. While the accounts audited during the first half of the 1980s disclosed net profits in most years, total losses were considerable and increasing, even in relative terms. In *Table 4.3,* they are related to official GDP and total public expenditure.

A problem with the TAC data is that losses reported for a particular year refer to the year when the accounts were audited, and not to the financial year when the losses were actually incurred.[24] In the table, we therefore let the total losses audited in a particular year (for instance, 1980/81) reflect actual losses incurred one year and a half earlier (in this case 1979). They are then related to the official GDP and total public expenditure in that year. The results suggest that

[22] The Tanzania Audit Corporation (1988-1991) claims to have audited 96 per cent of all parastatals, at least during the period 1987/88-1990/91. Parastatal domination is illustrated by the fact that of the 215 major loss- or profit-disclosing accounts audited in 1987/88, only 11 (5 per cent) were from private or 'other' non-parastatal organisations, and their losses and profits were minor. (Tanzania Audit Corporation, 1988.)

[23] Mukandala (1983), Table 3, p. 13, based on the Tanzania Audit Corporation Annual Reports.

[24] As revealed by a comparison between the first and the third columns in Table 4.2.

parastatal losses grew substantially, particularly in the early crisis years, also in relation to output and the government budget. Between 1982 and 1985, they appear to have averaged 4 per cent of official GDP and 13 per cent of total public expenditure.

Table 4.3: Audited Parastatal Losses in Relation to Official GDP and Public Expenditure in Tanzania, 1980/81-1986/87 (Million TSh)

Audited Total Losses		In Relation to Official GDP		In Relation to Public Expenditure	
Audit Year	*Value*	*Year*	*%*	*Year*	*%*
1980/81	319.4	1979	1	1979/80	-
1981/82	559.5	1980	1	1980/81	4
1982/83	910.2	1981	2	1981/82	5
1983/84	2,994.4	1982	6	1982/83	16
1984/85	1,853.0	1983	3	1983/84	9
1985/86	2,386.9	1984	3	1984/85	8
1986/87	5,809.3	1985	5	1985/86	18

Note: A dash (-) indicates data unavailable.
Source: Table A.7 in the appendix.

Although these calculations are rough, they seem to portray the actual development of parastatal financial performance relatively well. The periodisation made in Table 4.3 appears to be the most appropriate, as revealed by an inspection of the background data and by trials made with other periodisations.[25] This is further suggested by the fact that the relative magnitude of the periodised audited losses corresponds fairly well to calculations based on losses *actually* incurred in 1984 and 1985.[26]

The three sectors dominating parastatal losses were agriculture and livestock, industry and trade, and communication and transport. This reflects their relative importance in the economy.[27] Let us discuss the first two.[28] Parastatal losses within agriculture and livestock

[25] We examined the Tanzania Audit Corporation (1981-1992) data on all accounts reporting losses or profits in excess of 5 million TSh (20 million TSh if audited in 1991/92), audited during the whole period 1980/81-1991/92. These accounts amounted to around half of the total number of accounts audited in several years. In Table A.7 in the appendix, the result of an attempt to relate losses audited in one year (for instance, 1980/81) to the official GDP *two* years and a half earlier instead of one (in this case 1978) are shown in column three.

[26] The Tanzania Audit Corporation (TAC) has partly corrected for the flaw that losses audited in one year reflect losses made during several different years. The columns 5-7 of Table A.7 in the appendix show losses actually incurred by so-called commercial parastatals in a certain financial year and their relative size, regardless of when the accounts were audited. Data are only available from 1984, however, which is why they are presented in the following chapter. The TAC definition of commercial parastatals appears to correspond fairly well to the one used in this study, which was presented in Chapter II and refers to parastatal enterprises that are formally independent of the government budget. The TAC definition excludes some parastatal enterprises, however, mainly agricultural marketing boards/crop authorities and other agricultural parastatals, which is an important divergence from our definition. The overwhelming majority of the TAC clients nonetheless appear to be classified as commercial parastatals.

[27] Agriculture was the largest contributor to official GDP, and manufacturing and trade the second largest, during the whole period 1976-1986. (Tanzanian Economic Trends, 1988, Table 1, p. 45.)

[28] Data on the losses of parastatals within communication and transport are shown in Table A.8 in the appendix.

during the period 1979-1984 are presented in *Table 4.4,* where the same periodisations as in Table 4.3 above have been made.

Table 4.4: Audited Parastatal Losses within Agriculture and Livestock in Tanzania, 1980/81-1985/86 (Million TSh)

Audit Year	Estimated Actual Year	Losses			Sector's Share of Total Losses	Total Sector Accounts (No.)	Net Result
		Number	*% of Sector**	*Value*			
1980/81	1979	21	68	-	-	31	-
1981/82	1980	28	60	-	-	47	-
1982/83	1981	23	62	253	28	37	137
1983/84	1982	37	69	1,952	65	54	-1,895
1984/85	1983	40	66	713	38	61	-428
1985/86	1984	41	63	977	41	65	-658

Notes: A dash (-) indicates that data are unavailable. * Percentage of the sector's accounts disclosing losses.
Source: Table A.8 in the appendix.

Agricultural parastatals displayed the poorest record during the crisis. They accounted for the largest total loss value and the poorest net financial performance, and had the largest proportion of loss makers.[29] On average 65 per cent of the accounts of these parastatals disclosed losses during the period and the sector as a whole disclosed net losses, at least during 1982-1984. According to the table, agricultural parastatals accounted for on average 43 per cent of the total parastatal losses in the early 1980s.

Given the increasing inefficiencies of the crop authorities in the late 1970s,[30] the poor record of agricultural parastatals is perhaps not surprising. *Table 4.5* confirms that agricultural parastatals really did make huge losses during the crisis. It displays the financial performance of the major parastatals within agricultural marketing and livestock during 1978-1984. It is based on data from audited accounts compiled by the Ministry of Agriculture and Livestock Development.[31]

In every single year during the period, these parastatals made huge aggregate net losses. The losses were almost exclusively accounted for by the parastatals within agricultural marketing. Livestock parastatals were smaller and performed better. The losses of the ten crop authorities increased dramatically, particularly at the onset of the crisis, and totalled more than seven billion TSh over the whole period. During the first four years, the National Milling Corporation (NMC) accounted for most of these losses. Thereafter, the losses of the exporting crop authorities increased and dominated the picture. All of these parastatals, except the one exporting coffee, made net losses during the crisis.

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29 This is revealed by a comparison with Table 4.6 below and Table A.8 in the appendix.

30 As discussed in the previous chapter, their unit costs increased, with rising overheads for administration and employment and lower volumes traded. The lower volumes were partly due to weak incentives for peasant producers, who resorted to parallel markets.

31 Project Preparation and Monitoring Bureau (1992).

Table 4.5: Financial Performance of Agricultural Parastatals in Tanzania, 1978-1984
(Million TSh)

Parastatal	1978	1979	1980	1981	1982	1983	1984	1978-84
AGRICULTURAL MARKETING								
Cashew-nuts (CATA)	59	46	-7	133	-256	-200	-125	-350
Coffee (TCMB)	21	29	-90	33	27	-5	26	41
Cotton (TCMB)	39	-72	-2	-1	-367	-910	-645	-1,958
Pyrethrum (TPB)	-4	-3	0	-7	-30	-40	-54	-138
Sisal (TSA)	-25	-7	-27	34	-30	-6	-11	-72
Tea (TTA)	-8	-2	-8	-31	-40	-39	-16	-144
Tobacco (TTPMB)	-24	9	-106	-122	-125	-90	-38	-496
Total Exporting	*58*	*0*	*-240*	*39*	*-821*	*-1,290*	*-863*	*-3,117*
Food (NAFCO)	-1	5	7	-6	-1	22	74	100
Sugar (SUDECO)	-6	-35	-38	1	-8	7	3	-76
Total Marketing Except NMC	*51*	*-30*	*-271*	*34*	*-830*	*-1,261*	*-786*	*-3,093*
National Milling Corp. (NMC)	-300	-821	-1,072	-651	-332	-540	-349	-4,065
Total Agricultural Marketing	*-249*	*-851*	*-1,343*	*-617*	*-1,162*	*-1,801*	*-1,135*	*-7,158*
LIVESTOCK PARASTATALS								
Animal Feed (TAFCO)	0	0	0	0	0	0	5	5
Dairies (TDL)	4	-1	3	25	54	70	40	195
Dairy Farming (DAFCO)	-2	-2	-6	-8	-1	-16	-7	-42
Hides & Skins (THS)	3	2	1	1	0	0	4	11
Packers (TPL)	-5	16	0	-14	-16	-19	-21	-59
Poultry (NAPOCO)	0	0	0	0	0	0	0	0
Ranching (NARCO)	-6	9	-4	-2	10	-3	-7	-3
Total Livestock Parastatals	*-6*	*24*	*-6*	*2*	*47*	*32*	*14*	*107*
TOTAL AGRICULTURAL PARA.	*-255*	*-827*	*-1,349*	*-615*	*-1,115*	*-1,769*	*-1,121*	*-7,051*

Note: A dash (-) indicates that data are unavailable.
Source: Table A.9 in the appendix.

The *exporting* crop authorities thus made large losses in spite of the fact that they enjoyed residual pricing. As explained in Chapter III, this implied that the producer prices they paid for crops purchased were determined through deduction of their marketing costs from sales proceeds. However, this pricing procedure was based on *planned* marketing costs and *expected* world-market prices. When the actual marketing costs of these parastatals increased during the second half of the 1970s, and prices fetched in export markets declined because of the increasing overvaluation of the Tanzanian shilling during the crisis, the planned targets were no longer reached.[32] Instead, losses resulted.

Let us turn to the highly import-dependent manufacturing sector, where the systemic shortages had severe implications. During the period 1977-1981, the share of foreign exchange allocated to the manufacturing industry for importation of raw materials and machinery spares in relation to the amounts requested dropped from on average 56 to a mere 6 per cent.[33] Although firms can be expected to have increasingly overstated their importation needs as scarcities worsened, these figures suggest the growing severity of resource constraints. Consequently, the

[32] See Ödegaard (1985), pp. 112-133, for a detailed discussion on the applied residual pricing and developments in marketing margins and marketing costs.

[33] Skarstein and Wangwe (1986), Table 6.10, p. 211.

average degree of capacity utilisation in manufacturing continued to decline during the crisis, from an estimated 64-74 per cent in 1978 to a mere 26-29 per cent in 1982.[34] Manufacturing output collapsed, as shown earlier. Parastatals within manufacturing and trade, which already were problem-ridden, suffered large losses, *Table 4.6* reports.

Table 4.6: Audited Parastatal Losses within Industries and Trade in Tanzania, 1980/81-1985/86 (Million TSh)

Audit Year	Estimated Actual Year	Losses			Sector's Share of Total Losses	Total Sector Accounts (No)	Net Result
		Number	*% of Sector**	*Value*			
1980/81	1979	12	18	-	-	65	-
1981/82	1980	18	22	-	-	83	-
1982/83	1981	23	27	304	33	85	459
1983/84	1982	39	29	496	17	134	757
1984/85	1983	41	34	682	37	119	395
1985/86	1984	48	37	700	29	131	1,263

Notes: A dash (-) indicates that data are unavailable. * Per cent of the sector's accounts disclosing losses.
Source: Table A.8 in the appendix.

The share of loss-making parastatals in the sector doubled, from 18 to 37 per cent, between 1979 and 1984. During the last four of these years, these losses accounted for on average 29 per cent of the total parastatal losses. Still, the financial problems of parastatals within industries and trade did not approach the absolute or relative levels of those of agricultural parastatals.

Despite the substantial size of parastatal losses reported by the Tanzania Audit Corporation (TAC), the data are subject to weaknesses that bias the picture. Some of these are of relevance for establishing the nature of the parastatal financial performance.

Accounting Weaknesses and Biases

First of all, the TAC data are incomplete because many parastatal accounts were in arrears. *Table 4.7* shows that during the period 1975/76-1985/86, on average 34 per cent of all TAC clients were in arrears. This fact partly explains the need to make the periodisation adjustments above. It further implies that once all accounts have been audited, the total value of parastatal losses will grow.[35] The reliability of financial performance data reported in parastatal accounts may also be questioned. This is suggested by the fact that most of the accounts audited by the TAC during the period 1975/76-1985/86 were not given clean audit reports: only between 29 and 40 per cent were.

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[34] Ibid., Table 6.8, p. 208.

[35] When the accounts audited in 1992 were added to the previously audited ones, total commercial parastatal losses incurred in 1989 increased by some 18 per cent. (Tanzania Audit Corporation, 1991, p. 13, and 1992, p. 12.)

Table 4.7: Accounting Standard of Tanzania Audit Corporation Clients, 1975/76-1985/86

Audit	CLIENTS IN ARREARS		CLEAN REPORTS		NON-CLEAN REPORTS		Total No. of
Year	*No.*	*% of All Clients*	*No.*	*% of Audited*	*No.*	*% of Audited*	Audit. Acc.
1975/76	72	26	70	35	128	65	198
1976/77	56	18	76	36*	136	64	212
1977/78	92	28	76	33*	152	67	228
1978/79	100	30	76	31*	171	69	247
1979/80	-	-	-	-	-	-	-
1980/81	151	38	85	30	197	70	282
1981/82	185	43	108	29	268	71	376
1982/83	198	44	143	35	269	65	412
1983/84	174	38	168	40	254	60	422
1984/85	170	40	146	37	248	63	394
1985/86	163	39	171	40	260	60	431

Notes: A dash (-) indicates that data are unavailable. * Corrected for counting error.
Source: Table A.10 in the appendix.

The TAC analysed the causes of its own qualifications of accounts for the period 1986-1990.[36] Their findings appear to have applied also during the crisis. Several weaknesses were related to an erroneous reflection of parastatal assets and liabilities, implying for instance that overvalued assets led to understated costs of depreciation. A similar bias was the inadequate provision for bad and doubtful debts, as regards both trade and staff debts. Costs and consequently losses were hence under-reported, and profits were overstated. This bias was substantial, and would, if corrected for, give a far more pessimistic view of the magnitude of parastatal losses. It is illustrated by the fact that among the parastatals reporting the largest profits we find certain banks.

According to the accounts audited by the TAC during the period 1982/83-1986/87, parastatals under the Ministry of Finance accounted for on average 27 per cent of the total value of parastatal profits.[37] The Bank of Tanzania and the National Bank of Commerce (NBC) were reported as the two major profit makers practically every year. However, the NBC is a parastatal whose profits have been grossly overstated because of incomplete deduction for bad and doubtful debts, as suggested by data from the mid-1970s and the late 1980s. During the period 1974-1976, the NBC reported annual net surpluses of between 91 and 149 million TSh.[38] Provisions for bad, doubtful and difficult debts were made for a mere 73-126 million TSh (1973/74-1975/76), despite the fact that three crop authorities had overdue outstanding liabilities to the bank, not covered by stock of crops or profits, amounting to 777-1,049 million TSh annually.[39] The crop authorities had difficulties in servicing their debts to the NBC, which

[36] Tanzania Audit Corporation (1992), pp. 12-21. See Eriksson (1993), pp. 8-13, for a more detailed discussion on biases in parastatal financial performance data audited and reported by the TAC.

[37] Calculations based on Tanzania Audit Corporation (1983-1987).

[38] National Bank of Commerce (1977), Table 18, p. 26.

[39] Calculations based on Mtango (1981), Tables 1-4. The three parastatals are the National Milling Corporation, the Coffee Authority of Tanzania and the Tanzania Sisal Authority.

accumulated over time. If the reported profits are adjusted for only a fraction of these bad and doubtful debts, the bank's surpluses shift into huge losses.[40]

Similarly, during the period 1986/87-1989/90, the NBC made provisions for bad and doubtful debts for only between one and six per cent of its loans and overdrafts.[41] This was far from sufficient, since a larger share of the NBC assets were non-performing, as concluded for instance by a study conducted by Coopers & Lybrand. At the end of December 1988, the NBC needed to make total provisions of 39.9 billion TSh for loan losses, which amounted to 52 per cent of its total portfolio.[42] In 1987/88, the NBC recorded profits of 6.9 billion TSh, and made provisions for bad and doubtful debts to the value of 0.3 billion TSh. The corresponding figures for 1988/89 were 4.3 and 3.1 billion TSh.[43] A comparison of these figures reveals that, had the loan losses been fully taken into account, the NBC - one of the top profit-making parastatals - would have made huge losses, far exceeding those of any of the loss-making parastatals audited by the TAC. Although the data reported here refer to the mid-1970s and late 1980s, there is little reason to expect that the financial position of the NBC would have been significantly better in the meantime - during the economic crisis.

Several studies indicate that these accounting biases not only applied to individual cases or during limited time periods. The Ministry of Agriculture made a thorough financial analysis of ten agricultural crop authorities in 1979. It found a general tendency for inadequate cost deduction, so that losses (incurred mainly in 1978) were consistently under-reported.[44] A World Bank study of 72 major industrial parastatals concludes that their financial performance during the period 1988-1991 was generally worse than that indicated by their accounts. Among the major reasons for this bias were inadequate asset depreciation and 'provisions for stock deterioration/losses and doubtful debts', and non-reported 'receipt of hidden subsidies through import support and other cost avoidance mechanisms'.[45]

Hence, due to the biases in the data on parastatal financial performance based on audited accounts, parastatal losses actually incurred during the crisis are likely to have been larger than those indicated by the tables above. When dealing with the economic instability that characterised the crisis, actors now operated within an institutional set-up that was characterised by relative stability.

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40 We know from the previous chapter that in 1980/81 the government relieved the National Bank of Commerce of about 2,000 million TSh worth of bad debts, owed by the National Milling Corporation.

41 Calculations based on the National Bank of Commerce (1992).

42 Coopers & Lybrand Associates Limited (1989), p. 2. This study appears to have been conducted for the Banking Commission.

43 National Bank of Commerce (1992), Tanzania Audit Corporation (1989), p. 51, and (1990), p. 47.

44 Marketing Development Bureau (1979), *passim*, for instance p. 71.

45 World Bank (1991a), p. 2.

Institutional Stability

By the time the performance problems of the gradually evolving Tanzanian socialist system erupted into an acute crisis, the process of systemic formation came to an end. The system was consummated. The official socialist ideology was now reflected in the institutional and organisational structure. Parastatals were established in the commanding heights of the economy. While the sector continued to expand, its growth slowed considerably during the crisis, as shown by *Table 4.8.*

Table 4.8: Number of Parastatals in Tanzania, 1977-1984

Year	Number
1977	159
1978	-
1979	380
1980	-
1981	>380
1982	-
1983	400
1984	433

Source: Table A.1 in the appendix.

The major formal institutions - the supreme power of a single party, state ownership and bureaucratic co-ordination - were established, and informal institutions complemented them. Some of the informal behavioural rules were culturally inherited, notably those of the economy of affection. Others had emerged spontaneously in the process, such as the soft budget constraint. The formal and informal rules were thus interrelated. The formal rules had evolved within the country's historical and cultural context, and new informal rules were a consequence of and therefore adapted to the other rules. Hence, by the time the socialist system was established, the formal and informal rules together constituted a fairly coherent and consistent institutional network - a circumstance to which we shall return later.

For the moment, it suffices to note that in spite of its poor performance, the system was essentially stable during the crisis. The behavioural rules remained basically intact. This does not imply, however, that the institutional system was static, or that individual institutions were not altered, but institutional change was slower and less dramatic than in the past. In addition, most changes were consistent with the existing institutional framework or involved mere policy and organisational change within it. Hence, no detailed account of the institutional conditions prevailing for parastatal managers and bureaucrats within the parastatal sector is given here. They were presented at length in the previous chapter.

The leadership's initial response to the crisis was characterised by delayed action and lack of adequate measures. It essentially followed the patterns developed in the 1970s. During the period 1979-1981, several stabilisation attempts were made, but they were not thorough and did not tackle the systemic weaknesses. They relied instead on large external aid flows, which did

not in fact materialise. Their impact was negligible. The same applies to the Structural Adjustment Programme, which the government launched in 1982. As noted by Benno J. Ndulu, the programme included practically no institutional measures that would have reduced the system's rigidities and increased the efficiency of the allocation and utilisation of resources.[46]

Major organisational change was, however, initiated during the period. Agricultural marketing in particular was reorganised. The three-tier system, abolished in the mid-1970s, was reintroduced.[47] The crop authorities were turned into or replaced by marketing boards, and functions at district level were taken over by co-operative societies and those at regional level by co-operative unions. The Cooperative Societies Act was passed in 1982, and 1984 registered 1,900 societies and 20 unions.[48] These co-operatives were no longer locally developed, politically and economically independent organisations. They were introduced from the centre, incorporated into the official marketing system and subject to state and party control. The Cooperative Union of Tanzania was established as a branch of the party, which reserved to itself the right to examine and approve of candidates for the major co-operative positions.[49] The state also intervened directly in major decisions as well as local matters.[50] Hence, relationships and behavioural rules within the reorganised agricultural marketing chain remained by and large unaltered. The reintroduction of co-operatives was therefore mainly a modification of the existing organisational structure, and did not represent any major institutional change.

Certain elements of institutional reform were introduced. An import liberalisation scheme saw the light in 1978 and some price control was eliminated in 1980.[51] However, most of these reforms were minor and eventually reversed or counteracted by other regulatory measures. The import liberalisation scheme, for instance, was closed by a party order after one year. The partial price deregulation, in turn, was coupled with increased control over construction and rent charges.[52] Throughout the period, there continued to be 'a conspicuous absence of active use of [the] pricing system'.[53] A Tanzanian National Agricultural Policy was adopted in 1982. Land rights were strengthened in order to encourage private investment in large-scale farming. Certain large producers were also allowed to bypass the official marketing chain and export directly.[54]

To the extent that effective institutional measures were taken, they implied increased state control and regulation. When shortages worsened, commodity rationing and trade confinement

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46 Ndulu (1988), pp. 26-33, briefly accounts for the different programmes.

47 Cf. the discussion of agricultural marketing in Chapter III. Another major organisational change was the reintroduction of elected local governments - urban councils already in 1978, and district (rural) councils in 1982-1983 - that had been abolished in the early 1970s. See Kiondo (1989), pp. 175-180.

48 Schyberger (1987), p. 123.

49 Ibid.

50 See Kiondo (1989), pp. 179-180.

51 On the number of goods under price control, see Table 4.12 below.

52 See Kiondo (1989), p. 180 ff.

53 Ndulu (1988), p. 30.

54 Kiondo (1989), p. 197-199, (1990), p. 31, Lipumba (n.d.), p. 10, and Tanzanian Economic Trends (1988), p. 18.

were extended, particularly at the retail level, with the launching of the Internal Trade Policy in 1980.[55] In 1982, the control over the administrative allocation of foreign exchange was tightened. Previous biannual allocations were suspended, while import licences now were granted according to the availability of foreign exchange.[56] The most spectacular government action was its response to the growing parallel market activity and corruption. In 1983, it declared a 'war' against so-called economic saboteurs and racketeers in an intensive campaign.[57] Through the 'use of extra-legal force which set aside the whole judicial system provided for in the Constitution',[58] a total of 1,057 persons were arrested in three days.[59] However, the campaign did not reduce parallel market activity or corruption. Instead, scarcities worsened and prices hiked.[60]

While the formal institutions remained intact, the growth of parallel markets implied that they were not effectively enforced. As a result, the relative importance of market-determined pricing and exchange grew. However, these developments only partly reflected institutional change, now as a gradual replacement of formal by informal rules. Exactly like corruption, parallel markets were a systemic feature - a logical consequence of the opportunities and constraints provided by the system. Actors unable to earn their living by adhering to the formal rules resorted to whatever informal opportunities these rules provided. Administrative allocation created opportunities for rent seeking, and price control for trade in parallel markets.

The crisis period thus involved certain institutional changes. Kiondo even characterises the period as one of initial reform, although restricted to 'peripheral parts' of the state's domain.[61] Still, I argue, it was characterised by relative institutional stability, compared to the preceding period and to the one that was to follow. The formal system remained basically intact, and so did the informal institutions. Parallel markets and corruption were not new phenomena, although their relative importance grew during the crisis. The system was characterised by stability in the sense that there was little uncertainty about prevailing behavioural rules. This institutional stability was to remain until mid-1984, when the first *major* steps were initiated in a process of institutional change, which gave rise to new behavioural uncertainties.

The fact that the actors in the parastatal sector could operate within a system of stable rules significantly facilitated their behaviour. The uncertainty from the past, created by a system undergoing rapid change, was now largely gone. Parastatal managers and bureaucrats had become acquainted with the formal and informal institutions of socialism. They knew what rules applied, how to adhere to them and thus how to move about within the system. This institutional

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55 See Schyberger (1987), Appendix A, pp. 176-181, for details on the contents of the policy.

56 Kimei (1987), p. 107.

57 For surveys of this campaign, see e.g. Maliyamkono and Bagachwa (1990), pp. ix-xix, and Kiondo (1989), pp. 225-243, *passim.*

58 Havnevik (1993), p. 58.

59 Maliyamkono and Bagachwa (1990), pp. xii-xiii. See pp. xiii-xv for examples.

60 Kiondo (1989), pp. 241-242, and Sarris and van den Brink (1993), pp. 15 and 119.

61 Kiondo (1989), pp. 204-206.

stability made it easier to cope with the economic crisis in general, and with the financial problems of parastatals in particular.

The Soft Budget Constraint: A Guiding Rule

When the crisis erupted in the late 1970s, the soft budget constraint was already established as part of the socialist system. As an informal institution, it now directed the behaviour of parastatal managers and bureaucrats when parastatals were in financial trouble. And since the performance of the sector worsened, parastatal financial problems recurred over and over again.

The situation was not new. By now, the problems were common. Many actors were familiar with the situation themselves or were used to observing the behaviour of others in similar situations. Although they could not know with complete certainty how to behave successfully, their previous uncertainty about how to handle parastatal financial problems was to a large extent eliminated. The actors no longer had to worry about how to proceed or how their counterparts would respond, or to engage in time-consuming decision-making calculations. The soft budget constraint was there and shaped their expectations about how to behave successfully. In addition, it made the behaviour of their counterparts predictable. It did so by containing and channelling information about the actors' own and others' experience in similar situations in the past. Seeking and granting external assistance was hence expected to be the way - a successful way - to handle parastatal financial problems.

Expectations of government assistance in case of financial trouble generally prevailed, for instance, within the agricultural crop authorities at the onset of the crisis. The Marketing Development Bureau of the Ministry of Agriculture noted that these parastatals simply assumed that they would have government financial backing. They did not even quantify the expected support.[62] The fact that they did not spell out how far they believed the government was willing to support them suggests that they expected unlimited and ultimate assistance. Although conducted in 1987, a World Bank study similarly notes that many parastatals 'could realistically expect to be bailed out by the Government if they got into serious financial trouble'.[63]

The soft budget constraint reflected much of the official socialist ideology and the social values of the economy of affection. Society - the state, the party and the informal social networks - should look after its members, in particular the weak ones, by distributing resources and welfare to those in need. The soft budget constraint provided a concrete example of what this implied in practice: the state should cater for its parastatals. The general prevalence of this attitude is revealed by the role that Tanzanians assign to banks and their lending, as reported by the Banking Commission:

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[62] Marketing Development Bureau (1979), p. 78. See further pp. 40-83, *passim.*

[63] World Bank (1988a), p. 24.

> There is a strong belief in Tanzania that the banks should provide finance to the public sector and in particular the agricultural sector. The expectation is that finance will continue to be provided, irrespective of the repayment record of the borrower. Indeed this is borne out by newspaper articles, many quoting government officials, criticising the banks' decisions either not to lend or to restrict funds to poorly performing agricultural bodies. The banks are held to blame for inflicting cash shortages on the peasant farmer, whilst no mention is made of the ineptitude, inefficiency or diversion of funds by the primary borrower. Press headlines have referred to the role of the banks as being 'to give cash' to cooperative unions for crop purchasing rather than 'to lend', thus implying that there is no firm commitment to repay.
>
> Public pressure exerted through the press is compounded by the fact that the banks are state-owned, and are thus expected to support state companies, in particular those in key sectors such as agriculture.[64]

Adherence to the soft budget constraint was rationalised both ideologically and morally. By shaping actors' expectations, it created incentives for and thus guided their behaviour in situations of parastatal financial trouble. Handling the situation was now a relatively easy and uncomplicated process. When parastatal managers and bureaucrats no longer had to explore *how* to behave, they could simply go straight ahead and act, and thus apply the soft budget constraint.

APPLICATION OF THE SOFT BUDGET CONSTRAINT

Application of the soft budget constraint involves the external accommodation of parastatal financing gaps. The existence of these financing gaps was shown above. This section investigates their accommodation. It examines if and how actors sought and granted external parastatal finance, and the extent to which resources were transferred to parastatals - or not transferred *from* parastatals, when this is relevant - as a result of such behaviour.

It often proves difficult to establish the sequential and thus the direct causal link between parastatal financing gaps and their subsequent external accommodation. Particular attention is therefore devoted to the way in which actors behaved when they sought and granted external finance. This implies that we largely examine the budget-softening character of resource transfers, as suggested by Kornai.[65] 'Soft' finance must be subject to discretionary influence, so that it can be bargained or lobbied for and accommodated to the financing gap of the parastatals, and thus provided as external assistance in situations of financial trouble. Recall, however, that such application of the soft budget constraint may take many different forms, sometimes involving non-negotiated, non-enforced parastatal payment default.

The four major forms of external parastatal finance and their soft character referred to by Kornai - soft subsidies, soft taxation, soft administrative pricing and soft credit - are first

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[64] Banking Commission (1989a), p. 15.

[65] Discussed in Chapter II.

examined. We then consider a form of finance that was eventually to gain significant importance in Tanzania: import support from the donor community.

Direct Government Subsidies

The previous chapter discussed how the government budget accommodated parastatal financing deficits in the 1970s. One form of budgetary resource transfer, which increased during the crisis, was direct subsidies. When the financial problems of in particular the crop authorities worsened, their managers turned to the government for subsidies, as suggested by *Table 4.9.*

Table 4.9: Actual Payments of Government Subsidies in Tanzania, 1976/77-1983/84
(Million TSh)

Year	PARASTATAL										Total	Per Cent of	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)		C&C	TMS
1976/77	49	-	-	-	-	-	-	-	-	50	99	832	3
1977/78	84	-	-	-	-	-	-	-	-	100	184	215	5
1978/79	562	-	-	-	-	-	-	-	-	135	698	207	15
1979/80	419	-	-	-	-	-	-	-	-	135	554	911	13
1980/81	375	-	-	-	-	-	-	-	-	137	512	97	9
1981/82	655	-	-	-	-	-	-	-	-	203	858	45	10
1982/83	579	67	19	64	315	5	24	55	10	196	1,334	80	16
1983/84	496	54	13	-	276	8	-	102	29	215	1,193	83	12

Notes: A dash (-) indicates the value zero (0). C&C = Contractual and Contingent Liabilities. TMS = Total Ministerial Supply.
(1) National Milling Corporation, Total (for maize, government take-over of overdraft liabilities to the National Bank of Commerce, and other)
(2) General Agricultural Products Exports Corporation
(3) Tanzania Cashewnut Marketing Board
(4) Tanzania Coffee Marketing Board
(5) Tanzania Cotton Marketing Board
(6) Tanganyika Pyrethrum Board
(7) Tanzania Sisal Authority
(8) Tanzania Tobacco Processing and Marketing Board
(9) Sugar Development Corporation
(10) Tanzania Fertilizer Company
Source: Table A.11 in the appendix.

According to the last column of the table, actual payments of subsidies from the (central) government to individual parastatals (which were the only recipients) tripled in relative terms at the onset of the crisis. They grew from 5 to 15 per cent of total so-called ministerial supply in 1978/79,[66] and remained high throughout the crisis. To begin with, such subsidies were only

[66] Recurrent expenditure is separated into consolidated fund services, which are mainly used for foreign debt servicing, regional supply and ministerial supply. The major posts within ministerial supply are personal emoluments, other charges, grants, and contractual and contingent liabilities (to be explained below). (World Bank, 1989a, p. 16 ff.)

granted to the National Milling Corporation (NMC) and the Tanzania Fertilizer Company (TFC). But when the losses of the other crop authorities escalated in 1982,[67] subsidies were extended to most of them, from 1982/83 onwards.

It remains uncertain whether Table 4.9 reflects all direct central government budgetary subsidies, partly because definitions vary and hidden subsidies may appear under other budgetary headings. Nonetheless, it displays the parastatal subsidies explicitly reported, reflects the most detailed information available, and is fairly consistent with data according to other definitions.[68] The overall picture painted here is confirmed by data on so-called contractual and contingent (C&C) liabilities. These consist of various forms of assistance to parastatals, mainly extraordinary allocations, and 'other contingencies traceable to Tanzania's economic crisis', including the Strategic Grain Reserve.[69]

Table 4.10 shows that C&C liabilities more or less tripled in relative terms, first in 1978/79 - just as subsidies in Table 4.9 - and then once again during the crisis. During the period 1978/79-1983/84, they averaged 12 per cent of total ministerial supply, or 8 per cent of total recurrent expenditure, which is ten times their average size in the previous four years.[70] The correspondence between subsidies and C&C liabilities is imperfect. A Treasury budgeting manual defines C&C liabilities as 'those claims on the Government budget that, though foreseen, cannot be accurately determined e.g. cost-overruns, foreign exchange equalisation, state visits and gifts and compensation etc.'.[71] Hence, the proportion of subsidies in - and the extent to which they are covered by - C&C liabilities remain uncertain. However, the second last column in Table 4.9 suggests that during the latter part of the crisis, the C&C liabilities consisted more or less entirely of subsidies to parastatals.

Table 4.10: Contractual and Contingent Liabilities in Relation to Different Public-Expenditure Measures in Tanzania, 1977/78-1983/84 (Million TSh)

Year	C&C Liabilities	% of Total Ministerial Supply	% of Total Recurr. Expenditure
1977/78**	85.8	2.5	1.5
1978/79*	337.6	7.1	4.7
1979/80	60.8	1.4	0.8
1980/81	527.8	9.3	5.5
1981/82**	1,906.3	23.0	14.6
1982/83	1,664.8	19.6	11.8
1983/84**	1,420.1	13.9	9.3

Notes: * Estimates. ** Approved or revised estimates.
Source: Table A.21 in the appendix.

[67] As shown by Table 4.5 above.

[68] See the discussion in Eriksson (1993), pp. 23-28, *passim*, on the difficulties of obtaining a clear picture of direct government subsidies and on the problems associated with the varying definitions of subsidies.

[69] World Bank (1989a), p. 10. Handling Tanzania's Strategic Grain Reserve was to become one of the major tasks of the National Milling Corporation.

[70] Not shown here, but in Table A.21 in the appendix.

[71] United Republic of Tanzania (n.d.), pp. 57-58.

Subsidies are discretionary more or less by definition. Parastatal managers must have presented and argued their case in order to get access to the funds. This is at least what the managers of the TFC did, according to both Treasury staff and a TFC manager. The manager reports on the parastatal's intensive bargaining for subsidies, directly at the Treasury as well as via its holding corporation and parent ministry.[72]

The very definitions of C&C liabilities - as extraordinary allocations that were adjusted to parastatal cost overruns caused, for instance, by the economic crisis - suggest that subsidies were granted as assistance to parastatals in financial trouble. The use to which these subsidies were put points in the same direction. First of all, some of them consisted of government take-overs of the crop authorities' overdraft liabilities to the banks. These were debts assumed by the government because the parastatals had failed to service them.[73] Secondly, in the Treasury's budgeting manual, subsidies were narrowly defined as compensation to parastatals for revenue forgone due to government price control.[74] And at least part of the subsidies to the National Milling Corporation and the Tanzania Fertilizer Company compensated for losses caused by consumer subsidies on maize and fertiliser.[75]

A further indication that subsidies were granted to accommodate financing gaps is the fact that practically all the recipients in Table 4.9 were notorious loss makers. Almost all crop authorities made repeated and net losses during the period 1978-1984, as shown earlier. In addition, all recipients except the Tanzania Tea Authority (TTA) appear among the major loss makers audited by the Tanzanian Audit Corporation. These loss makers are listed in Table 4.20 below. Finally, subsidies were repeatedly granted to the same chronic loss-making parastatals year after year. They were soft.

Tax Exemptions

Another type of budgetary financial assistance to parastatals took the form of discretionary tax exemptions. These were applied for individually and were granted by the Minister for Finance, who possessed the formal power to issue them according to his discretion.[76] The number of such

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[72] Personal communications with senior staff at the Tanzania Fertiliser Company, 26 November, and at the Department of Public Investment of the Ministry of Finance and Economic Affairs, 2 December, 1992, Dar es Salaam.

[73] In Table A.11 in the appendix such subsidies to the National Milling Corporation are specified.

[74] United Republic of Tanzania (n.d.), p. 57.

[75] See Table A.11 in the appendix. During the period 1976-1984, the Tanzania Fertilizer Company received two different types of direct budgetary subsidies. Besides the subsidy on the product price of between 29 and 67 per cent, the government granted 'a 100% subsidy on transportation from the factory or port depot to regional or district distribution centres'. (Marketing Development Bureau, 1985, p. 3.)

[76] In Tanzania, ministerial powers were extensive. Ministerial orders on discretionary tax exemptions were government decisions and had the status of subsidiary legislation. (Ndulu *et al.*, 1987, p. 8.)

exemptions on customs duty, sales tax, excise duty and income tax granted by ministerial order is shown in *Table 4.11*. According to the table, most discretionary exemptions were granted on sales tax, which was levied on both imported and locally produced goods, and on customs duty. During the crisis, the total number of exemptions first dropped, but thereafter it grew rapidly, from 19 in 1981 to 79 in 1984. The actual number of exemptions may, however, be under-reported in the table, and figures for individual years may therefore be biased.[77]

Table 4.11: Number of Tax Exemptions Granted by Ministerial Order in Tanzania, 1978-1984

Year	Customs Duty	Sales Tax	Income Tax	Total Exemptions
1978	33	25	0	58
1979	10	10	3	23
1980	15	16	10	41
1981	9	8	2	19
1982	12	15	11	38
1983	22	22	4	48
1984	36	37	6	79

Notes: Remissions, and a limited number of rebates, relieves and deferments are also regarded as exemptions.
Source: Table A.12 in the appendix.

The data on which the table is based show that parastatals - including non-commercial ones - appear to be the major recipients of discretionary customs-duty and sales-tax exemptions. Other important recipients are foreign-aid related activities: government and donor projects, foreign companies and consultants and aid organisations. Excise-duty exemptions also appear to have been granted mainly to parastatals, which are important recipients of income-tax exemptions, although expatriate personnel dominate. Most of the latter exemptions appear to have been granted on personal income taxes rather than on corporate taxes, which also fall under this category.[78]

Data on the value of discretionary tax exemptions cannot be obtained. Available data do not distinguish between discretionary and so-called scheduled tax exemptions. Scheduled tax exemptions are automatically granted on certain specified items, and to specified government bodies and privileged persons and organisations, such as importing aid agencies.[79] It is, however, possible to get an idea of the relative magnitude of the combined scheduled and discretionary tax exemptions, which are shown in the two tables below.

Table 4.12 reveals that during the period 1982-1984, between 45 and 56 per cent of the country's total official imports were exempted from some payment of taxes, probably customs duty.

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[77] The table is based on ministerial orders on discretionary tax exemptions listed together with other subsidiary legislation. Without access to the individual orders, it was in some cases impossible to determine whether or not the decision concerned a tax exemption. All uncertain cases are excluded from the table.

[78] Ministry of Justice (1992a-1992d). The identity of the tax-exemption recipients was sometimes difficult to determine, which made it impossible to draw firm conclusions about their distribution.

[79] See Ndulu *et al.* (1987), pp. 8-10 and 39, for details.

Table 4.12: The Value and Share of Tanzanian Imports Exempted from Taxes, 1982-1984 (Million TSh)

Year	Imports Exempted from Tax*	Total Imports According to Customs**	Imports Exempted as % of Total Imports
1982	4,732.671	10,519.200	45%
1983	3,880.618	8,547.400	45%
1984	5,361.249	9,652.800	56%

Notes: A dash (-) indicates that data are unavailable. * Probably refers to imports exempted from customs duty only. ** Customs and Sales Tax Department.
Source: Table A.23 in the appendix.

According to *Table 4.13,* the value of customs-duty exemptions amounted to between 78 and 140 per cent of the value of customs duty actually collected as government revenue during the period 1982/83-1984/85. The budgetary impact of tax exemptions was thus tremendous, although we are unable to establish the contribution of discretionary exemptions.

Table 4.13: Customs-Duty Exemptions in Relation to Customs-Duty Revenue in Tanzania, 1982/83-1984/85 (Million TSh)

Year	Exemptions	Revenue	Exemptions as % of Revenue
1982/83	1,014.714	723.600	140%
1983/84	909.505	959.000	95%
1984/85	1,200.113	1,531.000	78%

Notes: The figures on exemptions relate to calendar years, 1982-1984.
Source: Table A.24 in the appendix.

The importance of discretionary tax exemptions is suggested by an official at the Revenue Department of the Ministry of Finance. He reported about an attempt within the Treasury to measure the amount of discretionary tax exemptions some time in the late 1980s or early 1990s. The study, he held, was closed down at a preliminary stage because the tax exemptions indicated were so large. They would not only have been 'a terribly discouraging discovery', but 'a dangerous fact' if they had become known.[80]

According to the official, tax exemptions were large and common during the economic crisis. He explained that as parastatals were increasingly unable to pay taxes, the offices of the Revenue Department were full of lobbying applicants. They often by-passed the staff entirely, and went directly to the Minister for Finance himself, who willingly signed exemption orders. The official perceived that the Minister had made up his mind in advance to grant exemptions,

[80] The official gave additional reasons for why discretionary tax data were unavailable. Since exemptions were often granted in advance, it was difficult - if not impossible - to quantify their value. For instance, tax exemptions on imports could be granted for a coming six-month period, without restrictions on the amount or value of such imports. In addition, registration of such tax exemptions was not computerised. Although data might have been available, they were 'scattered all over'. (Personal communication with staff at the Revenue Department of the Ministry of Finance and Economic Affairs, Dar es Salaam, 22 October and 12 November, 1992.)

since he had no chance to scrutinise all the applications.[81] These observations suggest that discretionary tax exemptions were granted in order to ease the growing financial problems of the parastatals. Although the official's view is subjective, the growing number of exemptions granted supports the picture. Besides, to the extent that parastatals in financial trouble actually did receive such tax exemptions, their financing gaps were partly accommodated, whether or not this was intended by the approving bureaucrats.

Control and enforcement of the fulfilment of payment obligations was generally lax, and this applied also in the case of taxes, at least for parastatals. While there were occasions, according to the Treasury official, when parastatals were taken to court for refusing to pay taxes, the government eventually rescued the parastatals by converting their unpaid taxes into exemptions.[82] Payment delay thus appears to have been tolerated, which implies that for parastatals in financial trouble, taxes were also accommodated to their financing gaps through non-enforced payments.

The proposition that discretionary taxation of parastatals was soft is further suggested by its negotiability. This implied that taxes were at least partly adapted to the conditions of the individual parastatals. The Marketing Development Bureau found that the requirement to pay direct and indirect taxes differed widely between the crop authorities in the late 1970s. Years after their formation, some parastatals still debated with the government about whether or not they should pay taxes.[83]

Administrative Pricing

When their costs increased during the crisis, many parastatals applied for compensating changes in the controlled prices of the goods that they traded or produced. As in the past, administrative pricing provided external parastatal finance through the application of cost-plus pricing in industry and trade and residual pricing in agricultural marketing. However, as mentioned earlier, residual pricing was no longer as effective as it used to be. Although some of the cost increases of the crop authorities were compensated for by depressed producer prices,[84] these parastatals had to resort to other forms of external finance, for instance direct government subsidies, as shown above.

The managers of parastatals that manufactured or traded price-controlled goods and experienced cost increases applied for their output prices to be administratively raised. The Sugar Development Corporation, for instance, was accused in the parliament as follows: 'instead

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81 Ibid.

82 Ibid.

83 Marketing Development Bureau (1979), pp. 112-113.

84 Ödegaard (1985), pp. 135-136.

of finding solutions to the problems of production ... [it] has resorted to such shortcuts as running to the National Price Commission [NPC] to cover up for its losses'.[85] As discussed in the previous chapter, parastatal cost increases were more or less automatically compensated for through the cost-plus mechanism. In addition, this form of finance was highly negotiable. Its soft character is therefore clear.

Soft administrative pricing further implied that price increases were adjusted to the particular cost situation of an individual parastatal. This practice implied that different firms within a sector were allowed to charge different prices so that 'a target rate of profit could be obtained to some extent independent [of] their level of inefficiency'.[86] The Tanzania Fertilizer Company (TFC), for instance, added a 15 per cent profit margin to its cost calculations presented to the NPC. Eventually, a slightly lower margin appears to have been accepted. The price accommodation was insufficient to compensate for cost increases because adjustments occurred after a certain delay. The TFC only had its prices renegotiated and revised once a year.[87] Otherwise, applications for price increases could be made whenever costs had changed.[88]

Table 4.14 shows that some 300-400 product categories or 1,000-3,000 individual items were subjected to price control during the late 1970s and early 1980s. This fact suggests that soft administrative pricing remained an important source of finance for many parastatals during the crisis. This applied, for instance, to textile firms. They had their output prices 'guaranteed by the cost-plus pricing method and sanctioned by the Price Commission',[89] although price increases did not fully compensate for their cost increases.[90]

Table 4.14: Number of Price-Controlled Goods in Tanzania, 1978-1984

Year	*Product Categories*	o/w Domestic	o/w Imported	*Individual Items*	o/w Domestic	o/w Imported
1978	-	-	-	*3,000*	-	-
1979	*325*	154	171	*1,031*	456	575
1980	-	-	-	*2,000*	-	-
Early 1980s	*> 400*	-	-	-	-	-
-	-	-	-	-	-	-
1983/84	*56*	50	6	*235*	226	9
1984	*72*	54	18	*333*	241	92

Notes: A dash (-) indicates that data are unavailable.
Source: Table A.2 in the appendix.

85 Daily News (1982), quoted by Schyberger (1987), p. 138.

86 de Valk (1992), note 12, p. 193.

87 Marketing Development Bureau (1985), p. 2, and (1986), pp. 1 and 15.

88 Rice (1979), p. 97.

89 Mbelle (1992), p. 194.

90 This is suggested by Table 4.20 below, which shows that several textile parastatals were among the major loss makers during the crisis.

Towards the end of the crisis, however, the number of price-controlled goods was quite substantially reduced. By 1983-1984, the number of price-controlled goods was reduced to roughly one-sixth of the number in the late 1970s. Although this implies that the availability of such parastatal finance declined, significant price control remained. It still applied to 56-72 product categories and 235-333 individual items. Besides, prices of imported goods were deregulated to a higher degree than those of domestic products. The number of domestically produced goods that remained under price control amounted to as much as one-third (categories) or half (items) of the number in 1979, compared to a mere seven to nine per cent of the imported goods. Hence, manufacturing parastatals retained this form of soft finance to a greater extent than trading parastatals.

Administrative price increases were reflected in the rate of inflation, as shown in Table 4.1 above. During the period 1978-1984 the prices of non-food items, which accounted for 35.8 per cent of the National Consumer Price Index, grew particularly fast. This was especially the case for clothing and footwear, fuel, light, water and rents,[91] which were largely price controlled, as discussed in the previous chapter.[92] Soft pricing thus remained important during the crisis, although less so towards the end.

Credit from the State-Owned Banks

External finance in terms of soft pricing was not very liquid. Consequently, in situations with acute liquidity problems, an important form of relatively quick finance was bank credit, notably in terms of overdrafts from the National Bank of Commerce (NBC).

Allocation of Credit to Parastatals

Since the initial efforts to manage the crisis left the socialist system basically unaltered, the state-owned financial sector continued to operate as in the past. If anything, changes in formal rules implied that the elements of discretion were strengthened, as reflected in the relaxed restrictions on government lending from the central bank and tightened foreign-exchange control. The system retained its role in accommodating the operating deficits of the government and the parastatals. Collier and Gunning hence characterised it as 'a device by which the public sector finances its expenditure'.[93]

Credit from the state-owned banks remained central for financing both the government

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[91] Hyuha and Ndulu (1989), p. 21, and Table 1, p. 22.

[92] See further Rice (1979), p. 96.

[93] Collier and Gunning (1991), p. 534; who examined the banking system during the period 1983-1988.

deficit, as shown in Table 4.1 above, and parastatals, particularly within agricultural marketing. The total public sector accounted for about 90 per cent of total commercial bank credit during the crisis. The relative share of parastatals declined, however, from 62 per cent in 1978 to 39 in 1983, whereas that of the government doubled.[94]

However, parastatals dominated non-government lending from the major commercial bank, the NBC, throughout the period 1977-1984, as shown by *Table 4.15*.[95] The public sector, which here consists almost exclusively of parastatals,[96] received on average 90 per cent of this credit. Moreover, NBC credit to parastatals grew quite substantially from 1978 onwards, by on average 19 per cent annually.

Table 4.15: National Bank of Commerce Lending to the Non-Government Sectors, 1977-1984 (Million TSh)

Year	Tot. Non-Govt Credit		*Public Sector*			Private Sector		
	Amount	% Change	*Amount*	*% Change*	*% of Tot.*	Amount	% Change	% of Tot.
1977	2,868	-3	*2,600*	*-5*	*91*	268	22	9
1978	3,580	25	*3,162*	*22*	*88*	418	56	12
1979	5,253	47	*4,674*	*48*	*89*	579	39	11
1980	5,521	5	*4,952*	*6*	*90*	569	-2	10
1981	6,413	16	*5,834*	*18*	*91*	579	2	9
1982	7,170	12	*6,514*	*12*	*91*	656	13	9
1983	7,799	9	*6,870*	*5*	*88*	929	42	12
1984	9,095	17	*8,584*	*25*	*94*	511	-45	6

Note: Due to data inconsistencies, only the amounts of lending to the public and private sectors are extracted from the source, whereas the total amounts and relative shares have been recalculated.

Source: Kiondo (1989), Table 5.3, p. 184, based on the National Bank of Commerce (1987), p. 12, and own calculations.

We know from the previous chapter that NBC lending for agricultural marketing dominated its total non-government lending by the end of the 1970s. It was, in fact, at the onset of the crisis that this lending grew, from 24 per cent of commercial bank non-government credit in 1978 to 63 per cent in 1980.[97] Thereafter the share declined only slightly, to 59 per cent in 1984.[98] More disaggregated data on credit allocation along ownership lines or to individual parastatals prior to mid-1984 are lacking. By then, however, the National Milling Corporation (NMC) alone accounted for 21 per cent of the total NBC non-government credit. All agricultural parastatals accounted for 65 per cent. Parastatals accounted for 87 per cent of all NBC non-government

[94] Kimei (1987), Table 6.6, p. 139 (data for the period 1977-1980), and Nyagetera (1992), Table 2, p. 77 (data for the period 1981-1984).

[95] Although not explicitly stated in the original source, there is little doubt that only non-central government credit is considered, as revealed by a comparison with related sources.

[96] Cf. Kimei (1987), p. 138.

[97] Since the National Bank of Commerce had a virtual monopoly in commercial banking on the mainland, total commercial bank lending can approximate its lending. Cf. Kimei (1987), pp. 126 and 138-141.

[98] Bank of Tanzania (1989), Table 14, p. 50.

credit, for 98 per cent of its credit to agriculture, 69 per cent of commerce and 57 per cent of the credit to industry.[99]

Lobbying, Intervention and Credit to Loss Makers

When in liquidity trouble, many parastatal managers lobbied for bank credit. Thus they did not apply for credit on commercial terms, but pleaded for access to discretionarily provided loans in spite of their non-creditworthiness. A senior NBC official denies that parastatals lobbied for overdrafts directly at the bank, 'because it would not have been worthwhile'.[100] This may well be the case. However, actors knew how to behave successfully within the system, and used the ways and means available, not least by relying on personal relationships within the state and party hierarchy.

A senior official at a department of the Ministry of Agriculture informed us about the practice among problem-ridden crop authorities, of using their contacts within the central government. General managers of these parastatals had an extremely strong position vis-à-vis their superiors, such as the Principal Secretary and even the Minister for Agriculture.[101] They simply sent their credit request to the government - perhaps with a supporting letter from the ministry - upon which an overdraft facility from the NBC was automatically granted.[102] A banker relates how bank officials received notes from people at the ministries, pleading for assistance for a client. He holds that in the atmosphere of mutual assistance and friendship that prevailed, such an official may have thought, 'If I help him I might be remembered'. According to the banker, this use of political pressure by parastatal managers via ministers, principal secretaries, members of the parastatal boards of directors, the boards of the banks and other influential people was common.[103]

It is recognised by many observers that superior bureaucrats intervened in credit allocation in this manner in the 1980s - pressuring the banks, which could not or would not resist, granting and renewing loans to non-creditworthy and even payment-defaulting borrowers.[104] According to the NBC official who denied the existence of direct lobbying, in particular parastatals within

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99 For further details, see Table A.18 in the appendix.

100 Personal communication with senior staff at the Corporate Banking Department of the NBC head office, Dar es Salaam, December, 1992.

101 Cf. the discussion in Chapter III. Principal Secretary is a top position within the state bureaucracy. Such an official may be a secretary to the president or the prime minister, or the most senior public official in the ministries.

102 Personal communication with senior staff at the Project Preparation and Monitoring Bureau of the Ministry of Agriculture and Livestock Development, Dar es Salaam, 25 November, 1992.

103 Personal communication with a senior official at the Short Term Finance Department of the Cooperative and Rural Development Bank, Dar es Salaam, 30 November, 1992.

104 For instance by the Bank of Tanzania (1991c), pp. 25-26, and not least the Banking Commission (1989a), p. 14, and (1990), p. 2.

agricultural marketing benefited from political intervention, but also, albeit to a lesser extent, parastatals within industry.[105] The other banker mentioned the government's priority for the Tanzania Fertilizer Company and for parastatals within the textile and agro-related industry.[106] As a result of intervention, the banks violated their formal lending criteria to the extent that 'even non-deserving or unviable operations have had recourse to bank facilities'.[107] Given the poor financial performance of parastatals, credit-worthiness was incompatible with priority granted to the sector.[108] Besides, distorted and non-existent financial information about parastatal clients meant that in practice, commercial criteria were difficult to apply.

However, bank officials confronted with managers of parastatals in financial trouble lobbying for credit, via bureaucrats exerting pressure, did not need such information in order to allocate credit. They could ignore the information problem. Recall from the previous chapter that by 1981, the internal accounts of the National Milling Corporation - the major NBC borrower - were four years in arrears and had not been audited since 1973. An analysis of the NBC loan portfolio found that in many cases, only limited financial analysis of the borrowers had been conducted before credit was granted.[109] The soft budget constraint was there and guided bankers' allocation of credit when parastatals were in financial trouble.

As observed by Collier and Gunning, 'Within the public sector, lending is determined by need rather than viability. That is, loans are made to cover the operating deficits of public agencies rather than being earmarked to asset formation.'[110] The fact that much of the NBC lending was granted to finance borrowers' losses is recognised by the Bank of Tanzania.[111] The NBC official referred to above also acknowledges that credit was extended to assist parastatals in great and permanent financial trouble, despite the fact that there was little hope for repayment. He remarks that it was principally those within agricultural marketing that were assisted,[112] which is further indicated by the persistent dominance of these chronic loss makers in NBC lending. Hence, credit allocated to parastatals was largely soft, but bankers could also apply the soft budget constraint in other ways.

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105 Personal communication with senior staff at the Corporate Banking Department of the NBC head office, Dar es Salaam, December, 1992.

106 Personal communication with a senior official at the Short Term Finance Department of the Cooperative and Rural Development Bank, Dar es Salaam, 30 November, 1992.

107 Bank of Tanzania (1990c), p. iv.

108 Mtango (1981), p. 109, noted that if the National Bank of Commerce had applied commercial principles for lending, none or very little would have been lent to three of its major clients during the 1970s: the National Milling Corporation, the Tanzania Sisal Authority and the Coffee Authority of Tanzania.

109 Price Waterhouse (1992a), p. 32. Although the study was conducted in the early 1990s, its findings are likely to have applied to earlier years also, not least because of the general information problem.

110 Collier and Gunning (1991), p. 533.

111 Bank of Tanzania (1991c), pp. 48-49.

112 Personal communication with senior staff at the Corporate Banking Department of the NBC, Dar es Salaam, December, 1992.

Non-Enforcement and Renewal of Credit to Defaulters

The NBC lacked both effective procedures and an organisation for the supervision of borrowers' fulfilment of credit contracts. It was not until mid-1992 that its head office established a unit for the monitoring and control of credit.[113] Supervision of loan recovery was also reported to be weak within the Cooperative and Rural Development Bank (CRDB).[114] Consequently, there was no systematic information about borrowers' payment records, which made it difficult to enforce credit contracts. However, bank officials did not need information about parastatal clients' payment records. Moreover, they did not seem to need to enforce the credit contracts. Non-enforcement became a means by which to apply the soft budget constraint. When parastatals in financial trouble failed to service their loans, bankers could refrain from enforcing repayment and thus automatically accommodate the financing gaps of the borrowing parastatals.

Coopers & Lybrand report that banks appear to have done little to enforce repayment.[115] Remember how the NBC allowed the National Milling Corporation to accumulate debts for years, before the government assumed two million TSh worth in 1980/81. The poor quality of the NBC loan portfolio in 1988 was discussed above. The 52 per cent of the portfolio that were classified as loan losses reflect non-enforced credit contracts and the poor payment history of many or major borrowers. Of the provisions for loan losses recommended by Coopers & Lybrand, public borrowers accounted for as much as 98 per cent, and those within agriculture for 81 per cent.[116] The loan recovery systems of the NBC and the CRDB were found to be inefficient, to the extent that 'loan repayment is more of the decision of the borrower' than the final say of the lender.[117]

An official at the CRDB explains failure of the bank to recover loans, particularly in its regional branches, with norms and values pertaining to the 'tribalist state'. 'People are proud to give money away, to give a gift', he tells us, 'but not to recover'.[118] Adherence to the soft budget constraint thus complied with the rules of the economy of affection - and with the formal rules. The banks' legal power to effectively recover bad debts was severely restricted prior to the early 1990s. They were not allowed to appoint liquidators, receivers or administrators of defaulting clients.[119] It was extremely difficult to foreclose on security and to realise value from such

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[113] Personal communication with senior staff at the Credit Review Department of the NBC head office, Dar es Salaam, December, 1992.

[114] Personal communication with a senior official at the Short Term Finance Department of the Cooperative and Rural Development Bank, Dar es Salaam, 30 November, 1992. Up to 1985, the bank operated under the name of the Tanzania Rural Development Bank (Rutayisire, 1992, p. 95). It will nonetheless be incorrectly referred to as the CRDB here, since it is under this name that it has been referred to in the sources used.

[115] Coopers & Lybrand Associates Limited (1989), p. 15.

[116] Ibid., p. 14 and Table 3.3.

[117] Bank of Tanzania (1990c), p. 27.

[118] Personal communication with a senior official at the Short Term Finance Department of the Cooperative and Rural Development Bank, Dar es Salaam, 30 November, 1992.

[119] Coopers & Lybrand Associates Limited (1989), p. 27.

assets. There was no market for many second-hand fixed assets, legal processes could take four or five years and certain securities had no legal effect.[120] Besides, the government intervened - even in the legal processes - to prevent foreclosure and liquidation.[121]

Banks not only refrained from enforcing payment, but when defaulting parastatals applied for renewed credit, it was often provided. In the past, the NBC had repeatedly renewed credit to chronic defaulters, such as the National Milling Corporation (NMC). This practice continued during the crisis. Despite being relieved of its huge debt to the NBC in 1980/81, the NMC was allowed to accumulate new debts to the bank. As early as December 1983, its outstanding liabilities were over two million TSh, which amounted to 640 per cent of the farm-gate value of its crops in stock. The NMC was in no position to service its loans. Similarly, eight other crop authorities accumulated debts to the NBC between 1981 and 1983, in spite of the fact that as early as 1981, three of them could not cover their debts with the value of their stock. For seven of the parastatals, the debts exceeded their stock by between 65 and 697 per cent in 1983, and their ability to service the loans deteriorated dramatically over time.[122]

There ought to be little doubt that bank credit was used as soft finance to parastatals during the crisis, at least within agricultural marketing. Managers lobbied for credit and refrained from repaying it. Bank officials and their superiors within the bureaucracy allocated credit and refrained from enforcing payment. Thus parastatal financing gaps were accommodated. However, in particular bankers' application of the soft budget constraint through non-enforced payment is likely to have been partly unintended and unrecognised. Given the poor information about the payment record of parastatals and the lack of a credit monitoring system, bankers were partly unaware of the fact that repayment was due and that they did not enforce these payments from parastatal borrowers.

Donor Import Support

Tanzania's dependence on foreign aid remained high during the crisis, but the way the crisis was handled created problems in its donor relations. In particular the International Monetary Fund (IMF) disapproved of the leadership's insistence on adhering to the socialist strategy. Negotiations between the IMF and Tanzania broke down in the early 1980s. Partly as a result of the lack of an agreement, total foreign aid to Tanzania declined in US dollar terms during the first half of the 1980s, as shown in *Table 4.16.* The grant element also dropped substantially, particularly during the early crisis years.

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[120] Ibid., p. 17, and Bank of Tanzania (1990c), pp. iv, vii and 5.

[121] Banking Commission (1989b), p. 16, and personal communication with senior staff at the Corporate Banking Department of the National Bank of Commerce, Dar es Salaam, December, 1992.

[122] Ödegaard (1985), Table 4.4, p. 114.

Table 4.16: Disbursement of Foreign Aid to Tanzania, 1977-1986 (Million USD)

Year	Net Loans*	Total Grants	Total Aid	Grants % of Total Aid
1978	-33	457	424	108
1979	101	487	588	83
1980	9	658	666	99
1981	193	509	702	73
1982	194	490	684	72
1983	164	430	594	72
1984	128	430	558	77

Note: * Concessional loans less principal repayments.
Source: Table A.3 in the appendix.

An important qualitative change of foreign aid was initiated during the crisis, through the growth of import support, often referred to as commodity import support.[123] It would eventually become a substantial source of external parastatal finance, but was provided already during the crisis as a means to apply the soft budget constraint.

Emergency Relief from Major Donors

The need to redress the balance between the creation and utilisation of productive capacity became increasingly recognised. At the turn of the decade, a gradual shift of the character of foreign aid, from project or investment finance to recurrent import support, was initiated. The overriding official purpose was to provide foreign exchange for imports to the input-starved economy, to restore capacity utilisation and output and to strengthen the balance of payments. Import support was initially seen as an emergency relief that would eliminate acute but temporary bottlenecks so as to prevent the economy from collapsing.[124] It was not intended to become a permanent form of aid. Rather, it was an unintended outcome of the previous aid strategy that 'funded a process of development which undermined its own momentum and, consequently, led to its own demise'.[125]

Import support offered importers scarce foreign exchange at the official exchange rate, thus at a subsidised price. Balance-of-payments data show that import support grew, from financing 10 per cent of Tanzanian imports in 1980 to 19 per cent in 1983.[126] Its share of total foreign aid is more difficult to establish. In 1981/82 and 1982/83, import support from the major donors amounted to 58 and 50 million USD. A comparison with Table 4.16 above reveals that this is less than ten per cent of the total aid to the country. This import support was almost exclusively

[123] To be distinguished from other forms, discussed in Chapter V.

[124] For a more detailed presentation of the official goals, see Eriksson (1995), pp. 18-22. For the official goals of Dutch, Norwegian and Swedish import support, see van den Andel (1992), pp. 30-31, Skarstein *et al.* (1988), pp. 38-40 and 44, and Eriksson (1987), pp. 7-9.

[125] Doriye *et al.* (1993), p. 56.

[126] Calculations based on Tanzanian Economic Trends (1989/90), Table 4, p. 75.

provided by the Netherlands, Norway and Sweden.[127]

Sweden, which was Tanzania's largest bilateral donor in the early 1980s,[128] provided significant amounts of import support. *Table 4.17* reveals that during the first crisis years, the amounts actually disbursed amounted to just over 20 per cent of the so-called country frame of the Swedish International Development Authority (SIDA).[129] In 1981/82 the share of import support was raised substantially, to on average 34 per cent during the remainder of the period.

Table 4.17: Disbursements of Swedish Import Support to Tanzania, 1978/79-1984/85 (Million SEK)

Year	Total Commodity Import Support	SIDA Country Frame	Import Support % of Country Frame
1978/79	68.792	315.980	21.8
1979/80	82.967	316.615	26.2
1980/81	66.752	304.163	21.9
1981/82	160.903	466.425	34.5
1982/83	152.468	409.967	37.2
1983/84	155.505	489.174	31.8
1984/85	165.260	482.083	34.3

Source: Table A.13 in the appendix.

Dutch programme aid, as opposed to project aid, also increased its proportion of total Dutch aid, from 15 per cent in 1975-1979 to 60 per cent in 1985-1990. The share of import support in the Dutch country programme rose from 37 per cent in 1980-1981 to 70 per cent in 1990-1991.[130] Norwegian import support was introduced in 1979 and accounted for on average 40 per cent of the total Norwegian bilateral aid during the period 1980-1984.[131]

Import Support to Parastatals and Projects

The allocation of Swedish import support reveals that parastatals were favoured. *Table 4.18* lists 12 large recipients of Swedish import support during the eight-year period 1980/81-1987/88, which may have been the principal ones.[132] It shows the minimum total amounts of import

[127] van den Andel (1992), p. 4.

[128] Kiondo (1989), Table 5.13, p. 216.

[129] The amounts *disbursed* are to be distinguished from the amounts *allocated,* which in the Swedish case refer to the amounts approved by SIDA.

[130] van den Andel (1992), pp. 30-37, *passim.*

[131] Bhaduri *et al.* (1993), p. 9, and Table 1.2, p. 10.

[132] These recipients were among the 16 largest recipients of Swedish import support (those allocated total amounts worth 12 million SEK or more) out of a total of 118 recipients during the period 1988/89-1991/92, shown in Table A.15 in the appendix. It is likely that they were also among the major recipients during the preceding period discussed here.

support allocated to each recipient during this period; since there are gaps in the data - some years the amounts cannot be identified - the true values are larger than those indicated.

Table 4.18: Large Recipients of Swedish Import Support to Tanzania, 1980/81-1987/88 (Million SEK)

Recipient Name	Type	SIDA Related	No. of Years	Minimum Total Amount*
Tanz. Automobile Manuf. Co.	Parastatal	Yes	7	174.190
Tanz. Fertilizer Co.	Parastatal	-	5	134.700
Tanz. Posts & Telecom.	Parastatal	Yes	8	84.673
Tanz. Portland Cement Co.	Parastatal	Yes	6	67.000
Small Industries Devel. Org.	Parastatal**	Yes	6	61.700
Tanz. Coffee Market Board	Parastatal	-	2	33.000
SAAB Scania	Private	Yes	7	113.310
Zanzibar Government	Government	-	1	3.000
Metal Industry Develop. Ass.	Private	Yes	5	19.675
Board of External Trade	Parastatal	Yes	4	19.000
Tanz. Karatasi Assoc. Indust.	Parastatal	Yes	4	33.000
Zana za Kilimo (Mbeya)	Parastatal	Yes	5	20.775
Sub-Total				764.023
o/w Parastatals[1]				628.038
o/w SIDA Related				593.323
Grand Total				1,343.670
Sub-Total/Grand Total[2]				*56.9%*
Parastatals/Sub-Total[2]				*82.2%*[4]
Parastatals/Grand Total[3]				*46.7%*
SIDA Related/Sub-Total[2]				*77.7%*[4]
SIDA Related/Grand Total[3]				*44.2%*

Notes: * *Minimum* total amount, since allocations prior to 1983/84 make it difficult to identify the individual recipients and in some years, values are not given. This does *not* apply to the grand total. The data refer to amounts *allocated,* not actually disbursed. ** Although a parastatal, Small Industries Development Organisation (SIDO) distributes a majority of the funds (about 90 per cent of the amounts allocated and disbursed) to private recipients. 1) Excluding Government and including SIDO, i.e. the opposite to Table A.15 in the appendix. 2) All quotas are uncertain since all values except the grand total are minimum values. 3) The share of import support to parastatals and SIDA-related recipients *in the table* in relation to total import support. 4) These ratios are particularly uncertain, since both the numerator and the denominator are uncertain.

Source: Table A.15 in the appendix and recalculations.

The 12 recipients in the table were allocated a massive 764 million SEK, and thus accounted for at least 57 per cent of the total Swedish import support allocated during the period. Nine of them were parastatals that accounted for 82 per cent of the import support allocated to the group - although this figure could be biased in any direction - and at least 47 per cent of the total Swedish import support.

Norwegian import-support allocations also display a strong parastatal bias, particularly during the period 1981-1985. *Table 4.19* is based on a list of the major recipients during the entire period 1981-1990. These recipients are also likely to have been the major recipients during the crisis. The table reveals that on average 15 recipients received 82 per cent of the total Norwegian import support during the period 1981-1985. On average 11 of these (or 73 per cent) were parastatals. They accounted for 93 per cent of the import support to the sub-group of major recipients, and for 76 of the total import support.

Table 4.19: Major Recipients of Norwegian Commodity-Import-Support Allocations to Tanzania, 1981-1985* (Million NOK)

IMPORT SUPPORT / RECIPIENTS	1981	1982	1983	1984	1985	Total 1981-1985
CIS** to Major Recipients	73.0	106.2	129.1	84.8	136.5	529.6
- o/w to Parastatals	58.6	101.9	124.6	83.8	123.5	492.4
Total Commodity Import Support	86.8	148.2	159.0	94.8	158.7	647.5
Major % of Total CIS	84.1	71.7	81.2	89.5	86.0	*81.8*
- Parastatals % of Major	80.3	96.0	96.5	98.8	90.5	*93.0*
*- Parastatals % of Total CIS****	67.5	68.8	78.4	88.4	77.8	*76.0*
Number of Major Recipients	12	15	19	11	16	15
- o/w Parastatals	7	12	16	10	11	11
Parastatals % of Major Recipients	58	80	84	91	69	73

Notes: * Receiving 10 million NOK or more during the period 1981-1990. ** CIS = Commodity Import Support. *** The share of parastatals *in the table* in relation to total import support.
Source: Table A.14 in the appendix and calculations.

The share of Dutch import support allocated to parastatals, however, is not so easy to establish. It was at least 48 per cent during the period 1980-1984, but most likely considerably higher.[133]

There was also a tendency, slightly weaker, to allocate import support to donor activities, as illustrated by the Swedish case. Table 4.18 above distinguishes the large recipients that were either SIDA projects or other activities supported by the donor. These nine 'projects' received 78 per cent of the import support to the group of large recipients, or at least 44 per cent of the total Swedish import support. Seven of them were parastatals. In the allocation of Norwegian import support during the period 1981-1987, the urgent import requirements for Norwegian-supported activities were given top priority.[134] Approximately half of the funds appear to have been allocated to donor projects.[135] Dutch import support to projects is difficult to establish, but like Norway, the Netherlands explicitly stated that import support should be granted to activities already financed by the donor.[136]

Discretionary Allocation of Import Support

Import support was administratively allocated to individual importers in negotiations between the Treasury and the respective donors. The relative influence of the parties varied, but they often tried to adapt to each other's preferences and consensus could easily be reached. The allocation of some of the funds, such as the Swedish so-called project-related import support, was decided by the donors. However, quite often the decisions were left to the discretion of the

[133] See Eriksson (1995), pp. 27-29, and Tables 5-6, pp. 105-106.

[134] Skarstein *et al.* (1988), pp. 39-40 and 45.

[135] Hansen *et al.* (1987), pp. 34-35.

[136] van den Andel (1992), pp. 34-35. For a survey of the formal criteria for allocation of import support, see Eriksson (1995), pp. 18-23.

Treasury, without any particular donor scrutiny or questioning.[137]

Specified criteria for allocation to *individual* recipients were almost completely absent prior to the late 1980s, particularly those related to the recipients' financial or economic performance. During the crisis, the only guidance was given by the vague overall macro-economic objectives, which at most stated that priority sectors should be assisted, apart from the priority given to donor activities. Under these circumstances, the discretionary element in import-support allocation was extremely high. In particular the parastatal dominance, but partly also the strong position of donor-supported activities, in actual allocations reflect the outcome of a process of lobbying, bargaining and discretionary allocation.

Potential recipients frequently lobbied for import support with both Treasury and donor officials, as acknowledged by all parties involved.[138] However, practically all parties deny yielding to such pressure. SIDA claims to have directed lobbying firms to the Treasury.[139] Treasury staff admits that there was 'a lot of lobbying', but maintains that the procedures for application were the same for all.[140] However, Stein Hansen *et al.* identified lobbying as one of the dominating factors determining the Treasury's import-support allocations.[141] Similarly, W.A. van den Andel refers to such pressure, exerted by firms on the Treasury, as a major criterion for the actual allocation of Dutch import support.[142]

Lobbying for import support is unlikely to have been both frequent and persistent unless successful. This was at least the case for the Tanzania Fertilizer Company (TFC), one of the major import-support recipients.[143] The TFC received import support annually from each one of our three donors, for between seven and eleven consecutive years during the period 1980-1990. It was the first or second largest recipient of Dutch, Norwegian and Swedish import support.[144] The TFC was one of the major loss-making parastatals in the country,[145] and its inefficient operations are well documented.[146] According to one of its managers, 'The TFC survived *entirely*

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137 See Eriksson (1995), pp. 14-18, for details on the allocation mechanism, particularly in relation to Dutch, Norwegian and Swedish import support.

138 In addition to the Swedish, Norwegian and Dutch donors, the British, Canadian and European Economic Community agencies in Dar es Salaam describe how firms lobbied for import support. (Personal communication with senior staff of the Planning Secretariat of SIDA, the NORAD office, the Royal Netherlands Embassy, the Canadian High Commission, the EEC Delegation and the Overseas Development Agency, in Dar es Salaam, between 26 October and 17 November, 1992.)

139 Personal communication with senior staff at the Planning Secretariat of SIDA, in Dar es Salaam, 26 October, 1992.

140 Personal communication with senior staff at the Department of External Finance of the Ministry of Finance and Economic Affairs, Dar es Salaam, 13 November, 1992.

141 Hansen *et al.* (1987), p. 40.

142 van den Andel (1992), p. 41.

143 Personal communication with senior staff at the Tanzania Fertilizer Company, Dar es Salaam, 26 November, 1992.

144 See Table 4.18 above, Table A.14 in the appendix, and Eriksson (1995), Table 5, p. 105.

145 See Table 4.20 below.

146 See, for instance, van den Andel (1992), Annex 4.

on donor finance. During many years, ... we didn't buy *any* imported inputs. The donor support was good, we got both import support and project finance, e.g. for lorries. The donors financed everything.'[147]

Import Support for Survival

As noted by Doriye *et al.*, the TFC is probably the most striking example of how the government sometimes used import support as 'its preferred means of subsidy to a chronically loss-making enterprise'.[148] Fidelis P. Mtatifikolo and Nathanael E. Luvanga, who have surveyed the import support from several donors, similarly conclude that it was utilised to rescue 'poor and ineligible companies'.[149] The problems of foreign-exchange shortage, low capacity utilisation and declining output were largely a crisis of donor-supported parastatals. The donors' tendency to allocate import support so as to guarantee the survival of their own projects or related activities is noted by several observers.[150]

Ole Elgström detected a strong emotional commitment among SIDA employees, not least in the recipient countries, where personal relationships also developed between donor staff and the local counterparts. In Tanzania, negotiations over aid to the industrial sector were characterised by an 'extremely friendly atmosphere'. SIDA officials entertained 'a strongly positive image of Tanzania and the Tanzanians', and an 'emotional involvement' in the country's development effort. The positive attitude was reinforced by 'strong personal ties' that developed between the parties, where '[k]ey officials look upon one another as friends'.[151] At the lower levels, 'group feelings' were even stronger:

> They are the best of friends, regardless of nationality. They are 'in it together' ... On the sector level, for example, sector interests in the two countries may coincide, resulting in a joint effort to attract as many resources to the sector as possible. These efforts are directed against central authorities in both countries.[152]

These emotional and personal attachments became important for the continuation of Swedish aid to particular projects or activities. Not only did everybody want 'his or her' project to succeed, but officials sometimes treated the projects like 'their baby' that had to be kept alive.[153] According to Elgström, this contributed to SIDA's tremendous difficulty in terminating or

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147 Personal communication with senior staff at the Tanzania Fertilizer Company, Dar es Salaam, 26 November, 1992; emphases added.

148 Doriye *et al.* (1993), p. 26.

149 Mtatifikolo and Luvanga (1988), pp. 12, 19 (quotation) and 22.

150 For instance, by Hansen *et al.* (1987), p. 18, Skarstein *et al.* (1988), p. 34, and van den Andel (1992), p. 3.

151 Elgström (1992), p. 105.

152 Ibid., p. 134.

153 Ibid., pp. 62 and 142.

drastically changing aid, in terms of phasing out projects.[154] The result was instead a protective behaviour, as reflected for instance in continued and renewed aid in the form of import support.

The Swedish allocations in Table 4.18 above suggest that the regular granting of import support was important for the survival of at least some donor activities and for several parastatals. This becomes even more clear when the whole period 1980/81-1991/92 is considered, as shown in Table A.15 in the appendix. Of the ten major recipients with other SIDA involvement, all but one received import support for six to eleven years during the twelve-year period studied. Of the seven largest recipients of Swedish import support (which are the same as those in Table 4.18), all but one received import support for at least seven years. Six were parastatals, five were SIDA supported activities, and four were among the major loss-making parastatals presented in Table 4.20 below.

The seven major Norwegian recipients during the whole period 1981-1990 are all parastatals, and are listed in Table A.14 in the appendix. Six of them received import support for seven to ten years during the ten-year period. At least four were projects of the Norwegian Agency for Development Cooperation (NORAD), and three appear among the major loss makers.[155] A large part of Dutch import support was allocated to the cotton and sugar sectors, where parastatal projects received import support for ten out of twelve years between 1980 and 1991.[156] Import support was found to be 'vital to maintain the continued operation of the sugar factories and the cotton ginneries during the 1980s'.[157]

Import support was thus not only granted to poor performers, but was regularly renewed. Still, this form of assistance could not be provided in situations of *acute* financial trouble. Allocations of import support were usually decided once a year. However, import support contained another subsidy element that could be more immediately adjusted to parastatal recipients' financing gaps.

Non-Enforced Cash-Cover Payments

Recipients were supposed to pay for the import support with local currency to the government. So-called cash cover or counterpart funds were to be used for budgetary expenditure. During the period 1980/81-1984/85, counterpart funds were reported to finance on average 5 per cent of total public expenditure or 16 per cent of the government's budget deficit. They accounted for on average 31 per cent of the total foreign financing of the deficit.[158] The government could use the

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154 This is one of Elgström's central theses, to which he returns throughout the book (ibid.).

155 The projects are the Tanzania Coffee Marketing Board, the TANELEC, the Steel Rolling Mills and the Sao Hill Saw Mills, of which the first two, together with the Tanzania Fertilizer Company, were major loss makers according to Table 4.20 below.

156 For details on Dutch allocation, see Eriksson (1995), pp. 27-29, and Tables 5-6, pp. 105-106.

157 van den Andel (1992), pp. 76 and 80 (quotation).

158 Calculations based on the Bank of Tanzania (1990a), Table 18, p. 57.

funds for any purpose, for instance as financial assistance to parastatals, either in the form of direct budgetary subsidies or indirectly, by *not enforcing* their payment. Hence, in the extreme case, not only were cash-cover payments postponed or partial, but the recipients got the scarce and valuable foreign exchange free of charge.

Unfortunately, data on cash-cover payments prior to the late 1980s are hardly available at all, either from the Tanzanian authorities or from any of the donor agencies. Records on cash-cover payments were not kept until then, partly because nobody asked for them. Payment was for a long time ignored by all parties involved.[159] This implies that we do not know to what extent the import-support revenue recorded in the budget was actually paid to the government. As will be discussed in the following chapter, non-enforced cash-cover payments were to become an important source of parastatal finance during the reform period. Data indicate that approximately half of the import support was not paid for.[160] However, the weak interest in the issue, the lack of data and the economic crisis suggest that the payment record may also have been poor prior to the late 1980s.

As early as 1981, an evaluation of Dutch import support recognised difficulties related to the recipients' financing of counterpart funds.[161] But according to staff at the Netherlands Embassy, the problem of non-payment was not perceived as serious.[162] Treasury staff confirm the picture. The donors did not consider non-payment to be their problem.[163] SIDA staff report that the donor was aware of the problem, but considered that the amounts of payment default were small because of the highly overvalued exchange rate.[164] Nonetheless, recipients of so-called project-related import support, which accounted for over half of the total Swedish import support in the late 1980s, were relieved of cash-cover payment by SIDA.[165] Hence, although foreign exchange was sold at a subsidised price, the fact that they did not have to pay for a whole year's worth of imports in advance was a major financial support for liquidity constrained parastatals.

Recipients lobbied for cash-cover payment relief.[166] The Tanzania Fertilizer Company put pressure on the government to exempt it from cash-cover payments,[167] and was successful. It

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[159] Eriksson (1995), pp. 55-56.

[160] The author (ibid.), pp. 49-55, examined the existing data on cash-cover payments. More details are presented in Chapter V.

[161] Netherlands Economic Institute (1982), referred to by van den Andel (1992), pp. 33, 41 and 64.

[162] Personal communication with senior staff at the Royal Netherlands Embassy, Dar es Salaam, 18 November, 1992.

[163] Personal communication with senior staff at the Department of External Finance of the Ministry of Finance and Economic Affairs, Dar es Salaam, 13 November, 1992.

[164] Personal communication with senior staff at the Planning Secretariat of SIDA, Dar es Salaam, 26 October, 1992.

[165] Bhaduri *et al.* (1993), pp. 12 and 28.

[166] Personal communication with senior staff at the Department of External Finance of the Ministry of Finance and Economic Affairs, Dar es Salaam, 13 November, 1992.

[167] Personal communication with senior staff at the Tanzania Fertilizer Company, Dar es Salaam, 26 November, 1992.

hardly paid anything for the enormous amounts that it received for more than a decade.[168] The Tanzania Portland Cement Company, one of the major parastatal recipients of Swedish import support, offers another example. The close personal relationship established between the parastatal management and SIDA staff enabled it to bargain for and obtain import support before any cash cover was paid.[169] In other cases, SIDA forwarded recipients' requests for deferred or exempted cash-cover payments to the Treasury.[170]

Formal payment rules were strict and uniform. They implied that 100 per cent cash cover should be paid in advance. Studies that eventually were conducted found that in practice, the situation was different. Recipients could negotiate the terms and conditions for cash-cover payments with the Treasury. They applied for so-called staggered payments,[171] and many firms were allowed to make payments of cash cover by instalments.[172] The Treasury applied or diverged from the cash-cover rules in a discretionary manner. Havnevik *et al.* suggest that firms with liquidity problems and parastatal enterprises were given preferential treatment, and that efficient firms had to pay whereas less efficient firms were granted exemptions.[173] As regards the Swedish and Norwegian import support, Amit Bhaduri *et al.* note that 'Some firms would pay full cash cover, others would pay some, and a large number which were given "high priority" by the GOT [Government of Tanzania] (almost without exception parastatals), would pay nothing'.[174]

Cash-cover payments were not enforced, and neither the Tanzanian authorities nor the donors were concerned about the issue until the late 1980s. Hence, no administrative mechanism for the systematic control and collection of cash cover had become established. According to a recent Treasury inquiry, this resulted in a number of operational problems, that ranged from planning to enforcement.[175] Operational guidelines were poorly defined, legislation and manpower were lacking and activities between units were poorly co-ordinated. The definition of roles and division of responsibilities between different entities were unclear. Record keeping

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[168] It paid for less than 20 per cent of its Dutch import support during the 1980s. (van den Andel, 1992, pp. 69-71 and 79-80.) As shown in Table A.15 in the appendix, it paid nothing for the last two allocations of Swedish import support - the only allocations for which payment data are available. Similarly, it did not pay for the 1988 and 1989 funds that it received from NORAD (n.d.a) and (n.d.b). According to unreconciled Treasury data, it paid for none of all the import support that it received during the period 1987/88-1992/93. (Doriye *et al.*, 1993, Table 4.3, p. 79.)

[169] Personal communication with senior staff at the Tanzania Portland Cement Company, Dar es Salaam, 11 November, 1992. This applied at least during the period 1984-1991.

[170] Personal communication with senior staff at the Department of External Finance of the Ministry of Finance and Economic Affairs, Dar es Salaam, 13 November, 1992, and at the Planning Secretariat of SIDA, Dar es Salaam, 26 October, 1992.

[171] Ministry of Finance (1993), p. 12.

[172] For examples of recipients of Swedish import support who negotiated payments of cash cover by instalment, see Tanna Somaiya & Co. (1992), Appendix XII.

[173] Havnevik *et al.* (1990), pp. 9-10 and 40-41.

[174] Bhaduri *et al.* (1993), p. 14; comment added.

[175] Ministry of Finance (1993), pp. 7-26, *passim,* in particular pp. 24-26.

was unsystematic and records were therefore in a mess, sometimes missing. There was hardly any payment monitoring and nobody knew who was responsible for the recovery of cash cover. In addition, the Treasury was prevented from taking action against defaulters, because it had no legal power to enforce payments. The inquiry concludes that 'It appeared as if the cash cover repayment was left to the beneficiary's initiative'.[176]

This lack of records for cash-cover payment and of an effective control and enforcement mechanism were systemic traits. The actors did not need them, exactly as in the case of the other forms of external parastatal finance. They knew how to behave anyway. When confronted with a manager of a parastatal in financial trouble who was seeking an import-support allocation or cash-cover payment relief, the Treasury - and donor - officials applied the soft budget constraint. In other cases, parastatals simply refrained from paying, and the Treasury refrained from enforcing payment, whether consciously or not. The donors asked no questions.

Doriye *et al.* suggest that in the 1970s foreign aid to Tanzania, which mainly consisted of project support, implied that 'the budget constraint on investment *softened* throughout the 1970s'. Instead, and as a consequence, 'the budget constraint on recurrent costs (particularly, but not only, on imported consumer goods, raw materials and spare parts) *hardened* considerably as the decade proceeded'.[177] Although this may well have been the case,[178] during the crisis it no longer applied, at least with respect to recurrent aid. This sub-section shows that with the relative shift towards import support some time around the turn of the decade, foreign aid introduced a new form of soft external parastatal finance.

Conclusion: The Prevalence of the Soft Budget Constraint

This survey of the application of the soft budget constraint shows that it prevailed as a behavioural rule for actors within the parastatal sector during the economic crisis. When parastatal financial problems recurred, managers and bureaucrats - and foreign donors - repeatedly applied the soft budget constraint. They lobbied for and granted external financial assistance in terms of budgetary subsidies, tax exemptions, administrative pricing, bank credit and import support. Sometimes they simply refrained from paying or from enforcing the payment of taxes, credit and cash cover. Hence, although the actors expected external accommodation to be a successful way to handle parastatal financial problems, they occasionally adhered to the rule without intending or being aware of their doing so. Let us, against this background, investigate what the prevalence of the soft budget constraint within the parastatal sector and its application by managers and bureaucrats meant for these actors and parastatals.

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[176] Ibid., p. 25.

[177] Doriye *et al.* (1993), pp. 57 (quotation) and 62.

[178] Cf. the discussion on how the aid-supported investment boom sharpened resource constraint in Chapter III.

DIRECT IMPLICATIONS OF THE SOFT BUDGET CONSTRAINT

The following three sections examine the consequences of the soft budget constraint for parastatal managers, bureaucrats and parastatals. Its immediate implications are studied in the present section, while the succeeding two sections explore its wider and indirect effects. We begin by discussing what the prevalence of the soft budget constraint implied for the actors' ability to deal with systemic problems. Then we consider what its application meant for the parastatals, and hence for the formal organisational structure within which the actors operated.

An Adaptive Mechanism to Systemic Problems

Recurrent Parastatal Financial Problems

We argued that once the soft budget constraint was established, it guided the behaviour of parastatal managers and bureaucrats in situations of parastatal financial trouble. It did so by shaping the actors' expectations about how to proceed and about how their counterparts would behave. By thus reducing the actors' uncertainty, the prevalence of the soft budget constraint - the existence of expectations of external accommodation of parastatal financing gaps - facilitated their behaviour in these increasingly common situations. The most immediate implication of the soft budget constraint for parastatal managers and bureaucrats, and its major function, is hence that it provided a *behavioural solution* for how to handle a recurrent systemic problem: parastatal financing gaps. By doing so, the soft budget constraint also enabled the actors to cope better with other systemic weaknesses: the information problem and adaptive rigidity.

Problems of Information and Flexibility

The information problem was inherent to the socialist system and worsened as the system consolidated itself. When the Tanzanian terms of trade deteriorated in the late 1970s, relative prices changed. However, the administratively determined exchange rate and domestic prices were less and less a reflection of the relative scarcities of the resources, and this delayed the transmission of the new price signals through the economy. The fact that relative prices became particularly distorted during the crisis is suggested by the growing shortages and parallel markets.

Price control and an overvalued exchange rate did not, however, insulate the Tanzanian parastatals from the effects of deteriorating terms of trade. Quantitative signals took the place of price signals: parastatals became quantitatively rationed in inputs, spare parts and other imported items. The distorted relative prices did not carry any information that could guide parastatal

managers in their response. Even if relative prices had indicated how to reorient parastatal activities efficiently, managers were effectively unable to act in the 'real sphere', as discussed at length in Chapter III. The capital-intensive organisational structure within manufacturing added to the rigidity, by locking up huge resources that could not easily be transferred to alternative uses. As shown earlier, this led to falls in output and capacity utilisation, with cost increases and deteriorating parastatal financial performance as a result. However, when parastatal managers faced financial problems, the soft budget constraint both provided information about how to respond and offered a means by which to adapt to the 'exogenous shocks'.

The socialist system was conspicuously poor in producing financial information. These problems were also thoroughly accounted for in the previous chapter. The situation did not improve during the crisis. By contrast, the proportion of the Tanzania Audit Corporation's clients with accounts in arrears grew, and reached its highest level at 44 per cent in 1982/83. The relative share of accounts with non-clean audit reports also peaked, being on average 70 per cent during 1978/79-1981/82.[179] The National Bank of Commerce complained about the failure of its parastatal clients to submit their accounts on request, in time, audited and of acceptable quality.[180] Hence, when bankers and other bureaucrats were approached by parastatals in financial trouble, financial performance data - based on controlled prices - were lacking and/or distorted. To the extent that they were available, they provided little guidance for bureaucrats on how to allocate resources efficiently, since financial data gave a poor reflection of economic performance. Besides, formal allocation criteria were often both poorly defined and unclear, as in the case of import support, or inconsistent, as in the case of bank credit.

Under these circumstances, it would have been difficult for bureaucrats to decide whether or not to financially assist a parastatal in trouble, had not the soft budget constraint applied. The soft budget constraint enabled bankers, for instance, to disregard the absent and/or poor-quality information, as shown above. It partly replaced price signals and financial data as information carriers in such situations, by providing alternative information upon which to act. This does not imply that the soft budget constraint was the sole informational device. It was complemented with other formal and informal rules. Nonetheless, it had an important role to play: the soft budget constraint made it easier for bureaucrats to allocate finance among all those hit by the crisis, not according to relative efficiency, but to parastatals in financial trouble - according to 'need'. Admittedly, its guidance was partial. The soft budget constraint did not prescribe how to prioritise between the many parastatals that were in financial trouble.

By this means, adjustment was made to the crisis, not through reallocation of resources and organisational restructuring, including the exit of parastatals, but through financial accommodation. The prevalence of the soft budget constraint provided information for adjustment, and the application of the soft budget constraint offered an adaptive mechanism for dealing with exogenous shocks, as well as with endogenous performance problems. External

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[179] Table 4.7 above.

[180] Mtango (1981), pp. 77, 81 and 95.

accommodation of the financing gaps of the existing parastatals introduced an element of flexibility, which partly compensated for the otherwise rigid institutional system and organisational structure. This had important consequences for the parastatal sector.

A Survival Mechanism for Parastatals

Just as informal activity and parallel markets provided survival mechanisms for individuals during the crisis, the soft budget constraint provided one for poorly performing parastatals. Without the application of the soft budget constraint, many parastatals - if not large parts of the sector - would probably have collapsed. Now, even chronic loss makers survived.

Survival of the Least Fit

Chronically loss-making parastatals were the least fit. They practically never managed to sustain themselves - although given the price distortions, they were not necessarily the least economically efficient ones. Identifying those parastatals is, however, complicated by the fact that it is difficult to establish how many years a firm has to make losses in order to be considered as a chronic loss maker. Any judgement has to be arbitrary. Besides, data limitations preclude the application of a precise and uniform definition of chronic loss makers. Instead we have to adapt our criteria to the material available. We need to identify parastatals with repeated and accumulated losses during such a long period as to render them non-self-sustaining.

The most obvious case, due to the availability of data, is that of the crop authorities. Their individual annual financial performance was shown in Table 4.5 above. During the seven-year period 1978-1984, six of the ten parastatals within agricultural marketing made losses in every or all but one year. These include the National Milling Corporation (NMC), plus those exporting cotton, pyrethrum, sisal, tea and tobacco. In addition to making losses in many of the individual years, these parastatals also made *net* losses over the period as a whole. Hence, any profits made did not compensate for the losses. These parastatals were clearly chronic loss makers.

Other cases are more uncertain. Of the remaining four parastatals, the Cashewnut Authority of Tanzania and the Sugar Development Corporation disclosed net losses over the entire period 1978-1984. In addition, like most of the crop authorities, they made losses prior to the crisis.[181] Among the livestock parastatals listed in the table, the one within dairy farming was a chronic loss maker. It made losses every year during the crisis, and a net loss, together with the packers

[181] Of nine agricultural marketing parastatals in the table (NAFCO excluded), five made losses in 1977, one in 1976 and one in 1975, whereas one made a profit in 1977 and another in 1976. (Marketing Development Bureau, 1979, p. 15.) According to projections in unaudited accounts, the NMC made losses every single year since 1973/1974. (Mtango, 1981, Table 1, p. 31, and pp. 48-49.)

and ranching parastatals, over the period as a whole. Both the chronic and the merely net loss-making parastatals survived throughout the crisis, and would continue to do so despite further losses.[182]

As shown by *Table 4.20*, which has already been referred to several times in this chapter, even the largest loss makers survived. The Tanzania Audit Corporation listed parastatals making profits and losses exceeding 5 million TSh (20 if audited in 1991/92) among accounts audited each year. The table reveals the parastatals with the ten largest losses among the accounts audited annually during the period 1980/81-1991/92. A mere 39 different parastatals appear among the ten major loss makers audited annually during the 12-year period. Hence, most of them made repeated losses. 18 of them, or 46 per cent, made losses exceeding 5 (or 20) million TSh during eight years or more. This suggests that the major loss-making parastatals since the late 1970s survived for more than a decade, although almost half of them made huge losses during at least eight years.[183]

Table 4.20 is a rather crude instrument for our purposes, partly because it covers both the crisis and the reform period. In addition, data for individual parastatals are lacking in many years. Consider now the financial performance prior to 1985 only, on the basis of the same data, regardless of when the accounts were audited. Only those parastatals for which data are available for four years or more are included. We find 27 such parastatals, preceded by a #-sign in the table. Of these 27 parastatals, 19 (or 70 per cent) made losses more often than profits during the period 1977-1984. For these 19 parastatals, data were available for 5.6 years on average, and they made losses in 5.1 of these, i.e. during 91 per cent of the years.

In addition, two parastatals, the Tanzania Cashewnut Marketing Board and the Tanzania Fertilizer Company, made net losses over eight and six years during the eight-year period. All these major loss makers during the crisis, 21 parastatals out of 27, are marked by italics in Table 4.20. They are all candidates as chronic loss makers and are found, for instance, within the leather and textile industries, transport and, not least, agricultural marketing.[184]

Chronic loss makers, which depend on external assistance for survival, provide strong indications of the prevalence of the soft budget constraint. However, the prevalence of profits contributes to the difficulty of establishing whether or not loss-making parastatals are chronic loss makers. Table 4.20 shows that many of the major loss makers also reported profits for several years, in particular the marketing boards. Since the profits compensated for part of the losses, some of our candidates may not qualify as chronic loss makers. Note that although this is not shown in the table, most of the profits within agricultural marketing were incurred during the late 1980s.[185] The fact that many of the major loss makers are found among the recipients of soft

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[182] See Table A.9 in the appendix.

[183] See Eriksson (1993), pp. 16-18, and Table 2.6, p. 68, for more details.

[184] The Tanzania Audit Corporation figures for the losses and profits of the crop authorities are not wholly compatible with those in Table 4.5.

[185] This is revealed by the background data on which the table is based and by Table A.9 in the appendix.

Table 4.20: Parastatals belonging to the Annual Top Ten Loss Makers in Accounts Audited by the Tanzania Audit Corporation during 1980/81-1991/92

PARASTATAL	*No. Of Losses > 5 Mill. TSh**	*Range of Years for Losses*	*Times Among Top Ten Loss-Makers*	*No. of Profits > 5 Mill. TSh**
AGRICULTURAL MARKETING				
# *Gen. Agri. Products Export Corp.*	4	1981-84	2	0
# *National Milling Corporation*	11*	1978-91	10	2
# *Sugar Development Corporation*	5	1980-85	2	7*
# *Tanganyika Pyrethrum Board*	8*	1981-91	1	3
# *Tanz. Cashewnut Marketing Board*	6	1980-90	2	8
# Tanzania Coffee Marketing Board	5*	1980-91	1	9
# *Tanzania Cotton Marketing Board*	10	1977-88	7	4*
# *Tanzania Sisal Authority*	12*	1977-90	2	2
# *Tanz Tobacco Process/Mark Board*	9	1980-88	5	4*
OTHER AGRICULTURAL				
# *Kilombero Sugar Company*	4	1980-86	1	7*
Mtibwa Sugar Estates	2	1979-86	1	7*
Mtwara Cashew Company	3	1978-87	1	0
CEMENT INDUSTRY				
Mbeya Cement Company	8*	1984-91	3	0
# *Tanga Cement Company*	8*	1982-91	3	3
LEATHER INDUSTRY				
# *Morogoro Shoe Company*	9	1981-89	3	0
Morogoro Tanneries	7	1979-89	1	0
# *Mwanza Tanneries*	9	1979-88	1	0
TEXTILE INDUSTRY				
# *National Textile Corporation*	9	1980-90	3	2
# Kilimanjaro Textile Corporation	8*	1980-90	1	2
Morogoro Polyester Textiles	5	1986-90	5	0
# *Musoma Textiles*	11	1980-90	10	0
# *Mwanza Textiles*	10*	1980-90	9	1
Tabora Textile Mills	1	1990	1	0
# Tangany. Dyeing & Weaving Mills	7*	1980-90	1	4
Tanz. Packages Manufact. Comp.	4	1987-90	1	0
OTHER MANUFACTURING				
# *National Bicycles Company*	9	1979-90	1	3*
# *Small Industries Development Org.*	11*	1980-90	5	0
Southern Paper Mills Company	5*	1986-90	5	0
# State Motor Corporation	5*	1986-91	1	6
# *Tanzania Fertilizer Company*	7*	1979-90	5	4
Tanzania Twine & Rope Works	1	1979	1	0
TRANSPORT & COMMUNICAT.				
# *Air Tanzania Corporation*	12*	1978-90	5	1
National Urban Water Authority	6*	1985-91	2	1
# Tanz. Electric Supply Company	4	1983-89	2	6
# Tanz. Post & Telecom. Corp.	5	1983-89	4	8*
# *Tanzania Railways Corporation*	12	1978-90	9	1*
Tanz. Zambia Railway Authority	1	1979	1	0
OTHER PARASTATALS				
# *National Housing Corporation*	12	1977-88	1	1*
Workers/Farmers Hous. Dev Fund	1	1985	1	6*

Notes: * For accounts audited in 1991/92: losses/profits exceeding 20 million TSh. # Parastatals for which data are available for four or more years prior to 1985 (1977-1984). *Italics:* Candidates as chronic loss makers among those marked by a #-sign: parastatals that made losses more often than profits, or net losses during the period.

Source: Calculations based on Tanzania Audit Corporation (1981-1992).

parastatal finance suggests that they really did survive on external finance, and not only on past accumulated profits.

Profit-making parastatals may also have faced soft budget constraints. We cannot, however, establish the extent to which this happened. The soft budget constraint provided a survival mechanism for more parastatals than those that were chronic loss makers according to their audited accounts. Some applications of the soft budget constraint, in particular soft administrative cost-plus pricing, 'improved' the financial result of the parastatals as reported in their accounts. Hence, poor financial performance and cost increases were not fully translated into observable financial losses.

Soft cost-plus pricing was most common within manufacturing and commerce. It was tremendously widespread during the first part of the crisis, and remained important during the whole period. Its significance can possibly contribute to explaining why losses among parastatals within industries and trade remained relatively moderate, in spite of the enormous performance problems of this sector. These parastatals suffered particularly from the shortages and their output slumped. They nonetheless disclosed net profits during the period, accounted for a smaller share of total parastatal losses than agricultural parastatals, and had a smaller proportion of loss makers.[186] The Tanzania Fertilizer Company is an example of a particularly poorly performing parastatal, which reported significant profits in 1981, 1983 and 1984.[187] These profits must have greatly exaggerated the actual financial results of the parastatal, which both enjoyed cost-plus pricing that allowed for a certain profit margin, and received large amounts of import support free of charge.

Keeping the Parastatal Sector Intact

Against this background, we may conclude that the soft budget constraint constituted a survival mechanism for a larger number of parastatals, and not simply the chronic, net and major loss makers. Its application hence contributed to and was important for keeping the whole parastatal sector intact. Only a few parastatals were dismantled prior to reform, although the exact number is difficult to establish. The Livestock Development Authority and two of its subsidiaries, one transport company and several trading firms are examples of what appear to be at most a dozen cases.[188] As a result, the state retained ownership over the huge sector.

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[186] Cf. Tables 4.4 and 4.6 above.

[187] According to the data on which Table 4.20 is based.

[188] World Bank (1988a), p. 36. Cf. Table A.20 in the appendix.

INDIRECT CONSEQUENCES FOR THE ACTORS

By influencing both the institutional set-up and the organisational structure, the soft budget constraint had consequences for parastatal managers and bureaucrats that went far beyond the situations in which it applied. Its implications for the ability of the actors to act and interact in pursuit of their official and private aims within the socialist system were wide-ranging. This section first discusses how the soft budget constraint influenced actors' adherence to the other formal and informal rules. It then illustrates the general discussion, by examining the importance of the soft budget constraint for actors' ability to cope with the crisis in defence of their private interests. The section concludes by summing up the beneficial consequences of the soft budget constraint for the actors.

Adherence to Other Rules

By facilitating behaviour in situations when parastatals were in financial trouble, the soft budget constraint enabled parastatal managers and bureaucrats to deal also with a number of other situations. As part of the institutional system, it made it easier to adhere to other formal and informal rules.

Focus on Tasks of Higher Priority

The prevalence of the soft budget constraint implied that parastatal managers and bureaucrats did not have to worry much about the financial consequences of their behaviour. They could focus on issues of greater importance. The soft budget constraint allowed them to devote their time and effort to solving problems and fulfilling tasks that were of higher priority within the socialist system. It thus conveyed certain information about relative priorities, according to both the prevailing ideas and values and the expectations of other actors. It signalled that the financial performance of parastatals was at most of secondary importance, which was consistent with the official ideology that condemned the profit motive. The soft budget constraint thereby contributed to solving the actors' problem of how to rank the importance of their different tasks.

Chapter III discussed how parastatal managers, on top of having to attend to their daily operative tasks, were exposed to a number of often inconsistent and *ad hoc* demands announced by state bureaucrats and political leaders at different levels. In combination with the multitude of formal roles that parastatals were over-loaded with, this made the running of parastatals according to the various requirements difficult, and often inconsistent with financial prudence. Under these circumstances, the soft budget constraint made it easier for managers to prioritise between their different duties. Although it did not rank all of the tasks, it highlighted the relative

unimportance of profitable management for the parastatals. Thus while focusing on the loyal execution of other duties and bureaucratic orders, managers could pay only limited attention to requests from controlling organs for financial information. This is illustrated by the case of the crop authorities, where there was no proper documentation or authorisation of cash losses, for instance. The external auditors severely criticised the handling of staff debtors, but such advice was totally ignored by the managements.[189]

Thus the soft budget constraint made it easier for managers to behave according to the other formal and informal rules of the system: one-party supremacy, bureaucratic co-ordination, state ownership and the economy of affection. As discussed in Chapter III, the managers' weak autonomy largely prevented them from running the parastatals profitably. During the crisis, the institutional constraints on managerial autonomy remained, while resource constraints became even more severe. By relieving managers from the requirement that parastatals should sustain themselves financially, the soft budget constraint enabled them to loyally execute even financially disastrous political tasks and commands, and to accept interference even in minor matters. Similarly, it made it easier to abide by the rules of compulsory purchase and sale under trade confinement, to seek bureaucratic approvals in operational as well as entrepreneurial matters, and to keep up employment in spite of falling output.

Generally, the soft budget constraint facilitated any behaviour that had negative consequences for parastatal financial performance. And as shown in the previous chapter, adherence to many of the other behavioural rules of the socialist system gave rise to financial problems for the parastatals.

Thus the soft budget constraint had the same type of function for bureaucrats as for the managers. The message that it sent made it easier for bureaucrats to prioritise between their many and sometimes inconsistent tasks, to perform their more important duties, and thus to adhere to the other rules of the system. Bureaucrats had to manage and control state property, the huge parastatal sector, and also to administratively set prices and allocate resources in the economy. The political leadership was in charge of leading the socialist development, and subordinate bureaucrats were responsible for the execution of the socialist policies. These were substantial and complicated tasks, which involved adherence to the prevailing rules and were constrained by them, as shown in the previous chapter.

Being in charge of the parastatal sector, for instance, was difficult. The multitude of partly contradictory parastatal tasks meant that promoting and supervising the managers' accomplishment of these tasks was as difficult for the bureaucracy as it was for managers to accomplish them. The formal rules required the bureaucrats to make the parastatals execute the socialist policies, through discretionary intervention and administrative decisions on prices, wages, employment, suppliers, output, location and investment. The soft budget constraint facilitated the bureaucratic management of the parastatals. It signalled that priority should not be given to promoting and ensuring profitable parastatal management. Demands for the parastatal

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[189] Marketing Development Bureau (1979), pp. 60-61 and 97.

managers' loyal execution of political tasks were more important, and could be forwarded more easily and exerted with greater force when their impact on the financial performance could be ignored. Since the soft budget constraint took care of the financial consequences of bureaucrats' discretionary intervention in and regulation of parastatal activities, it was easier for the bureaucrats to motivate managers to perform their tasks: to obey orders, implement policies and comply with the rules. This, in turn, made it easier for the bureaucrats to perform their own tasks.

Parastatal performance also had to be controlled. However, it was tremendously difficult to control outcomes, holding parastatal managers accountable for the financial performance of the parastatals, given for instance the poor division of responsibilities and authorities within the bureaucracy, the ineffective enforcement mechanisms and the vast information problems. Besides, intervention in and regulation of parastatal activities implied that the bureaucrats in fact controlled parastatal procedures. Hence, the bureaucrats *had* to control procedures, and would not have been able to perform their duties according to the formal rules if they also had to control parastatal outcomes. The soft budget constraint made this behaviour possible by relieving them of the requirement to control financial outcomes.

As suggested earlier, the soft budget constraint also made it easier for the bureaucracy to allocate resources. While the bureaucrats had to administratively allocate, for instance, bank credit and import support, the formal allocation criteria were inconsistent, unclear or missing. The soft budget constraint provided information that complemented the existing rules of bureaucratic co-ordination, and thereby facilitated adherence to these. It informed bankers about how to prioritise between the two formal criteria of creditworthiness and public sector priority. And it added to the formal (and informal) criteria for allocation of both credit and import support, by suggesting which particular parastatals were to be supported: those with financing gaps.

Finally, the penetration of the economy of affection into the public sector implied that both parastatal managers and bureaucrats were exposed to demands from members of their social networks. Relatives, friends and others required them to use their public position, not least by drawing on public resources 'even beyond the established rules of the formal system',[190] for the benefit of these network members. Although public officials, as noted by Peter de Valk, 'sometimes feel "strangled" by their affective obligations', they found it hard to resist such pressure.[191] Such adherence to the rules of the economy of affection was also facilitated by the soft budget constraint, as illustrated in the following sub-section. Let us first consider some of the implications of the functions of the soft budget constraint that have been discussed here.

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[190] de Valk (1992), note 4, p. 208.

[191] Ibid., p. 197 (quotation) and note 4, p. 208.

Incentives, Co-ordination and Coherence

By facilitating adherence to the other rules under which parastatal managers and bureaucrats operated, the soft budget constraint reinforced the actors' incentives to behave according to these rules. In this way, it mitigated some of the incentive problems inherent in the socialist system. These included incentives for managers to run the parastatals as political instruments of the leadership in spite of discretionary bureaucratic intervention and weak autonomy; and incentives for bureaucrats to ensure that the parastatals performed these roles, despite their inability to control parastatal outcomes and hold parastatal managers accountable for parastatal performance.

By making it easier to adhere to other institutions, the soft budget constraint enabled the actors to correlate their behaviour so that their actions fitted with each other. It thereby contributed to co-ordinate activity within the socialist system. It did so in several respects, first of all between managers and bureaucrats in situations with parastatal financial trouble. The soft budget constraint linked managers seeking external assistance to bureaucrats granting assistance. For the individual actors, the soft budget constraint co-ordinated behaviour in different situations and brought consistency between their adherence to different rules, as shown in this section. This further implies that the soft budget constraint correlated the interaction between managers and bureaucrats, not only when it applied, but also in other situations of interaction. For instance, the soft budget constraint made it easier both to give and to obey orders within the parastatal sector. Finally, the expectations of external accommodation of parastatal financing gaps correlated actors' behaviour over time.

By handling situations brought about by the other institutions, the soft budget constraint was consistent with the formal and informal rules of one-party supremacy, state ownership, bureaucratic co-ordination and the economy of affection. It governed activities in situations that were not governed by the other institutions, and thereby functionally complemented these institutions. Hence, one of the major consequences of the soft budget constraint was that as an informal institution, it brought institutional coherence. This made it easier for the actors who were moving about within the system, and enabled them to benefit from the behavioural opportunities that the system provided. The following sub-section shows the importance of the soft budget constraint for enabling actors to pursue their private aims during the crisis.

Coping with the Crisis

Considering the severity of the economic crisis, the primary concern for parastatal managers and bureaucrats should have been how to support themselves and their families. The public sector was increasingly unable to maintain the real incomes of its employees, even those in the higher income brackets. Top salaries within the parastatal sector declined by 57 percent in real terms

between 1980 and 1985, and salaries within the public sector as a whole fell by 66 per cent.[192] This decline made it virtually impossible to survive on official salaries alone, while commodities grew increasingly scarce and more expensive in parallel markets. Hence, these actors also found it necessary to engage in informal activities to cope with the crisis. Declining incomes and increased scarcities probably also led to increased pressure on the actors to use their official positions to support members of their social networks.

In addition, the political leadership faced emerging threats against its economic and political position during the crisis. The shift of economic activity from formal to parallel markets implied that the amounts of resources under its control became circumscribed.[193] This, together with economic decline *per se,* made it increasingly difficult for the leadership to deliver material welfare to the people through the formal system. This threatened its legitimacy, while social groups that were not yet incorporated under state and party control - the unemployed and members of the 'commercial bourgeoisie' - posed a growing threat of political instability.[194] The growth of black markets meant that potential private sector rivals threatened to become powerful.

Let us investigate how the soft budget constraint, by keeping the parastatal sector intact and facilitating adherence to other behavioural rules, influenced the ability of parastatal managers and bureaucrats to handle their economic, social and political problems during the crisis.

Retained Formal Positions and Benefits

By the time the socialist system had been consolidated, the state and party bureaucracy, including parastatal managers and the political leadership, constituted a large and fairly homogeneous group. This group has been referred to as the African public officials, the state or bureaucratic bourgeoisie or simply the leaders. The members were united by ideology, a strong group identity and common interests - although struggles over power within the group did occur, as discussed in Chapter III. Several observers have stated that the group assumed the role of a ruling class.[195]

A large and stable parastatal sector was crucial for the positions of the many managers and bureaucrats. When the crisis erupted, these actors could pursue their interests within an organisational structure that remained intact. The huge parastatal sector and its control organs offered an abundance, or even an increased number of employment opportunities for parastatal managers and bureaucrats. The number of parastatals continued to expand during the crisis, from

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[192] World Bank (1988a), Table 1.6, p. 15, and Appendix B, Table B5, p. 108.

[193] Cf. Ndulu (1988), p. 24.

[194] Havnevik (1993), p. 58.

[195] See, for instance, Hanak (1985), p. 53, Kiondo (1989), p. 14, and not least Shivji (1976), which is a classical reference.

380 in 1979 to 433 in 1984.[196] Although the actors not always remained in the same positions, 'it is common knowledge in Tanzania that those who get to higher circles of power are rarely dropped completely'.[197]

The growing size of the parastatal sector accorded greater power and prestige to those in charge of directing and controlling it. This enabled the leadership to retain control over a large part of the economy in spite of the increase in informal activities. It also increased the actors' opportunities of distributing lower-level positions to relatives and friends - an important means for managers and superiors to support their social networks. Total parastatal employment continued to grow during the crisis, by 24 per cent between 1980/81 and 1983/84.[198]

The formal benefits associated with public positions remained. For parastatal managers and other higher salaried personnel, the real decline in money income was partly compensated by increased non-wage incomes, in terms of various, often untaxed, fringe benefits. For chief executives they included 'housing, car, domestic servant, first class air travel, and entertainment allowance'.[199] During the first half of the 1980s, these was a severe shortage of housing, which was therefore an important benefit. So was access to a company car, maintained by the parastatal and available for full-time use.[200] Transport costs were one of the largest and most rapidly growing expenditure items among the agricultural crop authorities in the late 1970s, partly due to the high rate of private use by employees.[201]

By keeping the parastatal sector intact when large parts of it ran up huge deficits, the soft budget constraint made it possible for parastatal managers and bureaucrats to retain their formal positions and reap the associated material benefits, power and prestige. However, benefits did not accrue solely from the survival of parastatals, but also from the ability of actors to adhere to the behavioural rules within this organisational structure. During the crisis, public employment was beneficial not primarily because of the formal opportunities that it offered, but because of the informal ones. The contribution of the soft budget constraint was also important in this regard.

Informal Income Generation

Informal activity was rampant within the public sector during the crisis, and this applied also to parastatal managers and bureaucrats. When the economic problems emerged, 'individuals began to fend for themselves: members of the state bourgeoisie increasingly took to private

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196 See Table 4.8 above.

197 Kiondo (1989), p. 266.

198 World Bank (1988a), Table B1, p. 95.

199 Ibid., Appendix B, p. 106.

200 Ibid., p. 14, and Appendix B, pp. 106-107.

201 Marketing Development Bureau (1979), p. 93.

appropriation and accumulation as a way of ensuring their future'.[202] A number of means were resorted to. Diversion of parastatal property to private ownership was reflected, for instance, in so-called moonlighting that became common within the sector. This implied that 'an increasing proportion of official working hours [was] ... spent on secondary activities (such as farming, poultry, private sector consulting, etc.) that [were] ... equally if not more lucrative than official jobs, and commitment to primary work [was] ... eroded'.[203] 'As the crisis deepened ... some public servants ... began to use the public office as a market contact for their personal business, and spent a substantial part of the official working day attending to such business ...'[204] Parastatal managers benefited from office telephones, typewriters and computers, contacts and knowledge, secretaries and other more or less idle staff and material resources for private purposes.[205] There were additional means.

The General Agricultural Products Export Corporation (GAPEX) and the Arusha International Conference Centre (AICC) offer examples of how managements drew on parastatal resources in different ways. In 1980, the general manager of GAPEX was found to have used several of the parastatal's vehicles during his own wedding. He also let the parastatal 'pay for the petrol used as well as per diem and other expenses for the driver'.[206] The corporation secretary had used the vehicles for transporting 'his cement and iron sheets from Dar es Salaam to Moshi free of charge'.[207] The director general of the AICC, in turn, was accused of having employed three workers to tend his garden and clean his home, and security guards to watch his house 24 hours a day, all on the payroll of the AICC. The administrative officer had run his private coffee farm with workers paid by the AICC. He had also bought the farm, worth 25,000 TSh, for money misappropriated from the parastatal.[208]

The suspicion that direct theft and embezzlement of parastatal funds were not only occasional phenomena is reinforced by data on cases documented by the local newspapers. During 31 months in the period 1984-1986, 77 such cases were reported, of which parastatals accounted for 58 and the government for 19. The total amount of embezzled funds discovered was 881 million TSh.[209] Cash losses and non-repaid staff loans were also common. All crop authorities experienced cash losses in the late 1970s, some amounting to millions of shillings annually. Staff loans were granted without authorisation, sometimes to the same individual from several branches. Travel advances were not repaid and credit was extended regardless of the borrowers' repayment capacity. Collection procedures were extremely lax and staff left employment without having settled their debts. Sometimes the loans amounted to several times

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202 Kiondo (1989), p. 24.

203 World Bank (1988a), Appendix B, p. 108.

204 Maliyamkono and Bagachwa (1990), p. 46.

205 Cf. Maliyamkono and Bagachwa (ibid.) and Mihyo (1994), p. 114.

206 Kiondo (1989), p. 90.

207 Ibid., p. 91.

208 Ibid., pp. 92-93. For a full presentation of the GAPEX and AICC cases, with more examples, see pp. 90-95.

209 Bavu (1986), p. 17, referred to by Kiondo (1989), Table 2.6, p. 83.

the borrower's annual salary.[210] Within parastatals in general, 'it was common practice in the 1980s for officials to negotiate the elimination of a debt [to the parastatal] in return for a lower, unrecorded payment made directly to the officials'.[211]

In this manner, managers could use parastatal funds to benefit and support not only themselves, but also their families and wider social networks. Apart from employing relatives, using parastatal staff and approving non-repaid loans, they could promote activities. For example, the general manager of GAPEX ordered the free transport of a three-ton organ from Dar es Salaam to Moshi for a Lutheran church, and paid for the casual labour engaged. He also approved a cheque worth over 67 thousand TSh for the purchase of a flour-milling machine to an Ujamaa village in Moshi. The director general of the AICC, in turn, financed the formation of a football team, including recruiting paid players and employing a famous coach.[212] Hence, managers appear to have used parastatals as 'their personal properties'.[213]

All forms of private abuse and extraction of parastatal resources were facilitated by the soft budget constraint, since any resulting financing gaps were accommodated. Although these practices partly reflect the behavioural opportunities created by formal rules (or lack of formal rules), implying for instance unclear responsibilities and weak enforcement mechanisms, they largely reflect adherence to the rules of the economy of affection. These informal rules obliged the managers to exploit their official positions and the opportunities provided by the formal rules for the benefit of their social networks. Considering the poor financial position of the parastatals, such behaviour could not have persisted for long, had not the soft budget constraint prevailed. Now the behaviour was encouraged. Hence, by increasing the opportunities for private abuse and extraction of parastatal resources according to the informal rules of the economy of affection, the soft budget constraint not only facilitated but also created incentives for such behaviour.

By keeping parastatals alive, the soft budget constraint also, in a more indirect way, increased the managers' possibilities of benefiting from the behavioural opportunities provided by formal rules: trade confinement and price control. Managers exercised exclusive control over and access to goods in scarce supply that were produced, imported and traded by monopolistic parastatals, and this constituted a powerful source of potential income. Managers could earn large rents by selling price-controlled goods at high prices in the parallel markets, or by charging for selling goods at the official price. Regional Trading Companies, for instance, sometimes sold goods to private traders at the controlled price, and were guaranteed a 'tip' for this favour.[214] Many of the consumer goods available in the parallel markets had leaked from the official ones, particularly at the wholesale level. For instance, of the soap distributed from the factory gate,

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[210] Marketing Development Bureau (1979), pp. 60, 95 and 97.

[211] Mihyo (1994), p. 94; comment added.

[212] Kiondo (1989), pp. 90-93, who refers to a piano, but given its weight, it must have been an organ.

[213] Ibid., pp. 82-89 (quotation from p. 82).

[214] Maliyamkono and Bagachwa (1990), p. 92, referring to Bevan *et al.* (1987a). Additional examples of this type of rent seeking are provided by de Valk (1992), pp. 370-371, and by Kiondo (1989), p. 231.

only about one quarter reached the official village shops.[215]

This control of scarce goods enhanced the power and social status of parastatal managers. It was at their discretion to decide who should be granted the favour to buy goods at the official price. Consequently, just like the production supervisor in a textile parastatal, managers became popular in town and were greeted and treated respectfully by everybody.[216] This access to scarce goods also strengthened the managers' position when bargaining with bureaucrats, for instance, over external finance. The highly valued goods could be traded in the following manner.

> ... an official of NMC [National Milling Corporation] might give an official of the National Bank of Commerce a permit to obtain essential food from an NMC distribution depot, expecting that whenever he, the NMC official, visited the bank, he would be given priority of service. This sort of malpractice happens at all stages in the distribution system, from wholesale to retail levels ...[217]

Hence, scarce goods could be traded for application of the soft budget constraint. The example suggests that the soft budget constraint also made it easier for *bureaucrats* to draw on the parastatals for private access to scarce goods, informal income generation and network support. Bureaucrats' discretionary rights to intervene in parastatal activities and to allocate resources gave them exceptional opportunities to exercise this power in such a way as to benefit themselves. Just as the soft budget constraint created incentives for bureaucrats to use their discretionary power in the exercise of their official duties, it also created incentives for them to use this power for private rent extraction according to the rules of the economy of affection.

The supposition that bureaucrats benefited in this way is suggested by the demands that they forwarded to parastatals. Parastatals were expected to offer the government, the party and their top officials preferential access to services and commodities under parastatal control, and to provide them cheaply, on credit or even free of charge.[218] The Parastatal Organizations Committee of the parliament reported other examples of bureaucrats' private extraction of parastatal funds. During the period 1979-1982, internal parastatal debts included money advances for use in state business paid to officials in the parent ministries in several instances. Such '[u]nrecovered imprests in the period studied grew at an alarming 53 per cent annually'.[219] In 1981, the Central Committee of the party investigated cases of embezzlement of public funds and property in three parastatals. It found that some of the top leaders were involved: one minister, chairmen of the boards of directors, and general managers or managing directors of the parastatals and of a state-owned bank.[220]

According to Kiondo, the state sector with all its parastatals constituted the 'life-blood of the

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215 Bevan *et al.* (1987a), p. 40, and (1988b), pp. 31-33.

216 de Valk (1992), p. 370.

217 Maliyamkono and Bagachwa (1990), p. 92; comment added.

218 Mihyo (1994), pp. 115-116.

219 Mihyo (1994), p. 96, referring to Parastatal Organizations Committee (1979-1982).

220 Kiondo (1989), pp. 229-231.

state bourgeoisie'.[221] This is further suggested by 'the government's use of bureaucratic power to block accountability',[222] and its unwillingness to deal seriously with various forms of embezzlement of public funds.[223] Mihyo refers to 'the culture of accepting the looting or theft of the assets of public bodies'.[224] Bureaucrats, like managers, faced incentives to disguise and distort financial information about parastatals that might reveal their abuse of parastatal resources. Hence, parent ministries helped parastatals to evade the requirement to report on and defend their financial performance before the parliament during the period 1979-1982.[225] The investigation by the Central Committee, just referred to, was soon called off when it 'revealed more than the state bourgeoisie would want the public to know'.[226]

During the economic crisis, embezzlement of funds, theft and corrupt practices grew within the public sector.[227] Corruption became firmly established.[228] Together with the widespread parallel market activity, this forced the leadership to launch a war against economic saboteurs and racketeers, as mentioned earlier. However, while a large number of small black market traders were arrested, the campaign did not catch the 'big fish', and those of 'medium size' were released.[229]

The suggestion that parastatal managers and bureaucrats managed to cope with the crisis, by ensuring their personal and social network well-being in this way, is supported by the fact that informal activities were not only substantial, but also rewarding for the income groups to which these actors belonged. Sarris and van den Brink found that the relative importance of informal activities for income generation was greatest for the rich households, particularly in urban areas. The share of the total income of rich urban households that was accounted for by informal activities also grew, from 93 to 99 per cent between 1975-1977 and 1981-1983.[230] During this period, the urban rich were also the group that saw the most favourable development in their real income - a significant increase - in spite of the drop in their formal incomes.[231] The role of the soft budget constraint was important. It took care of the financing gaps that resulted from the actors' behaviour, which made it easier to benefit from the opportunities created by formal rules, and to abide by the constraints imposed by the economy of affection, and thus promoted such behaviour.

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221 Ibid., p. 145.

222 Mihyo (1994), p. 91.

223 Cf. Maliyamkono and Bagachwa (1990), pp. 47 and 93.

224 Mihyo (1994), p. 114.

225 Ibid., pp. 87-91.

226 Kiondo (1989), p. 231.

227 Adam *et al.* (1994), p. 141, and World Bank (1988a), Appendix B, pp. 103 and 109.

228 Maliyamkono and Bagachwa (1990), p. 44, and World Bank (1988a), Appendix B, pp. 103 and 109.

229 Kiondo (1989), p. 240.

230 Sarris and van den Brink (1993), Table 68, p. 182.

231 Ibid., Tables 66 and 69-79, pp. 180 and 183-184.

Conclusion: Beneficial Consequences for the Actors

We have shown that the soft budget constraint had important implications for the institutional and organisational context in which parastatal managers and bureaucrats operated. The most immediate consequence of the soft budget constraint was that, as an informal institution, it offered a behavioural solution for how to handle recurrent parastatal financial problems. Its prevalence provided information to guide behaviour, which mitigated the information problem inherent in the socialist system. Thus the soft budget constraint facilitated the actors' behaviour in the situations to which it applied. By accommodating parastatal financing gaps, the application of the soft budget constraint also introduced an element of flexibility into the rigid system, and offered an adaptive mechanism to counter not only internal weaknesses but also exogenous shocks. As a consequence, a survival mechanism for poorly performing parastatals was provided.

The soft budget constraint also facilitated actors' behaviour in situations that went beyond those in which it applied, and thus had indirect beneficial consequences. It made it easier to behave according to the other formal and informal rules within the system, and shaped incentives for such behaviour. It allowed the actors to focus on priority tasks, and increased their opportunities to pursue their official duties as well as their private aims. It thereby eliminated some of the incentive problems created by the system. By complementing the other institutions, the soft budget constraint made it possible for actors to co-ordinate their own behaviour and their interaction with each other.

Thus the informal rule brought coherence and consistency to the institutional set-up and kept the parastatal sector intact. This facilitated the actors' behaviour within the socialist system. In other words, the soft budget constraint permitted them to benefit from the opportunities that the system provided, while operating within its constraints. In this manner, the soft budget constraint also increased the actors' possibilities to cope with the economic crisis. It allowed them to retain their official positions and to reap the associated benefits, both material and non-material, formal and informal.

We may thus conclude that the soft budget constraint had direct and indirect consequences that were beneficial for parastatal managers and bureaucrats, so that it performed several functions. However, its consequences for the performance of the parastatals were less fortunate, as argued in the following section.

NEGATIVE CONSEQUENCES FOR PARASTATAL PERFORMANCE

When parastatal managers and bureaucrats benefited from the opportunities provided by the soft budget constraint, their behaviour had negative consequences for the performance of the parastatals. De Valk, who offers an example that he holds was typical among textile parastatals,

illustrates the contrast between these positive and negative effects. An expatriate within one of these parastatals suggested that a shift should be made to a domestic supplier, who offered inputs at half the price of the foreign supplier that was currently used. However, a unanimous parastatal board of directors refused to take this opportunity to cut parastatal costs, because the board members would have lost the private side benefits that the foreign supplier offered.[232] The individuals benefited, but the parastatal suffered. This section discusses how the soft budget constraint generated inefficiency within the parastatal sector.

By accommodating any financing gaps that resulted when the actors adhered to other formal and informal rules, the soft budget constraint allowed resource waste. However, it not only tolerated, but also fuelled, such waste. The soft budget constraint was not the mere absence of a financial constraint. As an institution, it shaped incentives for behaviour. Its prevalence - the existence of expectations of external accommodation of parastatal financing gaps - weakened incentives to economise on parastatal costs, for both managers and bureaucrats. By facilitating behaviour that involved resource waste, the soft budget constraint instead strengthened the incentives for such behaviour.

The case of crop authorities offers several examples of how the soft budget constraint contributed to a weak financial discipline in the late 1970s, and what the implications were for actors' behaviour and parastatal efficiency. Development projects, for instance, were often commenced before funds were secured, in spite of 'a general vagueness as to where extra funds were going to come from'.[233] Managements did not seem to worry, but expected government funding to be forthcoming in one way or another. Forward cash-flow planning was lacking, and as a consequence, shortages of funds recurred repeatedly. Since, external finance was expected, bank overdrafts were relied upon in the meantime, which generated costs for interest charges. The government ordered the crop authorities to hold large stocks of crops, but this was not considered to hamper their liquidity, since the government would ultimately assume responsibility for the financial consequences. Budgeting was almost wholly distribution and quantity oriented, while the costs and financial implications that resulted were simply accepted as inevitable.[234]

These examples suggest that the soft budget constraint tended to raise parastatal demand for both inputs and investment. Given the prevailing shortages, incentives were created to hoard inputs. The soft budget constraint made it easier to 'over-spend' by keeping large stocks, as a precaution against future shortages or simply for convenience, and thereby reinforced the incentives to hoard. The crop authorities kept stocks of crops that were large in relation to their turnover, and this hoarding was costly. Several of them also recorded high levels of non-trading stock, such as bags, stationery and spare parts.[235]

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[232] de Valk (1992), p. 370.

[233] Marketing Development Bureau (1979), p. 52.

[234] Ibid., pp. 40 and 75-83, *passim.*

[235] Ibid., p. 98.

As discussed in the previous chapter, a number of factors created incentives for parastatal managers and bureaucrats to expand parastatal activities. By facilitating and promoting such expansion, the prevalence of expectations that financing gaps would be accommodated may also have contributed to over-investment. According to the Marketing Development Bureau, the level of investment of the crop authorities did 'not bear any relationship to the returns from this investment'.[236] In many manufacturing sectors, for instance within the textile industry, parastatal production capacity was expanded during the crisis in spite of falling output.[237] The share of parastatals in total gross fixed capital formation did not increase, but it remained remarkably stable at around 30 per cent during the period 1978-1982.[238]

Thus behaviour according to the incentives created by the soft budget constraint gave rise to inefficiencies. The fact that resource waste in Tanzanian parastatals was huge is reflected in their poor economic performance. Laurean W. Rutayisire estimated inefficiencies within the parastatal manufacturing sector in Tanzania, and their impact on the sector's output and production costs, during the period 1968-1988.[239] Technical inefficiency during the whole period was estimated to be on average 53 per cent.[240] Hence, due to technical inefficiency within the firms themselves, the output of manufacturing parastatals was over 50 per cent less than the maximum possible output. This inefficiency was even higher during the sub-period 1983-1988, as implied by an estimated technical inefficiency of 13-14 per cent for the preceding sub-period (1968-1982).[241] Approximately 20 out of the 50 per cent of the average inefficiency could be traced to technological change as embodied in the machinery. Hence, 40 per cent of the output loss could be traced to factors that were at least partly beyond the control of the parastatals, whereas 60 per cent were due to inefficient use of resources within the firms. The technical inefficiencies raised the costs of manufacturing parastatals by some 24-28 per cent above the minimum possible total cost during the period 1968-1982.[242]

During the period 1983-1988, excess costs due to allocative inefficiency were relatively more important. The period included the first years of reform with several devaluations, but as pointed out by Rutayisire, what really mattered for the total cost structure of manufacturing parastatals was not the exogenous shocks *per se*. It was rather the ability - or inability - of the parastatals to adjust to such exogenous price shocks.[243] We argued earlier that given the rigidities

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236 Marketing Development Bureau (1979), p. 12.

237 See de Valk (1992), pp. 211-213 and 216, and Skarstein and Wangwe (1986), pp. 206-207.

238 Total gross fixed capital formation was around 25 per cent of official GDP annually, in real terms, during the same period. (Calculations based on the Bureau of Statistics, 1990, Tables 4 and 14-15, pp. 8 and 20-21.)

239 Rutayisire (1991) employed the so-called stochastic frontier production- and cost-functions method.

240 Technical inefficiency is defined by Rutayisire (ibid.), p. 15, as 'failure of the enterprise to derive the maximum possible output from the inputs employed as a result of factors internal to the firm'.

241 Ibid., p. 24. Rutayisire's sample did not allow for separate estimations for the second sub-period. (Ibid., p. 14.)

242 Ibid., pp. 24-27.

243 Ibid., p. 28.

created by the organisational and institutional structure, the soft budget constraint provided a means by which to accommodate shocks, financially. However, since the expectations of such accommodation weakened the incentives to economise on costs, they also made the actors reluctant to respond to changes in relative prices by reallocating parastatal resources to less costly factor combinations. By weakening parastatal price responsiveness, the soft budget constraint itself contributed to and *worsened* the adaptive rigidity within individual parastatals as well as the sector as a whole.

Thus the soft budget constraint also generated substantial allocative inefficiency. Rutayisire found that as a result of allocative inefficiencies during the period 1968-1982,[244] the manufacturing parastatals operated at costs that were 57 per cent higher than the minimum possible total costs. When the entire period 1968-1988 was studied, the allocative inefficiency was estimated to have created excess costs of 183 per cent. This suggests a higher allocative inefficiency during the period 1983-1988.[245] Allocative inefficiency is also reflected in excessive parastatal employment. During the first sub-period, the manufacturing parastatals employed an excess of labour in relation to capital that amounted to 291 per cent. The excess labour for the whole period was 411 per cent, which indicates an even higher over-employment during the latter sub-period.[246]

According to these findings, technical and allocative inefficiency was substantial during the first sub-period, but both types of inefficiency became more pronounced over time. Although we cannot distinguish the crisis period, this suggests that the inefficiencies caused by the soft budget constraint were gradually taking their toll, as the informal institution became established and increasingly applied. Economic inefficiency was not caused by the soft budget constraint alone, however. Nonetheless, some researchers argue that in developing countries the inefficiency, in terms of welfare losses, incurred by the soft budget constraint, defined as the irreversibility of projects, is likely to be larger than the losses caused by traditional allocational and X-inefficiencies.[247] In the present study, we are not only unable to separate the inefficiency caused by the soft budget constraint from that of other factors empirically, but also theoretically, since the soft budget constraint interacts with other formal and informal institutions in generating inefficiencies.[248]

The World Bank estimated the efficiency of the Tanzanian industrial sector in 1984, according to the so-called Domestic Resource Cost (DRC) criterion.[249] It found that although

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[244] Rutayisire (ibid.), p. 16, defines allocative inefficiency as the employment of 'inputs in proportions which violate the least cost input combination condition'.

[245] Ibid., p. 28. There is an inconsistency in the source, which might imply that the inefficiency should be 18.3 instead of 183 per cent. Such a result is unlikely, however, to judge from Rutayisire's other comments and findings reported here.

[246] Ibid., p. 29.

[247] Sah and Weitzman (1991).

[248] We will return to this interaction below.

[249] The World Bank (1987), Vol. 1, p. 33, defines the domestic resource cost as 'the cost of domestic resources (factors) that are necessary to save or earn one unit of foreign exchange by producing a (border-priced) unit of

most firms were inefficient according to the DRC criterion,[250] the parastatal performance was generally worse that that of the private firms. In particular, more than 50 per cent of the parastatal activities were extremely inefficient, producing negative value added at world-market prices.[251] A subsequent World Bank study commented on the parastatal bias in this tremendous resource waste. 'The most likely explanation for these findings is that parastatals enjoy preferential treatment and "bail-out" privileges that permit them to remain in business longer than can private firms when they are operating inefficiently.'[252] Although economic inefficiency according to the criteria discussed here does not necessarily correspond to financial loss, the resource waste was often translated into poor financial performance within the parastatal sector.

The soft budget constraint did not simply keep inefficient and loss-making parastatals alive through the external accommodation of their financing gaps. Through the incentives that this accommodation created, the soft budget constraint itself contributed to parastatal inefficiency, financial problems and losses. This suggests an answer as to how and why the soft budget constraint prevailed, which is the issue to which we now turn.

SYNTHESIS: MAINTENANCE AND REINFORCEMENT

This chapter argues that the soft budget constraint initiated a process that contributed to its own maintenance - and to its reinforcement - during the crisis. The process was cumulative, and a major part of the chapter has pursued a detailed analysis of the different causal links and sequential steps in this process. The present section summarises and synthesises our findings of how and why the soft budget constraint was maintained and reinforced.

First of all, it identifies the different reinforcement mechanisms that gave rise to the process, gives an account of the causal and sequential stages of the process, and explains how and why the mechanisms operated. We discuss the central role of actors' ability to learn successful behaviour and the element of unintendedness in the process. The cumulative process by which the soft budget constraint was maintained and reinforced had implications for the stable socialist system in crisis. The systemic and macro-economic consequences are discussed in the second sub-section.

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value added'.

250 Ibid., p. 40. The costs for the firms of producing goods that would have saved a unit of foreign exchange were higher than the net benefit of saving such a unit.

251 Ibid., p. 43. In particular, highly import dependent activities were extremely inefficient. (Ibid., p. 44.)

252 World Bank (1988a), pp. 18-19.

Mechanisms in a Cumulative Process

Once the soft budget constraint was established, its very prevalence set off a cumulative process of sequential and causal events that accounted for its self-generation. To better understand the process, a distinction is made between four different but interacting and partly overlapping reinforcement mechanisms.[253]

Established Advantage

During the crisis, parastatal managers and bureaucrats were repeatedly confronted with parastatal financial problems. Once the soft budget constraint had been established, it offered a behavioural solution to the actors, by devising a way of handling such problems: to seek and grant external finance. It conveyed information about past experience and prevailing values, and thereby shaped expectations that such behaviour would be successful. A first explanation for the maintenance and reinforcement of the soft budget constraint is thus that once it was in place as a behavioural rule, the actors faced incentives to apply it for the very reason that it prevailed.

Since the actors were familiar with the soft budget constraint, it was easier and safer to adhere to this rule than to search for another solution. Alternative behaviour was rare and largely unknown, associated with greater uncertainty about the outcome, and to the extent that it had been tried in the past, it had proven less successful. Given the prevalence of the soft budget constraint, the actors did not have to worry about how to proceed, to search for guiding information, or to concern themselves with how their counterparts would respond. Instead they could go straight ahead and act. The first mechanism through which the soft budget constraint contributed to its own maintenance could thus be called the *established advantage* mechanism.

The establishment of the soft budget constraint had been associated with learning or set-up costs, in terms of the uncertainty faced by the actors and the trials and errors that they had made during the process. Thus over time, the relative advantage of being able to apply the soft budget constraint in situations of parastatal financial trouble, as compared to searching for alternative behaviour, increased. The less the actors had to worry about how to behave in those situations, the more effectively they could apply the soft budget constraint, attend to issues of greater importance, and benefit from the opportunities provided by the system. Consequently, the returns from adhering to the soft budget constraint increased over time, just because it already existed, and the actors' incentives to apply it when parastatals were in financial trouble gradually grew stronger.

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[253] These mechanisms correspond more or less to those suggested by North (1990), pp. 94-95, discussed in Chapter II.

Adaptive Expectations

Given that parastatal managers and bureaucrats were adaptively rational,[254] their expectations of the prevalence of the soft budget constraint were adjusted to their experience of adhering to it. Every time the actors successfully applied the soft budget constraint, their expectations that such behaviour would be successful were confirmed and strengthened, and their uncertainty about the permanency of the soft budget constraint was reduced. Its repeated application also gradually reinforced expectations of its continued validity and success among other actors, such as the public at large, who observed the behaviour. Hence, the soft budget constraint contributed to its self-maintenance and self-reinforcement through what may be referred to as the *adaptive expectations* mechanism.[255]

Institutional Interaction

The soft budget constraint had implications for the actors' ability to adhere to other behavioural rules, and another important mechanism for its maintenance and reinforcement can be traced to the institutional relationships within the socialist system. The soft budget constraint was not any rule that offered a behavioural solution to recurrent parastatal financial problems. It was a rule that complemented and was consistent with many of the other formal and informal institutions that defined the context of our actors: those related to one-party supremacy, state ownership, bureaucratic co-ordination and the rights and obligations of the economy of affection. The soft budget constraint ruled behaviour in situations that were partly created by actors' adherence to the other rules, and its application thus dealt with problems that the other rules gave rise to. Expectations of external accommodation of parastatal financing gaps made it easier for parastatal managers and bureaucrats to behave according to the other institutions, and thus strengthened their incentives to do so.

These institutions, in turn, strengthened the actors' incentives to adhere to the soft budget constraint. It was a logical consequence of the other rules of the socialist system. These rules had once created incentives for parastatal managers and bureaucrats to behave so as to produce the soft budget constraint, and they now continued to shape incentives for such behaviour. The actors were severely constrained from behaving otherwise, and the discretionary character of decision making and resource allocation provided vast opportunities for them to seek and grant external finance. The third reinforcement mechanism is therefore the one through which the soft budget constraint and the other behavioural rules within the system interacted in a cumulative process of mutual institutional maintenance and reinforcement: the *institutional interaction* mechanism.

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[254] As defined in Chapter II.

[255] This term is borrowed from North (ibid.).

Problem Reproduction

The soft budget constraint itself and the other rules did not only interact in the strengthening of the incentives to apply the soft budget constraint. They also interacted in the reproduction of the situations in which it applied. A final reinforcement mechanism is thus related to the consequences of the soft budget constraint for parastatal performance.

First of all, by accommodating the parastatal financing gaps that resulted when actors adhered to the other formal and informal rules, thus allowing behaviour that generated resource waste, the soft budget constraint contributed indirectly to parastatal financial problems. Secondly, the prevalence of the soft budget constraint weakened the incentives for managers and bureaucrats to economise on parastatal costs. It also strengthened the incentives for behaviour that involved waste of parastatal resources, by facilitating, and thus promoting, actors' adherence to the other rules. Hence the soft budget constraint contributed to the reproduction of parastatal financial problems in two, conceptually distinct, ways: indirectly by tolerating resource waste, and directly by creating incentives for behaviour that wasted resources.

As the actors' expectations of the soft budget constraint grew stronger, through its repeated application, so the incentives for behaviour that it provided also became stronger. This suggests that its effects on parastatal financial performance increased gradually during the crisis. Private abuse and extraction of parastatal resources became widespread, and both technical and allocative inefficiency within Tanzanian manufacturing parastatals worsened over time, while the overall parastatal financial performance deteriorated. Thus the soft budget constraint reproduced the situations in which it applied and the very problem to which it provided a behavioural solution. It interacted with its own negative consequences for parastatal financial performance in a vicious circle, where the two maintained and reinforced each other. The fourth self-reinforcing mechanism of the soft budget constraint may hence be labelled the *problem reproduction* mechanism.

These reinforcement mechanisms - the mechanisms of established advantage, adaptive expectations, institutional interaction and problem reproduction - are not operating independently. They are closely interrelated, not least the last two, where the soft budget constraint interacts with other behavioural rules. In fact, these interactions - and therefore the reinforcement mechanisms - were more intricate than suggested here, because of the complexity of the institutional relationships. As an integral part of the institutional system, the soft budget constraint was a link in a network of several formal and informal rules that it functionally complemented. The interaction between the soft budget constraint and the other institutions was thus manifold. Consequently, reinforcement of the actors' incentives to apply the soft budget constraint was the outcome of multiple processes of institutional interaction, which simultaneously contributed to the reproduction of parastatal financial problems in a number of ways.

The Cumulative Process

The sequential and causal steps of the cumulative process in which the different reinforcement mechanisms operated were as follows. When parastatals were in financial trouble, the soft budget constraint was there and offered a behavioural solution for managers and bureaucrats. The actors expected its application to be successful, faced incentives to apply it, applied it and found the behaviour successful, which confirmed and reinforced their expectations of its continued prevalence and success. The expectations of external accommodation of parastatal financing gaps made it easier for the actors to adhere to the other rules, and thereby reinforced the incentives for such behaviour, while they weakened the incentives to economise on parastatal costs. The actors pursued their official tasks and personal aims according to the other formal and informal rules of the socialist system, which wasted parastatal resources. As a result, parastatal financial problems were reproduced.

When the situation recurred, the actors' incentives to apply the soft budget constraint were stronger than the previous time, for several reasons. First of all, the fact that the actors had already adhered to the other rules (for instance, by imposing political commands and extracting resources for network use), and thus contributed to the situation, shaped incentives for them to apply the soft budget constraint. Besides, the other rules left little room for alternative behaviour, while they created opportunities to apply the soft budget constraint. Secondly, the actors' expectations of the validity and success of the soft budget constraint were reinforced by its previous successful application. Thirdly, actors had now learnt to adhere to both this rule and the other ones a little better than during the previous round. This permitted them to increase their benefits from the system. The advantage of being able to adhere to the soft budget constraint was therefore stronger. They applied the soft budget constraint again and set off yet another loop.

This cumulative process is the one that maintained and gradually reinforced the soft budget constraint within the Tanzanian parastatal sector, through every loop that it completed, during the economic crisis. The soft budget constraint was reinforced in the sense that actors' expectations that parastatal financing gaps would be externally accommodated were strengthened. This process is similar to the one through which the soft budget constraint once emerged, and the mechanisms that contributed to its emergence are the same as the reinforcement mechanisms discussed here.

Reinforcement of the soft budget constraint is, first of all, indicated by its repeated application during the crisis period. It is also suggested by the fact that parastatal financial problems increased: the total number of loss-making parastatals expanded, the relative share of parastatals making losses increased, at least within the manufacturing and trade sector, and the value of the losses in relation to public expenditure and official GDP grew. This implies that the soft budget constraint was applied to more parastatals, more frequently, and that larger financial accommodations were made. The proposition that the soft budget constraint was increasingly applied over time is further suggested by the growth of most forms of soft finance. In addition,

the application of the soft budget constraint spread to new forms of finance, notably import support, and thereby introduced new actors into its application: the donors.

Learning about Benefits

All four reinforcement mechanisms operated because actors' ability to learn from experience implied that they recognised the beneficial consequences of rule-following and repeated successful behaviour. Just like its emergence, the maintenance and reinforcement of the soft budget constraint hinged on actors' adaptive learning. Besides, over time, parastatal managers and bureaucrats learnt to apply the soft budget constraint more skilfully and effectively, and thus to increase their benefits from such behaviour.

Once the actors knew how to behave when parastatals were in financial trouble, they could act more promptly and resolutely and thus solve the problem quicker and better. They learnt to apply the soft budget constraint more easily, so that to seek and grant finance required less effort. This is suggested by the manner in which the Minister for Finance approved of discretionary tax exemptions. The actors also learnt to locate new forms and sources of finance and to shift between these, to apply the soft budget constraint in new but similar situations and with new counterparts, and thus to spread its applicability. And they learnt to bargain better. This is illustrated by the case of import support.

When import support was introduced on a major scale during the crisis, it appears to have been perceived as a new potential source of external parastatal finance. The Tanzanian actors hence tried familiar behaviour that had proven successful in similar situations in the past: application of the soft budget constraint. When bargaining for import support, many actors could draw on their previous experience of interaction with foreign donors in the context of project aid. Both bureaucrats and potential parastatal recipients learnt to adapt their allocations and applications to the wishes of the donors. Treasury staff adjusted their own import-support allocations so as to get donor acceptance. They 'tried to please donors by listing recipients they believe[d] the donors would like to support',[256] and learnt that recipients of project aid were likely to receive import support from the same donor. As observed by the Norwegian donor, Tanzanian enterprises also learnt. They often located a supplier and then applied for import support from the donor agency of that supplier's home country.[257]

Elgström explains how the Tanzanians learnt to bargain successfully for Swedish aid by drawing on group feelings that developed within aid projects between donor officials and local officials. This sometimes resulted in the Swedes informing the Tanzanians about how to present

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[256] Hansen *et al.* (1987), p. 40. A study by the Ministry of Finance (1993), p. 13, confirms that one criterion on which its allocations was based was precisely such '[d]onor preferences and conditionalities'.

[257] Personal communication with senior staff at NORAD, Dar es Salaam, 5 November, 1992. Donors used import support to assist domestic industries that lobbied for such assistance. See Eriksson (1995), pp. 37-39, for a discussion and references.

their case before higher Swedish authorities, how to argue successfully, etc. Tanzanian project leaders also asked the Swedes to intervene on their behalf in interactions with higher Tanzanian authorities.[258] Tanzanian actors learnt how to rely on the emotional and ideological attachments of the donor officials, in terms of what arguments to use and what chords to strike. They alluded to the ideological and personal affinity with the Swedes, and referred to the closeness between Swedish aid objectives and Tanzanian development policies. They stressed the parties' close and long friendship and previous Swedish generosity: 'You are our very best friend'; 'You have been helping us for so many years, don't desert us now'. Elgström notes that this argumentation seems to have aimed at creating feelings of guilt - 'You should not abandon the child you have borne!' - which contributed to the Swedes' inability to terminate aid projects.[259]

In a similar manner, the actors learnt and developed skills in how adhere to the other rules more effectively. By drawing parallels to the former Soviet Union, Bagachwa *et al.* note that parastatal managements became 'adept at managing their relations' within the system, for instance 'at doing deals' to 'gain access to resources within the bureaucratic structure' where 'survival depended on political competence and bureaucratic access'.[260] The growth of informal activities and incomes suggests that both parastatal managers and bureaucrats succeeded in increasing their gains from such behaviour.

The fact that the soft budget constraint was maintained and reinforced because it had beneficial consequences that the actors became aware of does *not* imply that its reproduction was purely intentional, or that the actors were fully aware of all the ways in which they contributed to its reproduction. On the contrary, we argue that to some extent the soft budget constraint was maintained and reinforced unintendedly.

Beneficial Consequences and Unintendedness

The applications of the soft budget constraint, its effects on the operational context of the actors, its interactions with other institutions and the functions that it performed were manifold and complex. These complexities, together with general human perceptional and computational limitations, narrowed the actors' perspective and restricted their understanding of the world in which they operated. The previous chapter discussed how they had to resort to ideology to interpret, for instance, causal relationships. In addition, there was the tremendous information problem inherent in the socialist system. Hence, to the extent that parastatal managers and bureaucrats were boundedly rational, they are unlikely to have noticed all the beneficial consequences of the soft budget constraint and all the ways in which they contributed to its reproduction.

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[258] Elgström (1992), pp. 128-129 and 134-135.

[259] Ibid., pp. 138-139. See also p. 128.

[260] Bagachwa *et al.* (1992a), p. 11.

This suggests that the actors primarily considered the immediate context around them: that they were aware of and intended to reap the individual and most direct beneficial consequences of their behaviour, rather than all the aggregate and indirect functions of the soft budget constraint. Besides, part of the actors' application of the soft budget constraint was unintended, as discussed earlier. Since bankers and Treasury officials lacked records for payment of borrowers' credit and import-support recipients' cash cover, they were not fully aware of their own non-enforcement of payments. Moreover, the actors do not appear to have recognised the institution *per se:* the fact that there was a behavioural rule such as the soft budget constraint, which they adhered to. Financial matters were of subordinated importance, and as an informal rule, it was not specified anywhere. Besides, the concept was not in common use in public and academic circles in Tanzania at the time, in fact not until the early 1990s.

Even when its application was intended, the actors are unlikely to have applied the soft budget constraint for the express purpose of reproducing it. Neither can they have adhered to the other rules simply in order to reproduce and benefit from the soft budget constraint. During the crisis, the actors were busily providing for themselves and their nearest and dearest, by focusing on the professional and private tasks of high priority: managers' loyal execution of commands, bureaucrats' discretionary control over parastatals, and both their adherence to the rules of the economy of affection. Although the soft budget constraint was a precondition for much of this behaviour, its reproduction cannot have been the main or sole purpose. The maintenance and reinforcement of the soft budget constraint was instead a largely unintended outcome of the actors' behaviour. Its application was rule-governed behaviour as a means for coping with recurrent problems, which resulted when the actors focused on issues of major importance in pursuit of their aims within the system.

Finally, the soft budget constraint was also maintained through its negative consequences for parastatal performance. However, while its beneficial consequences were partly intended, its negative consequences cannot have been intended by anyone. Although the soft budget constraint created incentives for behaviour that involved resource waste, nobody gained from the waste of resources *per se.* Hence, we may conclude that the soft budget constraint was maintained and reinforced both organically (non-consciously and unintendedly) and pragmatically (consciously and intendedly) during the crisis.

Outcome: A Stable System in Crisis

As the soft budget constraint was maintained and reinforced in a cumulative process in interaction with other institutions, its consequences also accumulated at the aggregate level. This sub-section begins by considering what the prevalence of the soft budget constraint implied for the socialist system and its characteristics, and discusses the consequences for the performance of the system.

Contribution to Systemic Stability

In spite of its poor performance, the socialist system remained remarkably stable during the crisis. The official ideology and the institutional set-up were essentially unaltered. The parastatal sector was also intact. Being able to operate in a stable and familiar context facilitated the behaviour of parastatal managers and bureaucrats. It was this stability that enabled them to learn to better pursue their aims within the system, while maintaining their economic, political and social positions. The soft budget constraint contributed to the institutional, ideological and organisational stability in several ways.

First of all, it brought stability to the institutional set-up. It did so by offering behavioural solutions to recurrent systemic problems, parastatal financing gaps, and by mitigating others: the information problem, inflexibility and incentive problems. By dealing with problems created by other institutions, the soft budget constraint was adapted to and functionally complemented them, and thus brought coherence and consistency to the entire institutional network. The institutional relationships and actors' learning made the soft budget constraint interact with the other formal and informal institutions of the system in a process of mutual maintenance and reinforcement.

By providing a survival mechanism for the poor parastatal performers, the soft budget constraint kept the parastatal sector intact and brought stability to the organisational structure. It also reinforced another organisational form - an informal one. The close and repeated interaction between parastatal managers and bureaucrats over parastatal activity implied that firm personal bonds developed between the actors. Over time they became members of each other's informal social networks. The Tanzania Association of Parastatal Organisations bears witness to the close relationship between parastatal managers and their superiors at the ministerial level - ministers, permanent secretaries and ministerial executives.[261] The bonds between the president and his appointees were discussed in the previous chapter. The repeated application of the soft budget constraint gradually strengthened the personal ties between the actors, reinforced the informal networks and contributed to their spread within the public sector. By keeping the formal organisational structure intact and facilitating adherence to the other rules, the soft budget constraint also made it easier for the actors to nurse their social networks using parastatal resources. As a result, personalised relationships and social networks among the actors within the party, state and parastatal bureaucracy grew strong during the crisis. What may be referred to as an informal parallel organisational structure, partly overlapping the formal structure, was established.[262]

The institutions and power relationships of the socialist system, and even its poor performance, were rationalised by the official ideology, which formed part of the system. The

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[261] Tanzania Association of Parastatal Organisations (1989), pp. 29-30.

[262] Kiondo (1989), p. 210, offers an example of the intertwined formal and informal networks. He notes, for instance, that 'networks created by confinement policies can therefore extend all the way from the industry manager down to the distribution committees and the road blocks'.

soft budget constraint did not only reflect the socialist ideology and the social values of the economy of affection, but its application confirmed and reinforced their validity.

By bringing institutional and ideological stability, maintaining the parastatal sector intact and facilitating the nursing of informal social networks, the soft budget constraint contributed to the stability of the socialist system during the crisis. Its systemic impact was not unambiguous, however, because by stabilising the system, the soft budget constraint also reinforced its characteristic traits.

Reinforcement of Systemic Weaknesses

Puzzling as it may seem, in spite of 'solving' or mitigating several systemic weaknesses, the soft budget constraint contributed itself to these very weaknesses, as well as to some other ones. The most obvious case is that while it offered a behavioural solution to recurrent parastatal financial problems, it simultaneously reproduced and worsened those problems. The incentive problem is closely related. While the soft budget constraint reinforced the incentives for parastatal managers and bureaucrats to perform their official tasks - incentives which otherwise would have been weak - it created incentive problems itself, although slightly different ones. It weakened the incentives for both classes of actor to economise on parastatal costs, and strengthened the incentives for behaviour that involved resource waste, which worsened parastatal financial performance.

Another systemic weakness was the adaptive rigidity of organisational structures and resource allocation. We explained how through financial accommodation, the soft budget constituted an adaptive mechanism, which introduced an element of flexibility. However, it contributed to the very rigidity that it compensated for, in two distinct ways. First of all, since the soft budget constraint provided a survival mechanism for loss-making parastatals, there was practically no exit option for inefficient firms. Hence, by contributing to organisational stability, the soft budget constraint created organisational rigidity. It prevented 'creative destruction' through dynamic change of organisational structures.[263] Secondly, the soft budget constraint contributed to the rigid resource reallocation within the existing organisational structure, by weakening parastatal responsiveness to exogenous change, for instance in relative prices.[264]

By weakening incentives to economise on costs, reducing price responsiveness and preventing organisational change, the soft budget constraint aggravated economic inefficiency not only in individual parastatals, but also within the sector as a whole and thereby in the entire economy. Technical, allocative and dynamic inefficiencies were systemic characteristics, which the soft budget constraint fuelled, but in no way managed to mitigate. Inefficiency was also

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[263] Schumpeter (1942), who coined the term creative destruction, saw it as 'a dynamic kind of competition arising from innovation and change'. (Langlois, 1986c, p. 11.)

[264] Cf. Pelikan (1987), who distinguishes between two types of flexibility: *of* and *within* organisational structures.

partly a consequence of the information problem, in terms of price distortions and misleading or non-existent financial data - another systemic trait worsened by the soft budget constraint.

First of all, the application of the soft budget constraint biased the data on financial performance, as reflected, for instance, in the audited accounts of the parastatals. Administrative cost-plus pricing, in particular, disguised poor financial parastatal performance. The soft budget constraint also contributed to the lack of parastatal financial data. By providing alternative information as behavioural guidance and signalling the relative unimportance of financial matters, it made such information largely unnecessary. The soft budget constraint enabled the actors to refrain from producing and requesting parastatal financial information. Besides, by promoting the extraction, abuse or simple waste of parastatal resources, it shaped incentives for parastatal managers and bureaucrats to disguise and distort information on parastatal performance.

Finally, over-investment and shortages were other systemic weaknesses that were most probably worsened by the soft budget constraint, which facilitated hoarding and tended to raise demand for both inputs and investment. Hence, the soft budget constraint provided means for parastatal managers and bureaucrats to handle systemic problems, but by doing so, it simultaneously shaped incentives for behaviour that reproduced the problems, with negative consequences for the performance of the system.

Deepening the Crisis

The cumulative process through which the soft budget constraint was maintained and reinforced made the negative effects of the soft budget constraint accumulate over time. First of all, its worsening of the parastatal financial problems meant that its application - carried out to deal with these problems - grew increasingly costly. This had devastating economic consequences, not least for the domestic fiscal and monetary situation.[265]

Direct budgetary subsidies to the parastatals accounted for a growing share of government recurrent expenditure. They partly crowded out other expenditure items and possibly contributed to expenditure growth. Simultaneously, tax exemptions and non-enforced cash-cover payments for import support reduced government revenue, although the amounts of these forms of soft finance cannot be established. Still, the number of discretionary tax exemptions quadrupled during the early 1980s and total exemptions on customs duty - although not all necessarily soft - equalled to the value of customs duty collected.[266] The soft budget constraint thus worsened the recurrent budget deficit. As mentioned, there was a relative shift in the government budget deficit in the late 1970s, from the capital to the recurrent account. To the extent that the soft

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[265] See Table 4.1 and the text in the first section on selected macro-economic indicators for domestic balance, external balance and real growth.

[266] See Tables 4.11 and 4.13 above.

budget constraint fuelled government parastatal investment, it also contributed to the deficit in the development budget.

Through its contribution to the tremendous budget deficit, the soft budget constraint also increased the need for deficit financing. In particular domestic bank borrowing increased. Besides, parastatals in financial trouble were largely financed by soft bank credit. They completely dominated the non-government lending from the National Bank of Commerce.[267] The soft budget constraint thus contributed to the rapid credit and monetary expansion, via both the budget deficit and the banks, and thereby fuelled the rate of inflation, which increased drastically.

Mukwanason Hyuha and Ndulu argue that inflation in Tanzania is essentially structural, determined by supply-side constraints and channelled through costs. 'Demand-side variables merely reinforce the supply-pressures on prices', mainly through 'government bank borrowing to finance budget deficits and parastatal losses.'[268] Whatever the relative importance of structural versus monetary causes of inflation, the soft budget constraint contributed to both in the process of its self-generation. Its application implied that parastatal cost increases were accommodated, for instance through adjustment of the money supply via soft bank credit, or via administrative cost-plus pricing, which meant that they were directly translated into price increases. However, financial accommodation in itself weakened the parastatal financial discipline and the responsiveness to exogenous change, which generated further cost increases. Hence, by both accommodating and causing cost increases within the parastatal sector, the soft budget constraint linked structural and monetary factors, which interacted and reinforced one another in an inflationary process.

Accommodation of the parastatal financing gaps also had far-reaching consequences for the private sector. The parastatal domination of commercial non-government bank credit, for instance, continued to crowd out other borrowers. As shown in Table 4.15 above, the private sector share even declined, from a low 12 per cent in 1978, to a mere 6 in 1984, which must have hampered its contribution to production. Parastatals were also favoured in the allocation of other scarce resources at subsidised prices, not least foreign exchange in terms of import support.[269] The application of the soft budget constraint often implied that they got the resources for free.

Since the use of resources by parastatals was often more inefficient than that of private firms, at least in manufacturing as shown above, this implied that total output suffered. The soft budget constraint protected inefficient production lines and tied up working capital and investment finance in the parastatal sector. The entry and growth of new, private and more efficient firms was prevented and resource reallocation was hampered, resulting in inefficiency and loss of

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[267] See Table 4.15 above.

[268] Hyuha and Ndulu (1990), p. 26. See also (1989), pp. 33-36.

[269] For further examples of scarce resources that parastatals had privileged access to, see the World Bank (1988a), pp. 24-25.

output. Hence the soft budget constraint obstructed economic growth within the entire economy, by weakening incentives and worsening rigidities and inefficiencies within the parastatal sector.

The soft budget constraint also reduced agricultural output. It had a direct impact via its negative consequences for the performance of the crop authorities, and through the way that it was applied to accommodate the resulting financing gaps. Although we cannot establish the extent to which the soft budget constraint contributed to the inefficiencies, cost increases and losses of the crop authorities, its impact has been suggested by several examples. Together with soft residual pricing, the implications for peasant producers were severe. Although the cost increases of the exporting crop authorities were no longer fully compensated for, the producer prices paid to peasants for crops purchased were residually determined after the parastatal costs had been deducted. This application of the soft budget constraint, in combination with its fuelling of costs and worsening of inefficiencies of the crop authorities, contributed to low and declining producer prices.[270] As a result, peasants' incentives to produce for export and to market any crops via the official marketing channels were weakened. Despite a certain shift to parallel market trade, this is likely to have contributed to the slow output growth in agriculture.

Less marketed cash crops had severe implications for the country's external balance, since exports primarily consisted of agricultural crops channelled via the crop authorities.[271] Since also food crops escaped the official marketing channels, the distribution from surplus to deficit areas was hampered, given the severe restrictions on parallel market trade. The country consequently had to import large amounts of staple grains throughout the period 1980/81-1983/84.[272] By also stimulating hoarding and the demand for imports within the manufacturing sector, the soft budget constraint reinforced the shortage of foreign exchange and worsened the trade balance and the overall balance-of-payments problems.

It also had more indirect negative consequences on the external balance and domestic output, for instance through its impact on inflation. By fuelling inflation, it contributed to the overvaluation of the Tanzanian shilling, which reduced the export proceeds and increased the demand for imports, and thus worsened the shortages. Falling returns on exports further depressed peasant producer prices, given soft residual pricing, while the shortage of consumer goods further weakened incentives for peasants to produce for the market, particularly cash crops.[273] The shortage of inputs reduced capacity utilisation and output within manufacturing, which worsened the shortages of domestically produced commodities, and so forth.

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[270] Real producer prices for the major export crops coffee and cotton were more or less halved during the crisis. (Tanzanian Economic Trends, 1988, Table 10b, p. 56.)

[271] The volume of officially purchased export crops as well as the volume and USD value of agricultural exports from the Tanzanian mainland dropped quite substantially during the crisis. See, for instance, Marketing Development Bureau (1990), Appendices 1.a and 1.c, and Tanzanian Economic Trends (1988), Table 13, p. 60.

[272] This is when food aid to Tanzania also was at its highest level. (Marketing Development Bureau, 1987, p. 18.)

[273] Bevan *et al.* (1988b), pp. 46-64, established a positive relationship between the availability of consumer goods and the officially marketed supply of cash crops during the crisis.

Although the macro-economic implications of the soft budget constraint have not been examined thoroughly or in any detail here, its contribution to the economic crisis has been indicated.[274] The magnitude of the impact of the soft budget constraint remains to be established, and its effects are not easy to distinguish from those of other factors, since the soft budget constraint interacted with other institutions in producing them. However, given the general prevalence of the soft budget constraint within the parastatal sector, the substantial resource transfers that it gave rise to, the large part of the parastatal sector that it was applied to and the strong incentives that it shaped, its impact cannot have been negligible. Hence, while the soft budget constraint contributed to the stability of the socialist system, it simultaneously worsened its already poor macro-economic performance. It deepened the crisis. The outcome of the soft budget constraint was a stable system in crisis.

CONCLUSION: THE LOGIC OF THE SOFT BUDGET CONSTRAINT

This chapter studied the soft budget constraint within the parastatal sector in Tanzania during the late 1970s and the first half of the 1980s. The period was characterised by economic instability but institutional stability. The inherent performance problems of the evolving socialist system culminated in an acute economic crisis as the system consolidated itself. Years of recession, macro-economic imbalances and severe shortages followed. Nonetheless, the socialist system remained remarkably stable throughout.

The chapter first established the prevalence of the soft budget constraint during the crisis, by studying in particular its application to different forms of external parastatal finance and by observing the survival of chronic loss makers. As part of the institutional system in which parastatal managers and bureaucrats operated, the soft budget constraint contributed both to the stability of the socialist system and to its poor performance. It was not only maintained, but also reinforced, despite the fact that it had tremendous negative consequences for both parastatal and macro-economic performance. The second part of the chapter suggested an explanation of why this occurred - and thus accounted for the logic of the soft budget constraint - by examining what functions it performed and by what mechanisms it was reproduced.

The primary function of the soft budget constraint was to offer a behavioural solution for how to handle recurrent parastatal financial problems. This had beneficial consequences for parastatal managers and bureaucrats, first of all because it facilitated their behaviour in these increasingly frequent situations. The soft budget constraint functionally complemented the other rules and made it easier for the actors to adhere to them. It thus facilitated actors' behaviour in other situations also. In addition, it provided a survival mechanism for loss-making parastatals.

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[274] Some of the negative macro-economic consequences of the soft budget constraint were to become even more clearly displayed during the reform period that followed, as will be shown in Chapter V.

The soft budget constraint kept the organisational structure intact, brought coherence and consistency to the institutional system within which the actors operated, facilitated their nursing of informal social networks and was consistent with the official ideology and values of the economy of affection. This is how it contributed to the stability of the socialist system. It thereby made it easier for parastatal managers and bureaucrats not only to pursue their aims within the system, but also to learn to increase their benefits from the opportunities thus provided and to retain their economic, political and social positions during the crisis.

The soft budget constraint was maintained and reinforced because of its beneficial consequences for parastatal managers and bureaucrats, who learnt that applying it in situations of parastatal financial trouble was successful and therefore repeated their behaviour. It was not only reproduced consciously and intendedly by the actors, however, but partly - just as its emergence - without their being aware of or intending this outcome. Once established as an institution, its very existence - and hence the existence of expectations of external accommodation of parastatal financing gaps - set off a cumulative process of self-reinforcement. We identified four mechanisms through which the soft budget constraint was maintained and reinforced: those of established advantage, adaptive expectations, institutional interaction and problem reproduction.

Through the expectations and incentives for behaviour that the soft budget constraint gave rise to, it interacted with the other institutions, both in the reproduction of the situations in which it applied and in the strengthening of actors' incentives to apply it in those situations. While the maintenance and reinforcement of the soft budget constraint contributed to the stability of the socialist system, with beneficial consequences for parastatal managers and bureaucrats, its negative effects also accumulated over time. A vicious circle resulted, where the soft budget constraint and the other institutions interacted in a process of mutual reinforcement, while parastatal performance deteriorated and the socialist system performed worse and worse.

CHAPTER V

PERSISTENCE AND CHANGE DURING INSTITUTIONAL REFORM

The prevalence of the soft budget constraint within the socialist system in Tanzania was not the result of a conspiracy. It was the outcome of an invisible hand. Spontaneous self-reinforcing mechanisms accounted for the prevalence and reproduction of the soft budget constraint, without this being intended by anyone. By 'taking care' of the parastatal financing gaps that it contributed to creating, the soft budget constraint made the problems reach the macro-economic level.

The situation eventually became unsustainable for the political leaders. Their legitimacy and position were threatened, and this forced them to launch institutional reform. From mid-1984 onwards, a market-oriented transition process was initiated, which gradually dismantled the socialist system and involved attempts to come to grips with the soft budget constraint. This chapter tells the story of what happened to the soft budget constraint within the parastatal sector during this systemic transition, between 1984 and 1992.

The chapter begins with a presentation of the reform programmes, focusing on measures of systemic change that were significant for the parastatal sector. Then the programmes are contrasted with their outcome, and conclusions are drawn about the persistence and change of the soft budget constraint during the reform period. The next three sections suggest an explanation for the observations made. They examine how the operational context of firms and actors within the parastatal sector was influenced by the reform and its consequences. They discuss the uncertainty that change involved, the problems that the actors faced, their options for dealing with those problems and their actual behaviour during the period of transition. Throughout, emphasis is placed on the role of the heritage, persistence and change of the soft budget constraint for either behavioural rigidity or change. Finally, the implications for systemic transition itself are discussed.

DISINTEGRATION OF THE SOCIALIST SYSTEM

The year 1984 marked the starting point for a prolonged process of systemic change away from socialism in Tanzania. It initiated a period characterised by relative institutional instability, in contrast to the preceding period. The initial measures were dramatic and discrete, but the process of institutional reform was gradual and continuous, and emanated from within the system itself. This section presents the central elements and characteristics of the different reform programmes and related changes. Let us first briefly discuss their background: the failure of the stable socialist system.

Background to Reform: The Failure of Socialism

The previous chapter pointed to what seems to be a paradox: the fact that the socialist system remained stable in spite of its disastrous and deteriorating performance. The role of the soft budget constraint for both stability and crisis was central. However, this stability was coming to an end. The weaknesses, tensions and conflicts inherent in the system surfaced during the crisis. As commodity shortages worsened, the discrepancy between the official and the informal economy became increasingly apparent. Together with the growth of corruption, the widening gap reflected the inability of the government to enforce the formal rules and the failure of the official economy to provide opportunities for income generation and consumption. The disastrous economic situation fuelled public discontent, with hardships and with the ability of the privileged few to enrich themselves through parallel market trade, corruption and extraction of public resources.[1] As the 'resource base at the centre of the state's power eroded', Ndulu notes, 'it gradually lost legitimacy'.[2] The leadership faced a political crisis, worsened by its growing control of popular organisations and the lack of opportunities for democratic participation. The ideological justification of the system also crumbled, when the reality that people experienced diverged from the official model of the world. The crisis was a crisis of the entire socialist system.[3]

According to Kiondo, the most important pressure on the Tanzanian leadership came from the challenge posed by the informal sector. It provided 'a practical alternative to state control' and thus strengthened 'the forces and logic for change'.[4] Besides, the fact that an increasing amount of economic activity was taking place outside the domain of the state and the party circumscribed their economic control. Private businessmen accumulated wealth to such an

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1 Kiondo (1989), pp. 229-239, *passim.*

2 Ndulu (1986), pp. 81-82.

3 Cf. for instance Havnevik (1993), p. 56.

4 Kiondo (1989), pp. 222-223; quotation from p. 223.

extent that they constituted a strong economic power centre, threatening the economic and possibly also political position of the leadership. The organised nature and extended networks of 'big business' within the second economy made President Nyerere refer to it as an underground government.[5] The leadership first responded in 1983, by declaring the 'war' against 'economic saboteurs and racketeers' engaging in parallel market activity and corruption. This war was primarily directed against wealthy private businessmen who were perceived as potential rivals, and diverted the blame for the economic crisis, in particular the commodity scarcities, away from the leadership.[6] The campaign failed, as discussed in the previous chapter, and further weakened the legitimacy of the leadership.

Members of the leadership benefited from the existing order, but this order threatened their position and therefore became unsustainable. From the donor community pressure for reform built up, both verbally and in terms of reduced foreign aid.[7] Further decline in aid would have worsened the country's import capacity, increased shortages, and threatened the financing of public activity via both development and recurrent government expenditure. The leadership's strong resistance to reform was weakened both by this circumstance and by the fact that formal institutions were partly rendered ineffective by widespread parallel market activity. 'This situation', Ndulu noted, 'reduced the political constraints on change from the official *status quo* since such a change may in effect just legalize what is actually taking place.'[8]

The seeds of change were thus inherent in the socialist system itself. Its poor economic performance, repressive character and foreign dependence gave rise to spontaneous and gradual *de facto* institutional change. Reform of the formal system itself would follow.

Central Elements and Characteristics of the Reform Programmes

The government budget for 1984/85 altered institutions central to the socialist system through significant deregulation of imports, domestic trade and pricing. Together with policy measures - changes within the institutional context, such as devaluation and increases in agricultural producer prices - these reform measures constituted the country's first step out of the economic crisis.

The budget signalled that the leadership was willing to come to an agreement with the International Monetary Fund (IMF) and other donors in order to attract more foreign aid. In 1986, a comprehensive reform and policy package was announced: the Economic Recovery

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5 Maliyamkono (1985), in particular p. 13, referred to by Kiondo (1989), p. 224.

6 *Chama cha Mapinduzi* (1981), pp. 11-23, referred to by Kiondo (1989), pp. 234-235, Havnevik (1993), p. 58, and Maliyamkono and Bagachwa (1990), pp. ix-xi.

7 See Table 3.13 in Chapter III.

8 Ndulu (1988), p. 24.

Programme (ERP).[9] This made it possible to reach an agreement with the IMF, which opened the door to an influx of resources from the World Bank and bilateral donors who supported the programme.[10] The ERP, which was implemented during the period 1986/87-1988/89, consolidated and extended the 1984 measures into a comprehensive programme. It thereby confirmed the government's more market-oriented and outward-looking position. The ERP was followed by another three-year programme, the Economic and Social Action Programme (ESAP), between 1989/90 and 1991/92.[11]

Both programmes aimed at short-term macro-economic stabilisation and at structural adjustment and economic recovery in the medium term. The ESAP also stressed the need to consider the social sectors, which had been neglected for many years. The programmes were complemented with other measures, including political liberalisation, all of which were elements of the same reform process. Its major components and characteristics are presented below, but details are generally left out, except when they are of specific importance for our purpose.[12]

Economic Policy Measures

The major economic policy measures addressed the severe macro-economic imbalances. The ERP launched a comprehensive stabilisation policy, combining fiscal, monetary, exchange-rate and pricing measures. Internal balance would be restored through restrictive fiscal and monetary policies, for which targets were set. To reduce the budget deficit, revenue would be raised, through increased use of fees and charges and revised tax and tariff systems. Expenditure ceilings were established, the staffing level within the state sector was frozen and initial steps to reduce the civil service were taken. Consumer subsidies on maize and agricultural inputs were removed already in the 1984/85 budget.

The policies directed at containing inflation in the early 1980s had concentrated on fiscal measures, whereas with the ERP an active monetary policy was introduced. Limits were established for the overall monetary and credit expansion, and the government share of total credit, as well as that of specified marketing boards, was restricted in order to leave room for private borrowers. To mobilise domestic savings and improve the financial performance of the banking sector, nominal interest rates were raised until they eventually approached positive levels in real terms. Taxes on savings were reduced.

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9 United Republic of Tanzania (1986).

10 For a background and presentation of the 1986 agreements with the IMF and the World Bank, see e.g. Kiondo (1989), pp. 279-299.

11 United Republic of Tanzania (1989).

12 For details, see the programme documents (United Republic of Tanzania, 1986 and 1989), and various IMF and World Bank publications, which form the principal basis for the account of policy and reform measures below. Overviews and analyses of the economic reform process in general as well as specific areas are provided in Bagachwa *et al.* (1992b). Kiondo (1989), in particular Chapters 5-6, or his briefer (1995), provides insights into the political economy of reform and the political reforms.

The major policy instrument to restore external balance was exchange-rate management. This was initiated as early as 1984, with a 28 per cent devaluation of the overvalued Tanzanian shilling against the US dollar. Continuous devaluations were a condition for financial support from the IMF. In 1986 and 1987 they amounted to over 60 and 50 per cent respectively.[13] As the overvaluation was reduced, however, the government became reluctant to adjust further and did so only slowly, which led to repeated and protracted negotiations with the IMF. Other measures to stimulate exports were adopted. The most important one was the liberalisation of imports, to be discussed below, which increased the supply of consumer goods and inputs. Official nominal producer prices continued to be raised, particularly for cash crops. Several measures aimed at reducing the previous discrimination of agriculture. Gradually, import substitution was eliminated.

Deregulation of Trade and Pricing

The most important measure in the 1984/85 budget was the so-called own-funded-imports scheme. This scheme allowed a large number of consumer, intermediate and capital goods to be privately imported and sold, most of them at market-clearing prices. Barriers to domestic trade in the freely imported goods and in food grains were simultaneously reduced. Import liberalisation was generally coupled with decontrol of the prices of the goods in question, but the prices of many domestically produced goods were also freed. Hence, areas where formal rules had already been rendered ineffective by informal ones, such as pricing, imports and domestic trade, were deregulated first. Deregulation continued throughout the period, but it was partial, selective, gradual and largely non-legal. Certain areas were retained under state control, and there were reversals in the process.

The own-funded-imports scheme was extended to a larger number of goods in 1986. In 1988, a new official foreign-exchange window was introduced, devoid of administrative allocation and with gradually fewer quantitative restrictions. This open general licence (OGL) system made foreign currency from the donors - import support - available for any importer of priority commodities. The number of these commodities increased over time. Nonetheless, foreign exchange was still to a large extent administratively allocated. An examination of the different windows under which import licences were issued suggest that by 1990, market-determined allocation still accounted for less than half of the total official imports.[14]

In domestic markets, the confinement of wholesale trade to specific parastatals was gradually eroded by the own-funded-imports scheme. In addition, exemptions from the obligation to sell to or buy from these parastatals were discretionarily approved for individual firms and goods on

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[13] Calculations based on Tanzanian Economic Trends (1988), Table 5, p. 49, and (1992), Table 5, p. 68.

[14] Data on import licences issued are presented, for instance, by Bhaduri *et al.* (1993), Table 6.4, p. 118.

a case-by-case basis.[15] Agricultural marketing, particularly in food crops, was also liberalised, but private traders were only allowed access to selected markets, for specific crops or at specific levels in the distribution chain. There were also reversals in this process, when co-operative societies regained the monopsony on food purchase at the village level, and when local authorities intervened in centrally sanctioned private trade.[16] By the early 1990s, however, most food trade had been deregulated. Trade in cash crops was liberalised to a far lesser extent, and much more slowly. Monopoly remained strong for the major crops, at least up to mid-1991, and co-operative unions retained extensive responsibilities for their marketing.[17] In 1990, co-operative societies were allowed to export directly, by-passing unions and marketing boards, thus collecting world-market prices.[18]

The decontrol of prices, which was initiated during the late crisis period, continued gradually, as shown by *Table 5.1.* With the launching of the ERP, the numbers of product categories and individual items still under price control were more than halved, to just over 20 and 100 respectively. Imported commodities ceased entirely to be subjected to price control, and at the turn of the decade, only 10 product categories remained. Most agricultural prices remained under control into the 1990s, but by 1990 all producer prices for food had been deregulated. Similarly at higher levels of the food-marketing chain, prices eventually became freely negotiable. The prices of public services remained administratively determined at least as late as mid-1991, and within the parastatal sector, wage setting was still centralised by mid-1992.[19]

Table 5.1: Number of Price-Controlled Goods in Tanzania, 1983-1991

Year	Product Categories	*o/w Domestic*	*o/w Imported*	Individual Items	*o/w Domestic*	*o/w Imported*
1983/84	56	50	6	235	226	9
1984	72	54	18	333	241	92
1984/85	47	44	3	184	179	5
1985	56	50	6	225	216	9
June 1986	47	-	-	-	-	-
1986	21	21	0	107	107	0
July 1986	22	-	-	-	-	-
1987	22	22	0	83	83	0
July 1988	12	-	-	-	-	-
1988	12	-	-	-	-	-
1989	10	-	-	-	-	-
1990/91	10	-	-	-	-	-
Mid-1991	2	-	-	-	-	-

Notes: A dash (-) indicates that data are unavailable.
Source: Table A.2 in the appendix

[15] International Development Association (1988), p. 16.

[16] Amani (1990), p. 22, and (1992), p. 125 and endnote 12, p. 129.

[17] World Bank (1991c), p. 5, and Amani (1992), p. 121.

[18] World Bank (1991b), p. 62.

[19] World Bank (1991c), p. 4, and (1992a), p. 10.

These *de facto* deregulation measures were not legalised for a long period, and were only issued by decree. Thus the own-funded-imports scheme thus undermined the regulations governing foreign exchange, imports, domestic trade and pricing that legally still remained in place.[20] Although domestic manufacturers no longer had to sell their goods via Regional Trading Companies, the law still required them to do so, and some commodities that could be sold at free prices formally remained price controlled.[21] Thus liberalisation largely consisted in officially sanctioned non-enforcement of prevailing laws rather than changes of these. Eventually, legal provisions followed. In 1989, the confinement of trade to parastatals was legally abolished, except for a limited number of commodities.[22] The fairly comprehensive liberalisation of agricultural trade appears not to have acquired legal status until the 1990s.[23]

Liberalisation thus officially legitimised parallel-market activity and implicitly recognised the role of the private sector in the economy. However, this role was not legally established, and private investors grew increasingly anxious to see it formalised. After years of reluctance, statements, repeated promises and postponements,[24] the government finally launched an investment-promotion policy in 1990, which included the long awaited Investment Code.[25] The code defines areas open for private, including foreign, investors and was complemented by an incentive package. An Investment Promotion Centre was established, which centralised official investment decisions and reduced the number of bureaucrats involved. Besides increasing security for the private sector, the new policy made previously discretionary private investment 'promotion' an official political commitment.[26]

Measures Addressing Parastatal Problems

The inefficiency and liquidity problems of parastatals, partly a consequence of the soft budget constraint, had long been recognised. In particular, the financial burden of keeping the parastatals alive had been a concern for the political leadership right from the early 1980s. Hence, although the leadership depended on and benefited from the parastatals, it faced incentives to improve their economic and financial performance, so as to make them increasingly self-sustaining, and to otherwise secure their financing.

This was also at least an implicit purpose of many of the general policy and reform measures discussed above. Trade liberalisation, for instance, was meant to confront parastatals with

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20 Cf. Kiondo (1989), p. 377.

21 See Kiondo (1990), p. 32 and endnote 10, p. 43, and (1989), p. 377 and endnote 4, p. 463.

22 World Bank (1991b), p. 92, and International Monetary Fund (1990), p. 15.

23 Amani (1992), p. 125.

24 See Kiondo (1989), p. 389, for details.

25 United Republic of Tanzania (1990a) and (1990b).

26 The importance of these aspects was stressed by a senior manager of a large private corporation in a personal communication, 31 July, 1991, in Dar es Salaam.

competitive pressure for more efficient use of resources, and to provide additional foreign exchange to enable them to increase their capacity utilisation and output. Limits on government expenditure and direct subsidies were intended to reduce the budgetary accommodation of parastatal losses. Raised interest rates, complemented by credit ceilings for marketing boards, were aimed at improving the financial position of the banks and restricting parastatal borrowing. Price decontrol was meant to reduce price distortions and the related information and allocation problems. Besides increasing real producer prices in agriculture, an important objective of the large devaluations was to 'improve the financial position of the marketing institutions so that they [could] reduce their dependence on unpaid loans from the banking system'.[27]

Many of the measures thus aimed at limiting the application and negative consequences of the soft budget constraint. This does not imply that a conscious and comprehensive effort was made to eliminate the soft budget constraint. As mentioned in the previous chapter, the concept was not in common use until the early 1990s and the complexity of the phenomenon, which is revealed in this study, implies that the political leadership does not appear to have recognised all its applications and consequences. Hence, the efforts to come to grips with the problem focused on mitigating its consequences, by shifting part of the financial burden to other financiers, or closing certain ways of applying it.

Sectoral measures, such as cost-cutting campaigns, were also initiated.[28] The relationship between the behavioural rules within the parastatal sector and its poor performance was recognised in several studies.[29] Major problems that were often identified include weak incentives to economise on costs, lack of managerial autonomy, excessive bureaucratic intervention in and political control of operations, corruption and resource extraction, lack of financial accountability and control of results. The newly elected president, Ali Hassan Mwinyi, attacked some of these old behavioural patterns. In his first address to Parliament in 1985, he announced that its members were no longer to sit on parastatal boards to 'continue to defend the evils' within the sector.[30] To strengthen the boards, steps were taken to limit their size and appoint technical experts, clients and creditors as members, but implementation was slow.[31]

Moreover, the President declared that he gave the parastatals two years to put their economic house in order or they would face disciplinary action.[32] His statement was interpreted by several observers as an implicit but clear threat that ailing parastatals would no longer be bailed out: they were to 'perform or "die"',[33] show 'profitable performance' or 'face natural death'.[34] They

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27 Lipumba (1991), p. 28; comment added.

28 Between 1984 and 1986, for instance, the number of parastatal employees was reduced by about 20,000. (World Bank, 1988a, pp. 35-37.)

29 For a survey, see the World Bank (ibid.), pp. 35-38.

30 Kiondo (1989), p. 281, including quotation.

31 World Bank (1988a), pp. 37-38.

32 Ibid., p. 39.

33 Ngowi (1990), p. 47.

34 Mwapachu (1989), p. 124.

were told 'to behave like profit-making entities, that non-commercial goals were to take second place, and that after a period of adjustment they would be held accountable'.[35] According to Kiondo, it was the notorious accounting weaknesses of the parastatals that the president addressed. When two years had passed, parastatal book-keeping was found to remain poor, but instead of enforcing disciplinary action, Mwinyi extended the respite by another two years.[36] Threats not to refinance poorly performing parastatals were repeated, however, and the importance of parastatal autonomy and accountability, commercial orientation and profits were increasingly stressed during the reform period.[37]

Agricultural marketing was reorganised. The inefficient and loss-making crop authorities were converted into marketing boards and replaced by the reintroduced co-operatives. Co-operatives were nominally autonomous entities that the government would not have to subsidise,[38] but in practice they were state- and party-controlled organisations, operating under conditions similar to those facing the parastatals. Consequently, and as illustrated later in this chapter, co-operatives in their new form are often considered to belong to the parastatal category. In 1991, a law was adopted to make them formally independent, operating exclusively on commercial criteria.[39] The marketing boards were relieved of many of the all-encompassing tasks of the crop authorities, but many of their problems remained, particularly for the National Milling Corporation, which was constantly reorganised during the period. Its functions were redefined several times and its activities were gradually scaled down. In the early 1990s, the role of exporting marketing boards was reduced to that of exporting agents for the co-operatives.[40] However, as concluded by Louis Putterman, several years of 'tinkering' with the details of the official cash-crop marketing system led to little fundamental change.[41]

The state also disposed of a few parastatals. The exact number is difficult to establish, but Table A.20 in the appendix represents an attempt. It combines data from different sources which together suggest that about a dozen parastatals ceased to exist in the early years of reform. Reorganisation, closure and sale of parastatals were initially undertaken on a case-by-case basis, but towards the end of the period, a more all-encompassing strategy was employed. Specific rehabilitation programmes for the major industrial sectors would be developed and implemented under the ESAP, and initiated a comprehensive process of parastatal restructuring and reform.[42] Both planning and implementation were substantially delayed, however. In 1991/92, the government issued a major policy statement on reform of the entire parastatal sector,[43] and

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35 World Bank (1988a), p. 39.

36 Kiondo (1989), p. 278.

37 For instance, in the ESAP (United Republic of Tanzania, 1989, pp. 12-13).

38 Kiondo (1989), p. 363.

39 United Republic of Tanzania (1991c).

40 United Republic of Tanzania (1989), p. 17, and (1991a), p. 2.

41 Putterman (1995), pp. 316 and 321.

42 See the World Bank (1988b) for details on the contents.

43 Ministry of Finance (1991b).

established a Parastatal Sector Reform Commission (PSRC) to lead the process. Non-viable parastatals such as chronic loss makers would be disposed of, potentially viable parastatals would be restructured, and some small parastatals and some that were actually making a profit would be privatised rapidly in order to render credibility to reform.[44] During the second half of the 1980s, another 20 parastatals were disposed of, and in the early 1990s about a dozen more. In late 1992, about 30 parastatals were at different stages of reform.[45] These changes notwithstanding, the donors' overall judgement was that the process was far too slow, which made them question the decision makers' commitment to reform.[46]

Financial-Sector Reform

The state-owned financial system had been geared towards accommodation of the expenditure needs of the public sector instead of financial intermediation. Consequently, parastatal reform of in particular agricultural marketing was necessary, although not sufficient, for prudent monetary policy, efficient credit allocation and private-sector promotion. During the reform period, the importance of financial-sector reform became increasingly clear, not least for effective reform of the parastatal sector. After considerable delay, a financial-sector reform strategy was adopted in 1991. The banking system was meant to become competitive and independent through the entry of new banks, including private and foreign ones, restructuring of the existing banks, elimination of political interference and a radically changed role for the central bank.[47]

A new Banking and Financial Institutions Act was adopted. It ensured the autonomy of the Bank of Tanzania (BoT) and provided adequate powers for its regulatory and supervisory functions.[48] The BoT was now to conduct monetary policy by using traditional indirect tools, and price-level stability became a primary target. The BoT issued guidelines on provisioning and capital adequacy and the first licenses to two foreign banks.[49] The existing banks were to be financially reconstructed. In 1992, the National Bank of Commerce (NBC) and the Co-operative and Rural Development Bank (CRDB) were thus relieved of a large part of their non-performing assets. These were transferred to a newly established Loans and Advances Realization Trust (LART) and replaced by government securities.[50] The NBC would be reorganised to improve management control and all commercial banks were meant to become operationally and financially independent. Refinancing from the BoT would be strictly limited, and the

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44 World Bank (1992a), p. 9.

45 Table A.20 in the appendix.

46 Embassy of Sweden (1992), p. 2 and Appendix 1.

47 Ministry of Finance (1991a).

48 United Republic of Tanzania (1991b).

49 Bank of Tanzania (1991b), and Tanzanian Economic Trends (1992/93), pp. 106 and 109.

50 World Bank (1992a), p. 7, and United Republic of Tanzania (1991d).

government would refrain from intervention in the banks' 'day-to-day business decisions',[51] notably credit allocation. In addition, the banks would be a given certain degree of autonomy in setting their interest rates.[52]

The Tanzanian reform process was thus characterised by a gradual broadening and deepening of both policy and reform measures. Liberalisation of trade and pricing initiated the process, but this was partial and selective rather than general, and implemented in a step-wise manner. It was generally not legalised until in the early 1990s, and therefore remained quasi-formal for a long time; this contributed to the ambiguity and inconsistency that also characterised reform. Apart from deregulation and stabilisation measures, effective reform of and within the parastatal sector was slow in coming, in spite of many studies, recommendations, statements, organisational change and restructuring programmes. Despite the fact that an all-encompassing programme for reform of the whole sector, including privatisation, was launched in the early 1990s, reform was also characterised by a significant discrepancy between the ample official rhetoric and the small changes actually accomplished. Towards the end of the period, comprehensive reform of the financial system was initiated. In addition, political reform gained momentum.

Political and Ideological Change

The economic reform programmes were paralleled by and partly reflected changes within the political system. The position of the leadership was based on political monopoly, economic regulatory power, state ownership of the parastatals and support from the bureaucracy, but its public legitimacy and access to foreign aid increasingly required market-oriented reform. Reform, in turn, threatened to weaken the leadership's position by the growth of economically strong private potential rivals. The leadership thus faced conflicting interests and was caught in a struggle between the forces gaining from the *status quo* and those that stood to gain from reform.

According to Kiondo, the economic reform process partly expressed this struggle and the compromises that were struck.[53] In 1985, when parliamentary and presidential elections were held, the political *status quo* was maintained, because the party, the government and the parastatal bureaucracy managed to prevent the market-oriented forces from participating. However, while representatives of the old politics generally retained their positions, Nyerere was replaced as president by Mwinyi, who was in favour of reform. This most probably facilitated both the reform process and the IMF agreement, since the previous stance was intimately related to the person of Nyerere. The 1987 party elections deepened the controversy between those

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[51] World Bank (1992a), p. 8, and Mwinyi (1992), p. x (quotation).

[52] Lipumba (1992), p. 53.

[53] Kiondo (1989), pp. 248-350; the whole paragraph is based on this reference.

against and those in favour of reform. This time again, the outcome was a compromise between opposing forces. It implied that practically everybody within the political leadership retained their positions throughout the country, while the reform of the economic system continued.

The leadership thus traded economic control for political power. It used the official ideology to rationalise reform, which was interpreted as a flexible implementation of socialism in difficult times.[54] The gap between the ideology and market-oriented reform grew, and certain steps towards ideological reassessment were taken. When he first came into power, Mwinyi had already encouraged leaders to engage in activities outside their ordinary sphere of action,[55] although they were forbidden by the Leadership Code to run private businesses. When Mwinyi also replaced Nyerere as chairman of the party in 1990, the code could be formally revised. Since 1991, party members are allowed to own shares in private firms.[56]

With economic liberalisation and the expansion of the private sector, domestic and foreign demands on political liberalisation grew stronger.[57] In the early 1990s, the ruling party initiated a development towards a multi-party system. In 1992, the constitution was partly amended, a Political Parties Act was adopted, and by October a large number of new parties had been registered. The *Chama cha Mapinduzi* abolished its political monopoly. This implied that it would no longer receive state financial support, and that its party committees in workplaces, including the parastatals, were dismantled.[58] The fact that the leadership exposed itself to political competition may be seen as a necessary concession to the pressures for reform. On the other hand, by taking the initiative and thus controlling political reform, it may have created an advantage vis-à-vis its competitors and an opportunity to regain legitimacy and remain in power.[59]

The reform process implied that the old Tanzanian socialist system gradually disintegrated. Deregulation increased the element of market co-ordination and private ownership in the economy, at the expense of bureaucratic co-ordination and state ownership. The official ideology sounded increasingly hollow and the one-party state was breaking up. In the early 1990s, the formal political and economic institutions and the official ideology were all undergoing a process of transition, from socialism into something new, but yet unknown.

In the socialist system, parastatal managers and bureaucrats had operated in an environment that made it difficult to run parastatals efficiently and profitably. Recurrent parastatal financial problems were reproduced and the soft budget constraint made an important contribution to the reproduction process. When the reform programmes, which included measures to deal with poor

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54 Nyerere (1987), p. 11, referred to by Kiondo (1989), p. 321.

55 Kiondo (1989), p. 390.

56 Havnevik (1991), p. 33.

57 Pressure came, for instance, from mass organisations within the party, academics and the independent press and was organised by political opponents. See Kiondo (1995), pp. 75 and 87-89, and Mukandala (1995), pp. 64-66.

58 Reported by senior staff at the Swedish Embassy in a personal communication, Dar es Salaam, 20 October, 1992.

59 Cf. Kiondo (1995), p. 91.

parastatal performance and problems related to the soft budget constraint, altered this system, did that put an end to the prevalence of the informal institution within the parastatal sector? This is the question addressed in the following section.

DEVELOPMENTS WITHIN THE PARASTATAL SECTOR

This section begins by examining the financial performance of parastatals during the reform period. It thereafter explores how any remaining performance problems were dealt with, and hence the extent to which the soft budget constraint continued to be applied.

Financial Performance and Survival of Loss Makers

Contrary to the intentions of reform, the financial performance of the parastatals deteriorated dramatically during the period, particularly in the early years.[60] This is clearly demonstrated by data on their accounts audited by the Tanzanian Audit Corporation (TAC).[61] *Table 5.2* shows that the net result of all parastatals audited by the TAC turned into a loss in the beginning of the reform period.

Table 5.2: Tanzania Audit Corporation Clients, their Audited Accounts and Financial Results, 1985/86-1991/92 (Million TSh)

	No. of	Accounts	PROFITS		LOSSES			TOTAL	
Audit Year	TAC Clients	for Fin. Years	*No. of Accounts*	*Total Value*	*No. of Accounts*	*% of Tot No.*	*Total Value*	*No. of Accounts*	*Net Value*
1985/86	415	1977-85	190	5,927.0	203	47	2,386.9	431	3,540.2
1986/87	415	1974-86	157	6,463.3	171	46	5,809.3	368	654.0
1987/88	408	1975-87	211	12,675.1	227	47	20,128.7	482	-7,453.6
1988/89	430	1978-88	176	21,729.0	189	48	32,905.5	396	-11,176.5
1989/90	472	1979-89	191	34,911.2	239	52	39,110.1	461	-4,198.9
1990/91	445*	1982-90	180	51,425.3	159	42	56,041.3	376	-4,616.0
1991/92	350*	1982-92	184	51,911.2	158	43	34,058.9	367	17,852.3

Notes: * Number of *active* parastatals in 1990/91 and excluding 150 *passive* clients that were either dormant or under dissolution and 15 sports associations affiliated to the National Sports Council in 1991/92.
Source: Table A.6 in the appendix.

[60] Note, however, that part of the observed deterioration in parastatal financial performance may reflect the fact that some of the past parastatal inefficiency had been disguised by price control and an overvalued exchange rate, but now became revealed in financial terms.

[61] The characteristics of and problems associated with these TAC data were discussed in Chapter IV.

Table 5.3 reveals the relative size of the total losses of all the audited commercial parastatals.[62] It shows that these losses tripled, from 3 per cent of official GDP in 1984-85 to 10 per cent in 1986, and thereafter grew to 17 per cent in 1989. As a share of total public expenditure, the losses jumped from 10 per cent in 1984/85 to 46 per cent the following year, and further, to 52 per cent, in 1988/89. Thereafter the relative size of the losses declined temporarily during two years, but returned to the higher level at the end of the period.

Table 5.3: Commercial Parastatal Losses in Relation to Official GDP and Public Expenditure in Tanzania, 1984-1992* (Million TSh)

Year	Loss Value	% of Official GDP	% of Public Expenditure**
1984	2,437.7	3	12
1985	2,830.1	3	10
1986	14,736.0	10	46
1987	25,547.1	13	53
1988	36,764.2	13	49
1989	55,731.0	17	53
1990	34,414.0	9	24
1991	39,546.0	7	19
1992	111,918.0	16	43

Notes: * Parastatal enterprises, excluding mainly marketing boards and other agricultural parastatals. ** Public expenditure during the period 1983/84-1991/92.
Source: Table A.7 in the appendix.

These data are biased, however. The figures do not include losses incurred by agricultural marketing boards, which implies that the total parastatal losses were even greater than those indicated by Table 5.3, as revealed by a comparison with Table 5.6 below. On the other hand, recent revisions of the official GDP show that total output grew faster from 1989 onwards than is implied by the data used here.[63] This suggests that the relative size of total commercial parastatal losses was lower during the latter part of reform.

Reform implied a shift in the relative importance of loss-making parastatals between sectors. Whereas agricultural parastatals had accounted for on average 43 per cent of all parastatal losses in the early 1980s,[64] *Table 5.4* shows that their share declined to on average 20 per cent during the second half of the decade. Parastatals within industries and trade, by contrast, saw the share accounted for by their losses jump from 29 to 50 per cent. The losses of these parastatals increased dramatically during the period, and so did their net result, which turned negative in the mid-1980s. Parastatals within the third major loss-making parastatal sector, communication and transport, also saw their losses grow in relation to profits and total parastatal losses at the onset of reform.

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62 Remember from the previous chapter that commercial parastatals, according to the TAC definition used here, are parastatal enterprises excluding *inter alia* marketing boards and other agricultural parastatals.

63 See the discussion about the quality of Tanzanian official statistics and other data in Chapter I.

64 For the pre-reform figures referred to in this paragraph, see Tables 4.4 and 4.6 in Chapter IV and Table A.8 in the appendix.

Table 5.4: Losses of the Three Major Loss-Making Parastatal Sectors in Tanzania, Audited during 1986/87-1991/92 (Million TSh)

Audit Year	Estim. Actual Year	*Industries and Trade*				*Comm. & Transport*		*Agriculture*
		Losses			Net	Sector %	Net	Sector %
		% of Para.*	Value	% of Total	Result	Tot. Loss	Result	Tot. Loss
1986/87	1985	43	4,070	70	-1,964	7	451	14
1987/88	1986	52	8,861	44	-6,219	25	-4,789	23
1988/89	1987	55	13,020	40	-10,021	24	-5,584	22
1989/90	1988	63	16,607	42	-12,795	19	-67	18
1990/91	1989	60	36,929	66	-31,482	19	-5,235	11
1991/92	1990	55	11,996	35	-2,241	<1**	3,602	29

Notes: A dash (-) indicates that data are unavailable. * Percentage of the accounts of the sector parastatals disclosing losses. ** In 1991/92, the communication and transport sector was no longer among the top three loss-making sectors.
Source: Table A.8 in the appendix.

Within manufacturing, textile parastatals form a group whose financial performance deteriorated dramatically during the period 1985-1988. *Table 5.5* reveals that in 1988, only one out of 12 parastatals disclosed a profit.

Table 5.5: Financial Performance of Textile Parastatals in Tanzania, 1985-1988 (Million TSh)

PARASTATAL (TEXCO subsidiary)	1985	1986	1987	1988
Blanket Manufacturers	-6	-4	16	40
Friendship Textile Mill (URAFIKI)	55	37	38	-37
Kilimanjaro Textile Corp. (KILTEX)	-75	-97	-120	-261
Mbeya Textile Mill (MBEYATEX)	n.a.	-405	-405	-461
Morogoro Polyester Textiles (POLYTEX)*	-	-803	-4,203	-2,654
Musoma Textiles (MUTEX)	-193	-486	-1,257	-2,024
Mwanza Textiles (MWATEX)	51	-233	-1,345	-2,409
Tang. Dyeing & Weaving Mills (SUNGURATEX)	-9	-34	-95	-347
Tanzania Bag Corporation	17	47	17	-81
Tanzania Sewing Thread Manufacturers**	-	-	-	-48
Ubungo Garments	1	-	1	-12
Ubungo Spinning Mill***	-	-	-128	-263

Notes: The data appear to emanate from financial questionnaires answered by the companies, but it is unclear how they relate to the official accounts. * Commenced commercial operations in 1986. ** Commenced commercial operations in 1988, the figure for which only covers nine months. *** Appears to have commenced commercial operations in 1987.
Source: Overseas Consultancy Group (1990b), pp. 15-86, *passim*.

The details behind the improved financial performance of agricultural parastatals suggested above are shown by *Table 5.6*. The table reveals that it was primarily the profit and loss accounts of the exporting marketing boards that improved. They shifted from years of aggregate net losses to a net profit in 1988, and continued to show a profit at least until 1991. The losses of the marketing board dealing with food trade in the domestic market, the National Milling Corporation (NMC), sky-rocketed from 1987 onwards. And the net financial performance of livestock parastatals turned into a loss in 1985, which worsened over time.[65]

[65] See Table 4.5 in the previous chapter for a comparison with the pre-reform period.

Table 5.6: Financial Performance of Agricultural Parastatals in Tanzania, 1985-1992 (Million TSh)

Parastatal	1985	1986	1987	1988	1989	1990	1985-90	1991	1992
AGRIC. MARKETING									
Cashew nuts (CATA)	-306	83	487	277	65	-490	116	-496	-
Coffee (TCMB)	-37	269	26	776	18	-87	965	-397	56
Cotton (TCMB)	-644	-943	-1,379	-318	3,085	3,246	3,047	2,189	132
Pyrethrum (TPB)	-64	-52	-21	37	54	84	38	-121	-7
Sisal (TSA)	-14	-25	-59	-96	5	-216	-405	-142	244
Tea (TTA)	-15	-37	19	28	68	206	269	126	68
Tobacco (TTPMB)	-107	-410	-147	-340	297	612	-95	1,571	143
Total Exporting	*-1,187*	*-1,115*	*-1,074*	*364*	*3,592*	*3,355*	*3,935*	*2,730*	-
Food (NAFCO)	48	-66	0	23	-147	-171	-313	1,122	898
Sugar (SUDECO)	1	60	106	303	-5	539	1,004	864	527
Tot. Mark. Except NMC	*-1,138*	*-1,121*	*-968*	*690*	*3,440*	*3,723*	*4,626*	*4,716*	-
Nat. Mill. Corp. (NMC)	141	-561	-1,808	-6,552	-6,185	-4,619	-19,584	-6,255	-
Total Agri. Marketing	*-997*	*-1,682*	*-2,776*	*-5,862*	*-2,745*	*-896*	*-14,958*	*-1,539*	-
LIVESTOCK PARAST.									
Animal Feeds (TAFCO)	-54	-110	-14	-63	-48	-68	-357	-	-
Dairies (TDL)	-4	5	0	-39	57	167	186	-70	53
Dairy Farms (DAFCO)	-11	-17	9	-17	-14	-53	-103	21	13
Hides & Skins (THS)	-9	-10	-4	-4	-33	-23	-83	-	-
Packers (TPL)	-45	-40	0	-126	-119	23	-366	-10	-
Poultry (NAPOCO)	6	-2	-14	-12	13	6	-3	-	-
Ranching (NARCO)	11	-10	10	4	8	3	26	22	94
Total Livestock Parastat.	*-106*	*-184*	*-13*	*-257*	*-136*	*55*	*-641*	-	-
TOTAL AGRI. PARAST.	*-1,103*	*-1,866*	*-2,789*	*-6,119*	*-2,881*	*-841*	*-15,599*	-	-

Note: A dash (-) indicates that data are unavailable.
Source: Table A.9 in the appendix.

The last two tables show that parastatals within textile manufacturing, livestock production and agricultural marketing which regularly made losses (even growing ones) survived for years.[66] In fact, practically all parastatals survived throughout the period 1984-1992, in spite of the disastrous financial performance of the sector. The disposal of altogether some 50 parastatals, mentioned earlier, meant little for the overall size of the parastatal sector, which remained essentially intact. According to *Table 5.7,* the number of parastatals even appears to have grown between 1983 and 1991.

Not only most individual parastatals, but most of the loss-making ones survived throughout the period. The survival of the major loss makers audited by the TAC up to 1992 was shown by Table 4.20 in Chapter IV. Although the table is a rather crude instrument, it reveals that 46 per cent of the 39 major loss-making parastatals audited by the TAC during the period 1980/81-1991/92 incurred huge losses during eight years or more. A comparison with Table A.20 in the appendix shows that by late 1992, only the General Agricultural Products Export Corporation had been dissolved. Only three others were in the process of complete or partial disposal: the Morogoro Tannery, the Mwanza Tannery and the Morogoro Shoe Company.

[66] This tendency becomes even more clear when a comparison is made with Table 4.5 in Chapter IV.

Table 5.7: Number of Parastatals in Tanzania, 1983-1991

Year	Number
1983	400
1984	433
1985	-
1986	-
1987	413
1988	425*
1989	450
1990	425
1991	445

Note: * The number was *at least* 425.
Source: Table A.1 in the appendix.

Hence, after years of repeated commitments to disposing of loss makers, state ownership was maintained over a huge, and by and large intact body of parastatals, which performed worse than ever. Our observations provide strong indications that the soft budget constraint persisted within the parastatal sector during the reform period. Let us examine the application of the soft budget constraint to the major forms of external parastatal finance, as well as some other.

Application of the Soft Budget Constraint

The reform programmes had implications for how the soft budget constraint was applied. First of all they induced shifts in the relative importance of different forms and sources of soft external parastatal finance. One such shift could be observed during the first part of the reform period.

Reform and Policy Change: First Shift and Increase

Deregulation influenced the actors' ability to apply the soft budget constraint. It partly reduced the bureaucrats' discretionary powers to allocate resources and thus the managers' ability to bargain for such allocations in their favour. Price decontrol implied that soft administrative cost-plus pricing approved by the National Pricing Commission was gradually reduced as a form of soft parastatal finance. The ERP relieved all imports from price control, and by the early 1990s, most domestically produced goods were also decontrolled, as shown by Table 5.1 above. Prices of public services remained administratively determined, however. It is nonetheless safe to conclude that eventually this form of soft parastatal finance was more or less eliminated - except in the case of agricultural marketing.

The devaluations led to a tremendous growth of revenue from official agricultural exports, which almost exclusively were handled by the cash-crop marketing boards. *Table 5.8* shows that

between 1986 and 1989, the TSh value of official agricultural exports increased by 39-132 per cent annually. Over the entire period 1983-1989, this export revenue grew by no less than 1,032 per cent in TSh, despite the fact that both the volume exported and the dollar value in the world market declined.

Table 5.8: Official Agricultural Exports from the Tanzanian Mainland, 1983-1989*

	1983	1984	1985	1986	1987	1988	1989**	1983-1989
VOLUME:								
Thousand Tonnes	186.5	195.8	169.8	175.4	180.1	162.5	172.9	
Annual Change	*-20%*	*5%*	*-13%*	*3%*	*3%*	*-10%*	*6%*	*-7%*
VALUE:								
Million USD	258.45	293.68	217.19	270.76	211.65	247.30	238.55	
Annual Change in USD	*-10%*	*14%*	*-26%*	*25%*	*-22%*	*17%*	*-4%*	*-8%*
Million TSh	3,026	4,555	3,768	8,772	13,572	24,564	34,254	
Annual Change in TSh	*11%*	*51%*	*-17%*	*132%*	*55%*	*81%*	*39%*	*1,032%*

Notes: * Includes the six major, or traditional, cash crops cashew nuts, coffee, cotton, sisal, tea and tobacco, plus the minor crops cardamom, cocoa beans, oilseeds and pyrethrum. ** Provisional data for the values.
Source: Marketing Development Bureau (1990), Appendices 1a-c.

Thus the exporting marketing boards saw their export revenues multiply. This was one of the purposes of the devaluations. They came to constitute a new form of soft pricing and are one of the major explanations for the considerable improvement in the financial performance of these parastatals. However, it was not simply the large devaluations that reduced the financing gaps of some parastatals and created profits for others. The official marketing parastatals, including the co-operatives, enjoyed what resembled the residual determination of producer prices for cash crops in the past. They appropriated a growing *share* of the increased export revenues, and thus benefited even *more* from the devaluations than is suggested by the export proceeds. The producers' share of the export prices of the major export crops was reduced from 90 to 50 per cent between 1986 and 1990.[67] The marketing boards appear to have benefited relatively more than the co-operatives from the devaluations, as suggested by their dominating share of the export proceeds.[68] Hence, although several of these parastatals disclosed profits, the soft budget constraints still applied to them.

Other shifts in soft parastatal finance were induced by measures for domestic stabilisation. The government's fiscal restraint imposed limitations on budgetary sources of finance such as direct subsidies. The actual payment of government subsidies to parastatals, shown in *Table 5.9,* dropped immediately at the onset of reform in mid-1984. As a share of total ministerial supply, it declined from an average of 12 per cent during the crisis years to on average 4 per cent during

[67] World Bank (1991b), pp. 64-65. The decline was even greater for individual crops. (Marketing Development Bureau, 1990, Tables 10a-c, p. 26.) In practice, the mechanisms behind this outcome appear to differ from the old residual pricing. The Marketing Development Bureau (ibid., p. 24) refers to the fact that producer prices were set a year in advance and were not adjusted for subsequent devaluations, quoting this as a partial explanation.

[68] Bank of Tanzania (1990c), p. 63.

the reform period.[69] Other subsidy measures, including contractual and contingent liabilities, also declined in relation to different public expenditure measures in the early reform years.[70]

Table 5.9: Actual Payments of Government Subsidies in Tanzania, 1983/84-1992/93 (Million TSh)

	MARKETING BOARD / OTHER PARASTATAL RECIPIENT									*Total*	*% of*
Year	*NMC*	*GAPEX*	*Cashew*	*Cotton*	*Pyreth.*	*Tea*	*Tobacco*	*TFC*	*Other*	*Amount*	*TMS*
1983/84	496	54	13	276	8	-	102	215	-	1,193	12
1984/85	338	47	43	215	8	6	78	-	-	734	5
1985/86	334	45	74	204	7	5	41	-	-	710	4
1986/87	330	-	39	196	-	5	71	-	709	1,350	5
1987/88	326	-	37	186	-	5	67	-	-	622	2
1988/89	439	-	35	509	-	5	115	-	-	1,102	2
1989/90	415	-	366	1,011	-	26	366	1,402	847	4,431	7
1990/91*	532	-	-	506	-	-	81	1,000	-	2,119	2
1991/92*	661	-	-	628	-	-	101	4,071	-	5,461	5
1992/93*#	769	-	-	731	-	-	118	5,800	-	7,418	n.a.

Notes: A dash (-) indicates the value zero (0). Due to round numbers, the totals may differ from the sums of the individual figures. NMC = National Milling Corporation, GAPEX = General Agricultural Products Exports Corporation, TFC = Tanzania Fertilizer Company, TMS = Total Ministerial Supply. * Government take-over of overdraft liabilities to the National Bank of Commerce, except in the case of the TFC. # Budgeted and estimated figures.
Source: Table A.11 in the appendix.

Soft taxation, on the other hand, moved in the opposite direction. *Table 5.10* shows that the number of discretionary exemptions of customs duty and sales tax doubled in 1986, to reach a peak level. As discussed in the previous chapter, most of these exemptions were granted to parastatals.

Table 5.10: Number of Tax Exemptions Granted by Ministerial Order in Tanzania, 1984-1992

Year	Customs Duty	Sales Tax	Excise Duty	Income Tax	Total Exemptions
1984	36	37	-	6	79
1985	54	56	1	11	122
1986	104	107	-	14	225
1987	84	85	-	25	194
1988	48	55	-	11	114
1989	34	39	-	9	82
1990	33	38	2	11	84
1991	38	46	4	7	95
1992*	21	25	5	4	55

Notes: A dash (-) indicates the value zero (0). * The 1992 figures only include the first three quarters.
Source: Table A.12 in the appendix.

[69] Cf. Table 4.7 in Chapter IV. Remember that recurrent expenditure by the central government is separated into ministerial supply, regional supply and consolidated fund services.

[70] See Tables A.21 and A.22 in the appendix.

Changes in government deficit financing also had implications for soft parastatal finance. First of all, the government shifted from commercial to central bank borrowing between 1983 and 1986. The share of claims of the Bank of Tanzania on the government in relation to claims of the entire banking system grew from 49 to 90 per cent.[71] Secondly, with the launching of the ERP in 1986, the government faced restrictions on credit financing of its own budget deficit, and thereafter its total borrowing gradually declined. The claims on the government as a share of total domestic credit dropped from 65 per cent in the pre-ERP period to 17 per cent in 1991.[72]

The combination of these changes released large amounts of commercial credit for other borrowers. Between 1983 and 1987, the share of non-government sectors in total commercial bank lending increased dramatically, from 48 to 94 per cent. However, contrary to the intentions, lending to the private sector grew only moderately, from 9 to 10 per cent, while the parastatal sector, including co-operatives, benefited grossly. The decline in lending to the government was, in fact, almost exactly replaced by increased lending to the parastatal sector, whose share of total commercial credit grew from 39 to 84 per cent between 1983 and 1987.[73]

Thus the government partly shifted from direct budgetary financing of parastatals to indirect financing via the banking system during the first half of the reform period. *Table 5.11* shows the allocation and rapid expansion of non-government credit from the National Bank of Commerce (NBC). NBC lending to the parastatal sector expanded particularly rapidly during the ERP period, by 77, 100 and 41 per cent annually. Although the parastatals' share of total non-government credit from the NBC declined gradually, they still accounted for 80 per cent by mid-1989. In certain sectors they even saw their share increase. For industrial parastatals, the share grew from 8 to 20 per cent between 1983/84 and 1990/91.

The share of agricultural parastatals in NBC lending remained stable at 66 per cent on average, up to mid-1988. The co-operatives, however, saw their share grow rapidly right from their re-establishment. The NMC - a notorious credit defaulter - accounted for 15-21 per cent of NBC credit throughout the 1980s. Although the ERP imposed ceilings on credit to the agricultural marketing boards, total commercial bank lending to seven of them exceeded the targets colossally, by 131, 846 and 404 per cent annually during the three years.[74]

Given the poor financial performance of parastatals, most NBC credit continued to be soft in character. It was granted discretionarily as a result of bargaining and political pressure in order to accommodate parastatal and co-operative financing deficits, often despite previous payment defaults and poor prospects for recovery.[75] The Bank of Tanzania confirms that much of the

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71 Calculations based on the Bank of Tanzania (1989), Tables 1-2, pp. 37-38, and (1995), Tables 1.2-1.3, pp. 48-49.

72 Calculations based on the Bank of Tanzania (1989), Table 5, p. 41, and (1995), Table 1.1, p. 47.

73 Nyagetera (1992), Table 2, p. 77, and calculations based on this source.

74 Tanzania Delegation (1993), Table 3, p. 15, and calculations based on this source.

75 See, for instance, the Banking Commission (1989a), p. 14, and Coopers & Lybrand Associates Limited (1989), pp. 22-24.

NBC lending to marketing boards, other parastatals and co-operatives during the period 1987-1990 financed borrower losses.[76]

Table 5.11: National Bank of Commerce Non-Government Lending by Economic Sector in Tanzania, 1984-1992 (Million TSh)

End of June	1984	1985	1986	1987	1988	1989	1990	1991	1992
AGRICULTURE	6,035	8,887	10,700	19,400	38,595	52,562	63,396	66,699	58,955
% of Total	*66*	*67*	*64*	*69*	*69*	*62*	*60*	*50*	*48*
- Parastatals#	5,916	8,772	10,517	18,936	37,519	50,646	59,929	61,569	51,119
% of Agriculture	*98*	*99*	*98*	*98*	*97*	*96*	*95*	*92*	*87*
% Change	*n.a.*	*48*	*20*	*80*	*98*	*35*	*18*	*3*	*-17*
- Market. Boards	5,493	7,766	7,017	10,771	24,017	19,261	22,384	22,495	3,671
- NMC	1,919	2,745	2,739	4,106	10,445	15,305	15,230	17,722*	n.a.
- Co-operatives	-	466	2,466	6,150	11,004	15,813	21,738	23,479	32,512
% Change	-	-	*429*	*149*	*79*	*44*	*37*	*8*	*38*
COMMERCE	1,751	2,178	3,029	3,412	6,694	11,129	15,469	22,739	30,837
% of Total	*19*	*17*	*18*	*12*	*12*	*13*	*15*	*17*	*25*
- Parastatals	1,207	1,109	1,548	1,912	4,489	6,704	8,001	10,100	14,216
% of Commerce	*69*	*51*	*51*	*56*	*67*	*60*	*52*	*44*	*46*
% Change	*n.a.*	*-8*	*40*	*24*	*135*	*49*	*19*	*26*	*41*
INDUSTRY	1,309	2,106	2,912	5,489	10,546	21,028	27,639	44,533	33,730
% of Total	*14*	*16*	*18*	*19*	*19*	*25*	*26*	*33*	*27*
- Parastatals	746	1,024	1,414	3,034	5,723	10,049	14,331	26,767	11,985
% of Industry	*57*	*49*	*49*	*55*	*54*	*48*	*52*	*60*	*36*
% Change	*n.a.*	*37*	*38*	*115*	*89*	*76*	*43*	*87*	*-55*
TOTAL	9,095	13,173	16,641	28,301	55,834	84,720	106,504	133,970	123,521
% Change	*n.a.*	*45*	*26*	*70*	*97*	*52*	*26*	*26*	*-8*
TOTAL PARAST.	7,869	10,905	13,479	23,882	47,731	67,399	82,261	98,436	77,320
% Change	*n.a.*	*39*	*24*	*77*	*100*	*41*	*22*	*20*	*-21*
Parastatal/Total	*87*	*83*	*81*	*84*	*85*	*80*	*77*	*73*	*63*
- Agri. Para./Total	*65*	*67*	*63*	*67*	*67*	*60*	*56*	*46*	*41*
- Mark. Board/Tot.	*60*	*59*	*42*	*38*	*43*	*23*	*21*	*17*	*3*
- NMC/Total	*21*	*21*	*16*	*15*	*19*	*18*	*14*	*13*	*n.a.*
- Co-ops/Total	*0*	*4*	*15*	*22*	*20*	*19*	*20*	*18*	*26*
- Com. Para./Total	*13*	*8*	*9*	*7*	*8*	*8*	*8*	*8*	*12*
- Ind. Para./Total	*8*	*8*	*8*	*11*	*10*	*12*	*13*	*20*	*10*

Notes: The totals may differ from the sums of the individual figures, due to rounding errors. * End of March 1991. ## Including co-operatives.
Source: Table A.18 in the appendix.

Similarly, loan repayment was not enforced. This is indicated by the devastating standard of the loan portfolio of the bank, whose large non-performing assets by the end of 1991 had accumulated to astronomical proportions. *Table 5.12* shows that 94 per cent of its total loan portfolio was adversely classified, of which 48 per cent was outright credit losses. Similarly, 91 per cent of the bank's contingent liabilities were adversely classified and 63 per cent rated as losses. Continued lending to defaulting parastatals and co-operatives had completely eroded the financial position of the bank.

[76] Bank of Tanzania (1991c), pp. 48-49.

Table 5.12: National Bank of Commerce Portfolio Status as at 31 December, 1991 (Billion TSh)

Classification*	Satis-factory		Especially Mention.		Sub-Standard		Doubtful		Loss		*Adversely Classified*		Total
		%/Tot		%/Tot	(S)	%/Tot	(D)	%/Tot	(L)	%/Tot	*S+D+L*	*%/Tot*	
Loan Portfolio Sample													
Loan Review Sample**	2	2	5	4	26	22	20	17	65	55	*111*	*94*	118
Ageing Loans Sample#	0	0	1	5	3	12	20	83	0	0	*23*	*95*	24
Extrapolated Loans	1	2	2	4	8	22	6	17	21	55	*36*	*94*	38
TOTAL Loans	3	2	7	4	38	21	46	25	86	48	*169*	*94*	180
Contingent Liabilities													
Contingent Sample##	0	0	5	12	3	6	4	9	32	73	*38*	*88*	44
Extrapolated Contingent	1	2	2	4	11	22	8	17	28	55	*47*	*94*	50
TOTAL Contingents	1	1	7	8	14	15	12	13	59	63	*86*	*91*	94

Notes: The totals may differ from the sums of the individual figures, due to rounding errors. (Rounding off was done after calculation.) * Asset classification in accordance with the prudential guidelines of the Bank of Tanzania (1991b). ** Including 130 loans, representing 74 per cent of NBC loans and advances, as at 30 June, 1991. # Loans outstanding past their expiry date, amounting to 13 per cent of the portfolio, as at 31 December, 1991. ## All contingent liabilities related to the loan review sample.

Source: Price Waterhouse (1992a), pp. 2-5, and own calculations.

Donor response to the adoption of the ERP resulted in another major shift in soft parastatal finance. Although the allocation of foreign exchange was partly deregulated, bargaining and discretion remained important because of the growing amounts made available through import support. The ERP and the IMF agreement led to a massive inflow of foreign aid to support the programme, as shown by *Table 5.13*. Net foreign aid from the OECD increased by 40 per cent already in 1986, and by 1990 it had grown by over 150 per cent since 1985.

Table 5.13: Disbursement of Foreign Aid to Tanzania, 1984-1992 (Million USD)

Year	Net Loans*	Total Grants	Total Aid	Grants % of Total Aid
1984	128	430	558	77
1985	79	408	487	84
1986	102	578	680	85
1987	71	811	882	92
1988	68	906	975	93
1989	180	738	941	78
1990	288	887	1,252	71
1991	170	914	1,211	75
1992	413	933	1,424	66

Note: * Concessional loans less principal repayments.

Source: Table A.3 in the appendix.

In addition, the gradual shift from project to import support gained momentum. By the late 1980s, import support was estimated to account for about half of the total foreign aid to Tanzania.[77] Data on the value of import licenses issued by the central bank, shown in *Table 5.14*,

[77] van den Andel (1992), p. 4.

reveal that the share financed by import support grew from 7 per cent in 1984 to 31 per cent in 1991, most rapidly between 1987 and 1989.

Table 5.14: Import-Support Financing of Import Licences Issued in Tanzania, 1984-1992 (Million USD)

Year	1984	1985	1986	1987	1988	1989	1990	1991	1992
Total Value ILI*	1,283	1,448	1,279	1,516	1,825	1,668	1,739	1,704	1,955
Financed by:									
Total Import Support	86	67	105	123	217	371	467	529	547
- o/w CIS*	86	67	105	123	168	204	157	63	64
- o/w OGL*	0	0	0	0	50	168	310	465	483
% of Total Value ILI:									
Total Import Support	7	5	8	8	12	22	27	31	28
- CIS	7	5	8	8	9	12	9	4	3
- OGL	0	0	0	0	3	10	18	27	25

Note: * ILI = Import licences issued, CIS = Commodity Import Support, OGL = Open General Licence.
Sources: 1984-1985: Bank of Tanzania (1990b); 1986-1992: Bhaduri *et al.* (1993), Table 6.4, p. 118; and own calculations based on these sources.

Swedish import support increased already in 1985/86, as shown in *Table 5.15:* from on average 34 per cent of the country frame of SIDA in the preceding four years, to an average of 54 per cent during the remainder of the reform period.[78]

Table 5.15: Disbursements of Swedish Import Support to Tanzania, 1984/85-1991/92 (Million SEK)

Year	Import Support			SIDA	Import Support %
	Total Value	o/w CIS	o/w OGL	Country Frame	of Country Frame
1984/85	165.260	165.260	-	482.083	34.3
1985/86	231.362	231.362	-	424.099	54.6
1986/87	231.817	231.817	-	480.680	48.2
1987/88	248.366	248.366	-	441.155	56.3
1988/89	299.113	299.113	-	483.369	61.9
1989/90	368.064	368.064	-	668.667	55.0
1990/91	255.967	223.829	32.138	533.675	48.0
1991/92	333.733	94.473	239.260	583.083	57.2

Notes: A dash (-) indicates the value zero (0). CIS = Commodity Import Support, OGL = Open General Licence, SIDA = Swedish International Development Authority.
Source: Table A.13 in the appendix.

The importance of import support in the government budget also increased, to the extent that it largely replaced domestic borrowing as a source of deficit financing: from 15-16 per cent in the two preceding years to as much as 43 per cent in 1986/87, peaking at 107 per cent in 1990/91.[79]

Most likely, there was also a shift in the relative importance of the two subsidy elements of import support. Although data on cash-cover payments prior to the late 1980s are unavailable,

[78] Cf. Table 4.10 in Chapter IV.

[79] Calculations based on Bank of Tanzania (1990a), Table 18, p. 57, and (1995), Table 2.1, p. 63.

non-payment is generally considered to have grown and become comprehensive since 1986, when the devaluations increased the value of not having to pay cash cover in comparison with the value of being allocated import support in excess demand. As a senior Treasury official at the Department of External Finance expressed it, 'The non-payment of cash cover is a result of the success of the ERP'.[80]

Eventually, a major effort was made by the Treasury to estimate the outstanding cash-cover liabilities for commodity import support (CIS) from 14 bilateral and 3 multilateral donors for the period 1987/88-1992/93. It was then found that by the end of 1992, the total outstanding cash-cover debt at historical value (i.e. excluding interest) amounted to 110.6 billion TSh, equivalent to about one-third of total public expenditure in 1992/93. The public sector accounted for 71 per cent of this debt, parastatals for 64 and the government for 7 per cent.[81] On average 39 per cent of all cash cover was paid; hence the average default ratio was 61 per cent, while that of parastatals was 63.[82]

Table 5.16 reveals some details about the repayment record. It shows that on average, 19 per cent of all CIS recipients and 23 per cent of the parastatal recipients paid no cash cover at all, while the performance of government recipients was even worse. Two-thirds of the parastatals were granted renewed CIS, and 92 per cent of these did so in spite of the fact that they had defaulted on the repayment of previous allocations.

Table 5.16: Repayment Record of Commodity-Import-Support Recipients in Tanzania, 1987/88-1992/93

	Commodity-Import-Support Recipients			
	Total	o/w Government*	o/w Parastatal	o/w Private
(a) Number of Recipients**	269	15	91	163
(b) Allocation One Year Only	95	3	30	62
% of (a)	*35*	*20*	*33*	*38*
(c) (a)-(b): Renewed CIS	174	12	61	101
% of (a)	*65*	*80*	*67*	*62*
(d) No Payment Default	18	2	7	9
% of (a)	*7*	*13*	*8*	*6*
(e) Paid No Cash Cover at All	52	7	21	24
% of (a)	*19*	*47*	*23*	*15*
(f) Renewed Despite Default	150	11	56	83
% of (c)	*86*	*92*	*92*	*82*

Note: CIS = Commodity Import Support. * Government Ministries and Departments.
Source: Table A.19 in the appendix.

Thus the soft budget constraint continued to be applied to more or less the same forms and sources of external parastatal finance as in the past, but there was a marked shift in their relative

[80] Personal communication with senior staff at the Department of External Finance, the Ministry of Finance and Economic Affairs, Dar es Salaam, 13 November, 1992.

[81] Ministry of Finance (1993), p. 7, and calculations based on this source, and on Bank of Tanzania (1995), Table 2.1, p. 63 (public expenditure data).

[82] Ministry of Finance (1993), Appendix 3, and calculations based on this source.

importance during the first part of the reform period. Soft direct subsidies and cost-plus pricing were partly replaced by soft bank credit, taxation and import support. The importance of soft import-support *allocations* declined in relation to that of soft *non-enforced cash-cover payments,* and devaluation was introduced as a new form of soft pricing for agricultural marketing parastatals.

During the second half of the 1980s, the availability of soft external parastatal finance also appears to have increased. The amounts of soft bank credit, soft pricing through devaluation and soft import support grew tremendously and may well have compensated for the decline in soft budgetary subsidies and cost-plus pricing. Together with the growing parastatal losses, this suggests that the application of the soft budget constraint spread and became more frequent within the sector during this part of the reform period. However, the continued application of the soft budget constraint had repercussion effects on the forms and sources of finance, which contributed to a second shift in these towards the end of the period.

Repercussion Effects: Second Shift and Decline

The failure of parastatals to service their bank loans implied that the outstanding interest payments alone consumed much of the available credit space. When adjusted for accrued interest, *real* bank borrowing by the 72 major industrial parastatals actually fell in 1989/90.[83] The repeated renewal of credit to defaulters implied that the liquidity position of the National Bank of Commerce (NBC) itself deteriorated rapidly during the second half of the 1980s. Its growing financing gap, as well as that of the Co-operatives and Rural Development Bank, was covered by borrowing from the central bank.[84] By late 1991, all three commercial banks were insolvent,[85] as suggested not least by the poor loan portfolio of the NBC.

Table 5.11 above suggests that financial-sector reform implied a more restrictive stance in NBC lending to the non-government sector in the early 1990s, particularly to parastatals. They saw their relative share drop from 80 to 63 per cent between mid-1989 and mid-1992. During 1989/90 and 1990/91, credit expansion to parastatals just kept pace with the rate of inflation, averaging 22 and 20 per cent.[86] During 1991/92, total lending from the NBC even declined, by 8 per cent, and its lending to parastatals dropped by on average 21 per cent. Lending to industrial parastatals fell by 55 per cent, and lending to marketing boards by as much as 84 per cent. However, the latter decline, which had been initiated already in 1988/89, partly reflects the fact

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83 Haggerty and Makanda (1991), p. 7.

84 See Coopers & Lybrand Associates Limited (1989), p. 7, Banking Commission (1989a), p. 8, and Bank of Tanzania (1991c), p. 26. The liabilities of the commercial banks to the central bank grew from 503 million TSh in 1985 to 18,090 in 1987, and further to 74,997 million TSh in 1992. (Bank of Tanzania, 1995, Table 1.7, p. 53.)

85 Price Waterhouse (1992b), p. 1. The third commercial bank is the People's Bank of Zanzibar.

86 Cf. Table 5.19 below.

that several exporting marketing boards were able to repay old debts to the NBC with their revenue gains from devaluation.[87] Parastatals within commerce and co-operatives, by contrast, saw their borrowing from the NBC grow by around 40 per cent in 1991/92.

There was also a reduction in the availability of soft import support in the early 1990s. This was caused by a gradual shift from commodity import support (CIS) to open general license (OGL) funds. With the demise of socialism within the Soviet Block and economic recession in the Western world, donors were increasingly exposed to domestic pressure to increase the efficiency of foreign aid and more systematically to promote market-oriented reform. At the same time, their discontent grew with the inefficiency of traditional import support, CIS, notably its discretionary allocation to inefficient, loss-making and highly subsidised parastatals.[88] As a result, the OGL system was introduced in 1988 and expanded rapidly at the expense of CIS. Table 5.14 above shows how the relative importance of CIS in financing import licences declined in the early 1990s, and how it was increasingly replaced by OGL funds. The Swedish, Norwegian and Dutch donor agencies also began to turn from the CIS to the OGL system.[89]

The OGL system was supposed to allocate foreign exchange according to the principle of 'first come, first served', but importers complained about discretion in the issuance and handling of letters of credit at the NBC and in the approval of import licences.[90] During the second half of 1991, when there was a shortage of funds within the system, 'rumours started to circulate that ... favouritism was increasingly becoming a factor in the allocation of OGL funds'.[91]

The formal cash-cover requirements were stringent - 100 per cent local currency had to be paid in advance[92] - and appear to have been enforced to a greater extent than those of CIS. Although data on the payment of cash cover from recipients of OGL funds have not been readily available, the transfer of cash cover within the administration was relatively good.[93] Given the stringent cash-cover rules and the liquidity shortage of many importers, access to credit often became crucial for access to OGL funds. However,

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87 According to a senior NBC official, this applied to all marketing boards except the NMC. (Personal communication, Dar es Salaam, 2 July, 1991.) A declining share of total domestic lending to the marketing boards due to their improved liquidity position as a result of devaluation could be observed already in 1985, according to the Marketing Development Bureau (1990), p. 7.

88 Doriye *et al.* (1993), p. 7.

89 See Table 5.15 above on the Swedish case, Bhaduri *et al.* (1993), p. 10, on the Norwegian case and van den Andel (1992), Annex 1, on the Dutch case.

90 See, for instance, Bhaduri *et al.* (1993), pp. 23-27, Doriye *et al.* (1993), pp. 26-27 and 35-39, and the Swedish International Development Authority (1992).

91 van den Andel (1992), pp. 13-14.

92 Havnevik *et al.* (1990), pp. 41-42.

93 This implied, for instance, that by March 1991, the Treasury had received 97 per cent of the cash cover to be transferred from the Bank of Tanzania. (Mbelle and Karamagi, 1991, p. 47, referred to by Ofstad, 1992, p. 27.)

> the decision regarding the extension of credit for imports under OGL is not always made on a commercial basis and ... *the repayment and enforcement conditions are not applied evenly.* The OGL system has not, therefore, eliminated the gross distortions in this regard of the administrative CIS. In other words, some inefficient parastatals, and possibly also cooperatives, have been obtaining preferential treatment under OGL in the same way as under administrative CIS and in obtaining credit facilities in general.[94]

The notoriously loss-making Tanzania Fertilizer Company, which received OGL funds both in 1990 and 1991,[95] may be a case in point. Although both the access to OGL funds and the payment of cash cover were negotiable, the general impression is that the discretionary element was smaller than within the CIS system. This suggests that the soft budget constraint could be applied to a lesser extent to this form of import support than to CIS. Besides, parastatals only received about one-third of the OGL funds in the early 1990s.[96] Consequently, the gradual shift from CIS to OGL funds implied that soft import support became less available for parastatals.

As regards the devaluations, they were largest in the early reform years, 1986 and 1987. This implies that further exchange-rate adjustment provided relatively less accommodating finance to the agricultural marketing parastatals. Still, in 1991 and 1992, the official exchange rate for US dollars was devalued by 16 and 30 per cent.[97]

As soft bank and donor financing was gradually reduced, the government appears to have turned to budgetary financing again. Table 5.9 above shows that the actual payment of government subsidies increased in relation to total ministerial supply during the late 1980s and early 1990s, although not to the levels of the crisis years. The same applies to contractual and contingent liabilities,[98] but not to the number of discretionary tax exemptions, to judge from Table 5.10. However, the value of total (discretionary and scheduled) customs-duty exemptions in relation to customs-duty revenue was higher during the second half of the reform period than during the first half.

Another, possibly not entirely new, form of soft budgetary parastatal finance emerged and grew rapidly: so-called bridging finance loans from the Treasury. Between 1987/88 and the first half of 1990/91, this short-term lending increased ten-fold, from 141 to 1,521 million TSh.[99] Between November 1991 and November 1992, another 1,476 million TSh was lent, as shown by Table A.25 in the appendix. The loan servicing record was remarkably poor. At the end of the period, a mere 7 out of a total of 73 loans listed recorded no payment arrears. Of the total loan

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94 van den Andel (1992), p. 96; emphasis added. Further reports that importers under the OGL scheme could negotiate the conditions for cash-cover payment with the commercial banks, and that payment rules were not strictly enforced, are given by Ofstad (1992), p. 25, and the Swedish International Development Authority (1993a).

95 van den Andel (1992), pp. 68, A4.2 and A4.5.

96 See Bhaduri *et al.* (1993), p. 23, or Doriye *et al.* (1993), p. 25, and for the allocation of Norwegian OGL funds, Mbelle and Karamagi (1992), pp. 22 and 31.

97 Calculations based on the Tanzanian Economic Trends (1994), Table 5, p. 87.

98 Table A.21 in the appendix.

99 World Bank (1991b), p. 40.

amount, 61 per cent were in arrears, in addition to arrears on interest payments. The Treasury did not enforce payment and, in fact, 'never issued statements to parastatals to show what is owed and what is due for repayment' on *any* loans.[100] Treasury staff report that bridging finance was granted in acute situations and probably not budgeted for.[101] Potential recipients had to bargain for such assistance, and lobbying for extraordinary emergency allocations was common.[102] The amounts were significant for individual parastatals, well in parity with those of direct subsidies. Table A.26 in the appendix shows that the major recipients were parastatals within agriculture, transportation and textile manufacturing.

According to Treasury staff, the quality and accuracy of data on *any* Treasury loans prior to 1988/89 are uncertain, partly because data for the pre-reform period are missing.[103] Olly Haggerty and Mark Makanda found that according to data based on the accounts of 72 industrial parastatals, *direct* Treasury lending was several times higher than reported by the Treasury: 17 billion TSh outstanding in 1990, compared to the reported one billion.[104] The amounts of Treasury bridging finance may thus have been considerably larger than reported here.[105]

In addition to the forms of soft budgetary finance examined here, the Treasury channelled loans to parastatals for investment purposes. Most of these were financed by foreign donors, primarily as loans in foreign currency.[106] Although the softness of investment finance is not examined in this study, there is reason to believe that the non-payment and non-enforced payment of these loans was used as soft recurrent finance. *Table 5.17* shows the total government loans to parastatals, consisting mainly of long-term loans from foreign donors re-loaned by the Treasury. Given the reservations about the quality of the data, the table shows that parastatal arrears on payment of both principal and interest on these loans accumulated and became huge towards the end of the period. By mid-1992, total arrears stood at 171 billion TSh, which implies that their share of the total outstanding balance had increased from 19 per cent in 1984/85 to 50 per cent. In relation to total public expenditure, they had grown from one to no less than 66 per cent.

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[100] Haggerty and Makanda (1991), p. 8.

[101] Personal communication with staff at the Public Investments Department of the Ministry of Finance and Economic Affairs, Dar es Salaam, 2 December, 1992.

[102] Personal communication with senior staff at the Public Investments Department of the Ministry of Finance and Economic Affairs, Dar es Salaam, November, 1991.

[103] Personal communication with staff at the Public Investments Department of the Ministry of Finance and Economic Affairs, Dar es Salaam, 21 October, 1992.

[104] Haggerty and Makanda (1991), p. 10. Direct Treasury lending appears to mainly consist of short-term bridging finance loans, since long-term loans financed by the Treasury are rare, according to staff at the Public Investments Department of the Ministry of Finance and Economic Affairs. (Personal communication, Dar es Salaam, 21 October, 1992.)

[105] For a more detailed examination of Treasury bridging finance, see Eriksson (1993), pp. 34-38.

[106] Personal communication with staff at the Public Investments Department of the Ministry of Finance and Economic Affairs, Dar es Salaam, 21 October and 2 December, 1992. There was also a donor-grant component in these, but a comparison with data presented by Haggerty (1992), p. 6, on foreign loans re-loaned by the Treasury to parastatals, suggests that this was small.

Table 5.17: Government Loans to Parastatals in Tanzania, 1984/85-1991/92 (Million TSh)

Year	Issued or Re-Loaned	Amount Repaid	Balance Out-Standing	Principal Arrears	Interest Arrears	Total Arrears	Arrears % of Balance	% of Public Expenditure	
								Lending	Arrears
1984/85	34	30	1,828	213	136	349	19	< 1	1
1985/86	0	4	1,704	221	214	435	26	0	1
1986/87	1,612	49	11,218	1,673	1,656	3,330	30	3	7
1987/88	648	175	80,954	6,167	7,243	13,410	17	1	18
1988/89	2,187	475	119,639	17,158	19,951	37,109	31	2	35
1989/90	6,836	421	183,652	33,020	37,925	70,944	39	5	50
1990/91	14,954	1,017	224,003	49,337	57,185	106,522	48	7	52
1991/92	36,249	1,188	340,089	78,869	92,282	171,151	50	14	66

Source: Table A.27 in the appendix; Bank of Tanzania (1990a), Table 18, p. 57; (1995), Table 2.1, p. 63.

The table shows that throughout the reform period, the amount repaid constituted only a fraction of the growing payment arrears. In 1991/92, for instance, one billion was repaid, while principal arrears grew by 30 billion and interest arrears by 35 billion. When both the debt and the payment obligations grew, which was partly a result of devaluation, non-enforced payment implied that parastatal cost increases were accommodated automatically. Thus the soft budget constraint appears to have been applied to the non-payment of long-term donor loans to parastatals channelled by the Treasury.

Hence, in the late 1980s and early 1990s, a second shift could be observed in the relative importance of different forms of parastatal finance. When the amounts of soft bank credit and import support declined and the pace of devaluation slowed, direct subsidies expanded, soft Treasury bridging finance emerged and the non-enforcement of payment on long-term Treasury loans grew. Thus the initial departure from budgetary sources of parastatal finance was only temporary. The shift was partly enabled by a less *soft* import support, which generated more counterpart funds that could be spent within the framework of the budget. However, the total amounts of soft finance nonetheless appear to have declined in the early 1990s. The dramatic growth in arrears on long-term Treasury loans was not matched by a corresponding flow of resources to the parastatals, but largely reflected the impact of devaluation on foreign debt.

Conclusion: Persistence and Change

This section has demonstrated that in stark contrast to the intentions of the reform programmes, parastatal financial performance worsened tremendously during the period 1984-1992 and the soft budget constraint persisted within the parastatal sector throughout. However, it also showed that the different forms of finance to which the soft budget constraint was applied and the total amounts of soft finance changed over time. In particular, it suggests that the soft budget constraint was increasingly applied during the first half of the period, while thereafter, the extent to which it was applied appears to have declined.

These observations of behavioural rigidity and change give rise to several questions. Why did the outcome of reform differ so widely from the intentions as regards parastatal performance and elimination of the soft budget constraint? More specifically, why did the soft budget constraint persist, in spite of reform of the institutional system of which it was an integral part and in spite of efforts to come to grips with the problem? What did the observed change in the application of the soft budget constraint imply?

The remainder of this chapter seeks an answer to these questions. The following section accounts for how the reform programmes influenced the context in which parastatals, managers and bureaucrats, including the political leadership, operated. Thereafter, two sections study the behaviour of the actors during the reform period, in terms of their perceptions of and response to the problems they were confronted with. They focus on the role that the soft budget constraint played, first of all for behavioural stability, and then for behavioural adaptation.

A CHANGING AND UNCERTAIN CONTEXT

This section begins by studying how the reform and policy measures affected the market environment in which parastatals operated. It then examines how these changes, together with partial change in the formal rules, altered the behavioural opportunities and constraints of the actors. The consequences for the actors' economic, political and social positions are thereafter discussed. These changes implied, we finally argue, that unlike during the crisis, when the socialist system remained stable, the actors now faced considerable uncertainty about how to behave successfully.

A New Operational Environment for the Parastatals

Relative-Price Changes with Cost and Revenue Implications

As a result of both price deregulation and changes in administratively determined prices, drastic changes took place in relative prices during the reform period. Several policy measures implied adjustment in the levels of controlled prices, such as the official exchange and interest rates. The most important changes were the rapid, large and repeated devaluations. The official exchange rate for US dollars was raised from 12 to 300 TSh over the period 1984-1992.[107] Consequently, official imports grew increasingly expensive in relation to domestic products and exports fetched

[107] Tanzanian Economic Trends (1988), Table 5, p. 49, and (1992), Table 5, p. 68.

better returns in the world market. Higher interest rates implied that the cost of borrowed working capital increased and generally shifted from negative to positive in real terms.

The dramatically altered relative prices provided clear signals for reallocation of parastatal resources, and also had immediate consequences for the costs and revenues of many parastatals. How devaluation escalated the revenues of the exporting marketing boards was discussed above. By contrast, the highly import-dependent manufacturing parastatals within chemicals, fertilisers, rubber and plastics, and particularly the metals and machinery sector, faced rapid and sharp cost increases for all kinds of imported inputs.[108] Parastatals with foreign loans saw their debts and the burden of servicing them increase dramatically with the devaluations. This was, for instance, the case within the textile sector, where the foreign debt grew to the extent that in 1988, it amounted to almost twice the book value of the total fixed assets of the parastatals.[109] Table 5.17 above shows that the exchange-rate fluctuations alone accounted for two-thirds of the increase in the value of outstanding Treasury loans to parastatals in 1990/91 and 1991/92.

Price deregulation in combination with increases in the prices that remained controlled, and which thus moved closer to their equilibrium levels, reduced price distortions. The devaluations were important in this respect, although because of the multitude of foreign-exchange windows (own-funded imports, commodity import support, open general licences and others) several official exchange rates coexisted in practice. Decontrol also eliminated many of the discrepancies between official and parallel market prices.[110] Reduced price distortions implied that prices provided a better reflection of relative scarcities. Thus their informational content improved. Consequently, the availability of information about how to efficiently allocate resources increased, and financial information gave a better reflection of the relative performance of parastatals.

Growing Competition and Demand Constraints

Deregulation of domestic and foreign trade in combination with increased foreign aid increased competition with the parastatals, from both the private sector and imports. Liberalisation gradually expanded the markets open for private activity, and the private sector also grew in relative importance during the reform period. Figures on gross fixed capital formation suggest that it accounted for over 60 per cent of total investment at current prices during the period 1986-1992, compared to about 50 per cent during the period 1979-1985.[111] Much private activity

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[108] SINTEF Applied Economics (1992), p. 13, and Coopers & Lybrand Deloitte (1991), paragraphs 102, 142 and 217.

[109] Overseas Consultancy Group (1990a), pp. 7, 169 and 178, and (1990c), Appendix V.

[110] Hyuha and Ndulu (1989), p. 27.

[111] Adam *et al.* (1994), Table 7.5, p. 86. See Bhadhuri *et al.* (1993), pp. 109-116 for weaknesses in official investment data.

remained informal but nonetheless expanded, particularly small-scale enterprises.[112] Private investors initially entered into activities with high short-run returns, such as commerce and trade, partly due to the uncertainty about their future position. Consequently, private investment in the 1980s tended to be short-term in character.[113] In the early 1990s, however, large-scale private manufacturing also expanded.[114]

The character of private-sector expansion implied that competitive pressure created by the entry of private firms primarily appears to have confronted parastatals within commerce and trade that were accustomed to a strong market power. The National Milling Corporation (NMC) rapidly lost food trade to the so-called open market, and by the early 1990s it was practically out-competed.[115] Within wholesale and resale trade, the parastatal national and regional trading companies generally lost their previous market dominance because of domestic competitors, although the degree of competition varied.[116]

As a result of the launching of the own-funded-imports scheme in 1984, previously scarce commodities, particularly consumer goods, flowed into the country.[117] Import liberalisation continued throughout the reform period, and the Economic Reform Programme led to larger amounts of foreign aid with a growing share of import support. This combination of import liberalisation and increased foreign aid enabled imports to grow rapidly. Between 1985 and 1992, total imports to Tanzania grew by 106 per cent in USD terms.[118]

The increased supply of imported goods added to the competitive pressure on parastatals, particularly within manufacturing. The own-funded imports increased external competition 'virtually overnight', and levels of effective protection of industry dropped dramatically and certain firms became 'disprotected'.[119] As noted by Bhaduri *et al.*, import liberalisation and foreign aid generally appear to have contributed to reducing the demand for domestically manufactured goods in relation to competing imports. The ratio of the value added of the manufacturing sector to value added plus imports of consumer goods declined from 72 per cent during the period 1980-1985 to 36 per cent during 1986-1990.[120] Consequently, demand constraints again became binding for many parastatals, although to varying degrees.

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[112] Bagachwa (1992b), pp. 208-209, and Bagachwa and Naho (1995), p. 1393 and Table 1, p. 1394. The number of formally registered small private firms also increased dramatically, as did small-scale private construction. (World Bank, 1991b, p. 100, and Tanzanian Economic Trends, 1988, p. 25.)

[113] Tanzanian Economic Trends (1988), p. 43. This was for instance the case within food marketing. (Lipumba and Mbelle, 1990, p. 37.)

[114] This is suggested by the investment projects approved by the Investment Promotion Centre. See Bagachwa (1992b), pp. 213-216.

[115] World Bank (1991b), p. 61.

[116] Enterprise profile on the Board of Internal Trade Group, data prepared at the Ministry of Industries and Trade (1992).

[117] Hyuha and Ndulu (1989), Table 7, p. 32.

[118] Calculations based on Tanzanian Economic Trends (1992/93), Table 6b, p. 84. The data for the last four years (1989-1992) are provisional only.

[119] World Bank (1991b), p. 90.

[120] Bhaduri *et al.* (1993), pp. 51-52.

Local manufacturers complained about competition from imports,[121] not least within the textile sector, which was particularly affected. The domestic market share of local textile manufacturers dropped from 49 to a mere 10 percent between 1985 and 1988; this benefited imported textiles, in particular second-hand clothes, which were of higher quality and style.[122] The fact that textile parastatals were severely hit by the competitive shock is demonstrated by their share of total domestic physical output. It dropped sharply in the early reform years, from on average 84 per cent during 1980-1984 to 51 per cent during 1985-1990.[123]

Many parastatals in the chemicals sector also faced competition and demand constraints for the first time, primarily from imports, while local competition remained limited.[124] The tariff reform contributed to the reduced protection of locally manufactured goods, notably within chemicals, fertilisers and pharmaceuticals, and within plastics and rubber.[125] Other sectors were less affected. Within metals and machinery, for instance, demand in the domestic markets was latent during the period 1985-1988 after years of shortage. Although effective rates of protection had dropped significantly since 1984, they remained positive, ranging between 20 and 100 per cent in 1991.[126]

Reduced Supply Constraints

Increased aid, in particular import support, and import liberalisation reduced the previous scarcity of foreign exchange for parastatals as well as other importers. Although the devaluations raised the relative price of imports, the increased supply worked in the other direction, and less regulation generally made it easier to find one way or another to buy foreign exchange through legal channels. Consequently, throughout the reform period, supply constraints in terms of imported raw materials, other inputs and spare parts were gradually reduced.

Reduced supply constraints generally increased the rate of capacity utilisation in industry. A weighted average of the rates of capacity utilisation of 12 selected sectors within manufacturing, primarily parastatals, displays an increase from a bottom level of 27 per cent in 1986 to 37 per cent in 1991. The improvement was nonetheless limited. The average rate of capacity utilisation remained below 40 per cent, the average rate in the period 1982-1984, i.e. during the economic crisis.[127] The effect also varied between sectors. The metals and machinery sector benefited particularly from the increased supply of foreign exchange and imported inputs. As a result of increased capacity utilisation, both output and value added grew substantially between 1984 and

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121 Tanzanian Economic Trends (1988), p. 30.

122 Mbelle (1992), Table 3, p. 189, and Overseas Consultancy Group (1990a), p. 73 (on quality and style).

123 Mbelle (1992), Table 2, p. 188.

124 SINTEF Applied Economics (1992), Table 2.1, p. 22, and p. 27.

125 Ibid., p. 13.

126 Coopers & Lybrand Deloitte (1991), paragraphs 245 and 526.

127 Bhaduri *et al.* (1993), p. 82, and Table 4.4, p. 83.

1989, by on average 6 and 13 per cent annually.[128] In particular, parastatal value added grew during the period 1985-1988, compared to that of private firms. A sector study reports that the primary reason was not increased efficiency, but rather preferential access to foreign exchange and thus raw materials and spares via import support.[129]

Within the textile sector, the experience was quite the opposite. When parastatal output declined, as shown above, capacity utilisation dropped from on average 29 per cent during 1983-1986 to 16 per cent during the following four-year period.[130] Thus the major effect of increased availability of imports on textile parastatals appears to have been increased competition, as discussed above. Consequently, in some instances import support and liberalisation raised the rates of capacity utilisation and output by reducing supply constraints. In other cases, they increased competition from imports, which reduced the demand for parastatal products, output and capacity utilisation.[131]

Hence, during the reform period, the market conditions under which parastatals operated were quite substantially altered. Although reform and policy measures were gradually extended, in particular the own-funded-imports scheme in 1984 and the devaluations in 1986 and 1987 exposed parastatals to dramatic exogenous shocks. Relative prices changed. Costs and the degree of competition increased. The changes in these 'traditional' economic constraints influenced the behavioural options of parastatal managers and bureaucrats. So did the partial change in the formal behavioural rules. To this influence we now turn.

Partly Altered Behavioural Rules for the Actors

Reform implied that formal behavioural rules were altered. By also making official statements, the leadership signalled that a change of behaviour by the actors within the parastatal sector was desired. Managers were now expected to run parastatals efficiently and profitably, according to commercial principles in the market, with a higher degree of autonomy and responsibility. Bureaucrats should promote such behaviour, by employing commercial principles in their supervision of parastatals and allocation of resources, interfering less in parastatal operations and enforcing financial accountability - controlling outcomes instead of procedures. Reform increased the potential for such behaviour, through the constraints and opportunities provided by the increased role of market co-ordination and private ownership.

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128 Coopers & Lybrand Deloitte (1991), paragraphs 225-226.

129 Ibid., paragraphs 237-238. Bhaduri *et al.* (1993), pp. 49-51, make a similar observation.

130 In private textile firms, by contrast, output and capacity utilisation increased substantially. (Mbelle, 1992, Tables 2 and 4, pp. 188 and 190.)

131 Cf. Bhaduri *et al.* (1993), pp. 51-53 and 61-63.

The Market Option and the Private Alternative

Liberalisation of trade and pricing decentralised a significant amount of decision making, from authorities to actors in the market, and thus from bureaucrats to parastatal managers. Price decontrol increased the opportunities for managers to set their own product prices, through adoption of the prevailing market price or agreement with their customers, and to negotiate input prices with their suppliers. Thus output prices that had previously created excess demand could be raised to their market-clearing levels. It was hoped that deregulation of prices on industrial products would thus 'enhance the profitability of many enterprises'.[132]

Deconfinement of trade, in turn, reduced the number of compulsory purchases and deliveries, which made parastatal managers more free to select suppliers and seek new customers. Input suppliers offering lower prices and better quality and services could now be chosen, while import liberalisation and private-sector growth increased the number of suppliers to choose between. With more trading partners, a tougher attitude could be adopted towards customers who did not pay their bills, which used to be a problem for many parastatals.[133] Fewer export restrictions made the exploration of foreign markets possible, while the devaluations made this increasingly attractive. Eased supply constraints, notably on imports, enabled the expansion of output and a more efficient use of the existing resources, while reduced price distortions made efficient allocation of resources easier. Hence, a potential for increased parastatal autonomy in operational matters was created. Managers obtained more degrees of freedom to adapt parastatal activity to the new relative prices and market conditions and thus to improve parastatal financial performance through productive activity - action in the real sphere.

The opportunities for bureaucrats to promote the operational and financial autonomy of parastatals also increased. They no longer had or were allowed to interfere by deciding on parastatal pricing, trading partners and other operational matters to the same extent as in the past. Although many goods formally remained under price control, the Price Commissioner, for instance, was 'instructed by "word of mouth" (i.e. no written document) not to touch the items under trade liberalization'.[134] In combination with the reduced supply constraints, the lower level of interference and regulation made it easier for bureaucrats to hold managers responsible for parastatal performance.

The growth of the private sector as a legitimate alternative provider of goods and services made the leadership less dependent on parastatals for the performance of economic functions. This facilitated the exertion of pressure on managers to run parastatals efficiently and profitably, since a comparison with private firms now made it easier to assess parastatal performance. In general, the information problem inherent in the socialist system was substantially reduced

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[132] Mwinyi (1992), p. xi.

[133] The National Housing Corporation, for instance, was plagued by problems of this sort, as reported in Chapter III.

[134] Kiondo (1989), p. 377.

during the reform period, primarily due to the reduced price distortions. In addition, the parastatal accounting standards improved, as shown in *Table 5.18.* Between 1983/84 and 1991/92, the share of accounts audited by the Tanzania Audit Corporation that received clean audit reports grew from 40 to 60 per cent. Similarly, the share of clients - mainly parastatals - with their accounts in arrears declined during most of the period.

Table 5.18: Accounting Standard of Tanzania Audit Corporation Clients, 1983/84-1991/92

Audit	CLIENTS IN ARREARS		CLEAN REPORTS		NON-CLEAN REPORTS		Total No. of
Year	*No.*	*% of All Clients*	*No.*	*% of Audited*	*No.*	*% of Audited*	Audit. Acc.
1983/84	174	38	168	40	254	60	422
1984/85	170	40	146	37	248	63	394
1985/86	163	39	171	40	260	60	431
1986/87	141	34	164	45	204	55	368
1987/88	129	32	181	38	301	62	482
1988/89	128	30	204	52	192	48	396
1989/90	90	19	245	53	216	47	461
1990/91	120	27	238	63	138	37	376
1991/92	126	36	219	60	148	40	367

Source: Table A.10 in the appendix.

An improved accounting standard, reduced price distortions and the growth of private alternatives revealed the poor performance of the parastatals. More and better information made it easier for the bureaucracy not only to hold parastatal managers financially accountable, but also to apply commercial criteria in the allocation of resources, such as credit and import support. Consequently, the bureaucracy obtained better opportunities to promote relatively efficient activities and discourage inefficient ones.

The deregulated market and growing private sector did not only provide new behavioural opportunities for the actors. They also imposed new constraints. In particular increased competition and demand constraints created behavioural restrictions for parastatal managers. They implied, for instance, that the new institutional option to raise output prices was limited by the rules of the market. Demand constraints often prevented prices from being raised so as to fully compensate for cost increases or cover expenditure. This was the experience of many firms within the chemicals sector, which were unable to raise their prices in pace with inflation because of increased competition from imports.[135] During socialism, parastatals had strong market power and operated in a seller's market with excess demand, for instance within the textile sector, where 'whatever the industry used to produce would sell irrespective of quality and price'.[136] Increased competition and demand constraints led to a shift to a buyer's market, which imposed limits on how parastatals could mistreat their customers - or suppliers for that matter - for instance in terms of how late to deliver and pay and how poor a quality to offer. Parastatals no longer had a guaranteed outlet for their products.

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[135] SINTEF Applied Economics (1992), pp. 26-27.

[136] Mbelle (1992), p. 194. See also Overseas Consultancy Group (1990a), p. 152.

For political leaders and lower-level bureaucrats, deregulation implied that a growing share of economic activity was taking place outside their control. These actors could no longer direct the allocation of resources at their discretion to the same extent as in the past. Price decontrol and the greater role for market-based allocation of foreign exchange, for instance, also reduced their powers to favour parastatals. Nor could they intervene in the growing private business activities to the same extent as in parastatal operations.

Remaining Bureaucratic Options

The introduction of new behavioural rules notwithstanding, the partial character of reform implied that many of the old formal rules remained in place for a long time. In particular, the increased managerial autonomy was partly circumscribed by the remaining bureaucratic co-ordination. Price control and trade regulations were selective and only gradually phased out. In addition, parastatals were obliged to adhere to the remaining price controls and other regulations to a greater extent than private firms.[137] In practice, many operational parastatal decisions still had to be sanctioned by various superior organs, while the division of authorities and responsibilities within the bureaucracy remained unclear.[138] Deregulation did not generally apply to the labour market, and managers were still largely prevented from making decisions of a strategic and entrepreneurial nature: on 'capital works expenditure or on abandoning unprofitable activities'.[139]

The discretionary powers of bureaucrats to set prices, control trade and allocate resources were gradually curtailed, but they remained in legal force for a long time. In addition, party supremacy was constitutional and political intervention in state activities was thus still legally sanctioned. Managers found that regional and district political leaders, for instance, issued directives to parastatal branches or subsidiaries located in the area, and that officials in holding corporations and at the state house - the presidency - interfered in parastatal operations.[140] This partly reflects that fact that in many cases, as for instance within the banks, lower-level bureaucrats were themselves exposed to political pressure.[141] Although bureaucrats frequently exercised their discretionary powers, political interference grew less common.[142] In the early 1990s, one observer noted that 'Some managers are slowly gaining more independence from

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[137] Parastatal activities were easier to control and parastatal controls were easier to enforce. (World Bank, 1988a, p. 45, and Tanzania Association of Parastatal Organisations, 1989, pp. 38-39.)

[138] As reported, for instance, by the Tanzania Association of Parastatal Organisations (1989), p. 26.

[139] Mwapachu (1989), p. 119.

[140] Tanzania Association of Parastatal Organisations (1989), pp. 27-33, *passim.*

[141] See for instance the Banking Commission (1989a), p. 14, and Coopers & Lybrand Associates Limited (1989), pp. 22-24.

[142] Tanzania Association of Parastatal Organisations (1989), p. 27.

both the Board of Directors and from the holding companies'.[143] Still, bureaucratic procedures may have become more constraining for parastatal managers than in the past, since action in the real sphere required greater flexibility.

Bureaucratic co-ordination implied that bargaining remained important within the sector. This made it possible for parastatal managers to continue to act in the control sphere - lobby for redistribution - although to a slightly lesser extent than in the past. The formal opportunity to bargain for and discretionarily grant preferential access to foreign exchange, for instance, was restricted, but in practice such behaviour was often still possible. This applied to import support under the open general licence system, as discussed. There was also ample scope for 'manipulations and negotiations' over what goods should be entitled to free importation under the so-called export retention scheme and the own-funded-imports scheme.[144] Discretion and bargaining were further facilitated by the personal relationships between the actors, and by the importance of informal rules.

Informal Rules and Relationships

The informal, culturally bound, behavioural rules of the economy of affection remained intact and applied throughout the public sector. Personal relationships between parastatal managers and bureaucrats had already become well established as part of the actors' informal social networks during the socialist system after years of repeated interaction, not least in the application of the soft budget constraint. The rules required the members of these networks to mutually assist each other and to use their public positions to benefit other network members. The Tanzania Association of Parastatal Organisations noted that parastatal success and even survival continued to depend on the ability of managers to please bureaucrats, particularly political leaders.[145]

Relying on and supporting relationships and networks according to these informal rules imposed constraints on adherence to the new formal rules. The informal rules made it difficult for managers to resist costly interference and keep parastatal expenditure down, and for bureaucrats to refrain from interfering and refuse costly parastatal protection. Reform, in turn, had implications for the extent to which the informal rules could be adhered to, and thus for the actors' opportunities to utilise their public positions. Deregulation of trade and pricing reduced the opportunities for either managers or bureaucrats to collect rents from access to scarce, under-priced commodities that were traded or produced by the parastatals. On the other hand, private-sector growth created opportunities for the actors to establish new personal relationships and

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[143] ICS Interconsult Sweden AB (1991), pp. 36-37.

[144] Kiondo (1989), p. 382 (quotation) and endnote 8, p. 463. The export retention scheme implied that exporters were allowed to retain a portion of their foreign-exchange earnings for their own imports.

[145] Tanzania Association of Parastatal Organisations (1989), pp. 27 and 32.

extend their social networks within the private sector. This enabled bureaucrats in particular to adhere to the rules of the economy of affection by extracting rents from a host of new counterparts, for instance when approving business licences or allocating credit and foreign exchange.

Dual Institutional Set-Up

As shown above, formal and quasi-formal reform altered the behavioural opportunities and constraints for parastatal managers and bureaucrats, but only partly. While the options associated with market co-ordination and private ownership increased, they did not fully replace those related to bureaucratic co-ordination and state ownership, which remained important. Thus in addition to the informal rules, the actors faced two parallel sets of formal institutions: the old familiar socialist set and the new, or rather unfamiliar, more market-oriented bundle. Consequently, during the period of reform, parastatals came to operate under conditions similar to what Kornai has referred to as 'dual dependence', dictated by both the market and the bureaucracy.[146]

However, the two sets of rules were partly incompatible and therefore obstructed each other. In particular, adherence to the new market rules was constrained by the old bureaucratic ones. The inherent coherence and consistency of the socialist system was thus destroyed by partial reform. This brought institutional duplication and inconsistency, which characterised the system in transition, and made the institutional context of the actors far more complex than in the past. Change, duality and complexity had important implications for how parastatal managers and bureaucrats perceived their behavioural options, as will soon be discussed. Let us first consider how the position of the actors was influenced by reform.

Threats against the Position of the Bureaucracy

The fact that reform was initiated at all reflects the threat that the poor performance of the socialist system eventually posed to the legitimacy of the political leadership, as well as the leadership's concession to pressure for change in an effort to defend its position. In the past, the whole bureaucracy, including political leaders and parastatal managers, had depended on and benefited from the parastatal sector for their positions. The actors had learnt how to pursue their aims within the system and to increase their gains over time. Reform of the system now threatened their pay, power and prestige in several ways.

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[146] Kornai (1986d), pp. 1693-1697.

First of all, economic returns appear to have declined for the whole bureaucracy. Real incomes of rich urban households dropped by 11 per cent between the periods 1981-1983 and 1987-1989.[147] This was partly because formal incomes - top salaries within the public sector - fell, at least in the early reform years.[148] While in the past, the actors had been able to compensate the fall in formal incomes with informal ones, they no longer appear to have been able to do so when important sources of informal income in terms of scarcity rents were gradually eliminated.

Falling real incomes, in turn, weakened the social prestige of the actors. Less wealth could be distributed within their informal networks. The fact that a growing share of economic activity was taking place outside the control of leaders and bureaucrats had a similar effect. At the same time, deregulation enabled actors within the *private* sector, including potential rivals to the political leadership, to expand *their* networks, while strengthening their economic, social and political positions. Thus in combination with the declining output and market shares of parastatals, deregulation and private-sector growth weakened the status and influence of bureaucrats at all levels.

The escalating parastatal financial problems reached proportions that may have been perceived as an additional and serious threat to the actors. Given the growth, magnitude and spread of parastatal losses, a large part of the sector on which the actors depended would have collapsed unless finance was provided. By offering employment not least to members of the social networks of their managers,[149] parastatals functioned as a form of welfare establishment for 'idle workers' in '"ghost" factories'.[150] Although employees were largely engaged in side-line income-generating activities, the unemployment resulting from parastatal mass liquidation would have been substantial, with significant social consequences.

Parastatal collapse would also have implied that the leadership deserted 'its prot[é]gés in the public sector',[151] primarily lower-level bureaucrats and parastatal managers who, as members of its social networks, were also important supporters. The already weakened legitimacy of the political leaders would have been severely undermined and they would have lost face if they had led 'the requiem for what they themselves have fostered'.[152] The leadership had invested its whole ideological and political prestige in the socialist project, and the parastatals were its main vehicle. In addition, retained elements of regulation implied that it continued to depend on parastatal monopolies for the performance of important economic functions, such as the earning of foreign exchange through cash-crop exports.[153] Hence, the economic, political and social

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147 Sarris and van den Brink (1993), Table 66, p. 180.

148 They dropped, according to the World Bank (1988a), Table B5, pp. 108-109, by 8 and 19 per cent in real terms in 1984 and 1985, and probably further in 1986/87.

149 Mihyo (1994), p. 135.

150 Bagachwa *et al.* (1992a), p. 11.

151 Mihyo (1994). p. 135.

152 Ibid.

153 Cf. Bagachwa *et al.* (1992a), p. 13.

positions of the whole public bureaucracy were threatened by reform and its consequences. This threat, together with the other changes, created tremendous uncertainty.

Increased Behavioural Uncertainty

Reform created uncertainty for the political leadership, (lower-level) bureaucrats and parastatal managers about their future positions and how to successfully pursue their aims in the new and changing world. Deciphering the disintegrating system in transition with its increasingly complex inter-relationships was far more difficult than interpreting the familiar, stable and coherent socialist system. The actors' ability to reliably predict the consequences of their behaviour was weakened: they found it more difficult than in the past to distinguish preferred from non-preferred behaviour. This applied in general and is the major reason why the actors faced increased behavioural uncertainty during the reform period. Let us discuss, in more concrete terms, what this uncertainty consisted of.

The Leadership's Uncertainty about Reform

The character of reform partly reflects the behavioural uncertainty of the political leadership. When the past socialist strategy failed and domestic and foreign pressures for reform mounted, the situation was new for the leadership. Its most immediate reaction was to pursue its aims as in the past, but such behaviour now threatened its position. This created uncertainty about how to regain legitimacy.

Some systemic change had to be undertaken. The leadership, however, did not know what particular measures or combination of them would be successful, or how much or how radical a reform was required. Besides, the outcome of measures that involved change in the behavioural rules was more difficult to foresee, and therefore more uncertain, than measures that involved change within the existing system. Thus in parallel with its need to reform, the leadership faced incentives to maintain as much of the old system as possible, since it had built its position on it and knew how to behave successfully within it.

However, in contrast to the transition economies in Eastern Europe, where a full-fledged market economy was aimed at, the Tanzanian leadership had no ready strategy for the reform process. The leadership did not know where it was heading. Hence, while it introduced new formal rules and opportunities for behavioural change, the partial and gradual character of reform reflected its uncertainty. This uncertainty translated into uncertainty for parastatal managers and bureaucrats.

Confusion about the Validity of Old versus New Rules

The situation of parastatal managers and bureaucrats in the early 1990s was characterised by 'confusion'.[154] The leadership sent unclear and contradictory signals about what behaviour it expected from the actors. The *partial* nature of reform, which implied that the actors operated under two sets of institutions, generated uncertainty about the validity of the new rules. Were the actors to stick to the old rules and do as they always had done, or should they change their behaviour and adhere to the new rules in order to be successful?

The non-legal character of reform contributed to the creation of a 'double standard'.[155] The actors could not be certain about whether the new liberal quasi-formal rules applied or the old law would be enforced. The discrepancy between the official rhetoric and the actual practice added to this uncertainty, for instance as regards parastatal divestiture, which was consistently delayed. A similar discrepancy could be observed between central directives and their implementation at the local level.[156]

The partial, quasi-formal and ambiguous character of reform created uncertainty about the leadership's own commitment to reform and about the permanency of reform. When trade liberalisation was initiated, political leaders repeatedly stated that it was a temporary measure, 'to be abandoned as soon as the government attained the ability to import consumer goods'.[157] This notion of reform as temporary was reinforced by the partial and selective deregulation and by the fact that certain measures were actually reversed, which made change unpredictable.[158] The non-legal character of reform implied that new decrees could be issued easily and rapidly by any minister. Besides, even higher level bureaucrats were largely ignorant about the details of the reform programmes,[159] and in spite of the growing element of market-orientation, reform was rationalised ideologically by the leadership as steps on the road to socialism.

This created uncertainty about the values and rules that guided behaviour and interaction within the parastatal sector. Were the socialist principles really to be replaced by the previously condemned profit motive? In 1989, the parastatals reported that 'a clearly defined policy or systems framework either for the sector *per se* or *vis-à-vis* the private sector' had still not been established.[160] In the early 1990s, several parastatals in different sectors still lacked 'explicitly

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154 ICS Interconsult Sweden AB (1991), p. 35.

155 Shaidi (1990), p. 51.

156 See also Amani (1992), p. 125, and the World Bank (1991b), p. 101.

157 Shaidi (1990), p. 53. Cf. Lipumba (1992), p. 48.

158 The own-funded import scheme in itself represented such a drastic and unexpected shift in the official stance: from war against parallel market activity in 1983 to its legitimisation in the following year.

159 At least the 1989 government agreement with the IMF, which specified details generalised in the ERP, was kept secret not only from senior civil servants and central and commercial bank executives, but also from cabinet ministers and members of the National Executive Committee of the party. (Kiondo, 1989, pp. 288-289 and 414-415.)

160 Tanzania Association of Parastatal Organisations (1989), p. 25.

defined operational targets in market terms',[161] and faced a multitude of often ambiguous goals and tasks, just as in the past.[162] Thus profitability seems to have been *added* to the list of parastatal objectives, without replacing or ranking higher than the other ones. This created further confusion, in particular since it obviously contradicted many of the other goals.

Ignorance about How to Adhere to the New Rules

The 'drastically altered ... business environment' that made many parastatals face the market for the first time implied that they would 'have to respond to these developments, by actively starting to *serv[e] the markets, and not just produce'*.[163] It was predicted that unless they increased their efficiency and pursued an 'aggressive marketing strategy', they would not survive.[164] But how could parastatal managers, used to a seller's market, bureaucratic co-ordination, socialist principles and the soft budget constraint know what market rules, competition and commercial principles implied or how to serve the market, pursue a marketing strategy and compete for survival? They knew precious little about what these new rules implied or about how to behave successfully according to them.

Within the metals and machinery sector, for instance, 'an understanding of customer purchase criteria (trade-offs between price, quality, delivery time, after sales service) is absent from management, particularly in public sector enterprises'.[165] Similarly, chemical parastatals, used to both market and supplier power, did 'probably [not] know their markets' preferences, or how to segment them'.[166] Most parastatal managers lacked competence in 'marketing in general and export in particular'.[167] Within metals and machinery, for instance, they were largely ignorant about 'opportunities created by competitive markets, the potential for strong supplier and customer relationships, and market-based decisions on product mix, product cost structure and pricing'.[168] Besides, instead of competing, many parastatals were used to supporting each other, which is why competition introduced confusion about the relationship and interaction between the actors.[169]

Parastatal managers were also unfamiliar with commercial and financial analysis. While textile parastatals produced much financial information of acceptable quality, their financial and

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161 ICS Interconsult Sweden AB (1991), p. 35.

162 Tanzania Association of Parastatal Organisations (1989), pp. 25-26.

163 SINTEF Applied Economics (1992), pp. 16 and 45; emphasis in the original.

164 Ibid., p. 16.

165 Coopers & Lybrand Deloitte (1991), paragraph 4105.

166 SINTEF Applied Economics (1992), p. 44.

167 ICS Interconsult Sweden AB (1991), p. 9.

168 Coopers & Lybrand Deloitte (1991), paragraph 145.

169 ICS Interconsult Sweden AB (1991), p. 36.

other senior managers were generally unable to interpret it.[170] This ignorance was widespread within the parastatal sector, even among boards of directors and officials in parent ministries.[171] Hence, neither did bureaucrats know how to interpret and use the improved quality and increased availability of parastatal financial information, either as guidance in resource allocation or in their promotion and supervision of parastatal performance. They were used to managing and supervising parastatals via discretionary resource allocation, direct intervention and control of procedures, and were at least as unfamiliar with commercial principles and the rules of the market as parastatal managers. Bureaucrats did not know how to apply commercial and profitability criteria, foster financial discipline and hold parastatal managers financially accountable. Thus change *per se* created behavioural uncertainty.

It is against this background - a considerably altered and increasingly uncertain environment - that parastatal managers and bureaucrats, including the leadership, had to pursue their daily tasks. The soft budget constraint persisted as part of the institutional context in which the actors operated, and the following sections show that it played a role for the actors' behavioural stability as well as their adaptation during the uncertain reform period.

THE SOFT BUDGET CONSTRAINT AND BEHAVIOURAL STABILITY

The previous chapter showed how the soft budget constraint contributed to the stability of the socialist system during the crisis. Now this system was undergoing change, but the soft budget constraint nonetheless persisted, and the present section argues that it brought stability for parastatal managers and bureaucrats during the reform period. To understand how and why, the section begins by discussing what the heritage of the soft budget constraint implied for the actors' perception of the problems that change confronted them with. It continues by examining the role of the soft budget constraint for the response to exogenous shocks, and thereafter provides an argument for why the actors continued to apply it.

The Heritage and Perceptions of Change

The reform programmes created incentives for managers and bureaucrats to reallocate parastatal resources, guided the direction of change by reducing price distortions, and exerted pressure for change by increasing competition and parastatal financing gaps. However, the policy and reform measures were imposed on actors who were used to operating within the socialist system. Their

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[170] Overseas Consultancy Group (1990b), pp. 7-9.

[171] Tanzania Association of Parastatal Organisations (1989), p. 36.

perceptions of - and eventual responses to - the problems that the changes gave rise to were influenced by this institutional and ideological heritage, in particular to begin with. The new price signals, increased competitive pressure and worsening parastatal financial problems were interpreted on the basis of the actors' past experience and according to the pre-reform values and models of the world. The soft budget constraint was an integral part of this heritage.

The new relative prices raised the costs for most parastatals, but the price shocks were not seen as signals for reallocation of resources so as to economise on costs. Under the socialist system, prices had not contained information about relative scarcities and the price mechanism had been more or less eliminated as an allocative device within the parastatal sector. Besides, economising on costs had not been necessary. The actors' experience of the soft budget constraint was crucial in this regard. By offering alternative information, it used to partly replace relative prices as guidance for bureaucrats in their allocation of resources. Parastatal managers were also accustomed to ignoring price signals, since the consequences of not adapting to them were taken care of by the soft budget constraint, which itself was an adaptive mechanism. After years of repeated use, it had taught parastatal managers and bureaucrats *not* to regard price changes as signals that action should be taken to allocate resources away from the relatively more costly items.

The devaluations and the increased interest rates may not even have been interpreted as changes in relative prices. Parastatal representatives described the new situation as one where foreign exchange and working capital grew increasingly scarce, in spite of the increased supply of both during at least the first part of reform. Textile firms and members of the Tanzanian Association of Parastatal Organisations, for instance, continued to complain about a *lack* of foreign exchange in the late 1980s.[172] The actors thus appear to have perceived the situation as one of quantitative restrictions on resources when, in fact, the resources became more expensive in relative terms. In the socialist system, scarcity had signalled that one should try to get access to as much as possible of the resources - to hoard - rather than moving away from their use. Such behaviour had been promoted by the soft budget constraint.

By conveying the notion that parastatal financing gaps were to be externally accommodated, the soft budget constraint transmitted many of the central ideas and values of socialist system, which influenced how parastatal financing gaps and their causes were perceived. It reflected the idea that managers were not responsible for parastatal financial problems, and the values that the state should cater for its parastatals and the bureaucracy for its members, in particular the weak ones. The soft budget constraint had contributed to fostering a passive attitude on behalf of parastatal managers and a paternalistic attitude among bureaucrats. It also meant that exogenous causes of parastatal financing gaps were emphasised, instead of causes related to failure to adapt parastatal activity to the prevailing conditions and generate funds from operations.[173] The

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[172] Mbelle (1992), p. 194, and Tanzania Association of Parastatal Organisations (1989), pp. 39-40.

[173] Cf. the discussion in Chapter III. The strong ideological stance and the widespread support for the Tanzanian socialist model had similarly fostered a tendency among not only public officials, but also many foreign donors and academics, to blame the poor performance of the system during the crisis on 'external' factors, such as the

financing gaps were not primarily seen as performance problems, which would have signalled the need for managers and bureaucrats to behave so as to improve parastatal performance, given the external environment.

Financing gaps were instead regarded largely as a liquidity shortage: quantitative restrictions in the provision of finance, caused by exogenous shocks of which the parastatals were passive victims. This is reflected in frequent complaints that 'cooperatives can't buy crops because they can't have sufficient finance from banks, BIT [Board of Internal Trade] reports decline in profits because of liquidity constraints, Bora Shoes Company can't buy raw materials because of liquidity constraints etc.'[174] With financing gaps perceived as reflecting quantitative constraints instead of performance problems, external provisioning of compensating finance was an adequate response. The reform programmes were intended to improve parastatal performance, but how would under-capitalised liquidity-constrained parastatals manage to increase their capacity utilisation and output, let alone become competitive, efficient and profitable, unless adequate foreign exchange and working capital were provided?

Similarly, competition shocks do not appear to have been perceived as pressure to compete for customers and sales. During socialism, chemical parastatals for instance had been 'accustomed to a shortage economy where anything produced could be sold' and was 'collected by customers at the factory gate'.[175] Parastatal managers now appear to have perceived the increased competition, the shift to a buyer's market and the resulting demand constraints as injustice and discrimination. They complained that 'the surplus cashflow from liberalisation of trade had flown to the private sector from the pockets of the consumers',[176] suggesting that the parastatals were unfairly treated by the government. Under those circumstances, seeking financial compensation was considered appropriate behaviour.

By influencing the actors' perceptions of the world, the heritage of the soft budget constraint made them non-alert to the new and increased information. As a consequence, the new price signals were not perceived as signals, increased competitive pressure was not seen as pressure, and deteriorating parastatal financial performance was not perceived as a performance problem. This implies that the soft budget constraint also influenced how parastatals managers and bureaucrats responded to these changes. However, it was not only the heritage of the actors that was important for their behaviour, but also the context in which they now operated. Let us see how the actors, in particular parastatal managers, adjusted parastatal activity to the exogenous shocks that reform gave rise to.

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second oil price shock, as opposed to 'internal' factors. Although the Economic Recovery Programme (United Republic of Tanzania, 1986) for the first time acknowledged previous policy failure, the old attitude remained for a long time.

[174] Kiondo (1989), p. 357; comment added.

[175] SINTEF Applied Economics (1992), pp. 26 (first quotation) and 91 (second quotation).

[176] Tanzania Association of Parastatal Organisations (1989), p. 39.

Adaptation to Exogenous Shocks

Slow Response and Behavioural Change

> Some managers *do not know how* to react and others *are not motivated* enough. The managers who try to act *are still restricted* by the complex decision-making system, the laws and economic constraints.[177]

This observation, made in the early 1990s, reflects the importance of uncertainty, behavioural incentives and the remaining old rules for the response of parastatal managers to exogenous shocks through exploitation of their new opportunities. The soft budget constraint influenced the behaviour of managers through all these factors.

Trying out new behaviour meant throwing oneself into the unknown. Given the managers' limited experience of market conditions, the probability that they would make mistakes was high, particularly in comparison with more experienced private actors. Better then to be cautious and stick to familiar behaviour according to the old rules. Hence, many parastatal managers who faced increased uncertainty about how to behave successfully remained passive. Within the textile parastatals, for instance, they expected the holding corporation TEXCO to act on their behalf, and expressed concern that it did 'not sufficiently anticipate problems or take the lead in helping the mills with their difficulties'.[178] By the early 1990s, many parastatal managements and boards had still not identified any concrete measures for dealing with the new situation. They simply waited for somebody, for instance at the ministerial level, to tell them what to do. Consequently, little specific action was taken to improve parastatal performance.[179]

Managers were thus slow to adapt parastatal activity to exogenous change. Parastatals within the leather sector, for instance, did little to respond to increased competition, and highly import-dependent shoe factories did not shift to relatively cheaper imported inputs. By 1988, the output of leather parastatals had dropped to about one-third of the 1983 level, but they did not adjust their fixed costs, mainly for staff and administration, to the lower levels.[180] Within textiles (the sector perhaps most severely hit by competition) the parastatals were also slow to reorient their activities and reduce their fixed costs, especially for wages and salaries, so as to keep pace with declining output.[181]

The failure to reduce labour costs partly reflects how remaining bureaucratic co-ordination prevented managers from changing their behaviour towards independent adaptation of parastatal employment and wages. Managers found it difficult to lay off redundant workers on their own initiative, and were 'not entirely free' to determine wages, salaries, allowances, fringe benefits

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177 ICS Interconsult Sweden AB (1991), p. 36; emphases added.

178 Overseas Consultancy Group (1990a), p. 151.

179 ICS Interconsult Sweden AB (1991), pp. 35-37 and 42.

180 Ministry of Industries and World Bank (1989a), pp. 13-14 and 30-33.

181 de Valk and Mbelle (1990), p. 118.

and incentive schemes.[182] Besides, cutting parastatal employment may have affected their extended families and other network members. Managers also failed to adjust parastatal prices. The Tanzanian Association of Parastatal Organisations (TAPO) complained that 'several parastatals are unable to revise their prices promptly ... because of the delays in the process of price approvals' by the bureaucracy.[183] Because of political pressure to keep prices of essential services down, parastatals within public utilities found it difficult to increase their fees as late as in the early 1990s.[184]

Hence, it was difficult to change behaviour. Apart from the managers' perceptional heritage, both uncertainty and institutional constraints prevented them from adapting parastatal activity to the new conditions and from improving - or limiting the deterioration of - the financial performance. This contributed to a 'general feeling of helplessness' within, for instance, the textile sector.[185]

However, in many cases, the managers did not even react to stem losses with action that was within their scope for manoeuvre.[186] One study found parastatal 'Boards and Managing Directors voluntarily restraining themselves from ... "proper" action'.[187] The failure to respond so as to avoid cost increases and losses reflects the initial heritage and eventual persistence of the soft budget constraint, which shaped incentives for such behaviour. Managers expected parastatal financing gaps to be accommodated, and this weakened their incentives to economise on costs and prevent losses from arising or growing. While managers of textile parastatals complained about liquidity problems, they were less concerned than their private competitors with the price and quality of their major input, cotton, and with the negative cash-flow effects of having to pay cash on delivery.[188] According to one observer, textile parastatals faced 'considerable disincentive to perform better'.[189] By the early 1990s, after years of deteriorating performance, they had 'not undertaken serious efforts towards improving their efficiency especially in areas of cost effectiveness'.[190]

We know from the previous chapter that the soft budget constraint weakened parastatal responsiveness to exogenous shocks. This now applied to changes in relative prices, cost increases, growing competition and demand constraints. The central bank remarked that, judging from their expanded borrowing during the period 1987-1990, the major clients of the National Bank of Commerce (marketing boards, other parastatals and co-operatives) appear to have been

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182 Sanare (1991), p. 8.

183 Tanzania Association of Parastatal Organisations (1989), p. 17.

184 ICS Interconsult Sweden AB (1991), p. 42.

185 Overseas Consultancy Group (1990a), p. 152.

186 Ibid., pp. 4, 74-75 and 152, and Overseas Consultancy Group (1990b), pp. 3-7. Cf. the World Bank (1988a), p. 47, which notes that parastatal 'managers have often not exercised the full extent of the freedom they have'.

187 ICS Interconsult Sweden AB (1991), p. 36.

188 Overseas Consultancy Group (1990b), p. 6.

189 Overseas Consultancy Group (1990a), p. 187.

190 Mbelle (1992), p. 193.

unresponsive to the dramatic increases in interest rates.[191] It was not the soft budget constraint alone that weakened incentives to adjust parastatal activity to the new market conditions, but also the remaining institutional constraints and the behavioural uncertainty. However, it was to a large and increasing extent the soft budget constraint that made behavioural and adaptive rigidity possible. By taking care of the financial consequences and keeping the parastatals alive regardless of performance, it enabled the managers - and bureaucrats - *not* to respond flexibly to exogenous shocks, *not* to adapt parastatal activity and *not* to change behaviour according to the new formal rules.

The soft budget constraint allowed and shaped incentives for the actors to continue to behave as in the past. This implied, for instance, that financial and other senior parastatal managers failed to use the available financial information as guidance for the improvement of parastatal performance.[192] Instead of using price changes as signals for the reallocation of parastatal resources, the soft budget constraint also made the actors respond to the perceived quantitative constraints on foreign exchange by continuing to hoard inputs. Within metals and machinery, for instance, firms were reluctant to reduce their inventories. Several of them retained a policy of storing raw materials equivalent to one year's use, for fear of future shortages.[193] Similarly, pricing was done on a cost-plus basis as in the past, rather than in relation to market demand or foreign competition.[194]

Parastatals also continued to treat their customers poorly, as if there was still a seller's market. When for instance textile parastatals obtained an export order, they frequently missed the delivery dates and were generally unable to produce fabric of the required export quality.[195] Regional trading companies, in turn, did not adjust the opening hours of their retail outlets to the prime shopping hours, but tended to align them to the working hours of the civil service.[196] The Tanzania Coffee Marketing Board failed to give service to its clients, even after it had been converted into an exporting agent in 1990, and thereby damaged its relations with both farmers and buyers.[197] Hence, the actors responded to change in a manner that had been appropriate and successful within the old socialist system.

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191 Bank of Tanzania (1991c), pp. 48-49.

192 Overseas Consultancy Group (1990b), pp. 7-9.

193 Coopers & Lybrand Deloitte (1991), paragraph 467.

194 Ibid., paragraph 119. According to the International Development Association (1988), p. 15, this type of pricing may well have persisted within trade also.

195 Overseas Consultancy Group (1990b), p. 5.

196 Enterprise profile on the Board of Internal Trade Group, data prepared at the Ministry of Industries and Trade (1992).

197 United Republic of Tanzania (1992a), pp. 11-13.

Financial Problems Worsened by Rigidity

In the increasingly deregulated, competitive and continuously changing environment, relative prices and other conditions changed more rapidly and the information was transmitted faster through the system than during socialism. Market positions constantly had to be defended. This required greater flexibility and quicker response than in the past. Hence, behavioural rigidity had far worse consequences during the reform period, as revealed by the slumping financial performance and exploding losses of the parastatals.[198]

The situation was particularly severe for parastatals that became exposed to competition. The tremendous decline in output and market shares of parastatals within food trade and textiles, leather and shoe manufacturing together with their large and growing losses bear witness to this. The failure of leather manufacturing parastatals to adapt their fixed costs to their output decline led to the growing losses of, for instance, the Moshi, Mwanza and Morogoro Tanneries, and the Tanzania and Morogoro Shoe Companies.[199] Textile parastatals feature as perhaps the most illustrative example of how the virtual lack of action to counter the dramatic cost increases and competitive pressure led to collapsing financial performance during the first half of the reform period. Eight of these parastatals were among the major loss makers listed in the previous chapter.[200] By the end of the decade, one observer notes, the parastatal textile sector was bankrupt.[201]

Hence, while the exogenous shocks, through their immediate cost and revenue implications, contributed to parastatal losses at the onset of reform, non-adjustment of parastatal activity increased and permanented them. By giving rise to rigidity in a changing world, the soft budget constraint worsened the performance of the parastatals and contributed to the reproduction of their financial problems. It made the actors non-alert to the information about price changes and competition shocks, and weakened their incentives to respond to these. And when the partial reform increased the actors' uncertainty and imposed constraints that further weakened the incentives, and made flexible adaptation difficult, the soft budget constraint made rigidity possible. Hence the heritage and persistence of the soft budget constraint are an important explanation for the tremendous and rapidly growing parastatal financing gaps during the reform period. As in the past, the soft budget constraint reproduced the situations in which it applied, and we know that the actors continued to apply it in those situations. Let us now discuss why.

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198 Note that this did not apply to the exporting marketing boards, which saw their financial result improve with the increased revenues that devaluation gave rise to.

199 Ministry of Industries and World Bank (1989a), pp. 13-14, (1989b), Table 15, p. 10, (1989c), Table 30, p. 6, (1989d), Table 43, p. 7, (1989e), Table 56, p. 9, and (1989f), Table 65, p. 11.

200 See Table 5.5 above and Table 4.20 in Chapter IV.

201 Overseas Consultancy Group (1990a), pp. 7, 169 and 178, and (1990c), Appendix V.

Handling Parastatal Financial Problems

Much of the preceding discussion provides an argument for why the actors continued to apply the soft budget constraint during the reform period. It suggests that an answer can be found in the characteristic traits that the soft budget constraint possessed as an informal institution. We argued that as part of the actors institutional and ideological heritage, the soft budget constraint influenced how parastatal financial problems, as well as their causes and solutions, were perceived by the actors. The explanations suggested for the behavioural rigidity, in particular that of parastatal managers, in response to exogenous shocks also form part of an explanation of why the actors continued to apply the soft budget constraint. This sub-section elaborates and adds to the argument showing why the actors, now with a particular focus on the bureaucrats, applied the soft budget constraint during the changing and uncertain reform period. It discusses how the heritage and present context of the actors influenced their behavioural constraints and opportunities when parastatals were in financial trouble.

Application by Habit

Both parastatal managers and bureaucrats were used to parastatals being in more or less permanent financial trouble, and therefore perceived the problems as recurrent and familiar. Their behaviour in those situations was rule-governed, guided by the soft budget constraint, which made them expect the seeking and granting of external assistance to be successful. Consequently the actors' most immediate response was to respond in the manner that used to be successful in the past and, as discussed, that was consistent with the prevailing ideas and values. Hence, the soft budget constraint was largely applied by habit, in particular to begin with.

Available Solution to Acute Mass Problem

Eventually, however, when the problems escalated, the actors recognised that things were no longer what they used to be. Although parastatal financial problems were familiar, their rapid growth and tremendous size were new and unanticipated, even by the political leadership. The reform programmes aimed at exposing parastatals to exogenous shocks, and the leadership was apparently willing to get rid of individual loss makers, but the whole idea was to make them perform *better*. The discrepancy between intentions and outcomes suggests that the effects of reform on parastatal performance were severely misjudged. This reflects the leadership's limited recognition and understanding of the soft budget constraint and its wide-reaching implications. In particular, the devastating impact on parastatal response to exogenous shocks - the rigidity that it caused - was grossly underestimated, if recognised at all. Given the informational weaknesses of the old system and its strong ideological connotations, parastatal performance,

adaptability and competitiveness were probably overestimated. The crucial importance of adaptive capacity may not even have been fully understood, since the soft budget constraint provided a means to accommodate exogenous shocks in the past.

Consequently, when the parastatal financial problems escalated, the leadership, and not least the lower-level bureaucrats directly confronted with a large number of parastatals in financial trouble, were taken by surprise. However, whereas any persistent solution required careful consideration, immediate action also had to be taken. The problem was tremendous and acute, and the only behaviour that the actors were acquainted with in similar situations was to apply the soft budget constraint. Hence, when for instance the Revenue Department of the Treasury was crowded with applicants lobbying for discretionary tax exemptions in the early reform years, the Minister for Finance had no chance to scrutinise all the individual applications. Just as during the crisis, he signed exemption orders more or less automatically.[202] Thus a second reason for why the actors applied the soft budget constraint is that as an institution, it offered a ready behavioural solution for how to handle the recurrent, now large, unexpected and acute parastatal financial problems.

In Defence of Threatened Positions

Parastatal managers, bureaucrats and political leaders all faced incentives to avoid the collapse of the parastatal sector, on which their economic, political and social positions depended. Hence, when the worsening parastatal financial problems threatened the already weakened pay, power and prestige of the actors, they faced incentives to apply the soft budget constraint to compensate themselves and prevent the actual and potential declines in income, status and power.

The falling formal incomes and reduced ability to collect informal rents from parastatal goods in scarce supply made the direct private extraction and use of other parastatal resources for personal and network benefit increasingly attractive. The soft budget constraint was to an increasing extent a precondition for such behaviour. Reports from the textile sector reveal that this kind of practice continued among managements and boards of directors during the reform period.[203] According to the Tanzania Association of Parastatal Organisations, cash losses, fraud and other misuses of parastatal funds even increased during the second half of the 1980s.[204] Corruption is generally considered to have grown during the reform period,[205] and a public commission investigating the matter found that bureaucrats, for instance tax officers and bank

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202 Personal communication with staff at the Revenue Department, the Ministry of Finance and Economic Affairs, in Dar es Salaam, 22 October, 1992.

203 de Valk (1992), p. 370, and Overseas Consultancy Group (1990a), p. 186.

204 Tanzania Association of Parastatal Organisations (1989), p. 40.

205 Adam *et al.* (1994), pp. 141-145.

officials, received bribes in exchange for approved tax exemptions and non-enforced repayment of loans.[206]

Thus the soft budget constraint was partly applied in defence of threatened positions. As the parastatal financial problems grew and spread, these incentives were reinforced, at least for the political leadership. Over time, the restrictions on *abandoning* the soft budget constraint grew gradually more severe, since an increasingly larger share of the sector would have collapsed if it had *not* been applied.

Reduction of Behavioural Uncertainty

In spite of strong incentives to apply the soft budget constraint, the growing parastatal financial gaps created uncertainty, not only about the actors' future positions as suggested earlier, but also about how to successfully handle the problems. The uncertainty of the political leadership was fuelled by its diminishing control over resource allocation and the unknown effect of the reform programmes. The leadership could not know whether the problems would continue to grow, or whether reform would soon take its toll and lead to a turn-around of parastatal performance. Similarly, it did not know how it would manage to finance the tremendous parastatal losses, since important sources of finance were drained. It did not know the consequences of continued adherence to the soft budget constraint, although the outcome of not providing assistance was even more uncertain. In particular the long-term consequences were difficult to predict, while the immediate effects could be more easily foreseen. The action of refusing to assist parastatals in financial trouble ran the risk of directly hitting back, while the option of sticking to the soft budget constraint risked being unsustainable, but not until the more distant future.

In attempts to improve parastatal performance while coping with uncertainty, the leadership therefore threatened to stop aiding loss-making parastatals, while in practice it continued to apply the soft budget constraint. This resulted in unclear and contradictory signals to the other actors about the validity of the rule. In addition, the official rhetoric was confused by counter orders, which according to an official at the Co-operatives and Rural Development Bank meant that bankers did not know what the government wanted them to do. Despite several threats no longer to support ailing parastatals, the President called the heads of the banks in 1989 and commanded them to grant loans to the problem-riddled co-operatives. However, in October the following year, the government changed its mind once again, and instructed the banks to use commercial lending criteria.[207]

To begin with, managers and lower-level bureaucrats could not know how serious the leadership's threats were, or what they implied in practice. The actors' lack of commercial

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[206] Corruption Commission (1997), pp. 2 and 5.

[207] Personal Communication with a senior official at the Short Term Finance Department of the CRDB, Dar es Salaam, 30 November, 1992.

experience, discussed above, implied that they did not know how to behave to put the economic house of the parastatals in order and make them perform like profit-making entities. This ignorance was reflected in a superficial treatment of the new parastatal goal. A profit motive was sometimes stipulated, as for the National Textile Corporation that had quantified profitability targets for the period 1986-1990. In the operational documents of the parastatal, however - strategic plans, budgets and accounts - traditional quantitative and political targets continued to be emphasised.[208] Bureaucrats neither rewarded nor punished parastatal managers for the financial results,[209] and thus failed to use the increasingly available information to exert pressure on the managers to perform better. The leadership's threats were also poorly specified, which implied that the actors did not know what managerial behaviour and parastatal performance would suffice to qualify for additional finance in case of need. Were the bureaucrats to refuse assistance even if managers became more cost conscious, profit- and market-oriented, but nonetheless failed to make revenue cover expenditure?

The fact that many old behavioural rules, in particular bureaucratic intervention, remained in place added to the uncertainty, not least about what the alternative to the soft budget constraint implied for the bureaucrats. Were they only to refuse to renew finance to non-performing parastatals or were they also to hold payment defaulters financially accountable by enforcing payment of old debts? Legal processes of payment enforcement had been rare in the past and as late as 1989, bank officials still lacked experience and did not know how to administer legal avenues to debt recovery,[210] let alone how successful such behaviour would be. Was it not the higher-ups who should initiate such drastic decisions? Would they approve if lower-level bureaucrats tried to recover debt from the parastatals? As it appears, they would not.

> ... the banks claim that Government Ministries would not entertain the idea of the banks intervening in the affairs of another parastatal in this way. This is borne out by examples such as Tanganyika Packers and Mwanza Tanneries where CRDB [Co-operatives and Rural Development Bank] and TIB [Tanzania Investment Banks] have respectively tried to liquidate the companies and Government has intervened to prevent liquidation.[211]

As reported in the previous chapter, the banks found it extremely difficult to enforce the payment of debts prior to the early 1990s, because formal enforcement mechanisms were still either lacking or rendered ineffective by political intervention. The same applied to the payment of cash cover. Treasury officials were unable to take action against defaulters because they lacked formal legal powers to enforce payment.[212] It was not until mid-1992 that a law was

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[208] Overseas Consultancy Group (1990a), pp. 151-152.

[209] As reported by the World Bank (1988a), p. 47.

[210] Banking Commission (1989a), p. 16.

[211] Ibid.

[212] Personal communication with senior staff at the Department of External Finance, the Ministry of Finance and Economic Affairs, Dar es Salaam, 13 November, 1992. See the Ministry of Finance (1993), pp. 7-8, 12-14 and 22-25, for details.

adopted which treated unpaid cash cover as a debt to the government that could be recovered through legal procedures.[213]

Consequently, reform and its partial character created uncertainty for the leadership, lower-level bureaucrats and parastatal managers about how to behave when parastatals were in financial trouble. Just as in other uncertain situations, the actors faced incentives to stick to the old and familiar behaviour on the principle of 'better be safe than sorry', as illustrated by the behaviour of the bankers referred to above. When they did not know what the government wanted them to do with non-creditworthy and payment-defaulting clients seeking additional finance, they did not refuse to grant credit, but instead renewed the loans as in the past.[214] Since changing behaviour was perceived as a more risky venture, an additional reason for why the actors continued to apply the soft budget constraint is that it reduced their behavioural uncertainty.

Constraints on Change

As just illustrated, partial reform also implied that the remaining institutional constraints made it difficult for bureaucrats to change behaviour so as to hold parastatal managers financially accountable, and effectively prevented some of those who tried. This applied to the leadership itself, which retained its control over export trade in cash crops, as illustrated by the following quotation:

> As there was only one set of marketing channels, when it failed it had to be subsidized. Government could announce its intention to establish financial discipline and hold the marketing institutions (co-operatives and marketing boards) to account, but come the purchasing season it found itself held to ransom - either funds would be provided for crop purchase, or the peasant would find no market for his crops, with disastrous consequences for the next season's planting.[215]

In addition, by adhering to many of the old rules, in particular by interfering with parastatal activity, the bureaucrats effectively continued to control parastatal procedures. This made the control of parastatal outcomes difficult, for the same reasons as in the past. For one thing, it implied that the bureaucrats had themselves contributed to the parastatal financial problems, which created incentives to assume some of this responsibility. These incentives were reinforced by the ideological heritage, as discussed earlier. And since the leaders had launched the reform programmes, it was they who exposed the parastatals to the exogenous shocks. Besides, to the extent that bureaucrats had extracted parastatal resources for private use, they faced incentives to disguise their abuse from their own superiors and from the public. Such continued concealing of

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[213] United Republic of Tanzania (1992d).

[214] Personal Communication with a senior official at the Short Term Finance Department of the CRDB, Dar es Salaam, 30 November, 1992.

[215] Bagachwa *et al.* (1992a), p. 13.

information is suggested by repeated accusations in parliament, for instance, claiming that the leadership had not dealt with thefts of parastatal property.[216]

Informal rules also imposed constraints on any attempts to cease adhering to the soft budget constraint. Given the personalised relationships, interdependencies and loyalties within the parastatal sector after years of mutually beneficial exchange, the informal rules of the economy of affection added to the bureaucrats' difficulty to refuse to help parastatal managers in financial trouble. The fact that the bureaucrats had applied the soft budget constraint in the past, in repeated interactions that had contributed to the establishment and reinforcement of the informal networks, made it difficult to break the behavioural pattern. These informal constraints should have varied with the closeness of the relationships between the bureaucrats and the parastatal managers. This is borne out by the fact that it was the new president, Mwinyi, who threatened to cease bailing out parastatals, and not Nyerere, who once personally appointed many of the managers. It was also easier to express than to enforce the threat, partly because the practical enforcement in many cases would have had to been done by the lower-level bureaucrats - and not by the leadership - who frequently and directly interacted with the parastatal managers.

Hence, institutional interdependencies implied that the actors continued to apply the soft budget constraint partly because of the constraints on changes in behaviour imposed by partial reform and the remaining informal rules.

Learning about Successful Persistence

As shown earlier, the partial character of reform implied that parastatal financing gaps could be accommodated largely as in the past. Institutional opportunities, in particular the discretionary rights of the bureaucracy and the supreme power of the political leadership to intervene, were retained and growing amounts of finance were made available during the first part of reform, not least through donor import support. Besides, the informal networks and rules of the economy of affection could be relied upon. Hence, although the actors were uncertain about the continued validity of the soft budget constraint, those who tried to apply it soon found that it successfully persisted - while those who tried to change behaviour encountered problems. The leadership learnt that while the reform programmes forced it to withdraw certain sources of finance, new financing opportunities emerged. The parastatal managers and bureaucrats gained a similar experience. They found that the leadership's threats to cease assisting poorly performing parastatals were non-credible. Thus an additional reason why the actors applied the soft budget constraint during the reform period is simply that they learnt that it continued to prevail.

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[216] See, for instance, Kiondo (1989), p. 418.

Stability: Beneficial in a Changing World

When the reform programmes exposed the parastatals to exogenous shocks, partly changed the institutional context of the actors, threatened their positions and increased their behavioural uncertainty, the soft budget constraint persisted. As in the past, it offered a way to handle the parastatal financing gaps, which now grew larger than ever, and thereby performed several functions. However, given the changing context of the actors, the persistence of the soft budget constraint facilitated the behaviour and interaction of parastatal managers, bureaucrats and the political leadership in ways that were partly new. It provided a means for the actors to cope with the exogenous shocks, altered behavioural rules, remaining institutional constraints and uncertainty that reform gave rise to, without having to change their behaviour.

By making it possible for the actors to continue to behave as in the past, which was easier, safer and more convenient, the soft budget constraint reduced their behavioural uncertainty during the turbulent times, in situations of parastatal financial trouble as well as in general. It allowed adherence to many of the old rules and kept the ailing parastatal sector intact, which was crucial for the actors' ability to defend their threatened economic, political and social positions. The soft budget constraint allowed them to pursue their aims in the manner that they were used to and skilled at, and the outcome of which was more easy to predict than that of the unknown alternative.

Hence, one of the major beneficial consequences of the soft budget constraint for parastatal managers, bureaucrats and the political leadership was the stability and continuity that it provided during the otherwise unstable, threatening and uncertain period. By persisting as an informal institution that was part of the actors' heritage from the previous system in spite of formal institutional change, enabling stable behaviour in a changing world, it linked the present to the past. Thus the soft budget constraint made it easier for the actors to face the reform.

The fact that actors largely continued to behave as before does not, however, imply that behaviour was static during the reform period. Parastatal managers and bureaucrats modified and changed their behaviour, both in general and with respect to the application of the soft budget constraint. To this we now turn.

THE SOFT BUDGET CONSTRAINT AND BEHAVIOURAL ADAPTATION

Adherence to the old rules did not remain equally rewarding throughout the whole reform period. Behaviour that was appropriate to the old socialist system had not only beneficial but also negative consequences, and thereby repercussion effects on the success of such behaviour. The fact that such old behaviour was partly 'dysfunctional' was revealed by the worsening parastatal financial performance. This implied that parastatal resources became less available, for instance for private extraction and social network use. As shown above, our actors within the

parastatal sector faced problems in maintaining their real incomes. Besides, while other groups managed to increase their income shares derived from informal activity during the reform period, the urban rich failed to do so, at least prior to the 1990s.[217]

The actors within the parastatal sector nonetheless continued to behave as in the past for a long period. An important reason was the persistence of the soft budget constraint, which made their dysfunctional behaviour sufficiently successful to be retained, as compared to the risky project of venturing into new and unknown behaviour. However, the negative consequences of behaviour according to the old rules accumulated to the extent that the total amount of soft external parastatal finance appears to have declined in the early 1990s. Hence, eventually even adherence to the soft budget constraint became less successful, both directly, in accommodating financing gaps, and indirectly, through its consequences. As a result, the success of adherence to the other old rules, which partly depended on the success of the soft budget constraint, also declined.

As the actors' behaviour grew less rewarding, attempts to change or modify their behaviour became increasingly attractive. Incentives for behavioural change were eventually created, and at a certain point, they initiated a gradual process that gained momentum over time. This section examines how parastatal managers and bureaucrats handled the declining success of their 'old' behaviour and how their behaviour was adapted. It explores the role of the soft budget constraint for such behavioural adaptation and the modification of its own application during the period.

Trial, Error and Learning

How then, did the actors change their behaviour? Their perceptions of behavioural constraints and opportunities, how to innovate, experiment with behaviour and adhere to the new rules were largely determined by their past experience, skills and knowledge and prevailing ideas and values. Consequently, the actors' search for alternative behaviour, their behavioural trials and the outcome of such trials were influenced by their socialist heritage. Some actors tried to behave according to the new formal rules introduced by the reforms. Let us begin by considering attempts, primarily by managers, to improve parastatal performance through action in the real sphere: productive activity, as opposed to redistributive activity in the control sphere. We will then discuss the role of the soft budget constraint for these attempts.

[217] Sarris and van den Brink (1993), Table 68, p. 182.

Managerial Attempts to Act in the Real Sphere

Parastatal managers largely continued to behave as in the past, but certain efforts were nonetheless made to respond to the changing market conditions through action in the real sphere. Some managers were less risk avert and more creative. Relatively 'business-minded' or entrepreneurial managers waited for opportunities to develop their commercial talents, thus welcoming and exploiting the opportunities provided by the new behavioural rules. Among textile parastatals, '[t]he more competent mill managers tended to be the ones who resisted interference from TEXCO', the holding corporation.[218]

One study found that although there were few examples of manufacturing parastatals that increased their exports, some medium-sized ones which produced wood products and machinery had managed to locate new markets in neighbouring countries.[219] Ubungo Garments appears to be such an exception among textile parastatals.[220] Within this parastatal sub-sector, a certain substitution took place, from imported to locally produced inputs and from processed to unprocessed and less import-intensive production.[221] Although the industrial sector remained highly import-dependent in the early 1990s, an increased use of local substitutes in other sub-sectors also, such as leather, beer and soap manufacturing, was reported.[222] Hence, over time, some managers appear to have become more commercially oriented. Cases of textile parastatals have been reported where a good understanding of financial data was eventually acquired and the information was even used for commercial decisions.[223]

The extent to which the efforts of parastatal managers to change their behaviour were successful varied, however. 'Some managers have fired employees and encountered problems from the unions and the political level of the Tanzanian society. Other parastatals have been allowed and in practice been able to reduce the work force.'[224] Thus variations in managerial autonomy partly reflect varying degrees of behavioural change by their superiors within the bureaucracy. This had consequences for how they managed in the market place. 'Some companies are successful, while the majority is still striving to improve without progress.'[225]

Learning to successfully adhere to the new behavioural rules was a gradual process of trial and error. The actors' ignorance about the rules of the market and commercial principles and concomitant behavioural uncertainty implied that they groped in the dark. Managers (as well as bureaucrats) had to experiment with behaviour and, given their subjective perceptions, 'different

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218 Overseas Consultancy Group (1990a), p. 188.

219 ICS Interconsult Sweden AB (1991), p. 39.

220 Enterprise profile on Ubungo Garments Ltd., data prepared at the Ministry of Industries and Trade (1992).

221 de Valk and Mbelle (1990), p. 104.

222 Tanzanian Economic Trends (1990), p. 23.

223 Overseas Consultancy Group (1990a), p. 152, and (1990b), p. 8.

224 ICS Interconsult Sweden AB (1991), p. 36.

225 Ibid.

companies ha[d] ... different ideas on how to respond'.[226] Behavioural trials - just as behavioural rigidity - were largely guided by past experience, not least of the soft budget constraint. Hence, in many cases the actors tried to adapt with behaviour that would have been more relevant in the old system, for instance when parastatals faced increased competition. This is illustrated by observations of the metals and machinery sector made in 1991:

> The lack of market knowledge, and the absence of managerial understanding of market dynamics, is driving many Tanzanian enterprises into activities for which they are unsuited, or in which the long term prospects are at best uncertain. This trend is most apparent in parastatal enterprises where investment decisions in particular are taken without due consideration of commercial criteria, and the main objective is to establish a manufacturing capability in the public sector.[227]

Five years after the launch of the Economic Recovery Programme, production was still planned and investment realised without any significant estimation of market size or demand projections. It was assumed that there was a ready market for the products and that this would continue to exist. As a result, parastatals expanded in already over-supplied and highly competitive markets while they failed to exploit strong market positions.[228] The previous input shortages and dependence on a sole supplier made the major parastatal steel mills integrate backwards in order to guarantee the supply of raw materials, in spite of the fact that supply constraints were no longer binding. Since the demand situation was disregarded, excess capacity and under-utilisation resulted.[229] Such behavioural trials failed.

Opportunities for Behavioural Experimentation and Failure

The actors' heritage, their limited market experience compared to private competitors and the fact that changing behaviour requires learning implied that many behavioural attempts were not very rewarding to begin with. In the meantime - during the process of learning - the financial performance of the parastatals remained poor. The soft budget constraint now performed an important function.

By taking care of the financial consequences of behavioural failure, keeping the parastatals alive, the soft budget constraint allowed parastatal managers and bureaucrats to try the new formal rules and otherwise experiment with behaviour. It offered a period of grace, during which the 'infant' actors could gradually become acquainted with the new and changing context. The

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[226] Ibid.

[227] Coopers & Lybrand Deloitte (1991), paragraph 4117.

[228] Ibid., paragraphs 111 and 4106. See also paragraphs 4107-4113.

[229] Ibid., paragraphs 490-494. When, for instance, the Nyanza Engineering Foundry Company (NEFCO) failed to secure regular customers for its foundry products, it responded by integrating forward into machining and finishing operations. However, this market, for finished agricultural and industrial spares, was already fragmented and highly competitive, so that the NEFCO further undermined its own position. (Ibid., paragraphs 497 and 4100.)

managers could practice and learn within a parastatal 'nursery', without having to face the negative consequences of initial failure. Similarly, the bureaucrats were offered time and opportunities to learn how to interpret parastatal balance sheets, and how to operationalise commercial criteria and new procedures for performance control and resource allocation. The soft budget constraint allowed the actors to make not only repeated trials, but also errors. It reduced the uncertainty about the outcome of behavioural change, while it enabled the actors to gradually discover and adapt to the market and its institutions.

Thus the soft budget constraint had beneficial consequences in addition to those discussed in the previous section, and the actors faced incentives to apply it also during the reform period, since learning to change behaviour took time. The extent to which this also implied that the actors actually learnt to successfully adapt behaviour to the new environment so as to improve parastatal performance is, however, a different matter.

Delay of Learning

The soft budget constraint allowed the actors to repeat both faulty and successful behaviour. As mentioned earlier, parastatal managers were rewarded whatever the financial outcome. By shielding managers from the full consequences of their mistakes, the soft budget constraint contributed to keeping them ignorant about the functioning of the market and commercial principles. Although parastatal managers within the metals and machinery sector, for instance, faced increased competition from imports, by the early 1990s they did still not know what market conditions implied. They continued to believe that if only a product could be produced it would be sold.[230] Similarly, among textile parastatals 'normal commercial considerations' did not yet apply in 1989, in spite of the heavy competition that the sector had experienced since 1984.[231]

The soft budget constraint consequently hampered the feedback mechanism that would have informed the managers about the consequences of their behavioural trials, in terms of parastatal financial performance, and signalled when the trials had to be modified or changed in order to be successful. This is reflected in the fact that as late as 1992, the restructured Tanzania Coffee Marketing Board still had no functioning accounting and financial control system.[232] The soft budget constraint thereby tended to delay the managers' learning how to behave successfully according to the rules of the market and commercial principles. Hence, while it had beneficial consequences for the managers because it enabled them to experiment with action in the real sphere, it simultaneously contributed to rendering such trials unsuccessful.

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[230] Ibid., paragraph 4105.

[231] Overseas Consultancy Group (1990a), p. 152.

[232] United Republic of Tanzania (1992a), p. 7.

Change in the Soft Budget Constraint Itself

When the success of adherence to the soft budget constraint was reduced, the actors also tried to handle parastatal financial problems differently, and experimented with behaviour in several ways. Let us now consider the efforts made by in particular the political leadership and the bureaucracy to alter the application of the soft budget constraint.

Reduced and Selective Application

The political leadership's need to gradually step up the reform process in response to internal and external pressures, in order to defend its position, implied that various forms of soft parastatal finance were depleted. Towards the end of the reform period, the total amount of soft external parastatal finance available appears to have declined, as discussed earlier. This decline suggests that parastatal superiors within the bureaucracy actually applied the soft budget constraint to a lesser extent in the early 1990s than in the past.

To a significant extent, this was a result of the foreign donors' withdrawal of large amounts of soft import support. Donors were not only dissatisfied with the inefficient allocation of commodity import support (CIS), but eventually also with the non-payment of counterpart funds. This is an additional reason why they shifted to the open general licence system (OGL).[233] In the early 1990s, the donors jointly demanded that the Tanzanian authorities enforce payments. This required the establishment of payment records,[234] and resulted in the Treasury estimates of the total outstanding cash-cover liabilities for CIS. In 1992, the government agreed to regularly present cash-cover payment records for both CIS and OGL funds to the donors, to enforce 100 per cent cash-cover requirement, to refuse defaulters further access to funds, and to put them on a black-list.[235] The government adopted a Commodity Import Support Regulation Act as the first legal instrument empowering the Treasury to enforce cash-cover payment.[236]

In 1989, the Tanzania Association of Parastatal Organisations reported that it was 'easier for enterprises with political support, such as Co-operatives, or international interests as in TANESCO, to secure local funding easily than for the smaller parastatals'.[237] Although the ease with which the soft budget constraint was applied also varied prior to reform, the reduced

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[233] Bhaduri *et al.* (1993), p. 14, and Doriye *et al.* (1993), pp. 25-26.

[234] Already in 1988/89, the Swedish International Development Authority had contracted a local consultant to monitor Swedish import-support allocations and payment of cash cover. Data on the payment record for the period 1988/89-1991/92 are shown in Table A.15 in the appendix.

[235] SPA JEM (1992), pp. 4-5.

[236] United Republic of Tanzania (1992d).

[237] Tanzania Association of Parastatal Organisations (1989), p. 28. TANESCO stands for the Tanzania Electric Supply Company, a public-utilities parastatal heavily supported by donors. (See Doriye *et al.*, 1993, Table 4.3, p. 79.)

availability of finance suggests that it was more selectively applied towards the end of the period. Our observations support the picture. According to Table 5.9, only four parastatals received direct government subsidies in the early 1990s, and Table 5.15 shows that Swedish commodity import support was allocated to a considerably smaller number of parastatals than in the past.[238] A large number of non-operating parastatals may also reflect the restricted application of the soft budget constraint. By mid-1991, a mere 6 out of totally 72 District Development Corporations were 'somehow working', while the remaining 66 were 'dormant',[239] and in 1991/92, the Tanzania Audit Corporation recorded 150 such passive clients.[240]

Reduced application of the soft budget constraint was not necessarily a consequence of compelling circumstances only. While adherence to the soft budget constraint was crucial for keeping alive the parastatals on which the leadership still largely depended, it grew increasingly costly over time, as the financing gaps grew, and difficult, as the amounts of finance were reduced. Hence, although the *complete* abandonment of the soft budget constraint does not appear to have been perceived as a behavioural alternative, the leadership faced increasingly strong incentives to limit its use. Lower-level bureaucrats faced similar incentives, since their own financial resources were drying up.

To a certain extent, the leadership and the bureaucrats tried to change behaviour in this regard, and hence to enforce a *hard* budget constraint. There were occasions when the National Bank of Commerce (NBC) refused to renew loans to certain payment defaulting parastatals.[241] Bank officials within both the NBC and the Co-operatives and Rural Development Bank also claim that they granted credit more selectively and were exposed to less government pressure to lend to non-creditworthy parastatals than in the past. The 1991 Bank Act made it easier for the banks to adhere to their formal lending criteria and to enforce loan recovery, among other things, by facilitating the sale of securities of defaulters. The officials claim that the banks began to use these opportunities,[242] although we know from the preceding discussion that not all bankers succeeded.

With respect to the ministerial granting of discretionary tax exemptions, staff at the Treasury Revenue Department reported that from mid-1992, a more 'drastic attitude' was adopted towards parastatals. Efforts were made to 'encourage tax payments and to discourage those who seek exemptions', which was facilitated by the backing from a newly installed Minister for Finance. 'We have become bold', an official said, and 'are trying to be firm'.[243] The same year an act

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238 The same applies to the allocation of Norwegian import support, displayed in Table A.14 in the appendix.

239 Ministry of Finance (1991d).

240 See the note to Table 5.2 above.

241 For instance, partially to the Air Tanzania Corporation in 1989 or later, to the NMC in 1992 and to the Tabora Regional Cooperative Union after the 1990/91 season. (Price Waterhouse, 1992a, pp. 7, 17 and 25.)

242 Personal communications with senior staff at the Department of Commercial Banking of the Co-operative and Rural Development Bank, 30 November, and at the Department of Corporate Banking of the National Bank of Commerce, 4 December, 1992, in Dar es Salaam.

243 Personal communication with staff at the Revenue Department of the Ministry of Finance and Economic Affairs, Dar es Salaam, 22 October and 12 November, 1992.

revoking tax exemptions and remissions was adopted, but its applicability was limited. For instance, it did not apply to donor projects, and ministerial powers to grant exemptions remained.[244]

The strongest indication that the leadership learnt to at least partly abandon the soft budget constraint is the transfer of part of the non-performing assets of the banks to the Loans and Advances Realization Trust (LART). In 1992, the NBC suggested the transfer of debts worth 45 billion TSh owed by totally 56 enterprises. 22 parastatals and 6 co-operatives owed the overwhelming majority. The National Textile Corporation alone accounted for 69 per cent of the debt.[245] Data on the value of debts owed by parastatals *actually* transferred as well as on the *time* for the transfer vary. A World Bank Public Expenditure Review reported that the value amounted to 24 billion TSh during the whole of 1992/93.[246] According to the Parastatal Sector Reform Commission (PSRC), no transfers were made in 1992, but during the following two years, the actual number of parastatals placed under the LART totalled 20.[247]

However, the implications with respect to the application of the soft budget constraint are not unambiguous. First of all, we do not know what happened to parastatals placed under the LART. As late as 1995, the PSRC still simply *assumed* that the debt transfer of the 20 parastatals led to receivership or liquidation.[248] To the extent that it did not, and parastatals continued to operate, the transfer might be seen as an application of the soft budget constraint. However, according to the LART Act, parastatals were not to get any additional bank loans,[249] so continued operation may have been difficult.

Secondly, just as with government assumption of bad parastatal debts in the past, but on an even larger scale, the transfer relieved the state-owned banks of part of their non-performing assets. They were replaced with Treasury bonds through which the balance sheets of the banks were re-capitalised. The leadership thus again applied the soft budget constraint in its interaction with the banks when they were in financial trouble. The implication that the NBC perceived the measure in this manner, and thus expected the soft budget constraint to apply, is suggested by the fact that it continued to accumulate bad debts in the following years. In mid-1993, non-performing assets accounted for 49 per cent, and two years later, for two-thirds of its portfolio.[250]

Nonetheless, although bureaucrats, including the leadership, largely continued to adhere to the soft budget constraint in the early 1990s, they applied it in interaction with parastatal managers to a lesser extent than in the past. Thus they partly and gradually learnt to change their

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244 United Republic of Tanzania (1992b).

245 Loans and Advances Realization Trust (1992).

246 In addition, the government provisioned for 57 billion TSh worth of doubtful debts remaining with the NBC. (World Bank, 1994, p. 17, referring to the fiscal year 1993.) According to Haggerty (1992), p. 6, an estimated amount of 49 billion TSh was transferred in 1992.

247 Parastatal Sector Reform Commission (1995), p. 25. Again data differ. Cf. the previous footnote.

248 Ibid. Cf. the United Republic of Tanzania (1996), p. 5.

249 United Republic of Tanzania (1991d).

250 Ahlquist and Wissinger (1996), Table 5.6, p. 49.

behaviour. Hence, when external parastatal finance grew increasingly scarce, the actors - managers and bureaucrats alike - had to compete for it more fiercely than in the past, and thus faced incentives to innovate. However, behavioural change did not always occur in accordance with formally altered rules or intentions otherwise expressed in the reform programmes.

The actors found adherence to the soft budget constraint less successful than it used to be and had to compete harder for parastatal finance, but they did not necessarily perceive the old *behavioural rule* as obsolete. Given their past experience of substituting between forms and sources of finance, they are more likely to have perceived the problem as one where certain *modes of applying* the soft budget constraint had become less rewarding. Since they retained the soft budget constraint in their behavioural repertoire, changing behaviour largely came to imply that they tried, and learnt, to modify its application in different ways.

Debt Accumulation and Passive Application

The declining availability of external parastatal finance implied that it could not be provided as promptly and easily - or fully - as it used to. In the meantime, parastatals increasingly failed to service their payment obligations, so their debts accumulated. This is indicated by the non-performing loans of the banks, the cash-cover debt of parastatals and by Treasury bridging finance and other loans to parastatals.

A thorough attempt to estimate the total outstanding debt and its components in all commercial parastatals excluding banks as of mid-1992 was made on the basis of data for 245 parastatals and extrapolated to totally 344. Total debt was estimated to be 1.000 billion TSh, net indebtedness 790, and net debt less cash holdings 740 billion TSh.[251] Of the latter, three parastatals within public utilities and the Tanzania Railways Corporation accounted for 200 and co-operative unions for 67 billion TSh.[252]

Over 90 per cent of the total debt was owed to the state. Almost half (440 billion TSh) was owed to the Treasury, mainly for loans passed on from foreign sources (380), but also for direct lending including commodity import support (25) and taxes, duties and dividends (35). Parastatal debt to the local banks stood at 175 billion TSh, of which co-operatives accounted for 72. Debts for direct foreign loans guaranteed by the government amounted to 140 billion, and lending *within* the community of commercial parastatals (excluding the banks) to 165 billion TSh. Of the parastatals for which data were available, 45 per cent were unable to service any

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[251] To be compared with, for instance, total public expenditure in 1991/92, 228 billion TSh, or official GDP in 1991 and 1992, 835 and 1,031 billion TSh. (Tanzanian Economic Trends, 1994, Tables 1 and 7, pp. 82 and 91.)

[252] Haggerty (1992), pp. 6-7. The three parastatals were the notorious loss makers the National Urban Water Authority, the Tanzania Electric Supply Company and the Tanzania Posts and Telecommunications Corporation.

debt at all and 15 per cent would only be able to repay a portion. In fact, the majority of the parastatals were not servicing any of their debt to the Treasury.[253]

Managers of indebted parastatals found that non-payment of debt was successful. Cash-cover payment default, for instance, was not punished; it was not even detected, because records were not kept and payment was thus not controlled. As pointed out by the study referred to here, a major reason why parastatal debt accumulated was 'lack of action to enforce loan recovery procedures which, in turn, until recently encouraged some parastatals to rely on increasing debt to make good losses or shortages of working capital'.[254] As financial problems worsened, the number of occasions when managers failed to service parastatal debts in time and experienced that 'nothing happened' increased. Over time, they learnt that non-payment of debt did not have to be bargained for. The soft budget constraint was thus increasingly applied through passive non-payment and non-enforcement of payment, as compared to active bargaining and discretionary allocation or non-extraction of resources.

Inter-Firm Credit and New Counterparts

When the financial problems of the parastatals worsened, their debts grew, not only to the Treasury and state-owned banks, but also to their trading partners. In the late 1980s, the parastatals reported that credit collection became increasingly difficult,[255] and managers witness about increased inter-firm credit.

An example of such cross-lending is provided from the transport sector. Parastatals under the National Transport Corporation (NTC) accumulated debts to their suppliers. A senior NTC manager reported in 1991 that, for instance, the bus company in Dar es Salaam had used supplier credit as a means to finance losses incurred since 1986. Debts owed by customers to the NTC parastatals accumulated correspondingly, because the parastatals continued to deliver their services to the clients in spite of payment default. In the past, the manager reported, the reason was political pressure from the government, but as competitive pressure within the sector grew, such credit was increasingly used as a means to keep customers.[256] Debts due to inter-firm credit also accumulated within the group of parastatals under the Board of Internal Trade (BIT). National trading corporations (NTCs) sold to regional trading corporations, which faced financial problems and accumulated arrears. The NTCs were reluctant to claim payment, a BIT manager reports, at least by refusing to deliver goods, because of the loyalty between the 'sister'

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[253] Ibid., pp. 6-7 and 9.

[254] Ibid., p. 4.

[255] Tanzania Association of Parastatal Organisations (1989), p. 36.

[256] Personal communication with a senior manager at the National Transport Corporation, Dar es Salaam, 6 December, 1991.

companies.[257] Hence, contrary to what may have been expected, given the soft budget constraint, deconfinement of trade and increased competition did not necessarily lead to a tougher attitude towards payment-defaulting customers.

Inter-parastatal credit may have become a form of soft external finance that, although not entirely new, grew in relative importance with accumulating parastatal losses and the decline in other finance. Recall that by mid-1992, total inter-parastatal debt amounted to 165 billion TSh, or 16.5 per cent of the total parastatal debt, according to the estimates referred to earlier. Of this amount, inter-firm debt within the respective holding corporation groups accounted for 85 and debt to other parastatals for 80 billion TSh.[258]

Managers thus modified their application of the soft budget constraint also by shifting it to their interaction with partners other than public bureaucrats and foreign donors: to suppliers and customers, primarily - but perhaps not exclusively - within the parastatal sector. The case of transport parastatals suggests an additional modification, illustrating how actors tended to adapt to the new situation by trying old and familiar behaviour. Some managers applied the soft budget constraint as a means to compete for customers in the market.

Application through Parastatal Reform?

When reform and policy measures imposed constraints on state financing of parastatals, the leadership knew from experience to shift part of the burden to other financiers. When donors withdrew soft import support in the early 1990s, they simultaneously urged extended and speedier reform within the parastatal sector. While partly a response to this pressure, the government launching of the parastatal-sector reform programme in 1991/92 may also have been an attempt to keep the ailing sector alive, by attracting other forms of donor finance to the parastatals. Whether parastatal reform actually implied a continued application of the soft budget constraint remains uncertain, but it clearly provided such a *potential,* except in cases of outright liquidation. Individual cases of hardened budget constraints were thus the price that the leadership had to pay for keeping the remaining parastatals alive, at least for some time.

Rehabilitation and financial restructuring of many - if not most - parastatals that were to remain under state ownership were needed if they were ever to become self-sustaining. And in order to attract private partners to invest in existing parastatals, it was often necessary to remove excess debt and restore an acceptable debt-equity ratio. However, given the past experience of parastatal managers and bureaucrats, financial restructuring ran the risk of being perceived as a renewed application of the soft budget constraint, as implicitly noted by Haggerty:

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[257] Personal communication with a senior manager within the Board of Internal Trade, Dar es Salaam, 4 December, 1991.

[258] Haggerty (1992), p. 6.

> All of the ... possible methods of relieving excess debt run the moral hazard of inviting a return to the same situation ... unless effective steps are taken urgently to turn a parastatal to profitability and to close down those enterprises that fail to respond despite debt relief. This underlines the need for effective steps to be taken to ensure that normal bankruptcy processes ensue if a restructured parastatal returns to or is heading again for an insolvent position.[259]

The bad debt relief and re-capitalisation of the National Bank of Commerce may, as suggested above, illustrate this point. A few years later, the bank had again accumulated huge non-performing assets. Expectations of continued prevalence of the soft budget constraint for parastatals that were not liquidated were fuelled by the government. It clearly signalled that during the period of restructuring, parastatals would be granted 'transitional budgetary subsidies'.[260]

Reform also implied privatisation of some parastatals. To judge from Table A.20 in the appendix, privatisation during the period 1990-1992 was mostly partial in character. As pointed out by the World Bank, the approach adopted was to 'seek additional equity investment and a dilution of state ownership of parastatals, rather than liquidation of existing assets'.[261] By establishing joint ventures, the leadership eventually turned to private financing while it maintained some control over the parastatals.

The extent to which parastatal reform actually implied that the leadership continued to apply the soft budget constraint as suggested here cannot be established, but the possibility of such behavioural modification has been pointed out. The process was only initiated during the period studied.[262] Let us consider a final possible change in bureaucrats' application of the soft budget constraint.

Application in Interaction with Private Firms?

When real incomes and scarcity rents declined during reform, bureaucrats, including the political leadership, faced incentives to also seek compensation by other methods than by extracting parastatal resources for private use. Private-sector growth made them interact with private firms to an increasing extent, for instance when allocating bank credit and foreign exchange and

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[259] Ibid., p. 14.

[260] Ministry of Finance (1991b), p. 7. When the new law to make co-operatives autonomous, commercial and self-sustaining was adopted in 1991, the government similarly promised to guarantee the financing of co-operatives during their whole restructuring period. (Larsson, 1991, p. 6, and United Republic of Tanzania, 1991a, Attachment 1.)

[261] World Bank (1991b), p. 106.

[262] Recent preliminary observations are ambiguous. There are suggestions that loss-making parastatals survived for several years after 1992, partly through access to non-serviced credit from the National Bank of Commerce. See, for instance, the World Bank (1995), pp. i, iv, xiii and 9, and the International Monetary Fund (1996), pp. 6-7. On the other hand, a consultant involved in the reform of industrial and trade parastatals suggests that many of them survived by scaling down operations to a minimum. (Personal communication with Bo Andreasson at Swedish Development in Gothenburg, 24 June, 1997.)

issuing various business licences. The actors faced both opportunities and incentives to generate informal income by charging rents for all kinds of preferential treatment of private firms. To judge from the growth of corruption, such rent extraction also increased, and as a result, personal relationships developed. The close bonds between members of the political leadership and wealthy private businessmen gave rise to what Kiondo refers to as a new class, the *'nouveau riche'* class, and the consequent wealth accumulation of political leaders was criticised by Nyerere already in 1987.[263]

When internal and external parastatal resources were depleted towards the end of the reform period, bureaucrats' incentives grew stronger to compensate for the decline in informal income by increasingly turning to the private sector. These incentives were reinforced by the launching of a civil-service reform in 1992 that threatened to result in mass retrenchment,[264] and by the parastatal-sector reform that threatened to shrink the sector. Private-sector growth increasingly exposed bureaucrats to offers of bribes for preferential access to resources that remained under control or for non-enforced payments of taxes and other dues from private firms.

Under those circumstances, one option for bureaucrats to modify their behaviour was to stick to the soft budget constraint, but apply it in interaction with the new partners where the potential for rent extraction was greater. The commission on corruption reconfirmed the closeness between government and other political leaders and private businessmen in the 1990s. It found that the latter had bribed leaders for decisions in their favour, as well as for external finance, such as tax exemptions.[265]

Bureaucrats may not have intended to accommodate financing gaps of private firms through such an exchange of bribes for preferential access or payment relief, at least not to begin with. However, given their experience of the soft budget constraint, the personal relationships and the informal rules of the economy of affection applying to interaction within these, the soft budget constraint may easily have developed over time, through repetition of such behaviour. Besides, managers of private firms must also have learnt that non-payment of dues to the state was seldom detected or punished, and may have used the opportunities thus created when in financial trouble.

This spread of the application of the soft budget constraint is further suggested by the fact that several private firms repeatedly received renewed commodity import support despite previous payment default, as shown by Table 5.16 above. This was, for instance, the case with the DM Investment Group, a private firm suspected by donors to have successfully lobbied for free import support under the protection of the Treasury.[266] As regards bank credit, an official at the National Bank of Commerce reported that there had been some indirect private (as opposed

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263 Kiondo (1989), pp. 317-318.

264 Cf. Adam *et al.* (1994), pp. 142-143.

265 Corruption Commission (1997), *passim.*

266 Personal communications with senior staff at the offices of two bilateral donors, Dar es Salaam, 17 and 18 November, 1992. For Swedish import support to the firm, see Table A.15 in the appendix.

to open official) pressure to lend to private firms.[267] The bank was found to have granted credit to 'nonperforming clients' in the private sector during the period 1991-1992.[268] And when 67 per cent of the assets of the bank were non-performing in 1995, the private sector accounted for 56 per cent of its credit.[269]

Strictly speaking, we cannot establish that bureaucrats shifted part of their application of the soft budget constraint to interaction with private counterparts, but the possibility for such behavioural modification is indicated by these observations. To the extent that they did, this offers an additional example of how actors adapted during the reform period by modifying old behaviour rather than changing to a completely new one: bureaucrats applied the soft budget constraint to new partners within the growing private sector, as a means of generating informal income when rents that could be extracted from the parastatal sector declined.

Adaptation: Beneficial in a Changing World

When adherence to the old rules in the reforming system grew less rewarding and incentives to try alternative behaviour were created, the soft budget constraint played a role for behavioural adaptation. By offering a survival mechanism for parastatals, it first of all made it easier for the actors to try the new formal rules and otherwise experiment with behaviour. Learning to successfully compete in the market took time, and in the meantime, parastatal managers could rely on the soft budget constraint. However, as part of the actors' heritage, the soft budget constraint influenced both their trials and the outcome of such trials, and hence behavioural change, in two additional ways. Since parastatal managers were unfamiliar with the market but expected the soft budget constraint to prevail, they often tried to adapt with obsolete behaviour and consequently failed. Secondly, by allowing for the repetition of such failed trials, the soft budget constraint destroyed the feedback mechanism necessary for corrective action and retarded managers' learning to act successfully in the real sphere.

When the success of adhering to the soft budget constraint was also reduced, in particular the bureaucracy and the political leadership tried, and to some extent managed, to limit their application of the soft budget constraint. However, such behavioural change was partial and far from unambiguous. This suggests that learning to successfully enforce a hard budget constraint - and thus establish a new behavioural rule that replaced the old one - also took time. The actors largely adapted 'at the margin', by altering behaviour on the basis of their past experience in this regard also. Instead of ceasing to apply the soft budget constraint, they modified its application.

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[267] Personal communication with senior staff at the Research and Planning Department of the National Bank of Commerce, Dar es Salaam, 6 December, 1991.

[268] International Monetary Fund (1996), p. 7.

[269] Ahlquist and Wissinger (1996), Table 5.6, p. 49.

They searched for and located new forms and sources of finance and partners to the interaction. They were used to and therefore skilled in this type of modification, which appears to have been rather successful.

The soft budget constraint had beneficial consequences for parastatal managers, bureaucrats and the political leadership, not only because it enabled behavioural stability. It also made behavioural change and adaptation easier. In particular, its persistence allowed the actors to become gradually acquainted with and adapt to the new and changing world. It facilitated their behavioural experimentation and change in the execution of their professional tasks as well as in the pursuit of their private aims. Hence the soft budget constraint linked the present not only to the past, but also to the future. It performed a bridging function for the actors - between the old and the new system - during the process of transition. Thereby, and because its own application was adapted to the changing economic and institutional context, it also contributed to the pace, character and direction of the very process of systemic change. This is the subject of the following section.

IMPLICATIONS FOR SYSTEMIC TRANSITION

Obstruction of Formal Change

When the reform programmes introduced change in formal institutions and dramatically altered economic conditions for parastatals, the soft budget constraint weakened the willingness of parastatal managers and bureaucrats to adapt their behaviour. It generated behavioural rigidity, first of all, through the incentives that it shaped and, secondly, by providing opportunities for the actors to behave as in the past. The soft budget constraint made adherence to many of the old behavioural rules possible, and thereby contributed to their effective persistence during the reform period, despite the fact that the formal rules had been altered. Furthermore, to the extent that the actors tried to adhere to the new commercial and market-oriented rules, the soft budget constraint tended to delay their learning to do so successfully.

By retarding behavioural change, the persistence of the soft budget constraint slowed the process of effective formal institutional change and consequently rendered reform partly ineffective within the parastatal sector and the public bureaucracy. In a similar manner, it slowed formal organisational change and brought stability and rigidity to the organisational structure also. By accommodating the financing gaps of parastatals that resulted from adherence to the old rules and behavioural trials, it kept the sector virtually intact during the reform period. Thereby, it also enabled parastatal managers and bureaucrats to support their informal social networks, based on their official positions and not least parastatal resources, which thus persisted as informal organisational structures.

The soft budget constraint hampered formal institutional and organisational change, and thus brought some stability to the system in transition. This, in turn, has implications for the macro-economic performance and thus for the success of the reform programmes in a wider sense.

Consequences for the Performance of the System in Transition

The reform programmes, we recall, involved both policy and reform measures and aimed at macro-economic stabilisation, structural adjustment and economic recovery. While, in general, the combined measures had a positive impact on economic performance during the period, the soft budget constraint hampered their effectiveness in important respects.

Economic recovery was initiated with the own-funded-imports scheme in 1984. This early liberalisation of imports, domestic trade and pricing had an immediate and significant impact on the supply of consumer goods in particular. In combination with the deregulated home market for food, the increased availability of goods strengthened the incentives for peasants, previously starved of consumer goods, to produce crops for sale. *Table 5.19* shows that agricultural output increased in 1984, and thereafter stayed at the higher level.

Table 5.19: Selected Macro-Economic Indicators for Tanzania, 1983-1992 (Percentages)

Real Growth	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*
Total Official GDP	-2.4	3.4	2.6	3.3	5.1	4.2	3.3	3.5	5.8	3.6
- Agriculture	2.9	4.0	6.0	5.7	4.4	4.5	4.6	6.6	4.0	4.4
- Manufacturing	-8.7	2.7	-3.9	-4.0	4.5	7.1	7.7	-2.5	12.0	1.9
External Balance										
- Exp. % of Off. GDP	7	8	5	8	9	13	18	16	13	18
- Imp. % of Off. GDP	14	17	16	24	37	41	53	66	58	65
- Exp. % of Imp.	47	46	33	32	25	33	34	24	22	28
Domestic Balance	*83/84*	*84/85*	*85/86*	*86/87*	*87/88*	*88/89*	*89/90*	*90/91*	*91/92*	*92/93*
Budget Deficit										
- % of Total Expend.	34	35	31	39	37	34	31	34	34	51
- % of Official GDP	9	9	7	9	10	11	11	12	13	n.a.
*Deficit Financing**										
- o/w Foreign Finance	31	49	36	76	82	106	75	122	103	79
- o/w Dom Bank Borr	45	24	51	9	9	-15	17	-36	-13	18
	1983	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*
Monet. (M2) Expans.	18	4	29	29	32	35	29	42	26	38
Rate of Inflation	27	36	33	32	30	31	26	20	22	22

Note: A dash (-) indicates that data from compatible sources are unavailable. * Deficit sometimes over-financed, due, besides to negative domestic bank borrowing, to negative domestic non-bank borrowing, not shown in the table.
Source: Table A.5 in the appendix.

Increased supply of goods and deregulated trade and pricing strengthened incentives for economic activity in general, but the table reveals that manufacturing output was slower to recover. It even continued to decline until after the launching of the ERP, when the increase in foreign aid, in particular import support, relieved not least parastatal manufacturers from the

previously severe input constraints. Although capacity utilisation in the manufacturing sector consequently grew during the second half of the 1980s, it was not until in 1992 that manufacturing output reached the levels of the late 1970s.[270]

Given the dominant position of agriculture in domestic production, total official GDP shifted from negative to positive real per-capita growth at the onset of reform. Real growth persisted throughout the period.[271] Figures on official GDP do not include informal-sector activity, which is estimated to have grown particularly fast in the early years of liberalisation.[272] Economic recovery appears to have benefited the whole Tanzanian population, although to varying degrees. A survey of studies on poverty and income distribution suggests that no major groups experienced real income declines during the reform period, since they could largely resort to the informal sector.[273] This suggests that the public bureaucracy also managed to defend its economic position well during the reform period.

Economic recovery was initiated, but the system in transition was riddled with performance problems. To a large extent, these problems were related to the institutional and organisational rigidities to which the soft budget constraint contributed in such a crucial way, as well as to the application of the soft budget constraint in order to deal with the worsening parastatal financing gaps.

Structural Adjustment

Price deregulation and devaluation provided incentives for resource reallocation within firms as well as in the economy at large. Trade liberalisation increased the scope for private firms to emerge and expand in new markets. Incentives for entrepreneurship were thereby created,[274] and thus also a potential for a more flexible and efficient economic system and organisational structure. Inertia was reduced and a process of structural adjustment towards more efficient resource allocation in accordance with the new relative prices was initiated,[275] particularly in markets where parastatals faced growing private competition.

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270 Tanzanian Economic Trends (1992), Table 2, p. 64, and (1993/94), Table 2, p. 84.

271 Given an estimated population growth of 2.8 per cent per annum during the period 1978-1988. (Bureau of Statistics, 1989, p. 1.)

272 According to Bagachwa and Naho (1990), referred to by Sarris and van den Brink (1993), Table 16, p. 55, the second economy jumped from 47 per cent of official GDP in 1983 to 70 per cent in the following year, and thereafter declined to 61 per cent in 1988. Using a different approach, Sarris and van den Brink (1993), Table 15, p. 51, similarly found its share to fluctuate around 60 per cent during the period 1985-1988. See also their Table 17, p. 56. Cf. the discussion in Chapter I on the revised official GDP data, according to which total output grew faster from 1989 onwards than indicated by Table 5.19 above.

273 Income inequality appears to have increased, however, due primarily to more rapid growth in certain regions. (Danielson, 1996, pp. 14-19.)

274 According to the terminology of Pelikan (1987).

275 World Bank (1991b), p. 95.

However, the persistence of the soft budget constraint within the parastatal sector retarded this process by weakening response to exogenous change and contributing to behavioural rigidity. Consequently, parastatal activity was only reluctantly shifted towards cheaper, notably domestic, inputs and new, more profitable markets. When input-output combinations are not adjusted to price signals, 'allocative efficiency cannot be achieved'.[276] Given the dramatically altered relative prices during the first part of reform, the soft budget constraint appears to have increased inefficiency within the parastatal sector. (Recall Rutayisire's findings that particularly allocative, but also technical, inefficiency in manufacturing parastatals was higher during 1983-1988 than in the preceding period.)[277]

Financial accommodation of the tremendous parastatal losses that resulted prevented the exit of inefficient production units. Thus the soft budget constraint hampered not only resource reallocation within the existing organisational structure but also change of this structure, what Pelikan calls organisational processes.[278] Resources were locked into an inefficient production structure and could not be redeployed elsewhere, while additional resources had to be allocated to maintain it. The entry, operation and growth of new, potentially more efficient units, notably private firms, was hampered. The fact that parastatals crowded out private firms from access to financial resources is illustrated by the pattern of credit allocation. Although the parastatal share of non-government lending from the National Bank of Commerce gradually declined, it remained at or above 80 per cent during the entire 1980s.[279] This is far above the contribution of parastatals to output, which dropped from 22 per cent in 1983 to 16 in 1992.[280] Thus the soft budget constraint also tended to retard structural adjustment towards and within the private sector. This is further reflected in the weak response of exports to the devaluations.

External Balance

One purpose of devaluation was to increase the demand for domestic goods and the supply of exportables so as to reduce the balance-of-payments problems. A central idea was that raised producer prices would stimulate the exports of cash crops.[281] However, devaluation was also used as a means by which to cover the financing gaps of agricultural marketing parastatals, and producers received a declining share of the export revenue. Thus the application of the soft budget constraint prevented the devaluations from being fully translated into raised official producer prices for cash crops, which contributed to insufficient incentives for substantially

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276 Kornai (1990c), p. 26.

277 See Chapter IV.

278 Pelikan (1987), p. 31.

279 See Table 5.11 above.

280 Based on official GDP figures according to the *revised* national accounts by the Bureau of Statistics (1995a), Table 20, pp. 29-30. (Unrevised figures are incomplete.)

281 Cf. Lipumba (1991), p. 28.

increased exports via the official marketing system. As shown by Table 5.8 above, the volumes of cash crops exported between 1983 and 1989 even declined. Thus official exports, which mainly consisted of agricultural crops, did not grow as expected. Table 5.19 above shows that although they increased in relation to official GDP during the second half of the reform period,[282] they far from covered official imports.

By weakening the financial discipline in parastatals, the soft budget constraint also weakened incentives to keep and attract customers by treating them well, as reflected by the terribly poor services provided by exporting marketing boards in the early 1990s. Hence, although producer prices for cash crops were raised during the period 1983/84-1987/88, the quantities sold grew far less than those of the major food crops, whose real producer prices declined.[283] Illegal exports, however, appear to have doubled between 1985/86 and 1987/88.[284] Peasant producers thus preferred the deregulated food and informal export markets to the poorly functioning official marketing system, where they sometimes had to wait for months or longer before they were paid for the crops delivered.[285]

By weakening incentives to respond to devaluation within the parastatal sector, the soft budget constraint contributed to rendering exchange-rate adjustment partly ineffective, which retarded recovery of the external position. As suggested by Table 5.19, the trade deficits increased during the whole reform period. Official exports financed a declining share of the country's imports. This share dropped from 46 per cent in 1984 to a mere 28 in 1992, while imports grew, from 17 to 65 per cent of official GDP.[286] The country failed to restore external balance and instead grew increasingly dependent on foreign aid for its importation needs. The share of foreign aid in import financing grew from 25 per cent in 1986 to 47 per cent in 1992.[287]

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282 However, given the underestimated output indicated by the official GDP figures in the table, this growth is overestimated.

283 Calculations based on price and quantity indices, the one for food prices being a weighted average of official and open market producer prices. (World Bank, 1991b, II:1, pp. 32-33.)

284 The payments for these unrecorded exports are often presumed to be more or less equivalent to private transfers from abroad as recorded in the balance of payments, and to have financed most of the own-funded imports. (World Bank, 1995, pp. 27-28.) See Maliyamkono and Bagachwa (1990), pp. 98-108, for details on the 'second economy' within foreign trade.

285 Cf. Lipumba (1991), p. 29.

286 The trade deficits also grew when illegal exports are included. Bhaduri *et al.* (1993) note that when illegal exports more or less equalling regular exports during the period 1986-1991 are taken into consideration, the official trade deficits are reduced by 40-50 per cent (pp. 119-120). With revised official GDP figures, the share of imports grew less towards the end of the period.

287 According to data on import licences issued, which consistently overstate actual imports however. Calculations based on Bhaduri *et al.* (1993), Table 6.4, p. 118.

To restore domestic balance, the government was to reduce its resort to inflationary deficit financing, in terms of domestic bank borrowing, which had financed about half of the budget deficit during the first half of the 1980s. According to Table 5.19, this financing was reduced to a mere nine per cent during the first year of the ERP and eventually turned negative. The government also managed to keep the budget deficit within its projected limits.[288] Public finances nonetheless remained weak, not least because of the application of the soft budget constraint to various forms of budgetary resources.

Direct parastatal subsidies accounted for up to seven per cent of so-called total ministerial supply in one year, or about three per cent of total public expenditure.[289] Default on cash cover for import support and other payment dues deprived the government of revenue. The total outstanding cash-cover debt for commodity import support during the period 1987/88-1992/93, discussed earlier, was equivalent to about ten per cent of public expenditure during the whole period. Remember that parastatals accounted for 64 per cent. Discretionary tax exemptions cannot be measured, but the sum of discretionary and scheduled tax exemptions on imports can.

Table 5.20: Customs-Duty Exemptions in Relation to Customs-Duty Revenue in Tanzania, 1985/86-1991/92 (Million TSh)

Year	Exemptions	Revenue	Exemptions as % of Revenue
1984/85	1,200.113	1,531.000	78%
1985/86	1,393.520	1,468.400	95%
1986/87	2,843.664	4,067.300	70%
1987/88	7,533.841	5,506.800	137%
1988/89	-	8,478.200	-
1989/90	12,289.076	13,547.000	91%
1990/91	27,185.326	18,554.000	147%
1991/92	26,075.683	43,634.000	60%

Notes: A dash (-) indicates that data are unavailable. The figures on exemptions relate to calendar years, 1985-1991.
Source: Table A.24 in the appendix.

Table 5.20 shows that the value of customs-duty exemptions amounted to between 60 and 147 per cent of the value of customs-duty revenue during the reform period. The total value of exemptions on customs duty, sales tax and excise duty on imports in 1990/91 exceeded the revenue collected from such taxes by 77 per cent and amounted to 43 per cent of total budget revenue collected that year.[290] The share accounted for by soft exemptions to parastatals remains

[288] According to the Bank of Tanzania (1991c), Table 2.2, the actual budget deficits were well below the planned levels during the period 1986/87-1990/91.

[289] As revealed by a comparison of the figures in Table 5.9 with the public expenditure data on which Table 5.19 is based. The latter, as well as the associated data on budget revenues, also serve as the point of reference in the following assessments of the budgetary impact of soft finance.

[290] See Table A.24 in the appendix, where the data are compared to the public-revenue data on which Table 5.19 is based.

unknown, however. Bridging-finance arrears of both principal and interest, shown in Table A.25 in the appendix, although smaller than direct subsidies, imply that in practice unpaid loans were converted into expenditure while interest revenue failed to materialise.

By contrast, total arrears on all Treasury loans to parastatals grew tremendously, to 66 per cent of public expenditure in 1991/92.[291] Most of these loans were initially financed by donors and then re-loaned by the Treasury to parastatals, whose payment defaults thus shifted the burden of both principal and interest payments to the government. Parastatal arrears turned into public expenditure the moment they were serviced by the government. The government's debt service (including redemption) increased from 3 per cent of total public expenditure in 1984/85 to 13 per cent in 1991/92.[292] Most of this servicing was on debts to multilateral donors that could neither be rescheduled nor relieved.[293]

Thus the application of the soft budget constraint to budgetary resource transfers directly contributed to the budget deficit. Table 5.19 above shows that the deficit was never below 31 per cent of total public expenditure during the entire reform period, but grew in relation to official GDP, from 9 to 13 per cent.[294] It was increasingly financed by foreign aid, notably import support. According to the table, the share of foreign financing doubled, from 36 to 76 per cent in 1986/87, and thereafter filled the gap. The share of import support in deficit financing grew from 15 to 43 per cent in 1986/87, and peaked at 107 per cent in 1990/91.[295] While dependence on foreign aid for deficit financing thereby increased, it was hoped that the inflationary impact of the budget deficit would be reduced.

Inflation

Inflationary deficit financing was not reduced, however. It simply took different forms. Reduced government bank borrowing in combination with changes in its composition released tremendous amounts of commercial bank credit for other borrowers. In particular parastatal access to credit expanded tremendously. While total commercial bank lending increased by 139 per cent in real terms between 1983 and 1990,[296] the parastatal share grew from 39 to 76 per cent.[297] Hence, although the government credit targets were met during the period, credit to the

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[291] See Table 5.17 above.

[292] According to calculations based on the same data as those on public finances presented in Table 5.19. (Bank of Tanzania, 1995, Table 2.1, p. 63.) For reasons undetected by me, figures vary largely between sources. According to data from Economic Surveys *inter alia,* the share of total expenditure on 'public debt' grew from 18 to 24 per cent during the same period. (Bagachwa, 1992a, Table, 3, p. 55.)

[293] Bhaduri *et al.* (1993), p. 104.

[294] Again, this growth is overestimated since official GDP is underestimated.

[295] Bank of Tanzania (1990a), Table 18, p. 57, and (1995), Table 2.1, p. 63.

[296] Calculations based on Bank of Tanzania (1989), Table 14, p. 50, (1995), Table 1.11, p. 57, and Shitundu (1993/94), Table 2, p. 20.

[297] Nyagetera (1992), Table 2, p. 77, and calculations based on this source.

non-government sectors, and thus total credit, grew much faster than planned.[298] As noted by Kornai, 'a monetary ceiling is a necessary condition of financial discipline, but it is not sufficient to ensure it'.[299] The soft budget constraint contributes to explaining why.

'The main problem', Nguyuru H.I. Lipumba points out, 'is not extension of credit but non-payment of loans extended that leads to a high growth of overall domestic credit'.[300] The application of the soft budget constraint implied that parastatals did not service their loans, but received renewed credit despite payment default to the extent that limits on credit expansion were soon exceeded. This was the major source of a large monetary growth.[301] Calculations based on Table 5.19 above reveal that the money supply (M2) expanded by on average 33 per cent annually during the period 1985-1992, while during the ERP years, for instance, it was meant to be limited to around 10 per cent per annum.[302] It has been suggested that excessive credit expansion in relation to real output growth, via its effects on the money supply, was a major source of inflation in the 1980s.[303] The rate of inflation remained high, at around 30 per cent, and just over 20 per cent in the early 1990s.[304]

Since soft bank credit accommodated the operating deficits of parastatals, it was regarded by Collier and Gunning as a form of public expenditure, shifted from the government budget and instead channelled via the state-owned financial system.[305] By adding commercial bank credits to the government and the parastatals to the conventional figures on public expenditure, the authors calculated adjusted public expenditure and monetary deficit financing gaps for the period 1983/84-1987/88. What they found was a close correspondence between the adjusted monetary financing gap and the actual increase in the money supply, and a 'reasonable' correspondence between the money supply and the price level.[306] Thus the soft budget constraint meant that the actual public expenditure, budget deficit, government bank borrowing and inflationary deficit financing were larger than those indicated by conventional figures. It rendered both fiscal and monetary policy ineffective, and thereby contributed to the high rate of inflation. However, Doriye points out that,

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298 During the ERP period, credit grew by on average more than 30 per cent annually while the targets were about 15 per cent. (United Republic of Tanzania, 1989, p. 6.) See Bank of Tanzania (1991c), Table 2.1, for annual comparisons.

299 Kornai (1990c), p. 29.

300 Lipumba (1991), p. 36, continues that, 'Adequate credit can be extended without causing inflation provided that borrowers of working capital pay back'.

301 Ibid., p. 32.

302 United Republic of Tanzania (1989), p. 6.

303 Lipumba (1991), pp. 35-36. Cf. Doriye (1990), p. 9.

304 See Table 5.19 above.

305 Collier and Gunning (1991).

306 Ibid., pp. 534-536.

> While a relationship between inflation and changes in money supply can be econometrically established it does not necessarily follow that the causality runs from money supply to changes in the price level; the reverse is just as likely, in the sense that however price rises were caused, the authorities provided the means for their financing.[307]

Hence, as argued in the previous chapter, by both causing and accommodating cost increases within the parastatal sector, the soft budget constraint linked structural and monetary causes that interacted and reinforced one another in an inflationary process.

The soft budget constraint may have added to inflation in other ways also, first of all by rendering interest-rate policy ineffective. Given the soft budget constraint, increased interest rates most likely failed to reduce demand for credit within the parastatal sector, as mentioned earlier. With much of the bank loans to parastatals being non-performing assets, they may instead have worsened the inflationary situation in the following manner:

> Charging high interest rates on these assets will increase book profits and expenditure of commercial banks and their share holders which increases inflationary liquidity in the economy. The fictitious profits are likely to be spent which will increase liquidity and fuel further inflation.[308]

Secondly, the soft budget constraint may have rendered the non-inflationary impact of counterpart-fund financing of the budget deficit partly ineffective, if funds for which cash cover had not been paid were spent by the government anyway.[309]

We may conclude, with Thomas A. Wolf, that 'the achievement of tight financial policies at the macroeconomic level critically depends on whether financial discipline has been imposed at the micro-economic level'.[310] Although its quantitative impact is difficult to establish, the soft budget constraint delayed structural adjustment and worsened the external and internal imbalances, which in turn hampered economic recovery.

Conclusion: Impact on the Character and Direction of Change

The soft budget constraint influenced the process of systemic transition in several ways. By contributing to institutional and organisational rigidity and rendering formal reform measures partly ineffective, its major direct impact was to slow systemic change and hence the process of

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[307] Doriye (1990), p. 9.

[308] Lipumba (1991), p. 36. Also Collier and Gunning (1991), pp. 536-538, argue that given the role of the Tanzanian banking system in financing public expenditure, raised nominal interest rates may have increased the rate of inflation. Since government domestic debt then took the form of bank deposits, higher interest rates pushed up the debt-service payments - uncovered expenditure increases that had to be financed by the inflation tax.

[309] For a discussion of the monetary effects of counterpart funds, see Doriye *et al.* (1993), pp. 80-81 and 87.

[310] Wolf (1990), p. 5.

transition. The rigidity and the increasing parastatal financial problems that the soft budget constraint created and its handling of these problems had severe macro-economic implications. Thus it also contributed to rendering stabilisation policy partly ineffective and consequently to the partial failure of the entire reform programmes.

However, the failure of the reform programmes implied that through its negative implications for the performance of parastatals and the economy at large, the soft budget constraint had repercussion effects on actors' behaviour. Past behaviour was no longer as successful as it used to be, which eventually created incentives for behavioural change in different ways. First of all, the failure of partial reform to solve the macro-economic problems increased the pressure on the political leadership to extend reform; this included both implicit pressure from peasant producers of cash crops escaping the official marketing channels and explicit pressure from the foreign donors. In this way, through its negative consequences for the effectiveness of the reform programmes, the persistence of the soft budget constraint indirectly contributed to the further extension of formal reform - and to its gradual character.

For example, soft taxation that led to huge revenue losses eventually made the government adopt the law on the revocation of tax exemptions and remissions in 1992, and later to set up a commission investigating the evasion of import taxes.[311] Soft import support and cash cover made the foreign donors first shift from commodity import support to the open general licence system, and eventually to also abandon the latter in favour of a further deregulation of the market for foreign currencies. The problems created by soft bank credit contributed to the financial-sector reform in 1991 and the establishment of the Loans and Advances Realisation Trust in 1992. Similarly, the deteriorating parastatal performance, the growing cost of financing the parastatals and the accumulating negative macro-economic consequences promoted extended reform of the parastatal sector. Thus while, on the one hand, the soft budget constraint indirectly made further formal reform necessary, on the other hand, it rendered the measures that were introduced largely ineffective. Additional measures were eventually required. Thus formal reform was gradually stepped up.[312]

By providing institutional and organisational stability, the soft budget constraint also made it easier for the actors to try out the new formal rules and otherwise experiment with behavioural change when the success of old behaviour gradually declined. It facilitated the actors' gradual adaptation to the new and changing context and thus also played a role for institutional change during the period. However, while the persistence of the soft budget constraint made any behavioural *trials* possible, it also influenced the *choice* of behavioural experiments made by

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[311] The Selected Probe Team was established in 1994 and submitted its report in 1995 (The Selected Probe Team, 1995).

[312] Thus the partial and gradual character of reform, to which the soft budget constraint contributed, can be described as a process of repeated trial and error. While the political leadership tried to maintain large parts of the old system, it innovated with partial reform measures 'at the margin'. These were introduced reluctantly, in response to explicit or perceived pressures. The leadership's behaviour was reactive rather than active. Eventually, when partial measures did not sufficiently improve the situation, the leadership was forced to try yet another measure, and so forth.

parastatal managers and bureaucrats, as well as the degree of *success* of such trials. Behavioural change did not necessarily imply that the actors successfully learnt to adhere to the new formal rules in the manner expected or intended by the reform programmes. The soft budget constraint slowed up the process by which, for instance, parastatal managers learnt to act successfully in the real sphere. As part of the managers' institutional heritage, it made them attempt to behave in a manner that had been appropriate in the old system, so that they failed, while it simultaneously hampered the immediate feedback necessary for the correction of errors. Since behavioural change was influenced by the actors' past experience, much of the experimentation of parastatal managers and bureaucrats involved a modified adherence to old behavioural rules, including the soft budget constraint itself.

Modified application of the soft budget constraint involved shifts between forms and sources of parastatal finance, changes in the mode of application, interaction with new partners and even new uses. For instance, parastatal managers increasingly applied the soft budget constraint through passive non-payment of dues, owed partly, and possibly to an increasing extent, to suppliers. Some of them even appear to have used the soft budget constraint as a solution to a new problem, applying it as a means by which to compete for customers. Hence the heritage, persistence and modification of the soft budget constraint also influenced the direction and character of the actors' behavioural change during the reform period. Such change often involved variations of past behaviour according to old rules, rather than radical shifts and adherence to the new formal rules - hence, adaptation through *informal* institutional change.

Organisational change may also have been affected by the modified application of the soft budget constraint, although in a manner different from that intended by the reform programmes. By keeping parastatals and the informal networks dependent on these alive during the reform period, the soft budget constraint made it possible for bureaucrats to develop new personal relationships with firms within the growing private sector, while maintaining their old positions in the meantime. Bureaucrats may partly have shifted their application of the soft budget constraint to interaction with these new counterparts, and thereby used the rule as a means by which to develop relationships within and extract rents from an expanding sector. The soft budget constraint thereby provided a potential for the development of partly new informal social networks that might be able to support the future position and well-being of the bureaucracy, when the parastatal sector eventually and gradually diminished.

By rendering formal reform and organisational change ineffective while affecting informal change, the soft budget constraint diverted actual institutional and organisational change from the one intended by the reform programmes. Thus it influenced the path of the process of systemic transition. By slowing the pace of systemic change, influencing the direction of change and persisting throughout, the soft budget constraint not only performed a bridging function during the process of transition - linking the old and the new system - but it also contributed to shaping the new system that was in the making.

CONCLUSION: PERSISTENCE OF AN INFORMAL INSTITUTION

This chapter has examined what happened to the soft budget constraint within the parastatal sector in Tanzania during the reform period 1984-1992. Was it possible to do something about the 'problem', by adopting measures to improve parastatal performance and restrict the application of the soft budget constraint, and by reforming the system of which it was an integral part?

We found that in spite of the fact that systemic change eventually became quite comprehensive and certain efforts were made to come to grips with the problem, the soft budget constraint persisted throughout the period. Its application even increased during the first part of reform, when parastatal financial problems increased tremendously and soft external finance grew increasingly available. Towards the end of the period, however, the soft budget constraint was applied to a lesser extent, not least because market-oriented reform itself reduced the available finance.

Success in this regard was limited, however. Instead of radically changing their behaviour, the actors tended to modify their application of the soft budget constraint. When certain forms and sources of external parastatal finance were reduced and the total amounts eventually declined, the actors innovated by seeking alternative finance and turning to new counterparts. The application of the soft budget constraint took partly new forms.

Why did the soft budget constraint persist during the reform period? Why did reform fail in this regard? This chapter argued that the persistence of the soft budget constraint can be traced largely to its character as an informal institution, first of all, because as such it was part of the socialist heritage of parastatal managers and bureaucrats, including the political leadership.

As part of the actors' institutional heritage, the soft budget constraint influenced their perceptions and behaviour in a number of ways. It implied that the actors, who were used to parastatal financial trouble, applied the soft budget constraint by habit and well-tried experience when confronted with these problems. Given the past, they expected parastatal financing gaps to be externally accommodated. Hence, the soft budget constraint was already guiding the actors' behaviour at the onset of reform.

By reflecting the socialist experience, ideas and values, the soft budget constraint influenced how the actors interpreted and responded to exogenous shocks and other changes that the reform programmes gave rise to. This implied, for instance, that they did not regard the dramatically altered relative prices as signals for reallocation of resources and that their incentives to economise on parastatal costs were weak. The soft budget constraint hampered the actors' responsiveness and thus their adaptation of parastatal activity to the altered market conditions. Parastatal losses escalated, and an important reason for their rapid and tremendous growth in the early reform years is the behavioural rigidity created by the habitual use of the soft budget constraint. Hence, the very *heritage* of the soft budget constraint contributed to its persistence by reproducing parastatal financial problems that grew worse than ever. Besides, as an informal

institution, the soft budget constraint was there and offered a behavioural solution for how to handle the recurrent, massive and acute problems.

Hence, while reform implied that the socialist system of which the soft budget constraint had been an integral part was gradually changed, *formal* institutional change did not imply that the *informal* institution was automatically altered. By contrast, as an informal institution, the soft budget constraint facilitated the behaviour of the actors when their environment changed during the reform period.

Reform increased actors' behavioural uncertainty. They did not know how to behave according to the new commercial rules of the market. Besides, formal reform was only partial, which added uncertainty about whether or not to change behaviour while the remaining old rules imposed constraints on behavioural change. The soft budget constraint reduced uncertainty about how to behave successfully during this period, because it made it possible for the actors to behave largely as in the past - and hence to adhere to the old rules - which was easier and safer. Simultaneously, the other remaining old rules in turn made it easier to adhere to the soft budget constraint.

Hence, as an institution, the soft budget constraint persisted partly because it interacted with other remaining old institutions in retarding behavioural change and in mutual maintenance, despite formal reform, which was partial and which they rendered partly ineffective. The soft budget constraint also persisted because the actors did not know whether or how to change their behaviour and therefore adhered to the old rules to be on the safe side. Although reform also introduced uncertainty about the validity of the soft budget constraint, the actors soon learnt that it continued to prevail.

The soft budget constraint also persisted because learning to change behaviour took time. Successful adaptation to new formal rules or otherwise changing behaviour was a gradual process of learning through trial and error. As an informal institution, the soft budget constraint facilitated the actors' behaviour in this regard also. By keeping parastatals alive, thus taking care of the financial consequences of actors' failures in the meantime, the soft budget constraint enabled them to gradually become acquainted with the new rules, experiment and learn to adapt their behaviour. It gave them a period of grace for developing new ways to perform their official and personal duties and to establish relationships with partly new partners in formal as well as informal exchange. This implies that the soft budget constraint persisted not least because the informal institution itself was gradually adapted to the changing context. By being modified itself, and by facilitating certain behavioural adaptations while retarding other ones, the soft budget constraint also influenced the ways and means through which the change in this context was actually taking place. It constituted one of the factors that determined the path of behavioural and institutional change, which further contributes to explaining why it persisted during this period.

Thus as an informal institution, the soft budget constraint had a number of beneficial consequences for parastatal managers, bureaucrats and the political leadership, who faced incentives to adhere to it because it made it easier for them to defend their threatened positions

during the changing and uncertain reform period. However, its persistence was not solely the result of intention and conscious application. As an informal institution, it was self-maintained by the same reinforcement mechanisms as in the past: the mechanisms of established advantage, adaptive expectations, institutional interaction and problem reproduction. These meant that the soft budget constraint both reproduced the situations in which it applied and shaped incentives for actors to apply it in those situations, at least partly without the actors being aware of or intending its reproduction.

The actors were partly aware of the soft budget constraint, at least some of its applications and consequences, but they did not recognise the full complexity of its character as an informal institution. For instance, the political leadership appears not to have recognised the heritage of the soft budget constraint and its consequences for behavioural rigidity, as reflected in the failure of the reform programmes to improve parastatal performance. Similarly, the tremendous parastatal losses cannot have been intended. At the same time, the modified application of the soft budget constraint suggests that the leadership was unaware of all the ways in which the soft budget constraint was applied. While some avenues were closed, others were opened and sometimes even operated without the participation of the traditional counterparts.

Hence, reform failed to eliminate the soft budget constraint largely because the soft budget constraint was an informal institution, and it failed to improve parastatal performance partly because the soft budget constraint persisted. Reform of the socialist system did not put an end to the soft budget constraint within the parastatal sector in Tanzania - a conclusion which marks the end of *this* story of the soft budget constraint. Whether the soft budget constraint would persist and have a role to play even after 1992, in the new system in the making, is another story.

CHAPTER VI

CONCLUSIONS

The story has been told of the soft budget constraint - of its emergence, persistence and logic - in the case of Tanzanian parastatals. Does it increase our understanding of why the soft budget constraint exists? This concluding chapter reports the major findings and discusses the empirical and theoretical contributions of our study in relation to its research questions and overall purpose. The first section summarises the results and the second one considers the implications.

SUMMARY OF FINDINGS

The study set out to establish and explain the prevalence of the soft budget constraint within the parastatal sector in Tanzania. The soft budget constraint was defined as an informal institution and the method of invisible-hand explanation was applied. How did it succeed in its efforts? Does the study answer its questions and fulfil its goal? Let us begin by discussing what we learnt about this particular case. Was there a soft budget constraint in Tanzania, and if so, why did it exist?

Was There a Soft Budget Constraint in Tanzania?

Our study spans over 25 years of economic and institutional development in Tanzania, as the country moved from a pre- to a post-socialist system. The soft budget constraint came to play an important role for this systemic evolution. We found that it emerged gradually during the process by which the socialist system was formed, which was initiated in 1967, and

established its existence as an informal behavioural rule within the Tanzanian parastatal sector from the late 1970s. Its existence implied the prevalence of expectations of external accommodation of parastatal financing gaps, and it applied, first and foremost, in the interaction between parastatals and the state.

It is not possible to say exactly when the soft budget constraint was established. Its emergence was a gradual process and the data impose limitations. Our findings do not exclude the possibility that it was established prior to the late 1970s. It may already have prevailed in selected 'pockets', for instance within parts of the official agricultural marketing system, in the late 1960s or early 1970s.[1] Towards the end of the decade, the sector approached its full size and over one-third of almost 400 parastatals made losses. By that time, the soft budget constraint was firmly established as a widespread behavioural rule for social interaction within the parastatal sector, where financial problems were common.

In the late 1970s, the socialist system was nearing its completion, but it was plagued by inherent performance problems that culminated in an economic crisis. The system remained remarkably stable in spite of the crisis. We showed that the soft budget constraint was an integral part of the socialist system and prevailed during the crisis, despite the fact that it contributed to the systemic performance problems. Eventually, the situation became unsustainable and forced the Tanzanian political leadership to initiate market-oriented reform in the mid-1980s. This put an end to the acute crisis and set off a process of systemic transition away from socialism. Reform of the system involved efforts to come to grips with the soft budget constraint, but it did not disappear. On the contrary, we found that it persisted throughout the transition up to 1992, which is the end of the period studied.

The study examined the soft budget constraint within the parastatal sector. The institution applied primarily in the interaction between parastatal managers, on the one hand, and officials within the state and party bureaucracy, including the political leadership, on the other. The parastatal sector was a multi-level hierarchy. This implies that the soft budget constraint sometimes applied at several different levels, for instance between parastatals and between superior organs. Parastatal financing gaps and their accommodation were shifted upwards in the hierarchy, ultimately to the population via the government budget or the banking system and the printing press. Foreign donors were another source of last-resort financing. They assumed part of the responsibility for financing the government budget deficit.[2]

The application of the soft budget constraint took different forms. It either involved the transfer of external resources such as government subsidies or bank credit to parastatals, or the non-extraction of resources, such as non-enforcement of payments due, from parastatals. Its

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[1] The supposition that this may have been the case is suggested by the fact that bad debts owed by, and due to the accumulating losses of, co-operative societies to three co-operative unions were written off by the latter in 1966/67, 1968/69 and in 1971/72. (Ödegaard, 1985, Table 4.3, p. 111.)

[2] The possibility that the soft budget constraint also applied in the interaction between the Tanzanian government and the foreign donors was discussed in Eriksson (1995), pp. 87-89.

application was sometimes active, as when managers bargained for assistance and bureaucrats approved of granting it. In other cases it was passive, for instance when managers simply refrained from paying taxes or when the banks refrained from enforcing loan repayment.

The soft budget constraint sometimes appears to have been applied unintendedly and without the actors being aware of their doing so. This applied, for instance, when loans issued by the National Bank of Commerce fell due. The bank was at least partly unaware of its non-enforcement of payment, because it lacked records and mechanisms for loan supervision. When the Tanzanian Shilling was devalued during the reform period, parastatals with arrears on Treasury loans issued in foreign currency saw their debts increase tremendously. By simply doing nothing (hence, refraining from enforcing payment) the Treasury automatically, but unintendedly, accommodated the parastatal cost increases.

Other actors were also involved in the application of the soft budget constraint, notably the foreign donors. They accommodated parastatal financing gaps by granting soft import support and by not enforcing payment of local cash cover. Soft inter-firm credit between parastatals also occurred and may have increased during the reform period. We also saw examples of how parastatals applied the soft budget constraint as a means of competing for customers. Yet other findings suggest that bureaucrats may have begun to apply the soft budget constraint in interaction with some private firms, possibly in exchange for rents. Hence, it was partly put to new uses.

An important finding is that the variation in the application of the soft budget constraint reflects its tendency to be adapted to changing circumstances. This appears to be one of its central characteristics. Throughout its prevalence, its application to different forms of finance changed with the availability of finance. When certain sources of finance were depleted or reduced, the actors shifted to others or sought and found new ones. Towards the end of the period, when the availability of finance declined as reform proceeded, the extent of passive application of the soft budget constraint grew and resulted in debt accumulation.

It is beyond the scope of this study to establish variations in the degree of softness of the budget constraint, and hence in the strength of the expectations of its prevalence. We nonetheless argue that the soft budget constraint was reinforced during the crisis period when the socialist system remained stable. This is reflected in its increased application within the parastatal sector. During the first part of the reform period, its application spread even more, as parastatal losses sky-rocketed and the amounts of available soft finance grew. So it may have been further reinforced. Caution should be observed in drawing such a conclusion, however.

First of all, the reform period was characterised by uncertainty, including uncertainty about the prevalence of the soft budget constraint. Secondly, a process parallel to any reinforcement was taking place. Towards the end of the period, the declining availability of external parastatal finance strongly suggests that the soft budget constraint was applied to a lesser extent than in the past. Certain efforts were made to restrict its application, and it

appears to have been applied more selectively. Hence a process towards reduced application of the soft budget constraint may have been initiated.

Given the poor parastatal financial performance, the soft budget constraint had a widespread applicability within the parastatal sector. And given the tremendous size of the parastatal sector and its losses, it had far-reaching consequences for the economy. Hence, its importance for the Tanzanian socialist system, from establishment to disintegration, and for its performance was significant. The soft budget constraint had severe negative consequences for both parastatal and macro-economic performance. Our findings about the consequences of the soft budget constraint are discussed below. They form part of our answer to the central question of this inquiry.

Why Did the Soft Budget Constraint Exist?

The study shows that there is no simple explanation of the existence of the soft budget constraint. This is not a truism, but an important conclusion. An answer to why the soft budget constraint existed in Tanzania has to be complex, and involves answering several questions, the answers to which are not simple either. We posed questions about how and why the soft budget constraint emerged, was maintained during socialism in spite of its inefficiencies and persisted in spite of reform of the system of which it was an integral part. In order to seek answers to these questions, and thus trace the logic of the soft budget constraint, a story was told of the evolution of the informal institution.

How the Soft Budget Constraint Emerged

Understanding the existence of the soft budget constraint involves, first of all, understanding how it came about. The story therefore began with the origin of the soft budget constraint, by studying the evolution of the socialist system in Tanzania and the consequences for actors and organisations within the parastatal sector and the state-cum-party hierarchy. The following are the main findings.

The early socialist developments involved ideological formation, parastatal expansion, increased political control and forced policy making. These ideological, institutional and organisational changes, together with the influence of traditional values and informal rules, soon gave rise to performance problems. Financial problems within the parastatal sector emerged on a large scale and macro-economic difficulties surfaced. The early socialist developments also gave rise to power struggles within the public sector and to the political leadership's struggle to retain its position.

The early performance problems and power struggles gave rise to further institutional and organisational changes that gradually formed the socialist system. The leadership responded to financial, economic and political problems with increased control over society, including the parastatal sector, and with increased reliance on foreign aid. The power struggles within the bureaucracy and the increased availability of foreign aid fuelled parastatal sector growth. Towards the end of the 1970s, a socialist system was established. It was characterised by the official Tanzanian brand of socialist ideology under the catchword *ujamaa,* the supreme power of the single Revolutionary Party, state ownership over a huge parastatal sector and bureaucratic co-ordination of large parts of economic activity. Formal institutions were complemented with informal rules, in particular those of the economy of affection. Traditional values and rules characterised Tanzanian socialism in both theory and practice. Within this process of systemic evolution, the soft budget constraint emerged.

The systemic performance problems worsened. Parastatal financial problems were not occasional, but were regularly reproduced as managers and bureaucrats behaved according to the rules of the evolving socialist system. When first confronted with the problems, the actors did not know how to behave. Managers and bureaucrats often lacked business experience, and had not yet learnt how to successfully adhere to the new and changing rules. They had to proceed by trial and error. Apart from uncertainty, the period was characterised by optimism. Parastatals were seen as the main vehicle for socialist development, while their difficulties were initially perceived as temporary infancy problems. The strong ideological stance, new formal and old informal rules and traditional values all shaped incentives for managers to turn to the bureaucracy for external assistance when parastatals were in financial trouble and for bureaucrats to grant such assistance. The actors found such behaviour successful.

When parastatal financial problems recurred, the consolidation of the socialist system gradually reinforced actors' incentives to behave in a similar manner. Increased opportunities for such behaviour were created, while alternative behaviour was further restricted. Growing political control and bureaucratic intervention, and administrative resource allocation and pricing reduced the autonomy of the managers, while they increased the bureaucrats' contribution to and responsibility for parastatal problems. These institutional developments imposed additional constraints. They worsened shortages and information problems and increased the bureaucracy's dependence on parastatals. Simultaneously, the increasingly discretionary decision making made it easier to bargain for and grant external finance, and raised the amounts of available finance. The rules of the economy of affection involved obligations to mutually assist members of informal social networks. The behavioural incentives thus created were reinforced by developing personal relationships within the growing public sector and by the emerging economic hardships that the evolving system gave rise to.

When confronted with recurrent parastatal financial problems, the actors gradually adapted their behaviour to the incentives created by the institutional set-up and other contextual circumstances. They learnt, over time, that seeking and granting external finance was a

successful way to handle those problems. As they repeated their behaviour, a behavioural rule gradually evolved. This is how the soft budget constraint emerged organically during the forming of the socialist system in the 1970s - spontaneously, as an unintended outcome of the actors' repeated behaviour and interaction. The soft budget constraint was a logical consequence of the Tanzanian socialist system. By the end of the decade, it was established as an informal behavioural rule.

How and Why the Soft Budget Constraint was Maintained

When the socialist system was consolidated and its problems culminated in a crisis in the late 1970s, the consequences for parastatals and actors were severe. Imbalances and shortages worsened, output and formal incomes declined and parastatal financial problems grew. Seeking an answer to how and why the soft budget constraint was maintained within the stable socialist system involved an examination of the role that it played for parastatal managers and bureaucrats during the crisis. We studied its consequences for the institutional and organisational context of the actors, and hence for their ability to pursue their aims within the system and cope with the crisis and other systemic problems.

We found that the soft budget constraint had both direct and indirect beneficial consequences for the actors, and hence performed a number of functions within the socialist system. Its major function was to offer a *behavioural solution* for how to handle a specific recurrent problem, inherently produced by the system: *parastatal financing gaps.* Once established as a rule, the soft budget constraint guided the behaviour of managers and bureaucrats when parastatals were in financial trouble. Its prevalence reduced the actors' previous uncertainty, which facilitated their behaviour and co-ordinated their interaction within the system, in the situations in which it applied as well as in others.

The application of the soft budget constraint strengthened the actors' expectations of its prevalence. This signalled that parastatal financial performance was of subordinated importance within the socialist system, which made it easier for the actors to divert their attention to issues of greater importance in the pursuit of their official and private tasks. The political leadership was managing the crisis, amending and patching the socialist system. Lower-level bureaucrats were managing the system: implementing policies, allocating resources, setting prices and, not least, administering and controlling the parastatal sector. Managers were executing policy directives, obeying *ad hoc* intervention, seeking approvals from superiors and bargaining with the bureaucracy. The soft budget constraint provided guiding information, for instance, for bureaucrats who were to administratively allocate resources, but lacked either specified formal criteria or information about the performance of the potential recipients. The soft budget constraint thereby *mitigated the information problem* inherent in the socialist system, and also reduced some of the systemic *incentive problems.* Without the soft budget constraint, it would have been difficult to motivate the actors to

adhere to the other rules - for instance, to make bureaucrats demand parastatal execution of political orders with negative financial consequences for parastatals, and to make parastatal managers obey such orders.

Considering the severity of the crisis, these actors were, above all, busily securing their immediate private and family needs. The parastatal sector was crucial, not simply as a source of formal employment and income. It also offered informal incomes and access to scarce commodities for managers, bureaucrats, political leaders and their social network members - all according to the rights and obligations of the economy of affection. Given the poor parastatal performance, the soft budget constraint made it possible to abuse and extract parastatal resources. Its application provided a *survival mechanism* for poorly performing parastatals, even chronic loss makers, which all remained in existence during the crisis. The soft budget constraint allowed for financial adjustment to both inherent performance problems and exogenous shocks, and thus *introduced flexibility* into the rigid socialist system - while it simultaneously contributed to keeping the parastatal sector intact. By taking care of the parastatal financial problems that resulted when the actors adhered to the other formal and informal rules, the soft budget constraint functionally complemented these rules. This made it easier for the actors to behave according to the other rules and strengthened their incentives to do so.

By offering behavioural solutions to parastatal financing gaps and mitigating systemic weaknesses related to adaptation, information and incentives, the soft budget constraint brought coherence and consistency between the other institutions. It thus contributed to the stability of the socialist system that characterised the crisis period. And by constituting a survival mechanism for parastatals, it preserved the organisational structure. This stability made it easier for the actors not only to pursue their tasks within the system and cope with the crisis, but also to learn to increase their benefits from the opportunities that the system provided. And they did.

When the actors behaved according to the incentives created by the soft budget constraint and the other rules within the system, this had negative consequences for parastatal financial performance. Expectations of external accommodation of parastatal financing gaps weakened incentives to economise on parastatal costs and reinforced those to spend. Adherence to the other rules, which was facilitated by the soft budget constraint, also gave rise to waste of parastatal resources. As a result, parastatal financial problems recurred.

Hence, in its interaction with the other rules, the soft budget constraint contributed to the reproduction of the very problem to which it offered a behavioural solution. And when confronted with this problem, the actors faced incentives to apply the soft budget constraint: first of all, because it was already there and offered a means for handling the problem; secondly, because its previous application had reinforced the actors' expectations of its successful applicability; and thirdly, because the other institutions, which the soft budget constraint in turn reinforced, shaped incentives for such behaviour. We concluded that once the soft budget constraint was established as a behavioural rule, its very existence set off a

cumulative process of self-generation. In this process, four overlapping and interacting mechanisms linked its beneficial consequences to its reproduction. The soft budget constraint was maintained and reinforced by the mechanisms of *established advantage, adaptive expectations, institutional interaction* and *problem reproduction.* These are the same mechanisms that once gave rise to the institution.

Thus parastatal managers and bureaucrats applied the soft budget constraint because they had learnt that such behaviour was successful. However, the fact that they enjoyed its direct and indirect beneficial consequences does not imply that they reproduced the soft budget constraint consciously and intendedly. We argue that the actors contributed to its reproduction partly without intending or being aware of doing so, as they pursued their official and private tasks by adhering to the other rules of the system. Their behaviour generated inefficiency within the parastatals and worsened the financial problems, which was neither a beneficial nor an intended outcome.

This is the logic of the soft budget constraint within the Tanzanian socialist system. It was rational for the actors to maintain it in spite of the inefficiencies it generated because it also performed functions. Through its functions, the soft budget constraint made the actors behave so as to, partly unintendedly, both reproduce the situation in which it applied and reinforce the incentives to apply it in those situations. It was maintained in a vicious circle. The soft budget constraint did not solve the systemic problems to which it offered a behavioural solution, but worsened them. The poor performance of the socialist system that resulted forced the political leadership to undertake systemic change. The process of gradual market-oriented reform was initiated in 1984. It involved efforts to improve parastatal performance and to come to grips with the problems associated with the soft budget constraint. However, the soft budget constraint persisted.

Why the Soft Budget Constraint Persisted

We found that an explanation of why the soft budget constraint persisted during the transition period of the socialist system can be traced to its character as an informal institution. As such it was part of the institutional heritage of the actors. It consequently influenced their perceptions and behaviour in a number of ways right at the onset of reform. This implies, first of all, that the actors applied it by habit when confronted with parastatal financial problems. The problems were acute and grew unexpectedly to tremendous proportions. They had to be dealt with promptly or large parts of the sector would have collapsed. The soft budget constraint was there and offered a ready behavioural solution.

By reflecting the socialist experience, ideas and values, the soft budget constraint influenced the interpretation of and response to exogenous shocks. For instance, the dramatically altered relative prices caused by devaluation were not perceived as signals for reallocation of resources. Since the soft budget constraint weakened incentives to economise on costs, it hampered

responsiveness to change and any adaptation of parastatal activity to the new market conditions by the actors. Hence an important reason for the rapid and tremendous growth of parastatal losses in the early reform years is the behavioural rigidity that was created because the actors were used to the soft budget constraint. The very heritage of the soft budget constraint contributed to its persistence.

Hence, formal institutional change did not imply that the soft budget constraint was automatically altered. On the contrary, its persistence as an informal institution facilitated the actors' behaviour in the changing environment. Reform increased behavioural uncertainty. The actors did not know how to behave according to the new commercial rules of the market. The partial character of formal reform added uncertainty about whether or not to change behaviour. The soft budget constraint reduced this uncertainty about how to behave successfully during transition. By ensuring parastatal survival, it enabled the actors to behave largely as in the past, hence *not* to change behaviour, which was easier and safer. It persisted partly because when the actors did not know how to behave, they adhered to the old rules in order to be on the safe side. This also applied to the soft budget constraint itself. And the actors soon learnt that it continued to prevail.

This implies that the soft budget constraint persisted partly because reform was only partial. The remaining old rules both imposed constraints on behavioural change and created opportunities for adhering to the soft budget constraint. However, there was no simple causal relationship between the persistence of the soft budget constraint and partial reform. As just mentioned, the soft budget constraint facilitated adherence to other old rules, and thus contributed to their persistence and rendered formal reform partly ineffective. The soft budget constraint interacted with other old rules in mutual maintenance, creating behavioural rigidity and retarding institutional change.

Learning to change behaviour took time. This is an additional reason for the persistence of the soft budget constraint. Successful adaptation to new formal rules and other behavioural change was a gradual process of trial and error. The soft budget constraint also facilitated behaviour in this respect. Apart from bringing some institutional stability during the reform period, it brought organisational stability. By protecting the parastatals, it took care of the actors' failures while they were learning. This allowed them to gradually become acquainted with the new institutions, experiment with behaviour and learn to adapt. The soft budget constraint gave them a period of grace for developing new ways to perform their official duties, fulfil their personal aims, and to establish relationships with partly new partners in formal as well as informal exchange.

However, while the persistence of the soft budget constraint made behavioural trials possible, it simultaneously retarded the process by which the actors learnt to adhere to the new formal commercial and market rules. It influenced the choice of behavioural trials and their outcomes by shaping expectations. The actors largely attempted the behaviour that had been appropriate in the old system and therefore now failed. In addition, the soft budget constraint

destroyed the feedback mechanism necessary for corrective action, which contributed to the reproduction of parastatal financial problems.

However, by keeping the parastatal sector intact and helping the actors to retain their positions, the soft budget constraint did promote certain successful behavioural change. In particular, its own application was altered. This implied variation of past behaviour according to the old rule, which the actors were already skilled in, and adaptation through informal behavioural change. While, on the one hand, the application of the soft budget constraint was eventually reduced, it was also modified in a number of ways. Such modification included changes in the counterparts of the actors and in the use of the soft budget constraint: as a means to compete for customers and possibly to develop new relationships for informal income generation. It may thereby also have promoted certain informal organisational changes: the development of informal social networks between bureaucrats and the growing private business sector. Hence the soft budget constraint persisted partly because as an informal institution it was adapted to the changing environment.

This institution had beneficial consequences for the actors during transition just as in the past, but it now performed a new function in one important respect. The soft budget constraint facilitated the actors' behavioural adaptation, both by providing stability during the unstable and uncertain times, and by allowing for gradual learning to successfully change behaviour. It performed a bridging function, between the old and the new systems. This enabled actors within the entire bureaucracy to defend their positions as in the past, while they gradually learnt new ways to pursue their aims in the future. On the one hand, the actors faced incentives to maintain *status quo,* and the soft budget constraint allowed them to do so. Eventually, they faced incentives to adapt to the changing world. The soft budget constraint allowed them to do that too.

This is the logic of the soft budget constraint during the transition period of the socialist system in Tanzania and may explain why it persisted in spite of reform of the system of which it was an integral part. It was an informal institution that performed functions which were linked to its partly unintended reproduction by the same four self-reinforcing mechanisms as in the past.[3] While these mechanisms were the same, the functions that the soft budget constraint performed were partly altered. This implies that once established, it persisted for reasons that partly differ from those that accounted for its emergence and for its prevalence during socialism. More specifically, the soft budget constraint persisted because as an informal institution, it was part of the actors' heritage, facilitated their behavioural adjustment during transition and was adapted to the changing context of the actors. However, it persisted in spite of the fact that the conditions that once gave rise to it had changed not only because it was adjusted to the changing environment, but also because once established, it influenced the character and direction of the

[3] We argue that although the actors became increasingly aware of the applications and consequences of the soft budget constraint, the complexity of its character as an informal institution was not fully recognised. Hence, to the extent that the actors were not aware of all the ways in which they contributed to the persistence of the institution, any attempts at elimination of the soft budget constraint were rendered difficult.

behavioural change of the actors. Thus the soft budget constraint constituted a link from the past to the present and the future: it prevented change, adapted to change and shaped the path and nature of change.

Against this background, this study claims to offer answers to the research questions posed. It establishes the prevalence of the soft budget constraint in the Tanzanian parastatal sector and suggests an explanation of its emergence, persistence and logic during the period studied.

IMPLICATIONS OF THE STUDY

Against the summary of our major findings, let us discuss the wider implications of this study: its contributions to the body of knowledge. This section begins by considering the significance for our understanding of economic and institutional developments in Tanzania. The contribution to the literature on the subject matter, the soft budget constraint, is then accounted for. Finally, lessons learnt about institutional evolution in general are discussed. Implications for further research are suggested in relation to these topics.

Increased Understanding of Tanzanian Developments

By increasing our knowledge about the prevalence, evolution and logic of the soft budget constraint within the parastatal sector, the present study deepens our understanding of the functioning and performance of the Tanzanian economy at various levels. The scope has been broad. It spans across a long time period, from the micro-economic to the macro-economic level and from the perspective of the individual to that of the system. It considers the role of economic, political, institutional, ideological, cultural and historical factors, and examines causes as well as consequences. The wide outlook implies that the major contributions of the study may be found in its highlighting both complex and more general relationships and developments rather than in its specific details.

First of all, this study provides insights into the performance and functioning of the parastatal sector. The data material that displays parastatal financial performance and the various forms of soft external financial assistance represents a unique collection and compilation.[4] Hence, in this particular respect, the study does provide specific and detailed

[4] This even applies to several tables that consist of scattered, partly inconsistent, pieces of information from many different sources. In spite of these weaknesses, the data cover a large number of years and display trends and changes in these in a manner not presented before.

information. By establishing the prevalence of the soft budget constraint, a better understanding is offered of the weak cost consciousness and price responsiveness, general behavioural rigidity and poor adaptability within the sector. This, in turn, contributes to an explanation of the tremendous performance problems of parastatals, not least during the reform period.

However, the soft budget constraint is not simply yet another explanation of poor parastatal performance. It links other explanations into a richer and more complex picture, for instance by showing that the adaptive rigidity that it caused may partly account for why the devaluations had such devastating consequences for the financial results of the parastatals. In particular our recognition of the relationship and interaction between the soft budget constraint and other institutions provides a coherent image of the institutional context under which the actors within the parastatal sector operated. We mapped this context by identifying economic, political and social opportunities for and constraints on behaviour, the influence of ideology and traditional values, and the role of past experience and uncertainty for actors' perception of their situation and behavioural response. A thorough understanding of the situation of the actors and the consequences for parastatal performance is thereby offered.

The examination of the consequences of the soft budget constraint for actors' behaviour and parastatal performance also adds to our knowledge about the poor overall performance of the Tanzanian economy, not least during the transition period. While the cost of financing the parastatals has become increasingly recognised, the implications of the soft budget constraint for retarding behavioural, institutional and organisational change have been less understood. These consequences are illustrated in the present study, which also surveys the macro-economic effects of the soft budget constraint, especially during the reform period. Although it has not been possible to quantify the impact - in terms of slowed structural adjustment, partly ineffective stabilisation and hampered economic growth - the crucial role that the soft budget constraint played for partial failure of the reform programmes is indicated.

In the process of seeking answers to our research questions, the evolution of the soft budget constraint was studied in the broader context of the historical, institutional, political and economic developments during a 25-year period. This implies that a comprehensive account of the evolution of the entire socialist system in Tanzania is provided. The contribution in this regard is not merely descriptive, however. The perspective adopted allows for a better understanding of the functioning, performance and development of the Tanzanian economic and political institutional system, and for the relationship between these aspects, from pre- to post-socialism.

The soft budget constraint was not only a logical consequence of the socialist system, but also an integral part of it. As such it influenced the very process of systemic evolution. Our study emphasises its role for the functioning, performance, stability and change of the system. First of all, the emergence of the soft budget constraint was important for the development of the socialist system itself, since it 'took care' of problems that the evolving system generated in the process. Once the soft budget constraint was established, it contributed to both the

stability and the crisis of the socialist system. It brought coherence and consistency between the other formal and informal institutions, by dealing with or mitigating the systemic problems that they gave rise to. However, by thus bringing institutional (and organisational) stability, it reinforced the systemic weaknesses, notably parastatal financing gaps, but also inflexibility, informational and incentive problems and the resulting inefficiencies. The negative consequences of its interaction with the other institutions for the performance of the system accumulated over time.

When the system embarked on a process of transition away from socialism into something as yet unknown, the soft budget constraint influenced this process. Its first and major *direct* impact was to slow the pace of transition by retarding behavioural and organisational change. It rendered reform - formal institutional change - partly ineffective. This had negative consequences for the macro-economic performance of the system in transition and forced the leadership to extend reform even further. Thus by again rendering the extended measures partly ineffective, the soft budget constraint *indirectly* contributed to the gradual extension of reform.

As the reform process proceeded, the success of 'old' behaviour declined and this eventually created incentives for behavioural change. The soft budget constraint also affected the institutional change that resulted. While it retarded formal reform, it promoted adaptation through informal behavioural change, in particular by modifications of its own application. Similarly, while it retained the parastatals and the informal social networks dependent on these, it facilitated the development of informal social networks between the bureaucracy and the private sector.

Consequently, apart from influencing the speed of institutional and organisational change, the heritage, persistence and change of the soft budget influenced its character and direction. By retarding formal changes but promoting informal ones, it diverted the process of transition from that intended by the reform programmes. The soft budget constraint constituted a link between the old system and the future one in the making, which it also contributed in shaping.

This conclusion raises questions about what happened to the soft budget constraint in Tanzania after 1992, when the market orientation continued and parastatal sector reform eventually gained momentum. We know that the soft budget constraint changed, but into what? Was its application further reduced? Did it continue to prevail within the parastatal sector? Did it shift to new applications and new actors? Did it emerge in interaction between the bureaucracy and the private sector? These possibilities are all suggested by our study, but we cannot say in what direction the soft budget constraint evolved. Exploring these issues would be a task for future research.

After this account of what we have learnt *about* this particular case, let us discuss what we may learn *from* the case of Tanzania.

Contribution to our Knowledge about the Soft Budget Constraint

This sub-section discusses how the study adds to our knowledge about the nature and existence of the soft budget constraint and thus contributes to the empirical and theoretical literature on the subject. Empirical studies on the soft budget constraint are rare. The present one supplements the literature in several ways. First of all, it complements the few existing attempts to thoroughly establish the prevalence of the soft budget constraint, being based, as it is, on a unique set of data. The collection of sectoral and firm level data on a large number of forms of soft resource transfers represents an unusual coverage but also provides some detail.

By also using other data, notably on the financial performance of parastatals, it has been possible to paint a fairly good picture of the general prevalence and importance of the soft budget constraint in the Tanzanian case. In addition, there has been sufficient detail to allow us to observe variations in the application of the soft budget constraint. These observations reveal information about the empirical relevance of different applications of the soft budget constraint as well as about some of the characteristic traits of the institution. The combination of good coverage and detail in our data material would allow for a more thorough analysis of variations in the application and applicability of the soft budget constraint, for instance, over time, between individual parastatals and sectors. However, since the varying degrees of budget softness are of subordinate importance in this study, the analysis has been left out.[5]

Secondly, this study is unique in covering such a long time period and in spanning over three different institutional settings, from pre- to post-socialism. It is this coverage that has allowed us to study the emergence, persistence and logic of the soft budget constraint, which has not been done before either. Hence this is the first study that shows how the soft budget constraint emerges; how it performs its different functions, during socialism as well as transition; and how the mechanisms that contribute to its maintenance operate. Thirdly, it constitutes not only the first attempt to empirically study why the soft budget constraint exists in this particular manner, but the first known attempt to empirically examine theoretically suggested explanations for its existence.

Our definition of the soft budget constraint as an informal institution clarifies, unifies and extends János Kornai's different and often vague definitions. This makes it easier to operationalise the concept in a consistent manner. Together with the available data, the definition allows us to incorporate any additional applications of the soft budget constraint besides the four traditional ones of Kornai, and to study the expressions and prevalence of the phenomenon with a better precision than in several other empirical studies. The definition has further methodological implications. It directs our attention towards the situation of both parties involved in the 'budget-softening process' and the interaction between them, and towards the characteristic traits that the soft budget constraint may possess as an institution.

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[5] Part of such an analysis is performed in the two background studies to the present work, Eriksson (1993) and (1995).

We also add to the method of studying the soft budget constraint, by regarding it as the outcome of an invisible-hand process.

Seeing the soft budget constraint as an institution also proves to be useful for increasing our understanding of its existence. By applying an invisible-hand explanation to the emergence, persistence and logic of the soft budget constraint in the case of Tanzania, this study generates fresh knowledge both about the nature of the phenomenon and about why it exists. Hence it also claims to contribute to the theoretical literature on the subject.

János Kornai implicitly recognises that complexity and interdependence are important in the explanation of the soft budget constraint. In the present study, they are central themes and their crucial importance for our understanding of why the soft budget constraint exists is emphasised. More specifically, by defining the soft budget constraint as an informal institution, we show that complexity and interdependence are pivotal elements in the explanation of why it exists. Hence, our explanation is not only complex, but complexity forms a direct part of the explanation.

This circumstance is illustrated by our story of how the soft budget constraint emerged, an issue that no other study has attempted to explain. We suggest that the institution emerged spontaneously and unintendedly in the process of establishment of a socialist society, as a solution to a recurrent systemic problem, and as the actors gradually learnt to behave according to the incentives created by the evolving system. A multitude of institutions (and other factors) contributed to its generation - and to its maintenance. This suggests that the soft budget constraint is a logical consequence of the context in which it emerges. It forms part of a complex network of institutions that, while not necessarily inter*dependent,* are inter-related and interact in mutual maintenance and reinforcement. We claim to show that the causal relationship between the soft budget constraint and other institutions is far from uni-directional, as implicitly assumed in several studies, but runs in both directions.

By emphasising causal complexity and interdependence, this study complements the existing partial and linear explanations of the soft budget constraint. It adds knowledge about the multitude of factors that contribute to the soft budget constraint and combines partial explanations into a richer, but more complicated, one. The present study increases our understanding of circular causal relationships within institutional networks, which further imply that the soft budget constraint is the outcome of a process of sequential and causal steps that evolves over time.

Another contribution of the study is that it offers knowledge about the functions of the soft budget constraint, in the socialist system as well as under transition. The study recognises that the soft budget constraint has beneficial consequences, and not only negative ones. While Jasinski suggested some of its functions within the socialist system, we identify additional ones during both socialism and transition, and show that they partly change. In particular, we trace its primary function. In addition, insights are provided about how and why the soft budget performs its functions, which is important for understanding its existence.

The study further shows that the functions of the soft budget constraint contribute to its maintenance, but unlike many studies, it does not simply stipulate the relationship between function and existence. It accounts for the very process through which the soft budget constraint is maintained and reinforced, once established. We identify four different mechanisms that link the consequences of the soft budget constraint, beneficial and negative, to its reproduction in a cumulative process of self-generation.

Defining the soft budget constraint as an informal institution also increases our comprehension of its persistence during transition of the system. By emphasising the complex institutional relationships between the soft budget constraint and the other rules, the role of partial reform for its persistence is given a more profound meaning. The study also points out the importance of culturally determined informal rules with which the soft budget constraint interacts, and which contribute to its persistence in spite of formal reform. The crucial importance of the socialist institutional and ideological heritage of which the soft budget constraint is part is further recognised, as well as the inherent stability characteristics pertaining to the soft budget constraint as an informal institution.

Another important finding is that although the soft budget constraint persists, its application is modified. Its adaptation to changes in the surrounding context contributes to its persistence, and so does its tendency as an institution to influence the actual institutional change that takes place. We also show that the functions of the soft budget constraint partly change during the transition period. It performs a new - bridging - function. This raises questions for further research about change in the soft budget constraint during transition away from socialism. To what extent does it survive through applications to new, as yet undetected, forms of finance? To what extent does its applicability shift to interaction between new counterparts? Which are the implications for change in its functions? Finally, does this imply that the soft budget constraint as an informal rule becomes adapted to a new institutional set-up? Hence, will it continue to prevail in post-socialist economies even when these have been sufficiently altered to be characterised as market economies? If so, how does it relate to and interact with the new institutions?

Remaining questions notwithstanding, we conclude that the present study fulfils its purpose. It increases our understanding of why the soft budget exists. Apart from contributing to the empirical literature, it also makes a contribution to the theory of the soft budget constraint - about what it is, what its characteristics are and why it exists.

In a strictly formal sense, we are unable to generalise from the study of a case. Still, the findings of this study may be more generally valid and not apply exclusively to the case of Tanzania. The possibility of generalising depends on the extent to which the conditions that characterise this case resemble those in other countries. The Tanzanian case is characterised by its socialist ideology and institutions. This suggests that our findings may primarily be relevant for other socialist and post-socialist countries. However, the Tanzanian socialist system is not only characterised by its formal structure, but also by the informal rules and values of the economy of affection. Although the particular Tanzanian combination of formal

and informal rules is unique, the economy of affection is not a specifically Tanzanian cultural trait. This circumstance, in combination with the persistence of the soft budget constraint in spite of the demise of socialism in Tanzania, raises questions about the prevalence of the soft budget constraint in other - non-socialist or non-former socialist - Sub-Saharan African countries where the economy of affection prevails.

An Example of Empirical Institutional Evolution

In this study, the role of uncertainty for human behaviour is emphasised. Human beings face behavioural uncertainty because the world is complex and our competence is limited. Uncertainty is particularly great during periods of comprehensive institutional change, such as the establishment of a socialist system and market-oriented reform. It is the underlying rationale for the existence of institutions, as they reduce our uncertainty by shaping expectations that guide behaviour. Institutions shape our expectations by conveying information about past experience and prevailing values.

The role of past experience - our looking backwards - is important for human behaviour. We show, for instance, that the heritage of the soft budget constraint was central for its persistence during reform. Similarly, our subjective perceptions of the world, shaped by past experience but also by prevailing ideas and values, influence our behaviour. This study discusses, among other things, how the condemnation of the profit motive and the optimism of the socialist ideology contributed to the emergence of the soft budget constraint. Our findings suggest that if we want to understand why actors behave the way they do in producing certain economic outcomes, we must recognise, firstly, 'where' the actors come from and what 'luggage' they carry and, secondly, how the world was interpreted and what the predominating values about how it should be were at the time.

These aspects are central ingredients in our example of empirical institutional analysis. It represents a rare attempt to empirically portray the evolution of an informal, or organic, institution. More specifically, it illustrates the sequential and causal process through which an informal institution emerges, is maintained and modified. Our contribution includes the endeavour to operationalise an informal institution. By studying the evolution of a specific institution in a larger institutional context, insights are provided about institutional evolution in at least two additional ways: first of all, about the evolution of an entire institutional system and, secondly, about the role of informal institutions for systemic evolution.

Several characteristics of institutional change referred to in the literature, such as path dependence and lock-in, are illustrated by our case. The evolution of the Tanzanian socialist system was a gradual process. It consisted of small steps, minor alterations of the existing institutional set-up at the margin, determined throughout by its past and hence by the present state that the past had taken it to. It provides an example of the 'incremental' character of

institutional change, to use the terminology of North.[6] This suggests that the establishment of the socialist system was a less well-designed and consciously planned process than it may appear in retrospect. It was probably largely the outcome of a series of short-sighted adaptations to recurrent and new situations, created both endogenously and exogenously.

This can only partly be true, however, since the Arusha Declaration set off a rapid change of formal institutions. However, we also show that during the process of market-oriented reform, actual institutional change was far slower than indicated by the formal reform measures. Formal reform was largely rendered ineffective by the prevalence of informal rules. The study also discusses the circumstance that the period of institutional stability, the socialist and crisis period, was not as stable as it first seemed. This was partly because informal institutional change was taking place while the formal rules remained stable. These examples illustrate the continuous character of the process of institutional evolution.

This discussion leads us to the role of informal institutions for institutional evolution, which, in our case, is illustrated by the soft budget constraint. An important reason why institutional change is gradual and slow is the prevalence of informal institutions. They influence systemic evolution in a number of ways. While they are partly adaptations to the formal rules, they also influence the shaping, effectiveness and actual application of formal rules. In Tanzania, the forming, functioning, performance and evolution of the socialist system was largely shaped by the soft budget constraint, but also by the traditional informal rules and values of the economy of affection. Hence, to a certain extent, this study also recognises the significance of culturally determined rules in influencing economic and institutional outcomes.

Institutional change is incremental and path dependent partly because of the self-reinforcing mechanisms of institutions and their relationship with the behaviour of the individuals. The Tanzanian case illustrates how institutions give rise to interest groups, as actors learn to benefit from the behavioural opportunities that institutions provide, and how as a result, these groups face incentives to maintain the *status quo*. The resulting interaction between the actors within the interest groups and the prevailing institutions gives rise to lock-in, which makes it difficult to get rid of or dramatically change institutions, such as the soft budget constraint, or whole institutional set-ups, such as the socialist system. The stability of informal rules implies that they may influence not only the speed but also the character and direction of institutional evolution, as illustrated by our case. This case informs us about the difficulty of predicting where institutional evolution is heading and shows that it may take unintended and unexpected ways. Hence, the story of what happened to the soft budget constraint in Tanzania after the point when we now leave it is yet to be told.

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[6] North (1990).

APPENDIX

Table A.1: Number of Parastatals in Tanzania, 1966-1990

Year	Number
1966	46[1]
1967	64[2*]
1968	73[2]
1969	78[2]
1970	85[2]
1971	99[1]
1972	104[2]
1973	117[3]
1974	139[4]
1975	142[2]
1976	-
1977	159[2]
1978	-
1979	380[5]
1980	-
1981	>380[6]
1982	-
1983	400[3]
1984	433[6]
1985	-
1986	-
1987	413[5]
1988	>/=425[7]
1989	450[8]
1990	425[9]
1991	445[10]

Notes: A dash (-) indicates that data are unavailable.
* After the Arusha Declaration.

Sources:
1. Ndulu (1984), pp. 22-23.
2. Hartmann (1990), p. 250, referring to the World Bank (1981).
3. Chandrasekhar & Bagachwa (1984), p. 124.
4. Havnevik (1993), p. 45.
5. World Bank (1988a), pp. 3 & 9.
6. Kiondo (1989), pp. 75-76.
7. de Valk (1992), p. 198.
8. Of which at least 15 sports associations affiliated to the National Sports Council and about 70 District Development Corporations. Sayore (1989), p. 62.
9. Parastatal Sector Reform Commission (1993), p. 3.
10. Tanzania Audit Corporation (1991), p. 11, excluding an unknown number of non-active parastatals.

Table A.2: Number of Price-Controlled Goods in Tanzania, 1973-1991

YEAR	PRODUCT* CATEGORIES	o/w Domestic	o/w Imported	INDIVIDUAL ITEMS	o/w Domestic	o/w Imported
Early 1973	-	-	-	400[1]	-	-
1973	-	-	-	1,000[2]	-	-
March 1974	1,066[1]	602[1]	464[1]	-	-	-
1978	-	-	-	3,000[2]	-	-
1979	325[3]	154[3]	171[3]	1,031[3]	456[3]	575[3]
1980	-	-	-	2,000[4]	-	-
Early 1980s	>400[5]	-	-	-	-	-
1983/84	56[6]	50[6]	6[6]	235[6]	226[6]	9[6]
1984	72[3]	54[3]	18[3]	333[3]**	241[3]**	92[3]**
1984/85	47[6]	44[6]	3[6]	184[6]	179[6]	5[6]
1985	56[3]	50[3]	6[3]	225[3]	216[3]	9[3]
June 1986	47[5]	-	-	-	-	-
1986	21[3]	21[3]	0[3]	107[3]	107[3]	0[3]
July 1986	22[5]	-	-	-	-	-
1987	22[3]	22[3]	0[3]	83[3]	83[3]	0[3]
July 1988	12[5]	-	-	-	-	-
1988	12[3]	-	-	-	-	-
1989	10[7]	-	-	-	-	-
1990/91	10[8]	-	-	-	-	-
Mid-1991	2[8]	-	-	-	-	-

Notes: A dash (-) indicates that data are unavailable. Although it remains unknown to what extent goods that were price controlled by other agencies than the National Price Commission are included in the figures, my impression is that in most cases they are not.
* As noted by Rice (1979), Footnote 4, p. 109, 'The number of controlled prices is several times this as there are several different sizes and types for many of the groups of items that are counted as one item in this list'.
** According to Maliyamkono & Bagachwa (1990), p. 85, these figures were 235, 226 and 9. The data by Kiondo are used because they are more detailed and cover more years.

Sources:
1. Rice (1979), p. 96.
2. Maliyamkono & Bagachwa (1990), p. 85.
3. Kiondo (1990), Table 4, p. 34; Years confirmed in personal communication, 9 September, 1991, Dar es Salaam.
4. Schyberger (1987), p. 131.
5. International Monetary Fund (1988), p. 14.
6. International Monetary Fund (1986), p. 14.
7. International Monetary Fund (1990), p. 15.
8. World Bank (1991b), p. 92.

Table A.3: Disbursement of Foreign Aid to Tanzania, 1970-1992 (Million USD)

Year	Net Loans*	Total Grants	Total Aid (%)	Grants/ Tot Aid
1970	24	28	51	54
1971	32	31	62	49
1972	17	45	61	73
1973	35	65	100	65
1974	63	99	163	61
1975	114	188	302	62
1976	71	196	267	73
1977	125	215	340	63
1978	-33	457	424	108
1979	101	487	588	83
1980	9	658	666	99
1981	193	509	702	73
1982	194	490	684	72
1983	164	430	594	72
1984	128	430	558	77
1985	79	408	487	84
1986	102	578	680	85
1987	71	811	882	92
1988	68	906	975	93
1989	180	738	941	78**
1990	288	887	1,252	71**
1991	170	914	1,211	75**
1992	413	933	1,424	66**

Note: * Concessional loans less principal repayments.
** Own calculations, based on the figures in the table.

Sources: Lipumba (1995), Table 2.1.1, p. 97, based on OECD development cooperation annual DAC figures, 1970-1993, and own calculations.

Table A.4: Parastatal Decision Making and Supervision in Tanzania

Function	Formally Responsible Organ	
Overall Parastatal Policy	1.	National Assembly
	2.	Ruling Party
	3.	Office of the President
Parastatal Subsector Policy	1.	Holding Corporations
	2.	Parent Minstries
Review & Approve Subventions	1.	Board of Directors
	2.	Holding Corporations
	3.	Parent Ministries
	4.	Ministry of Finance & Planning
Review & Approve Investments	1.	Board of Directors
	2.	Holding Corporations
	3.	Parent Ministries
	4.	Ministry of Finance & Planning
	5.	Investment Banks
Review & Approve Dividends	1.	Board of Directors
	2.	Holding Corporations
	3.	Parent Ministries
	4.	Ministry of Finance & Planning
Review & Approve Corporate Plans & Budgets	1.	Workers' Councils
	2.	Board of Dir. & Managem. Committ.
	3.	Holding Corporations
	4.	Parent Ministries
	5.	Registrar of Companies
	6.	Ministry of Finance & Planning
Performance Supervision & Evaluation	1.	Board of Dir. & Managem. Committ.
	2.	Holding Corporations
	3.	Parent Ministries
	4.	Ministry of Finance & Planning
	5.	Other Central Ministries
	6.	Tanzania Audit Corporation (TAC)
	7.	Parastatal Org. Committee (POC)
	8.	Investment and Commercial Banks
	9.	Presidential Commissions
	10.	Ruling Party
	11.	President's Office
Review & Approve Compensation Plan (Pay Scales, Allowances & Fringe Benefits)	Standing Committee on Parastatal Org. (SCOPO)	
Review & Approve Parastatal Technical Management Contracts	Parastatal Management Services Committee (PMSC)	
Price Control	Price Commission*	
Analyse Sectoral Trends & Macro-Economic Impact	Ministry of Finance & Planning	

Note: * Not all prices were controlled by the Price Commission, but there were additional bodies controlling for instance the prices of agricultural products and public utilities.

Sources: Adapted from Ngowi (1990), pp. 36-40, and the World Bank (1988a), Table C2, pp. 121-122.

Table A.5: Selected Macro-Economic Indicators for Tanzania, 1977-1992 (Percentages Throughout)

Real Official GDP Growth		**1977**	**1978**	**1979**	**1980**	**1981**	**1982**	**1983**	**1984**	**1985**	**1986**	**1987**	**1988**	**1989**	**1990**	**1991**	**1992**
Total		0.4	1.2	3.4	2.9	-0.5	0.6	-2.4	3.4	2.6	3.3	5.1	4.2	3.3	3.5	5.8	3.6
- Agriculture		1.1	-1.7	0.8	3.9	1.0	1.3	2.9	4.0	6.0	5.7	4.4	4.5	4.6	6.6	4.0	4.4
- Manufacturing		-6.0	3.4	3.3	-4.9	-11.2	-3.3	-8.7	2.7	-3.9	-4.0	4.5	7.1	7.7	-2.5	12.0	1.9
External Balance																	
- Exports as % of Off GDP		18	13	14	13	12	8	7	8	5	8	9	13	18	16	13	18
- Imports as % of Off GDP		24	31	28	27	23	20	14	17	16	24	37	41	53	66	58	65
- Exports as % of Imports		76	42	49	47	50	40	47	46	33	32	25	33	34	24	22	28
Domestic Balance	**76/77**	**77/78**	**78/79**	**79/80**	**80/81**	**81/82**	**82/83**	**83/84**	**84/85**	**85/86**	**86/87**	**87/88**	**88/89**	**89/90**	**90/91**	**91/92**	**92/93**
Budget Deficit																	
- % of Total Expenditure	-	-	-	-	42	46	34	34	35	31	39	37	34	31	34	34	51
- % of Off. GDP	11	11	18	17	14	15	10	9	9	7	9	10	11	11	12	13	n.a.
Deficit Financing*																	
- o/w Foreign Financing	48	66	35	39	43	71	54	31	49	36	76	82	106	75	122	103	79
- o/w Domestic Bank Borrow	-3	13	50	45	36	65	71	45	24	51	9	9	-15	17	-36	-13	18
		1977	**1978**	**1979**	**1980**	**1981**	**1982**	**1983**	**1984**	**1985**	**1986**	**1987**	**1988**	**1989**	**1990**	**1991**	**1992**
Monetary (M2) Expansion		20	13	47	27	18	19	18	4	29	29	32	35	29	42	26	38
Rate of Inflation		12	12	13	30	26	29	27	36	33	32	30	31	26	20	22	22

Note: A dash (-) indicates that data from compatible sources are unavaliable.
* Deficit sometimes over-financed, due (besides to negative domestic bank borrowing) to negative domestic non-bank borrowing, not shown in the table.

Sources: Calculations based on the following:
Real official GDP growth (at factor cost): Tanzanian Economic Trends (1989/90), Table 2, p. 73; (1992), Table 2, p. 64; and (1993/94), Table 2, p. 84.
External balance (in Tanzanian Shilling terms): Bank of Tanzania (1991c), Table 2.3; (1991a), Table 20, p. 75; and (1995), Table 4.4, p. 85.
Nominal Official GDP: (1977-1992) Tanzanian Economic Trends (1989/90), Table 1, p. 72; and (1993/94), Table 1, p. 83.
Budget deficit and deficit financing: Kimei (1987), Table 8.7, p. 188 (1976/77-1979/80); Bank of Tanzania (1990a), Table 18, p. 57; and (1995), Table 2.1, p. 63.
Monetary expansion: Bank of Tanzania (1989), Table 5, p. 41 (1977-1984: unclear whether M2 or M3); and (1995), Table 1.1, p. 47.
Rate of inflation (Annual Change in NCPI): Shitundu (1993/94), Table 2, p. 20.

Table A.6: Tanzania Audit Corporation Clients, their Audited Accounts and Financial Results, 1980/81-1991/92 (Million TSh)

Audit Year	No. of TAC Clients*	Accounts for Fin. Years	PROFITS		LOSSES			TOTAL	
			No. of Accounts	Total Value	No. of Accounts	% of Tot No.	Total Value	No. of Accounts*	Net Value
1980/81	398	-	117	1,518.3	110	39	319.4	282	1,198.9
1981/82	433	1974-82	168	2,189.9	181	48	559.5	376	1,630.4
1982/83	448	1977-82	196	3,876.5	165	40	910.2	412	2,966.2
1983/84	460	1977-83	213	2,911.9	171	41	2,994.4	422	-82.5
1984/85	420	1973-84	189	3,811.4	165	42	1,853.0	394	1,958.4
1985/86	415	1977-85	190	5,927.0	203	47	2,386.9	431	3,540.2
1986/87	415	1974-86	157	6,463.3	171	46	5,809.3	368	654.0
1987/88	408	1975-87	211	12,675.1	227	47	20,128.7	482	-7,453.6
1988/89	430	1978-88	176	21,729.0	189	48	32,905.5	396	-11,176.5
1989/90	472	1979-89	191	34,911.2	239	52	39,110.1	461	-4,198.9
1990/91	445**	1982-90	180	51,425.3	159	42	56,041.3	376	-4,616.0
1991/92	350**	1982-92	184	51,911.2	158	43	34,058.9	367	17,852.3

Notes: A dash (-) indicates that data are unavailable.
* The number of TAC clients and the number of accounts audited differ, partly because many clients submit delayed accounts.
** Number of active parastatals in 1990/91. Excluding 150 passive clients that were either dormant or under dissolution and 15 sports associations affiliated to the National Sports Council in 1991/92. Whether passive clients also were excluded during the 1980/81-1989/90 period or not remains unknown.

Source: Calculations based on the Tanzania Audit Corporation (1981-1992).

Table A.7: Audited Parastatal Losses in Relation to Official GDP and Public Expenditure in Tanzania, 1980/81-1991/92 (Million TSh)

TOTAL LOSSES AUDITED								PARASTATAL COMMERCIAL LOSSES*			
Audit Year	Value	% of Official GDP				% of Publ Exp		Year	Value	% of Off GDP	% of Publ Exp
(1)		(2)		(3)		(4)		(5)		(6)	(7)
1980/81	319.4	1979	1	1978	1	1979/80	-	1981	-	-	1980/81 -
1981/82	559.5	1980	1	1979	2	1980/81	4	1982	-	-	1981/82 -
1982/83	910.2	1981	2	1980	2	1981/82	5	1983	-	-	1982/83 -
1983/84	2,994.4	1982	6	1981	7	1982/83	16	1984	2,437.7	3	1983/84 12
1984/85	1,853.0	1983	3	1982	4	1983/84	9	1985	2,830.1	3	1984/85 10
1985/86	2,386.9	1984	3	1983	4	1984/85	8	1986	14,736.0	10	1985/86 46
1986/87	5,809.3	1985	5	1984	7	1985/86	18	1987	25,547.1	13	1986/87 53
1987/88	20,128.7	1986	14	1985	19	1986/87	42	1988	36,764.2	13	1987/88 49
1988/89	32,905.5	1987	16	1986	23	1987/88	44	1989	55,731.0	17	1988/89 53
1989/90	39,110.1	1988	14	1987	20	1988/89	37	1990	34,414.0	9	1989/90 24
1990/91	56,041.3	1989	17	1988	20	1989/90	40	1991	39,546.0	7	1990/91 19
1991/92	34,058.9	1990	8	1989	10	1990/91	16	1992	111,918.0	16	1991/92 43

Notes: A dash (-) indicates that data are unavailable.
* According to the Tanzania Audit Corporation definition, excluding inter alia marketing boards and other agricultural parastatals.

Sources: Calculations based on the following:
Total losses audited: Table A.6 above.
Commercial parastatal losses: Tanzania Audit Corporation (1990), p. 13; (1991), p. 13; (1992), p. 12; and (1995), p. 11.
Official GDP: Tanzanian Economic Trends (1993/94), Table 1, p. 83.
Public Expenditure: Bank of Tanzania (1990a), Table 18, p. 57, and (1995), Table 2.1, p. 63.

Table A.8: Losses of the Three Major Loss-Making Parastatal Sectors in Tanzania, Audited during 1980/81-1991/92 (Million TSh)

		INDUSTRIES AND TRADE						COMMUNICATION AND TRANSPORT						AGRICULTURE AND LIVESTOCK					
	Estim.	Losses			Sector %	Total/Net		Losses			Sector %	Total/Net		Losses			Sector %	Total/Net	
Audit Year	Actual Year	No.	%/Sector*	Value	Tot. Loss	No.	Value	No.	%/Sector*	Value	Tot. Loss	No.	Value	No.	%/Sector*	Value	Tot. Loss	No.	Value
1980/81	1979	12	18	-	-	65	-	5	56	-	-	9	-	21	68	-	-	31	-
1981/82	1980	18	22	-	-	83	-	3	60	-	-	5	-	28	60	-	-	47	-
1982/83	1981	23	27	304	33	85	459	8	50	153	17	16	159	23	62	253	28	37	137
1983/84	1982	39	29	496	17	134	757	23	53	372	12	43	-51	37	69	1,952	65	54	-1,895
1984/85	1983	41	34	682	37	119	395	6	26	232	13	23	471	40	66	713	38	61	-428
1985/86	1984	48	37	700	29	131	1,263	15	50	309	13	30	18	41	63	977	41	65	-658
1986/87	1985	52	43	4,070	70	121	-1,964	8	36	426	7	22	451	44	75	787	14	59	-272
1987/88	1986	62	52	8,861	44	120	-6,219	14	47	4,979	25	30	-4,789	43	68	4,629	23	63	-4,076
1988/89	1987	61	55	13,020	40	110	-10,021	9	38	7,736	24	24	-5,584	41	56	7,084	22	73	-6,025
1989/90	1988	83	63	16,607	42	132	-12,795	10	45	7,542	19	22	-67	38	56	7,176	18	68	-4,891
1990/91	1989	69	60	36,929	66	115	-31,482	5	23	10,449	19	22	-5,235	25	42	6,117	11	60	672
1991/92	1990	61	55	11,996	35	111	-2,241	1**	6	108*	<1	17	3,602	33	56	9,946	29	59	-2,223

Notes: A dash (-) indicates that data are unavailable.
* Per cent of the sector's accounts disclosing losses.
** In 1991/92, the communication and transport sector was no longer among the top three loss-making sectors.

Source: Calculations based on Tanzania Audit Corporation (1981-1992).

Table A.9: Financial Performance of Agricultural Parastatals in Tanzania, 1978-1992 (Million TSh)

Parastatal/Year	1978	1979	1980	1981	1982	1983	1984	1978-84	1985	1986	1987	1988	1989	1990	1985-90	1978-90	1991	1992
AGRI. MARKETING:																		
Cashewnut (CATA)	59	46	-7	133	-256	-200	-125	**-350**	-306	83	487	277	65	-490	**116**	**-234**	-496	-
Coffee (TCMB)	21	29	-90	33	27	-5	26	41	-37	269	26	776	18	-87	**965**	**1,006**	-397	56
Cotton (TCMB)	39	-72	-2	-1	-367	-910	-645	**-1,958**	-644	-943	-1,379	-318	3,085	3,246	**3,047**	**1,089**	2,189	132
Pyrethrum (TPB)	-4	-3	0	-7	-30	-40	-54	**-138**	-64	-52	-21	37	54	84	**38**	**-100**	-121	-7
Sisal (TSA)	-25	-7	-27	34	-30	-6	-11	**-72**	-14	-25	-59	-96	5	-216	**-405**	**-477**	-142	244
Tea (TTA)	-8	-2	-8	-31	-40	-39	-16	**-144**	-15	-37	19	28	68	206	**269**	**125**	126	68
Tobacco (TTPMB)	-24	9	-106	-122	-125	-90	-38	**-496**	-107	-410	-147	-340	297	612	**-95**	**-591**	1,571	143
Total Exporting	**58**	**0**	**-240**	**39**	**-821**	**-1,290**	**-863**	**-3,117**	**-1,187**	**-1,115**	**-1,074**	**364**	**3,592**	**3,355**	**3,935**	**818**	**2,730**	-
NAFCO (Agri Food)	-1	5	7	-6	-1	22	74	**100**	48	-66	0	23	-147	-171	**-313**	**-213**	1,122	898
Sugar (SUDECO)	-6	-35	-38	1	-8	7	3	**-76**	1	60	106	303	-5	539	**1,004**	**928**	864	527
Total Except NMC	**51**	**-30**	**-271**	**34**	**-830**	**-1,261**	**-786**	**-3,093**	**-1,138**	**-1,121**	**-968**	**690**	**3,440**	**3,723**	**4,626**	**1,533**	**4,716**	-
NMC	-300	-821	-1,072	-651	-332	-540	-349	**-4,065**	141	-561	-1,808	-6,552	-6,185	-4,619	**-19,584**	**-23,649**	-6,255	-
Total Agri Mark	**-249**	**-851**	**-1,343**	**-617**	**-1,162**	**-1,801**	**-1,135**	**-7,158**	**-997**	**-1,682**	**-2,776**	**-5,862**	**-2,745**	**-896**	**-14,958**	**-22,116**	**-1,539**	-
LIVESTOCK PARA.:																		
Animal Feed (TAFCO)	0	0	0	0	0	0	5	**5**	-54	-110	-14	-63	-48	-68	**-357**	**-352**	-	-
Dairies (TDL)	4	-1	3	25	54	70	40	**195**	-4	5	0	-39	57	167	**186**	**381**	-70	53
Dairy Farm (DAFCO)	-2	-2	-6	-8	-1	-16	-7	**-42**	-11	-17	9	-17	-14	-53	**-103**	**-145**	21	13
Hides & Skins (THS)	3	2	1	1	0	0	4	**11**	-9	-10	-4	-4	-33	-23	**-83**	**-72**	-	-
Packers (TPL)	-5	16	0	-14	-16	-19	-21	**-59**	-45	-40	0	-126	-119	23	**-307**	**-366**	-10	-
Poultry (NAPOCO)	0	0	0	0	0	0	0	**0**	6	-2	-14	-12	13	6	**-3**	**-3**	-	-
Ranching (NARCO)	-6	9	-4	-2	10	-3	-7	**-3**	11	-10	10	4	8	3	**26**	**23**	22	94
Total Live Para	**-6**	**24**	**-6**	**2**	**47**	**32**	**14**	**107**	**-106**	**-184**	**-13**	**-257**	**-136**	**55**	**-641**	**-534**	-	-
TOTAL AGRI PARA	**-255**	**-827**	**-1,349**	**-615**	**-1,115**	**-1,769**	**-1,121**	**-7,051**	**-1,103**	**-1,866**	**-2,789**	**-6,119**	**-2,881**	**-841**	**-15,599**	**-22,650**	-	-

Note: A dash (-) indicates that data are unavailable.

Source: Data compiled by the Project Preparation and Monitoring Bureau (1992), based on the audited accounts of parastatals and, for 1992 and sometimes 1991 and 1990, draft accounts, estimates and parastatal budgets; and own calculations.

Table A.10: Accounting Standard of Tanzania Audit Corporation Clients, 1975/76-1991/92

Audit Year	CLIENTS IN ARREARS No.	% of All Clients	CLEAN REPORTS No.	% of Audited	NON-CLEAN REPORTS No.	% of Audited	TOTAL No. Acc Audited	Financial Year	FINANCIAL YEAR ACCOUNTS Clean No.	Clean (%)	Non-Clean (%)
1975/76	72	26	70	35	128	65	198	1976	-	-	-
1976/77	56	18	76	36*	136	64	212	1977	-	-	-
1977/78	92	28	76	33*	152	67	228	1978	-	-	-
1978/79	100	30	76	31*	171	69	247	1979	-	-	-
1979/80	-	-	-	-	-	-	-	1980	-	-	-
1980/81	151	38	85	30	197	70	282	1981	-	-	-
1981/82	185	43	108	29	268	71	376	1982	-	-	-
1982/83	198	44	143	35	269	65	412	1983	-	-	-
1983/84	174	38	168	40	254	60	422	1984	-	-	-
1984/85	170	40	146	37	248	63	394	1985	402	41	59
1985/86	163	39	171	40	260	60	431	1986	395	43	57
1986/87	141	34	164	45	204	55	368	1987	378	52	48
1987/88	129	32	181	38	301	62	482	1988	357	59	41
1988/89	128	30	204	52	192	48	396	1989	368	63	37
1989/90	90	19	245	53	216	47	461	1990	347	67	33
1990/91	120	27	238	63	138	37	376	1991	333	70	30
1991/92	126	36	219	60	148	40	367	1992	510	68	32

Notes: A dash (-) indicates that data are unavailable.
* Corrected for counting error.

Sources: Mukandala (1983), Table 3, p. 13 (data for 1975/76-1978/79), based on Tanzania Audit Corporation Annual Reports; Tanzania Audit Corporation (1981-1992) and (1995); and own calculations.

Table A.11: Actual Payments of Government Subsidies in Tanzania, 1976/77-1992/93 (Million TSh)

Financ. Year	NMC Maize	NMC O/D*	NMC Other	Total NMC	GAPEX Minor	TCMB Cashew	TCMB Coffee	TCMB Cotton	TPB Pyreth	TSA Sisal	TTA Tea	TTPMB Tobacco	Tot MBs@ excl NMC	Tot MBs@ incl NMC	SUDECO Sugar	TFC Fertilis	Other	TOTAL	% of C&C@	% of TMS@
1976/77	49.3	-	-	49.3	-	-	-	-	-	-	-	-	-	49.3	-	49.7	-	**99.0**	831.9	3.1
1977/78	84.3	-	-	84.3	-	-	-	-	-	-	-	-	-	84.3	-	100.0	-	**184.3**	214.8	5.4
1978/79	562.4	-	-	562.4	-	-	-	-	-	-	-	-	-	562.4	-	135.4	-	**697.8**	206.7	14.6
1979/80	419.1	-	-	419.1	-	-	-	-	-	-	-	-	-	419.1	-	134.7	-	**553.8**	910.9	13.1
1980/81	125.2	250.0	-	375.2	-	-	-	-	-	-	-	-	-	375.2	-	136.5	-	**511.6**	96.9	9.0
1981/82	405.3	250.0	-	655.3	-	-	-	-	-	-	-	-	-	655.3	-	202.8	-	**858.1**	45.0	10.4
1982/83	216.6	250.0	112.0	578.6	66.7	19.2	63.9	315.3	5.0	23.9	-	55.0	549.0	1,127.6	10.0	196.0	-	**1,333.5**	80.1	15.7
1983/84	245.6	250.0	-	495.6	54.2	12.7	-	275.8	7.8	-	-	102.3	452.7	948.3	29.1	215.0	-	**1,192.5**	83.4	11.7
1984/85	-	250.0	88.2	338.2	47.3	42.9	-	215.0	7.7	-	5.5	77.8	396.2	734.4	-	-	-	**734.4**	70.3	4.8
1985/86	-	250.0	83.8	333.8	44.9	73.9	-	204.1	7.3	-	5.2	40.8	376.2	710.0	-	-	-	**710.0**	71.5	3.9
1986/87	-	250.0	80.3	330.3	-	39.1	-	195.7	-	-	5.0	70.8	310.6	640.9	-	-	708.7	**1,349.6**	41.6	5.2
1987/88	-	250.0	76.3	326.3	-	37.1	-	186.0	-	-	4.8	67.3	295.3	621.6	-	-	-	**621.6**	11.2	1.7
1988/89	-	50.0	388.8	438.8	-	35.2	-	508.9	-	-	4.5	114.9	663.6	1,102.3	-	-	-	**1,102.3**	11.4	2.1
1989/90	-	-	414.7	414.7	-	365.7	-	1,010.5	-	-	26.0	365.7	1,767.9	2,182.6	-	1,402.2	846.9	**4,431.4**	82.1	6.7
1990/91*	-	532.0	-	532.0	-	-	-	506.0	-	-	-	81.0	587.0	1,119.0	-	1,000.0	-	**2,119.0**	11.4	2.0
1991/92*	-	661.0	-	661.0	-	-	-	628.0	-	-	-	101.0	729.0	1,390.0	-	4,071.0	-	**5,461.0**	30.5	4.5
1992/93*#	-	769.0	-	769.0	-	-	-	731.0	-	-	-	118.0	849.0	1,618.0	-	5,800.0	-	**7,418.0**	n.a.	n.a.

Notes: A dash (-) indicates the value zero (0).
Due to round numbers, the totals need not equal the sums of the individual figures.
* Government take-over of overdraft liabilities to the NBC, except in the case of Tanzania Fertilizer Company (TFC).
# Budgeted and estimated figures.
@ MBs = Marketing Boards, C&C = Contractual and Contingent Liabilities, TMS = Total Ministerial Supply. Other abbreviations represent the names of the parastatals.

Sources: Calculations based on Ministry of Finance (1990), updated and corrected by officials at its Public Investment Department in December 1992, and (for data on C&C and TMS) on the World Bank (1989b), Table B10; (1992b), Table B10.

Table A.12: Number of Tax Exemptions Granted by Ministerial Order in Tanzania, 1966-1992

Year	Customs Duty	Sales Tax	Excise Duty	Income Tax	Total Exemptions
1966	13	n.a.	n.a.	n.a.	n.a.
1967	3	n.a.	n.a.	n.a.	n.a.
1968	15	n.a.	n.a.	n.a.	n.a.
1969	12	5	1	n.a.	n.a.
1970	23	17	3	n.a.	n.a.
1971	22	22	3	n.a.	n.a.
1972	26	19	1	n.a.	n.a.
1973	31	21	1	n.a.	n.a.
1974	29	27	-	10	66
1975	30	22	2	12	66
1976	25	27	1	10	63
1977	23	18	2	7	50
1978	33	25	-	-	58
1979	10	10	-	3	23
1980	15	16	-	10	41
1981	9	8	-	2	19
1982	12	15	-	11	38
1983	22	22	-	4	48
1984	36	37	-	6	79
1985	54	56	1	11	122
1986	104	107	-	14	225
1987	84	85	-	25	194
1988	48	55	-	11	114
1989	34	39	-	9	82
1990	33	38	2	11	84
1991	38	46	4	7	95
1992*	21	25	5	4	55

Notes: * The 1992 figures only include the three first quarters.
As exemptions are also remissions, and a limited number of what are referred to as rebates, relieves and deferments, regarded. The ministerial orders have been assigned to the year they were published as Government Notices. Uncertain cases have been excluded.

Sources: Own calculations, based on Ministry of Justice (1992a-1992d).

Table A.13: Disbursements of Swedish Import Support to Tanzania, 1972/73-1991/92 (Million SEK)

YEAR	IMPORT SUPPORT											SIDA ASSISTANCE		IMPORT SUPPORT % OF	
	CIS* Tied (1)	CIS Untied (2)	CIS Total (3=1+2)	OGL* (Untied) (4)	TOTAL IMP SUP (5=3+4)	o/w Total Untied (6=2+4)	% of Total (7=6/5)	Tied % of Total (8=1/5)	BoP*Supp (Untied) (9)	TOTAL Less BoP (10=5-9)	OGL % of Total (11=4/5)	Country Frame (12)	Total SIDA (13)	Country Frame (14=5/12)	Total SIDA (15=5/13)
1972/73	-	4.000	4.000	-	**4.000**	4.000	100	-	-	4.000	-	95.438	96.308	**4.2**	**4.2**
1973/74	-	3.904	3.904	-	**3.904**	3.904	100	-	-	3.904	-	132.429	132.879	**2.9**	**2.9**
1974/75	-	22.523	22.523	-	**22.523**	22.523	100	-	-	22.523	-	199.892	201.731	**11.3**	**11.2**
1975/76	-	53.665	53.665	-	**53.665**	53.665	100	-	-	53.665	-	228.177	231.805	**23.5**	**23.2**
1976/77	-	63.901	63.901	-	**63.901**	63.901	100	-	-	63.901	-	274.330	278.480	**23.3**	**22.9**
1977/78	14.910	11.200	26.110	-	**26.110**	11.200	43	57	-	26.110	-	251.845	255.651	**10.4**	**10.2**
1978/79	37.652	31.140	68.792	-	**68.792**	31.140	45	55	-	68.792	-	315.980	325.451	**21.8**	**21.1**
1979/80	32.802	50.165	82.967	-	**82.967**	50.165	60	40	-	82.967	-	316.615	346.576	**26.2**	**23.9**
1980/81	31.980	34.772	66.752	-	**66.752**	34.772	52	48	-	66.752	-	304.163	313.006	**21.9**	**21.3**
1981/82	52.904	107.999	160.903	-	**160.903**	107.999	67	33	-	160.903	-	466.425	490.677	**34.5**	**32.8**
1982/83	103.135	49.433	152.468	-	**152.468**	49.433	32	68	-	152.468	-	409.967	425.738	**37.2**	**35.8**
1983/84	123.833	31.627	155.505	-	**155.505**	31.627	20	80	-	155.505	-	489.174	508.217	**31.8**	**30.6**
1984/85	138.591	26.669	165.260	-	**165.260**	26.669	16	84	-	165.260	-	482.083	506.211	**34.3**	**32.6**
1985/86	163.355	68.007	231.362	-	**231.362**	68.007	29	71	n.a.	n.a.	-	424.099	451.845	**54.6**	**51.2**
1986/87	131.881	99.936	231.817	-	**231.817**	99.936	43	57	n.a.	n.a.	-	480.680	517.706	**48.2**	**44.8**
1987/88	117.074	131.292	248.366	-	**248.366**	131.292	53	47	72.800	175.566	-	441.155	519.737	**56.3**	**47.8**
1988/89	126.585	172.528	299.113	-	**299.113**	172.528	58	42	115.600	183.513	-	483.369	551.054	**61.9**	**54.3**
1989/90	-	368.064	368.064	-	**368.064**	368.064	100	-	135.000	233.064	-	668.667	872.145	**55.0**	**42.2**
1990/91	-	223.829	223.829	32.138	**255.967**	255.967	100	-	68.540	187.427	12.6	533.675	723.785	**48.0**	**35.4**
1991/92	-	94.473	94.473	239.260	**333.733**	333.733	100	-	96.018	237.715	71.7	583.083	793.907	**57.2**	**42.0**

Notes: A dash (-) indicates the value zero (0).
* CIS = Commodity Import Support, OGL = Open General Licence, BoP = Balance of Payment.
Prior to 1989/90, Balance of Payment Support, which is mainly for debt relief, was administered by the Ministry of Foreign Affairs, but since then it is handled and registered by SIDA. It is not, however, included in SIDAs country frame, except for 65.000 million SEK in 1989/90. The low figure for OGL in 1990/91, and the high figure in 1991/92, is due to the fact that disbursements of OGL funds in 1991/92 included disbursements of the 1990/91 allocation. The allocation in 1990/91 was 123.000 million SEK, and in 1991/92 it was 175.000 million SEK. (Peterson, 1993, Appendices II & III.)

Sources: Own calculations, based on the following:
Commodity Import Support: (total tied and untied, but not otherwise specified) SIDA (1993d); except for 1991/92: SIDA (1993b), Table 32.
Open General Licence: Peterson (1993), Appendices II & III.
Balance of Payment Support: 1985/86-1986/87: Larsson (1990), p. 36 (BoP support for debt relief since 1985/86 to Tanzania amounted to 290.000 million SEK up to 1987/88.); and 1987/88-91/92: SIDA (1993b), Table 32.
SIDA Assistance: SIDA (1993c).

Table A.14: Major Recipients of Norwegian Commodity-Import-Support Allocations to Tanzania, 1981-1990* (Million NOK)

RECIPIENT	Type	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	Total	% of Total	Years
Tanz. Fertilizer Company (TFC)	Para	6.6	21.1	28.3	20.0	38.4	25.0	10.0	12.0	15.0	-	176.4	11.2	9
Tanz. Coffee Marketing Board	Para	12.0	30.0	27.7	20.6	24.5	15.0	14.0	10.0	10.0	-	163.8	10.4	9
TANELEC	Para	23.2	19.3	8.7	19.5	24.4	21.0	19.0	12.0	12.0	8.0	159.1	10.1	10
General Tyre (East Africa)	Para	-	5.9	10.0	10.0	10.0	18.0	12.0	10.0	10.0	-	85.9	5.4	8
Steel Rolling Mills	Para	8.0	-	5.0	2.0	2.0	12.0	7.0	7.0	-	-	43.0	2.7	7
Tanz. Petroleum Dev. Corp.	Para	-	-	-	-	-	-	-	-	40.0	-	40.0	2.5	1
Sao Hill Saw Mills	Para	3.9	4.8	3.0	4.1	3.6	5.0	4.4	5.0	5.0	3.0	38.8	2.5	10
GALCO (Aluminium Africa)	Para	-	-	-	-	-	4.0	7.0	6.0	15.0	-	32.0	2.0	4
Tang. Tegry Plastics	Para	-	6.9	2.0	-	3.3	4.0	3.0	3.0	5.0	-	27.2	1.7	7
Tang. Farmers Association	Priv	-	-	-	-	1.0	9.0	10.0	4.0	3.0	-	27.0	1.7	5
Steel Cast	Priv	-	-	-	-	3.0	7.0	3.0	3.0	10.0	-	26.0	1.6	5
A to Z Textile Mills	Priv	-	-	-	-	2.0	-	-	7.0	15.0	-	24.0	1.5	3
Tanz. Spring Ind. & Auto Parts	Priv	-	-	-	-	-	3.0	5.0	6.0	10.0	-	24.0	1.5	4
Ubungo Farm Implements (UFI)	Para	-	-	10.0	-	-	2.0	5.0	5.0	-	-	22.0	1.4	4
National Steel Company	Para	-	1.1	6.0	-	-	4.0	5.0	5.0	-	-	21.1	1.3	5
Polysacks Company	Para	-	-	2.0	1.1	-	4.0	-	4.0	9.0	-	20.1	1.3	5
Kibo Match Corporation	Para	-	-	-	-	-	-	-	5.0	15.0	-	20.0	1.3	2
Lube Oil Blending Plant (Agip)	Para	-	-	-	-	-	-	20.0	-	-	-	20.0	1.3	1
Amboni Plastics	Priv	-	1.0	-	-	-	-	0.7	8.0	9.5	-	19.2	1.2	4
Jeje Industries	Priv	-	-	-	-	-	-	-	3.0	15.0	-	18.0	1.1	2
Tanz. Oxygen (TOL)	Para	-	1.1	1.0	0.5	1.0	4.0	2.0	5.0	3.0	-	17.6	1.1	8
TACOSHILI	Para	3.1	3.1	3.0	-	-	1.3	2.0	1.6	3.0	3.0	17.1	1.1	8
Tanz. Bag Corporation	Para	-	-	-	3.0	10.0	4.0	-	-	-	-	17.0	1.1	3
Agri. & Ind. Supplies Company	Para	-	4.5	11.9	-	-	-	-	-	-	-	16.4	1.0	2
TANESCO	Para	1.8	2.1	1.5	3.0	4.8	-	-	3.0	-	-	16.2	1.0	6
Zanzibar Revolutionary Gov.t	Govt	-	-	-	-	-	4.0	5.0	6.0	-	-	15.0	1.0	3
G M Dewji & Company	Priv	-	-	-	-	-	2.0	2.2	5.0	5.0	-	14.2	0.9	4
Cooperative Union of Tanz.	Coop	-	-	-	-	-	-	4.0	5.0	5.0	-	14.0	0.9	3
Mbegani Fisheries Dev. Centre	Priv?	-	-	0.5	-	6.0	3.0	4.0	-	-	-	13.5	0.9	4
TEXCO	Para	-	-	2.5	-	1.5	4.5	-	5.0	-	-	13.5	0.9	4
TIPR, Crude Oil	Para	-	-	-	-	-	-	13.3	-	-	-	13.3	0.8	1
Anche-Mwedu	Priv	3.0	-	-	-	-	-	-	6.0	4.0	-	13.0	0.8	3
Azania Industries	Priv?	2.0	-	-	-	-	-	-	5.0	5.0	-	12.0	0.8	3
Vegetable Oil Ind. (VOIL)	Priv	-	-	-	-	-	2.0	-	3.0	7.0	-	12.0	0.8	3
Simba Plastics Company	Priv	4.0	-	-	-	-	4.0	3.0	-	-	-	11.0	0.7	3
Vacu-lug Traction Tyres (T)	Priv?	0.4	1.3	1.0	1.0	1.0	4.0	2.0	-	-	-	10.7	0.7	7
Keko Pharmaceutical Industries	Para	-	2.0	2.0	-	-	3.0	-	3.0	-	-	10.0	0.6	4
Min. of Agricult. & Livestock	Govt	5.0	2.0	3.0	-	-	-	-	-	-	-	10.0	0.6	3
SUB-TOTAL (38 recipients)		73.0	106.2	129.1	84.8	136.5	165.8	162.6	162.6	230.5	14.0	1,254.1	79.5	
- o/w PARASTATALS (22)		58.6	101.9	124.6	83.8	123.5	127.8	123.7	101.6	142.0	14.0	1,001.5	64.3	
TOTAL COMMODITY IMPORT SUPPORT:		**86.8**	**148.2**	**159.0**	**94.8**	**158.7**	**233.5**	**204.1**	**219.2**	**259.5**	**14.0**	**1,557.8**	**100.0**	
Sub-Total/Total (%)		**84.1**	**71.7**	**81.2**	**89.5**	**86.0**	**71.0**	**79.7**	**74.2**	**88.8**	**100.0**	**79.5**		
Parastatal/Sub-Total (%)		**80.3**	**96.0**	**96.5**	**98.8**	**90.5**	**77.1**	**76.1**	**62.5**	**61.6**	**100.0**	**79.9**		
Parastatal/Total (%)		**67.5**	**68.8**	**78.4**	**88.4**	**77.8**	**54.7**	**60.6**	**46.4**	**54.7**	**100.0**	**64.3**		

Note: * Receiving 10 million NOK or more during the whole period. Sources: Calculations based on NORAD (1990) (data for 1981-1989) and NORAD (1991).

Table A.15: Major Recipients of Swedish Commodity Import Support to Tanzania, 1980/81-1991/92* (Million SEK)

RECIPIENT		No. of	CIS[&]	CIS[&]	Disb/All	CASH COVER PAYMENTS[&]			
Name	Type	Years	Allocat.	Disburs.	(%)	TS & Co	% of Disb	Treasury	% of Disb
Tanz Automob. Manuf. Co[P]	Para.								
80/81			n.a.						
81/82			likely						
82/83			likely						
83/84			25.990**						
84/85			36.000						
85/86			35.300						
86/87			38.900						
87/88			38.000						
A: Sum 80/81-87/88		**7**	**>/=174.190**						
88/89			43.500	40.418	92.9%	37.022	91.6%	37.021	91.6%
89/90			37.000	34.901	94.3%	11.385	32.6%	28.278	81.0%
90/91			26.500	24.904	94.0%	3.992	16.0%	3.991	16.0%
91/92			0.0	0.0	-	0.0	-	0.0	-
B: Sum 88/89-91/92		**3**	**107.000**	**100.223**	**93.7%**	**52.400**	**52.3%**	**69.290**	**69.1%**
A+B: 80/81-91/92		**10**	**>/=281.190**						
Tanz. Fertilizer Co.	Para.								
80/81			n.a.						
81/82			n.a.						
82/83			n.a.						
83/84			9.000						
84/85			48.000						
85/86			25.000						
86/87			28.700						
87/88			24.000						
A: Sum 80/81-87/88		**5**	**>/=134.700**						
88/89			30.000	30.000	100.0%	0.0	0.0%	0.0	0.0%
89/90			30.000	28.543	95.1%	0.0	0.0%	0.0	0.0%
90/91			0.0	0.0	-	0.0	-	0.0	-
91/92			0.0	0.0	-	0.0	-	0.0	-
B: Sum 88/89-91/92		**2**	**60.000**	**58.543**	**97.6%**	**0.0**	**0.0%**	**0.0**	**0.0%**
A+B: 80/81-91/92		**7**	**>/=194.700**						
Tanz Posts & Telecom.[P]	Para.								
80/81			>/=9.073[a]	9.073	100.0%				
81/82			9.300						
82/83			2.300	2.300	100.0%				
83/84			13.000						
84/85			10.000						
85/86			13.000						
86/87			13.000						
87/88			15.000						
A: Sum 80/81-87/88		**8**	**>/=84.673**						
88/89			15.000	15.000	100.0%	22.671	151.1%	22.671	151.1%
89/90			18.100	11.995	66.3%	n.a.	n.a.	0.0	0.0%
90/91			15.000	18.302	122.0%	14.594	79.7%	14.594	79.7%
91/92			0.0	2.987	-[a,d]	0.0	0.0%	0.0	0.0%
B: Sum 88/89-91/92		**3**	**48.100**	**48.244**	**100.3%**	**>/=37.265**	**>/=77.2%**	**37.265**	**77.2%**
A+B: 80/81-91/92		**11**	**>/=132.773**						
Tanz Portland Cement Co[P]	Para.[$]								
80/81			n.a.						
81/82			likely						
82/83			n.a.						
83/84			1.000						
84/85			10.000						
85/86			15.000						
86/87			25.000						
87/88			16.000						
A: Sum 80/81-87/88		**6**	**>/=67.000**						
88/89			16.000	16.000	100.0%	0.0	0.0%	5.804	36.3%
89/90			14.000	14.902	106.4%	n.a.	n.a.	13.800	92.6%
90/91			8.000	7.745	96.8%	8.000	103.3%	4.300	55.5%
91/92			4.000	4.818	120.5%	0.731	15.2%	0.900	18.7%
B: Sum 88/89-91/92		**4**	**42.000**	**43.465**	**103.5%**	**>/=8.731**	**>/=20.1%**	**24.804**	**57.1%**
A+B: 80/81-91/92		**10**	**>/=109.000**						

to be continued...

RECIPIENT		No. of	CIS	CIS	Disb/All	CASH COVER PAYMENTS			
Name	Type	Years	Allocat.	Disburs.	(%)	TS & Co	% of Disb	Treasury	% of Disb
Small Ind. Develop. Org[P]	Priv.[$$]								
80/81			n.a.						
81/82			6.000						
82/83			n.a.						
83/84			10.000						
84/85			10.000						
85/86			11.000						
86/87			14.700						
87/88			10.000						
A: Sum 80/81-87/88		**6**	**>/=61.700**						
88/89			10.000	7.165	71.7%	1.975	27.6%	1.994	27.8%
89/90			11.000	7.138	64.9%	3.514	49.2%	3.163	44.3%
90/91			10.000	6.643	66.4%	1.427	21.5%	1.356	20.4%
91/92			5.000	6.223	124.5%	1.276	20.5%	0.726	11.7%
B: Sum 88/89-91/92		**4**	**36.000**	**27.169**	**75.5%**	**8.192**	**30.2%**	**7.239**	**26.6%**
A+B: 80/81-91/92		**10**	**>/=97.700**						
Tanz Coffee Market Board	Para.								
80/81			n.a.						
81/82			n.a.						
82/83			n.a.						
83/84			18.000						
84/85			15.000						
85/86			-						
86/87			-						
87/88			-						
A: Sum 80/81-87/88		**2**	**>/=33.000**						
88/89			15.000	14.627	97.5%	5.083	34.8%	5.082	34.7%
89/90			20.000	18.809	94.0%	4.964	26.4%	4.963	26.4%
90/91			0.0	0.0	-	0.0	-	0.0	-
91/92			0.0	0.0	-	0.0	-	0.0	-
B: Sum 88/89-91/92		**2**	**35.000**	**33.436**	**95.5%**	**10.047**	**30.0%**	**10.045**	**30.0%**
A+B: 80/81-91/92		**4**	**>/=68.000**						
SAAB Scania[P]	Priv.								
80/81			n.a.						
81/82			>/=20.000						
82/83			likely						
83/84			28.010**						
84/85			16.300						
85/86			30.000						
86/87			6.000						
87/88			13.000						
A: Sum 80/81-87/88		**7**	**>/=113.310**						
88/89			13.000	13.000	100.0%	12.930	99.5%	12.930	99.5%
89/90			10.000	10.462	104.6%	14.705	140.6%	14.705	140.6%
90/91			5.000	4.800	96.0%	4.914	102.4%	4.913	102.4%
91/92			0.0	0.0	-	0.0	-	0.0	-
B: Sum 88/89-91/92		**3**	**28.000**	**28.261**	**100.9%**	**32.549**	**115.2%**	**32.548**	**115.2%**
A+B: 80/81-91/92		**10**	**>/=141.310**						
Zanzibar Government	Govt.								
80/81			n.a.						
81/82			n.a.						
82/83			n.a.						
83/84			-						
84/85			-						
85/86			-						
86/87			-						
87/88			3.000						
A: Sum 80/81-87/88		**1**	**>/=3.000**						
88/89			5.000	2.181	43.6%	0.0	0.0%	0.0	0.0%
89/90			1.900	0.999	52.6%	0.0	0.0%	0.0	0.0%
90/91			10.000	8.655	86.6%	9.400	108.6%	9.242	106.8%
91/92			10.000	9.953	99.5%	9.825	98.7%	9.824	98.7%
B: Sum 88/89-91/92		**4**	**26.900**	**21.788**	**81.0%**	**19.225**	**88.2%**	**19.066**	**87.5%**
A+B: 80/81-91/92		**5**	**>/=29.900**						

to be continued...

RECIPIENT		No. of	CIS	CIS	Disb/All	CASH COVER PAYMENTS			
Name	Type	Years	Allocat.	Disburs.	(%)	TS & Co	% of Disb	Treasury	% of Disb
Tanz. Investment Bank[P]	Para.								
80/81			n.a.						
81/82			n.a.						
82/83			n.a.						
83/84			-						
84/85			-						
85/86			-						
86/87			-						
87/88			-						
A: Sum 80/81-87/88		**0**	**>/=0.0**						
88/89			0.0	0.911	-@@	0.0	0.0%	0.0	0.0%
89/90			25.000	5.116	20.5%	0.0	0.0%	0.0	0.0%
90/91			0.0	4.476	-@@	0.0	0.0%	0.0	0.0%
91/92			0.0	1.495	-@@	0.0	0.0%	0.0	0.0%
B: Sum 88/89-91/92		**1**	**25.000**	**11.998**	**48.0%**	**0.0**	**0.0%**	**0.0**	**0.0%**
A+B: 80/81-91/92		**1**	**>/=25.000**						
Metal Ind. Devel. Ass.[P]	Priv.								
80/81			n.a.						
81/82			n.a.						
82/83			n.a.						
83/84			2.375						
84/85			3.000						
85/86			3.000						
86/87			4.800						
87/88			6.500						
A: Sum 80/81-87/88		**5**	**>/=19.675**						
88/89			7.300	6.136	84.1%	5.829	95.0%	8.350	136.1%
89/90			5.000	6.164	123.3%	n.a.	n.a.	4.900	79.5%
90/91			5.500	6.303	114.6%	4.509	71.5%	4.791	76.0%
91/92			2.500	3.173	126.9%	1.852	58.4%	1.852	58.4%
B: Sum 88/89-91/92		**4**	**20.300**	**21.775**	**107.3%**	**>/=12.190**	**>/=56.0%**	**19.893**	**91.4%**
A+B: 80/81-91/92		**9**	**>/=39.975**						
Aluminium Africa Ltd.	Para.								
80/81			n.a.						
81/82			n.a.						
82/83			n.a.						
83/84			-						
84/85			-						
85/86			-						
86/87			-						
87/88			-						
A: Sum 80/81-87/88		**0**	**>/=0.0**						
88/89			0.0	0.0	-	0.0	-	0.0	-
89/90			18.000	16.516	91.8%	4.647	28.1%	13.119	79.4%
90/91			0.0	0.0	-	0.0	-	0.0	-
91/92			0.0	0.0	-	0.0	-	0.0	-
B: Sum 88/89-91/92		**1**	**18.000**	**16.516**	**91.8%**	**4.647**	**28.1%**	**13.119**	**79.4%**
A+B: 80/81-91/92		**1**	**>/=18.000**						
Board of External Trade[P]	Para.								
80/81			n.a.						
81/82			n.a.						
82/83			n.a.						
83/84			5.000						
84/85			-						
85/86			4.500						
86/87			3.000						
87/88			6.500						
A: Sum 80/81-87/88		**4**	**>/=19.000**						
88/89			4.100	4.100	100.0%	3.680	89.8%	3.679	89.7%
89/90			6.000	4.282	71.4%	n.a.	n.a.	0.0	0.0%
90/91			3.000	6.049	201.6%	0.121	2.0%	0.593	9.8%
91/92			2.000	1.840	92.0%	0.330	17.9%	0.328	17.8%
B: Sum 88/89-91/92		**4**	**15.100**	**16.271**	**107.8%**	**>/=4.131**	**>/=25.4%**	**4.600**	**28.3%**
A+B: 80/81-91/92		**8**	**>/=34.100**						

to be continued...

RECIPIENT Name	Type	No. of Years	CIS Allocat.	CIS Disburs.	Disb/All (%)	CASH COVER PAYMENTS TS & Co	% of Disb	Treasury	% of Disb
Tanz Karatasi Ass. Ind.[P]	Para.								
80/81			n.a.						
81/82			n.a.						
82/83			n.a.						
83/84			-						
84/85			3.500						
85/86			9.500						
86/87			12.000						
87/88			8.000						
A: Sum 80/81-87/88		**4**	**>/=33.000**						
88/89			5.000	5.000	100.0%	0.0	0.0%	0.0	0.0%
89/90			10.000	9.382	93.8%	n.a.	n.a.	0.0	0.0%
90/91			0.0	0.0	-	0.0	-	0.0	-
91/92			0.0	0.0	-	0.0	-	0.0	-
B: Sum 88/89-91/92		**2**	**15.000**	**14.382**	**95.9%**	**>/=0.0**	**>/=0.0%**	**0.0**	**0.0%**
A+B: 80/81-91/92		**6**	**>/=48.000**						
DM Investments	Priv.								
80/81			n.a.						
81/82			n.a.						
82/83			n.a.						
83/84			-						
84/85			-						
85/86			-						
86/87			-						
87/88			-						
A: Sum 80/81-87/88		**0**	**>/=0.0**						
88/89			0.0	0.0	-	0.0	-	0.0	-
89/90			4.200	4.096	97.5%	n.a.	n.a.	0.796	19.4%
90/91			10.000	10.000	100.0%	0.101	1.0%	0.0	0.0%
91/92			0.0	0.0	-	0.0	-	0.0	-
B: Sum 88/89-91/92		**2**	**14.200**	**14.096**	**99.3%**	**>/=0.101**	**>/=0.7%**	**0.796**	**5.6%**
A+B: 80/81-91/92		**2**	**>/=14.200**						
Zana za Kilimo (Mbeya)[P]	Para.								
80/81			n.a.						
81/82			n.a.						
82/83			n.a.						
83/84			4.375						
84/85			4.000						
85/86			5.000						
86/87			3.500						
87/88			3.900						
A: Sum 80/81-87/88		**5**	**>/=20.775**						
88/89			4.000	4.000	100.0%	0.0	0.0%	0.0	0.0%
89/90			9.000	9.000	100.0%	n.a.	n.a.	0.0	0.0%
90/91			0.0	0.0	-	0.0	-	0.0	-
91/92			0.0	0.0	-	0.0	-	0.0	-
B: Sum 88/89-91/92		**2**	**13.000**	**13.000**	**100.0%**	**>/=0.0**	**>/=0.0%**	**0.0**	**0.0%**
A+B: 80/81-91-92		**7**	**>/=33.775**						
National Steel Corp.	Para.								
80/81			n.a.						
81/82			n.a.						
82/83			n.a.						
83/84			-						
84/85			-						
85/86			-						
86/87			-						
87/88			-						
A: Sum 80/81-87/88		**0**	**>/=0.0**						
88/89			0.0	0.0	-	0.0	-	0.0	-
89/90			12.000	9.539	79.5%	3.110	32.6%	9.000	94.3%
90/91			0.0	0.0	-	0.0	-	0.0	-
91/92			0.0	0.0	-	0.0	-	0.0	-
B: Sum 88/89-91/92		**1**	**12.000**	**9.539**	**79.5%**	**3.110**	**32.6%**	**9.000**	**94.3%**
A+B: 80/81-91/92		**1**	**>/=12.000**						

to be continued...

	CIS Allocat.	CIS Disburs.	Disb/All (%)	CASH COVER PAYMENTS TS & Co	% of Disb	Treasury	% of Disb
SUB-TOTAL							
A: Sum 80/81-87/88	**>/=764.023**						
88/89	167.900	158.538	94.4%	89.190	56.3%	97.531	61.5%
89/90	231.200	191.844	83.0%	42.325	22.1%	92.724	48.3%
90/91	93.000	97.877	105.2%	47.058	48.1%	43.780	44.7%
91/92	23.500	30.489	129.7%	14.014	46.0%	13.630	44.7%
B: Sum 88/89-91/92	**515.600**	**478.706**	**92.8%**	**>/=192.588**	**>/=40.2%**	**247.665**	**51.7%**
A+B: 80/81-91/92	**>/=1,279.623**						
o/w PARASTATALS#							
A: Sum 80/81-87/88	**>/=569.338**						
88/89	137.600	132.237	96.1%	68.456	51.8%	74.257	56.2%
89/90	201.000	163.984	81.6%	24.106	14.7%	69.160	42.2%
90/91	62.500	70.131	112.2%	36.107	51.5%	32.720	46.7%
91/92	16.000	21.093	131.8%	10.886	51.6%	11.052	52.4%
B: Sum 88/89-91/92	**417.100**	**387.405**	**92.9%**	**>/=139.556**	**>/=36.0%**	**187.189**	**48.3%**
A+B: 80/81-91/92	**>/=986.438**						
GRAND TOTAL£							
80/81	122.840	66.455	54.1%				
81/82	143.980	160.900	111.8%				
82/83	113.400	152.000	134.0%				
83/84	162.000	191.100	118.0%				
84/85	181.900	185.000	101.7%				
85/86	190.500	176.000	92.4%				
86/87	247.500	231.817££	93.7%				
87/88	181.550	248.366££	136.8%				
A: Sum 80/81-87/88	**1,343.670**	**1,411.638**	**105.1%**				
88/89	212.300+	179.042	84.3%	100.753	56.3%	105.860	59.1%
89/90	290.500+	231.588	79.7%	58.872	25.4%	119.821	51.7%
90/91	105.942	110.663	104.5%	48.662	44.0%	44.558	40.3%
91/92	25.000	30.988	124.0%	14.156	45.7%	13.717	44.3%
B: Sum 88/89-91/92	**633.742**	**552.280**	**87.1%**	**>/=222.443**	**>/=40.3%**	**283.956**	**51.4%**
A+B: 80/81-91/92	**1,977.412**	**1,963.918**	**99.3%**				
Sub-Total/Grand Total (%)							
A: 80/81-87/88	**>/=56.9%**						
88/89	79.1%						
89/90	79.6%						
90/91	87.8%						
91/92	94.0%						
B: 88/89-91/92	**81.4%**	**86.7%**		**86.6%&&**		**87.2%**	
Parastatals/Sub-Total (%)							
A: 80/81-87/88	**74.5%&&**						
88/89	82.0%						
89/90	86.9%						
90/91	67.2%						
91/92	68.1%						
B: 88/89-91/92	**80.9%**	**80.9%**		**72.5%&&**		**75.6%**	
Parastatals/Grand Total (%)							
A: 80/81-87/88	**>/=42.4%**						
88/89	64.8%						
89/90	69.2%						
90/91	59.0%						
91/92	64.0%						
B: 88/89-91/92	**65.8%**	**70.1%**		**62.7%&&**		**65.9%**	

to be continued...

Notes: Data on cash-cover payments and disaggregated disbursements prior to 1988/89 are generally lacking. Hence, the emply spaces indicate that data are unavailable. Allocations prior to 1983/84 make it difficult to identify the individual recipients.
& CIS = commodity import support. Allocat. = amount allocated (approved) by SIDA. Disburs. = amount actually disbursed. TS & Co. = Tanna Somaiya and Company. Cash-cover payment data emanate from both TS & Co. and the Treasury, but the two sources differ.
* Receiving 12 million SEK or more (allocated commodity import support) during 1988/89-1991/92.
P SIDA projects or recipients otherwise related to/supported by SIDA.
** Of 52.980 million SEK allocated to TAMCO and SAAB Scania together, 50 per cent has been ascribed to each recipient here. An additional 2.020 million SEK was allocated to SAAB Scania.
@ Assuming that the allocated amount is larger than or equivalent to the amount disbursed.
@@ Quota (percentage) not possible to calculate.
$ 50 per cent privately owned since January 1992.
$$ SIDO is a parastatal, but distributes a majority of the funds (about 90 per cent of both the allocated and the disbursed CIS) to private recipients.
Including a Government recipient.
£ The figures on the amounts allocated in 1980/81-87/88 are calculated so as to correspond as closely as possible to the total amounts allocated (according to government agreement and reallocated from other uses) less the so-called reservations of undisbursed funds from previous years.
££ Source: Table A.13, Column 3.
+ These figures exclude a total allocated amount of project-related CIS of 191.150 million SEK for the two years together. (Embassy of Sweden, 1993a, pp. 1-2.)
&& These ratios are particularly uncertain, since both the numerator and the denominator are uncertain.

Sources: Own calculations based on the following:
1980/81-85/86: Eriksson (1987), Tables 6-16, based on SIDA data.
1986/87-87/88: Interconsult Sweden (1988).
1988/89-91/92: Embassy of Sweden (1993b).

Table A.16: Statement of Number of Government Guarantees in Tanzania, Issued for Liabilities in the 1980s, as at 30th June, 1992

Parastatal	Year for Guarantee	Tot.	Number of Guarantees	Tot.	Lender
Air Tanzania Corporation	1980	4	1	5	Foreign
	1987		1		NBC*
	1988		1		NBC
	1989		2		NBC
Kimamba Sisal Estates**	1985	1	1	1	NBC
Mombo Sisal Estates**	1985	1	1	1	NBC
Morogoro Shoe Company	1988	1	1	1	NBC
Muheza Sisal Estates**	1985	1	1	1	NBC
Musoma Textiles	1986	2	1	2	Foreign
	1987		1		NBC
National Pharmaceutical Company	1988	1	1	1	NBC
Ngombezi Sisal Estates**	1985	1	1	1	NBC
Nyanza Salt Mines	1988	1	1	1	NBC
State Motor Corporation	1988	1	1	1	NBC
Tanganyika Packers	1985	3	1	3	NBC
	1986		1		NBC
	1988		1		NBC
Tanzania Packages Manufacturers	1988	1	1	1	NBC
Tanzania Railways Corporation	1980	3	3	11	NBC (1)
					Foreign (2)
	1987		4		NBC
	1988		4		NBC
Tanzania Shoe Company	1988	1	1	1	NBC
Tanzania Sisal Authority	1982	1	1	1	NBC
Capital Development Authority	1980	1	3	3	Foreign
Small Industries Organization	1980	2	1	2	Foreign
	1981		1		Foreign
Southern Paper Mills	1982	1	1	1	Foreign
State Mining Corporation	1980	1	1	1	Foreign
Tanzania Cashewnut Marketing Board	1983	1	3	3	Foreign
Tanzania Electrical Supplies	1980	6	5	13	Foreign
	1981		2		Foreign
	1983		1		Foreign
	1984		1		Foreign
	1985		3		Foreign
	1986		1		Foreign
Tanzania Harbours Authority	1981	3	1	3	Foreign
	1983		1		Foreign
	1985		1		Foreign
Tanzania Investment Bank	1981	1	1	1	Foreign
Tanzania Leather Associated Industries	1982	1	1	1	Foreign
Tanzania Petroleum Development Corporation	1985	2	1	2	Foreign
	1986		1		Foreign
Tanzania Posts and Telecommunications	1983	2	3	4	Foreign
	1987		1		Foreign
Tanzania Saruji Corporation	1980	3	3	6	Foreign
	1984		1		Foreign
	1985		2		Foreign

Total number of parastatals:	27
Total number of guarantees:	72
- o/w NBC liabilities:	28
- o/w foreign liabilities:	44
Average number of guarantees:	2.7
Parastatals with NBC guarantees:	15
Parastatals with foreign guarantees:	15
Parastatals with > 1 guarantee:	12
Guarantees from 1980-1984:	35 (mostly for foreign liabilities)
-"- 1985-1989:	37 (mostly for liabilities to the NBC)

Note: * NBC = National Bank of Commerce.
** Subsidiary companies to the Tanzania Sisal Authority.

Source: Own calculations based on the Ministry of Finance (1992b).

Table A.17: Statement of Value of Government Guarantees in Tanzania, Issued for Liabilities in the 1980s, as at 30th June, 1992 (Million, Different Currencies)

Parastatal	Original Amount TSh	Original Amount USD	Original Amount Other	Liability TSh	Liability USD	Liability Other	Paid (%)
Air Tanzania Corp	406	26		11,020 (incl other liab)			0*
Morogoro Shoe Co	90			LART**			?/little
Musoma Textiles	25		DM 15	LART (all liab)			?/little
			FFR 87				
			BFR 246				
Nat Pharmaceutical Co			£ 1	1,123			?
Nyanza Salt Mines	50			41			18
State Motor Corp	3,244			925			**71**
Tanganyika Packers	171			LART			?/little
Tanz Packages Manufact	45			LART			?/little
Tanz Railways Corp	303		£ 1,809	934 (incl all liab)			?
			ASH 20				
			SEK 35				
Tanzania Shoe Co	160			LART			?/little
Tanz Sisal Authority	69			19			**72**
- 4 Subsidiaries***	29			32			0
Capital Devel Author		6			6		0
			ASH 170			ASH 170	0
Small Industries Org		1			1		0
Southern Paper Mills		8			10		0
State Mining Corp			SEK 3			SEK 3	0
Tanz Cashewnut Mark Board		4			3		7@
Tanz Electrical Supplies		158			119		25
			DM 54			DM 43	19
			FFR 31			FFR 31	0
			SDR < 1			SDR < 1	**73**
			JY 1,600			JY 1,593	< 1
			FM 50			FM 39	22
			KD@@ 4			KD 2	**49**
			UA# 13			UA 11	14
Tanz Harbours Author			SDR 26			SDR 24	8
			KD 2			KD 2	0
			DFL 2			DFL < 1	**88**
Tanz Investment Bank			UA 5			UA 5	0
Tanz Leather Assoc Indust			ECU 3			ECU 1	**51**
Tanz Petroleum Devel Corp		22			4		**81**
Tanz Posts and Telecom			SDR 40			SDR 16	**61**
			JY 5,504			JY 8,491	0
Tanz Saruji Corp			BFR 1,461			BFR 1,419	3

Total TSh guaranteed (million):##	4,592
Total USD guaranteed (million):	225
Total BFR guaranteed (million):	1,707
Total £ guaranteed (million):	1,810
Total JY guaranteed (million):	7,104

Notes:

* My own calculation, where the official exchange rate for USD and a proxy for DFL were used for the foreign currency amounts, suggest that the total outstanding liability exceeds the original guaranteed amounts with a broad margin, which makes me conclude that none of the original debts has been serviced.

** All the parastatal's liabilities were (or were to be) transferred to the Loans and Advances Realisation Trust (LART).

Bold Numbers: 8 out of totally 72 guaranteed loans (i.e. 11 per cent) were repaid by approximately 50 per cent or more.

*** The Kimamba, Mombo, Muheza and Ngombezi Sisal Estates.

@ The percentage of the liability that has been paid or otherwise reduced prior to the 30th of June, 1992, has been calculated on the basis of the actual figures and not the round figures in the table.

@@ Currency for liabilities to Kuwait.

\# Currency for liabilities to the African Development Bank.

These totals are sums of the round figures in the table.

Source: Own calculations based on the Ministry of Finance (1992b).

Table A.18: National Bank of Commerce Non-Government Lending by Economic Sector, 1984-1992, (Million TSh)

End of:	June 1984	June 1985	June 1986	June 1987	June 1988	June 1989	June 1990	June 1991	June 1992
AGRICULTURE	**6,035**	**8,887#**	**10,700**	**19,400**	**38,595**	**52,562**	**63,396**	**66,699**	**58,955**
% Change	n.a.	47	20	81	99	36	21	5	-12
% of Total	66	67	64	69	69	62	60	50	48
Parastatal##	**5,916**	**8,772#**	**10,517**	**18,936**	**37,519**	**50,646**	**59,929**	**61,569**	**51,119**
% Change	n.a.	48	20	80	98	35	18	3	-17
% of Agric.	98	99	98	98	97	96	95	92	87
Market Board	5,493	7,766	7,017	10,771	24,017	19,261	22,384	22,495	3,671
% Change	n.a.	41	-10	53	123	-20	16	5	-84
MNC	1,919	2,745	2,739	4,106	10,445	15,305	15,230	17,722*	n.a.
% Change	n.a.	43	0	50	154	47	0	16	n.a.
Co-operatives	-	466	2,466	6,150	11,004	15,813	21,738	23,479	32,512
% Change	-	-	429	149	79	44	37	8	38
Private	**119**	**115**	**183**	**464**	**1,075**	**1,916**	**3,467**	**5,129**	**7,835**
% Change	n.a.	-3	59	154	132	78	81	48	53
COMMERCE	**1,751**	**2,178**	**3,029**	**3,412**	**6,694**	**11,129**	**15,469**	**22,739**	**30,837**
% Change	n.a.	24	39	13	96	66	39	47	36
% of Total	19	17	18	12	12	13	15	17	25
Parastatal	**1,207**	**1,109**	**1,548**	**1,912**	**4,489**	**6,704**	**8,001**	**10,100**	**14,216**
% Change	n.a.	-8	40	24	135	49	19	26	41
% of Commerc.	69	51	51	56	67	60	52	44	46
Private	**544**	**1,070**	**1,481**	**1,500**	**2,205**	**4,425**	**7,468**	**12,639**	**16,621**
% Change	n.a.	97	38	1	47	101	69	69	32
INDUSTRY	**1,309**	**2,106**	**2,912**	**5,489**	**10,546**	**21,028**	**27,639**	**44,533**	**33,730****
% Change	n.a.	61	38	88	92	99	31	61	-24
% of Total	14	16	18	19	19	25	26	33	27
Parastatal	**746**	**1,024**	**1,414**	**3,034**	**5,723**	**10,049**	**14,331**	**26,767**	**11,985**
% Change	n.a.	37	38	115	89	76	43	87	-55
% of Indust.	57	49	49	55	54	48	52	60	36
Private	**563**	**1,083**	**1,498**	**2,455**	**4,823**	**10,980**	**13,308**	**17,766**	**21,745**
% Change	n.a.	92	38	64	96	128	21	33	22
TOTAL	**9,095**	**13,173**	**16,641**	**28,301**	**55,834**	**84,720**	**106,504**	**133,970**	**123,521****
% Change	n.a.	45	26	70	97	52	26	26	-8
Total PARASTATAL	**7,869**	**10,905**	**13,479**	**23,882**	**47,731**	**67,399**	**82,261**	**98,436**	**77,320**
% Change	n.a.	39	24	77	100	41	22	20	-21
Parastatal/Total	**87**	**83**	**81**	**84**	**85**	**80**	**77**	**73**	**63**
Agri Para/Total	65	67	63	67	67	60	56	46	41
Mark Board/Total	60	59	42	38	43	23	21	17	3
NMC/Total	21	21	16	15	19	18	14	13	n.a.
Co-ops/Total	0	4	15	22	20	19	20	18	26
Comm Para/Total	13	8	9	7	8	8	8	8	12
Ind Para/Total	8	8	8	11	10	12	13	20	10
Total PRIVATE	**1,226**	**2,268**	**3,162**	**4,419**	**8,103**	**17,321**	**24,243**	**35,534**	**46,201**
% Change	n.a.	85	40	40	83	114	40	47	30
Private/Total	**13**	**17**	**19**	**16**	**15**	**20**	**23**	**27**	**37**

Notes: The totals may differ from the sums of the individual figures, due to rounding errors.
* March 1991.
** Figure corrected due to what appears to be a counting or printing error.
\# Adjusted (due to counting error) according to the Bank of Tanzania (1991b), Table 2.16.
Including co-operatives.

Source: Own calculations based on Bank of Tanzania (1990d), updated by its officials in 1991 and 1992.

Table A.19: Repayment Record of Commodity-Import-Support Recipients in Tanzania, 1987/88-1992/93

	CIS# DONORS				CIS RECIPIENTS		
	SWEDEN	NORWAY	NETHER	TOTAL	GOVERN.*	PARAST.	PRIV.
(A) Total Number of Recipients**	95	57	72	269##	15	91	163
(B) With Allocations in One Year Only	32	24	45	95	3	30	62
- % of (A)	34%	42%	63%	35%	20%	33%	38%
(C) With Renewed CIS (A-B):	63	33	27	174	12	61	101
- % of (A)	66%	58%	38%	65%	80%	67%	62%
(D) With No Cash Cover Payment Default	15	15	3	18	2	7	9
- % of (A)	16%	26%	4%	7%	13%	8%	6%
(E) Paid No Cash Cover at All	21	8	32	52	7	21	24
- % of (A)	22%	14%	44%	19%	47%	23%	15%
(F) Renewed CIS Despite Prev Default	54	19	27	150	11	56	83
- % of (C)	86%	58%	100%	86%	92%	92%	82%

Notes: * Government Ministries and Departments
** One parastatal and 16 private firms of the recipients studied by the Treasury have been disregarded here, since they were only allocated CIS, but appear, for one reason or another, never to have utilised any of the funds.
# CIS = Commodity Import Support.
The number of recipients of CIS from the three donors does not add up to the total number, since recipients of CIS from other donors also are included, and since some of the recipients got CIS from several donors.

Source: Own calculations, based on Ministry of Finance (1993), Appendices 3a-3c.

Table A.20: Closure and Sale of Parastatals in Tanzania during the Reform Period

	Parastatal	Year	Measure	Status:
	1983-1985:			
1	Zambia Tanzania Road Services (ZTRS)	1983 or 84	Dissolved/Liquidated	
2	Tanzania Crown Corcs	1984	Sold to priv/Accessed by para	
3	East African Tractor Assembly	1984	Sold to priv/Accessed by para	
4	Tanzania Motor Services Co.	1984	Sold to priv/Accessed by para	
5	General Foods Co. (GEFCO)	1984	Merged with parastatal (BCS)	
6	Tanzania Motor Corporation	1984	Sold to priv/Accessed by para	
7	Tanz. Livestock Marketing (KABIMITA)	1984	Dissolved/Liquidated	
8	Ridoch Motors	1984	Sold to priv/Accessed by para	
9	Biashara Transport Co. (BITCO)	1984	Dissolved/Liquidated	
10	Tanz. Livestock Devel. Authority (LIDA)	1984	Sold to priv/Accessed by para**	
11	National Cold Chain Operations (NCCO)	1984	Dissolved/Liquidated	
12	Domestic Appliances & Bicycles (DABCO)	1985	Dissolved/Liquidated	
13	Tanzania Timbers Marketing (TANTIMBERS)	1985	Dissolved/Liquidated	
14	Tanzania Overseas Shipping Co. (TOSCO)	1983-1988	Dissolved/Liquidated	
	1986-1989:			
1	Coastal Hotels	1986	Dissolved/Liquidated	
2	General Agric. Products Export (GAPEX)	1986	Dissolved/Liquidated	
3	Tanganyika Coffee Curing Co.	1986/87	Transf. to TCGA, priv & KNCU, coop	
	Sisal farms under Tanz. Sisal Authority:			
4	Kwa Shemshi Sisal Estate	1986	Sold	
5	Bombuera Sisal Estate	1986	Sold	
6	Kwamgwe Sisal Estate	1986	Sold	
7	Kwafungo Sisal Estate	1986	Sold	
8	Aldina Sisal Estate	1986	Sold	
9	Kisangata Sisal Estate	1986	Sold	
10	An additional one	1986-1987	Sold to private	
11	Mombo Sisal Estates Co.	1988	Sold to private	
12	Ngombezi Sisal Estates Co.	1988	Sold to private	
13	Kimamba Sisal Estates Co.	1988	Sold to private	
14	Muheza Sisal Estates	1988	Sold to private	
15	Morogoro Sisal Estates Co.	1988	Sold to private	
	Under Tanzania Tea Authority:			
16	East Usambara Tea Company	1988/89	JV:[££] 60% private	
17	Mufindi Tea Company	1988/89	JV: 75% private	
18	Tanzania Agric. Research Org. (TARO)*	1989	Into Govt Department	
19	Mang'ula Saw Mills	1984-1991	Dissolved	
20	Kilwa Saw Mills	1984-1991	Dissolved	
	1990s:			
1	Tanz. Livestock Research Org. (TALIRO)*	1990	Into Govt Department	
	Farms under National Food Company:			
2	Hanang/Villa Estate	1990	Sold	
3	Sino	1990	Sold	
4	TANSCAN	1990	JV: 49% private (minority)	
5	Pamba Engineering Ltd.	1990	51% private	
6	Kamata Bus Services	1990	Merged with para (UDA)	
7	Tanzania Portland Cement Co. (TPCC)	1991	26% private (minority)	Agreem sign[£]
8	Poultry Development Co. of Zanzibar	1992	80% private	Deal conclud
9	Buckreef Gold Mining Co.	1992	80% foreign private	Deal conclud
10	Pugu Kaolin Mine	1992	JV: 80% foreign private	Agreem signed
11	Morogoro Tannery	1992	JV: 55% private (?)	Agreem signed
12	Burns & Blane	1992	JV: 60% foreign private	Govt approved
	PRIVATE MANAGEMENTS 1992:			
1	Tanzania Railways Corp. (TRC)	1992	Priv franchise of catering	Agreem signed
			Priv lease of hotel services	Negotiations
	Tourist hotels under Tanz. Tourist Corp.:			
2	Lake Manyara	1992	Private Management Contract	Approv/Effect
3	Ngorongoro Wildlife Lodge	1992	Private Management Contract	Approv/Effect
4	Serengeti	1992	Private Management Contract	Approv/Effect
5	Lobo	1992	Private Management Contract	Approv/Effect
6-8	Another three	1992	Private Management Contract	Approv/Effect

to be continued...

UNDER PREPARATION MID-1992:

1 New Africa Hotel	77% private (?)	Draft agreem.
2 Tangold (T)	JV	Negotiation##
3 TAFCO	JV	Negotiations
4 Tanzania Motor Services Co.	JV	Negotiations
5 Landrover (T)	JV	Negotiations
6 Tanzania Tea Blenders	100% private	Negotiations
7 Tanzania Cordage	JV: 60 foreign private	Negotiations
8 Mwanza Tannery	JV	Negotiations
9 Tanzania Diamond Cutting Co.	JV	Negotiations
10 Morogoro Ceramics Wares	JV	Negotiations
11 Manawa Ginnery	JV: 51% private	Negotiations#
12 MOPROCO	JV: 70% private	Negotiations#
13 Tanzania Tractors Manufacturing Co.	100% foreign private	Negoti. begun
14 Kilimanjaro Hotel	Intercont. & Contractors (?)	Discussions
15 Kilosa Carpet Co.	JV	Seek. partner
16 Tanzania Gemstone	JV	Seek. partner
17 Express Tanzania	JV	Seek. partner
18 Morogoro Shoe Co.	Disposal by tender	Price evalu.
19 Mbozi Maize Farms	Disposal	Asset evalu.
20 Tanganyika Meerschaum	Liquidation	Under consid.
21 TAMCO	Divest to foreign private	Under evalu.
22 Moshi Tannery	?	?

Notes:
* Non-commercial parastatal.
** Dissolution still pending by mid-1992, according to United Republic of Tanzania (1992c).
£ Not yet completed by 3 June, 1992, according to Embassy of Sweden (1992), Appendix 1.
££ JV = Joint Venture.
\# Negotiations broke down and sale to private owners had to be readvertised, according to a senior Treasury official, making comments on United Republic of Tanzania (1992c), in personal communication, November, 1992.
\## Not JV, but lease arrangement, according to the same Treasury official.

Sources: United Republic of Tanzania (1992c) is the major source of this table; complemented with comments by a senior Treasury official in personal communication, November 1992; Ministry of Finance (1992a), with comments by SIDA staff in Dar es Salaam (Embassy of Sweden, 1992, Appendix 1); Ngowi (1990), p. 46; and Kiondo (1989), pp. 360 & 387, and (1990), p. 36.

Table A.21: Government Expenditure on Grants and Contractual and Contingent Liabilities in Tanzania, 1974/75-1991/92 (Million TSh)

Year	Contractual and Contingent Liabilities		
	Value	% of TMS#	% of TRE#
1974/75	11.9	0.5	0.3
1975/76	12.8	0.6	0.3
1976/77**	38.1	1.2	0.8
1977/78**	85.8	2.5	1.5
1978/79*	337.6	7.1	4.7
1979/80	60.8	1.4	0.8
1980/81	527.8	9.3	5.5
1981/82**	1,906.3	23.0	14.6
1982/83	1,664.8	19.6	11.8
1983/84**	1,420.1	13.9	9.3
1984/85	1,044.8	6.8	4.9
1985/86**	993.0	5.4	3.8
1986/87*	3,240.8	12.5	7.6
1987/88	5,532.2	15.1	9.5
1988/89	9,703.5	18.1	11.1
1989/90	5,394.4	8.2	5.0
1990/91**	18,637.7	17.5	11.3
1991/92*@	17,899.9	14.8	9.6

Notes:
* Estimates.
** Approved/Revised Estimates.
@ The figures for 1991/92 are uncertain due to poor readability.
# TMS = Total Ministerial Supply, TRE = Total Recurrent Expenditure.

Sources: Own calculations based on World Bank (1989b), Tables B1 & B10, and (1992b), Tables B1 & B10.

Table A.22: Selected Government Expenditure on Parastatals in Tanzania for Contractual and Contingent Liabilities, 1984/85-1988/89 (Million TSh)

ITEM	1984/85*	1985/86@	1986/87@	1987/88*	1988/89#
Crop Authority Overdrafts**	500	460	464	925	1,100
Government Guarantee NBC/NMC	250	250	250	250	50
Financial Assist. to Parast.	-	150	175	665	1,202
Parastatal Rehabilitation	-	-	-	-	762
Managem. & Supervision of SGR@@	-	-	-	-	440
Other	5	4	31	5	10
TOTAL	755	864	920	1,845	3,564
% of Total C & C##	72	87	28	33	37
% of Total Ministerial Supply	5	5	3	5	7
% of Total Recurrent Expenditure	4	3	2	3	4

Notes: A dash (-) indiactes that data are unavailable. NBC = National Bank of Commerce.
NMC = National Milling Corporation.
* Approved Estimates.
@ Actuals.
\# Estimates.
** Including NMC.
@@ SGR = Strategic Grain Reserve.
C&C = Contractual and Contingent Liabilities.

Sources: Own calculations based on World Bank (1989a), pp. 125 & 175, and (1992b), Tables B1 & B10.

Table A.23: The Value and Share of Tanzanian Imports Exempted from Taxes, 1982-1991 (Million TSh)

Year	Imports Exempted from Tax	Total Imports		Exempted/Total	
		BoT**	C&STD**	(1)/(2)	(1)/(3)
	(1)	(2)	(3)	(4)	(5)
1982	4,732.671	-	10,519.200	-	45%
1983	3,880.618	9,073.400	8,547.400	43%	45%
1984	5,361.249	13,363.400	9,652.800	40%	56%
1985	6,140.631	17,456.000	15,287.800	35%	40%
1986	12,730.961	34,326.600	30,577.100	37%	42%
1987	31,119.337	73,899.000	59,340.100	42%	52%
1988	-	117,892.200	80,828.100*	-	-
1989	54,126.415	176,353.590	-	31%	-
1990	121,659.353*	-	-	-	-
1991	205,737.189*	-	-	-	-

Notes: A dash (-) indicates that data are unavailable.
In column one (1), the figures for 1982-1987 probably refer to imports exempted from customs duty only, whereas the 1989-1991 figures refer to imports exempted also from sales tax and excise duty. Since the two times series on total imports from different sources diverge considerably, both are presented and used here, instead of linked to a single series. The figures on imports exempted from tax are based on data from the major stations (entry points) only, at least for 1989, probably also for 1990-1991 and possibly for 1982-1987.
* Provisional.
** BoT = Bank of Tanzania. C&STD = Customs and Sales Tax Department.

Sources: Own calculations based on the following:
Column 1: Customs & Sales Tax Department (1992a-1992d).
Column 2: Bank of Tanzania (1991a), p. 17; and (1989), p. 8.
Column 3: Customs & Sales Tax Department, referred to by the Bank of Tanzania (1991a), p. 79.

Table A.24: Tax Exemptions on Tanzanian Imports in Relation to Tax Revenue, 1982/83-1991/92 (Million TSh)

	CUSTOMS DUTY			SALES TAX					EXCISE DUTY				
Year	Exemptions (1)	Revenue (2)	(1)/(2) (3)	Exemptions (4)	Rev. Imp. (5)	Rev. Tot. (6)	(4)/(5) (7)	(4)/(6) (8)	Exemptions (9)	Rev. Imp. (10)	Rev. Tot. (11)	(9)/(10) (12)	(9)/(11) (13)
1982/83	1,014.714	723.600	140%	-	-	-	-	-	-	-	-	-	-
1983/84	909,505	959.000	95%	-	-	-	-	-	-	-	-	-	-
1984/85	1,200.113	1,531.000	78%	-	-	-	-	-	-	-	-	-	-
1985/86	1,393.520	1,468.400	95%	-	-	-	-	-	-	-	-	-	-
1986/87	2,843.664	4,067.300	70%	-	-	-	-	-	-	-	-	-	-
1987/88	7,533.841	5,506.800	137%	-	-	-	-	-	-	-	-	-	-
1988/89	-	8,478.200	-	-	7,841.200	33,237.500	-	-	-	-	-	-	-
1989/90	12,289.076	13,547.000@	91%	12,693.089	10,445.000@	30,645.000@	122%	41%	769.126	2,683.000@	13,823.000@	29%	6%
1990/91	27,185.326*	18,554.000#	147%	25,575.429*	10,601.000#	38,028.000#	241%	67%	5,513.456*	3,762.000#	20,003.000#	147%	28%
1991/92	26,075.683*	43,634.000#	60%	27,705.918*	-	-	-	-	6,409.973*	-	-	-	-

Notes: A dash (-) indicates that data are unavailable.
The figures on exemptions relate to calendar years, ranging between 1982 and 1991. They are based on data from the major stations (entry points) only, at least for 1989, probably also for 1990-1991 and possibly for 1982-1987.
* Provisional.
@ Provisional Actuals.
# Likely Turn Out.

Sources: Own calculations based on the following:
Column 1: Customs & Sales Tax Department (1992a-1992d).
Column 2: 1982/83: World Bank (1989c), p. 56; 1983/84-1984/85: Tanzanian Economic Trends (1989/90), p. 79; and 1985/86-1991/92: Tanzanian Economic Trends (1992), p. 71.
Columns 4 and 9: Customs & Sales Tax Department (1992a-1992d).
Columns 5, 6, 10 and 11: Tanzanian Economic Trends (1992), p. 71.

Table A.25: Government Bridging-Finance Loans to Parastatals in Tanzania (Million TSh)

Loan No.	Recipient Parastatal	Loan Amount Nov-91	Loan Amount Nov-92	Interest Rate %	Interest Rate (Penal)	Repayment Period	Outstand Nov-91[a]	Arrears as at Nov-91 Princ	Arrears as at Nov-91 Inter	Arrears as at Nov-91 Penal	Arrears as at Nov-91 Total	Outstand Nov-92[a]	Repaid as at Nov-92 Princ	Repaid as at Nov-92 Inter	Repaid as at Nov-92 Total	Arrears as at Nov-92 Princ	Arrears as at Nov-92 Inter	Arrears as at Nov-92 Total
63	Tanz. Saruji Corp.	0.6	0.6	12.5	-	Jul-84 - Jun-85	0.6	0.6	0.5	-	1.1	0.6	-	-	-	0.6	0.6	1.2
64	AICC	5.6	5.6	5.0	-	Mar-86 - Feb-88	5.6	5.6	2.1	-	7.7	5.6	-	-	-	5.6	2.6	8.2
65	AICC	5.6	5.6	-	(5.0)	Jun-86 - Dec-88	5.6	5.6	1.4	-	7.0	5.6	-	-	-	5.6	1.8	7.4
66	CORETCO	2.5	2.5	7.5	-	Dec-83 - Dec-86	1.9	1.9	1.1	-	3.0	1.9	0.6	-	0.6	1.9	1.3	3.2
83	TAFICO	4.5	4.5	8.0	-	Mar-86 - Feb-87	1.2	1.2	0.6	-	1.8	1.0	3.5	-	3.5	1.0	0.6	1.6
170	TEXCO	80.0	80.0	10.0	-	Apr-88 - Jun-88	42.3	42.3	13.2	-	55.5	42.3	37.7	2.3	40.0	42.3	19.2	61.5
171	Tanz. Hides & Skins	12.0	12.0	10.0	(2.0)	Nov-87 - Apr-88	10.8	10.8	4.6	-	15.4	10.8	1.2	-	1.2	10.8	6.5	17.3
178	Tanzania Shoe Co. (Bora)	16.0	16.0	-	-	Aug-87 - Jul-88	16.0	16.0	-	-	16.0	16.0	-	-	-	16.0	-	16.0
179	Morogoro Shoe Co.	15.0	15.0	10.0	(1.0)	Dec-88 - Dec-90	15.0	15.0	4.1	-	19.1	15.0	-	-	-	15.0	6.5	21.5
181	Morogoro Tanneries	10.0	10.0	10.0	-	Feb-88 - May-88	9.5"	10.0"	3.2	-	13.2	9.5	0.5	-	0.5	9.5	4.5	14.0
182	Tanz. Packages Manuf. Co.	10.0	10.0	10.0	-	Dec-88 - Jun-90	10.0	10.0	2.5	-	12.5	10.0	-	-	-	10.0	3.9	13.9
185	Light Source Manuf. Co.	15.0	15.0	10.0	-	Nov-87 - Jun-88	15.0	15.0	5.4	-	20.4	15.0	-	-	-	15.0	7.5	22.5
195	Mwanza Tanneries	20.0	20.0	10.0	-	Dec-88 - Dec-90	20.0	20.0	5.0	-	25.0	20.0	-	-	-	20.0	7.8	27.8
198	Musoma Textiles	65.0	65.0	10.0	-	Dec-88 - Dec-89	65.0	65.0	16.3	-	81.3	65.0	-	-	-	65.0	25.5	90.5
209	Steel Rolling Mills	28.1	28.1	10.0	-	Jun-89 - Dec-93	28.1	14.1	5.6	-	19.7	28.1	-	-	-	19.7	9.6	29.3
224	AICC	10.0	10.0	-	(5.0)	Jan-89 - Jul-89	10.0	10.0	1.2	-	11.2	10.0	-	-	-	10.0	1.9	11.9
229	Friendship Textile Mill	66.0	66.0	10.0	-	Jan-89 - May 89	25.6	25.6	4.3	-	29.9	25.6	40.4	3.3	43.7	25.6	8.0	33.6
236	TACONA	1.2	1.2	-	-	Feb-87 - Jan-88	1.2	1.2	-	-	1.2	1.2	-	-	-	1.2	-	1.2
240	NAPOCO	2.5	2.5	10.0	-	Jul-89 - Jun-90	2.5	2.5	0.5	-	3.0	2.5	-	-	-	2.5	0.8	3.3
241	Mikumi Wildlife Lodge	10.0	10.0	10.0	-	Jul-89 - Jul-93	10.0	4.0	1.9	-	5.9	10.0	-	-	-	8.0	3.3	11.3
242	Buckreef Gold Mine Co.	15.0	15.0	10.0	-	Jun-89 - May-90	9.5	9.5	2.0	-	11.5	9.5	5.5	-	5.5	9.5	3.3	12.8
265	Tanz. Sisal Markt. Board	73.0	73.0	-	-	Mar-90 - Jun-90	73.0	73.0	-	-	73.0	73.0	-	-	-	73.0	-	73.0
266	Tanz. Saruji Corp.	100.0	100.0	-	-	Mar-90 - Jun-90	100.0	100.0	-	-	100.0	100.0	-	-	-	100.0	-	100.0
275	National Lottery of Tanz.	33.2	33.2	15.0	-	Dec-90 - Mar-91	-	-	-	-	-	-	33.2	3.6	36.8	-	-	-
276	Morogoro Canvas Mill	120.0	120.0	14.5	(27.0)	Mar-91 - Dec-91	120.0	48.0	4.4	1.7	54.1	120.0	-	-	-	120.0	29.0	149.0
277	TEXCO	520.0	520.0	14.5	(27.0)	Mar-91 - Aug-91	520.0	346.7	37.7	13.4	397.8	520.0	-	-	-	520.0	144.5	664.5
278	NAPOCO	29.8	29.8	15.0	(27.0)	Aug-91 - Aug-93	29.8	-	1.5	-	1.5	29.8	-	-	-	19.1	7.8	26.9
280	Nyanza Salt Mines (T)	56.0	56.0	-	(1.0)	Mar-91 - May-91	-	-	-	-	-	-	56.0	-	56.0	-	-	-
282	KILTIMBER Co.	100.0	100.0	15.0	(27.0)	Feb-94 - Aug-98	100.0	-	-	-	-	100.0	-	-	-	-	-	-
286	Tangany. Meerschaum Corp.	10.0	10.0	20.0	(27.0)	Dec-91 - Jun-92	10.0	-	-	-	-	10.0	-	-	-	10.0	1.8	11.8
n.a.	Tanz. Gemstone Ind.	2.0	2.0	-	-	Feb-88 - Jun-88	-	-	-	-	-	-	2.0	-	2.0	-	-	-
	Sub-Total 31 Loans	**1,438.6**	**1,438.6**				**1,258.2**	**853.5**	**134.1**	**15.1**	**987.6**	**1,258.0**	**180.6**	**9.2**	**189.8**	**1,136.9**	**298.3**	**1,435.2**

to be continued...

With Respect to the First 31 Loans:

Balance Outstanding Relative to Loan Amount (%):	Nov-91:	87.5
	Nov-92:	87.4
Principal Arrears Relative to Loan Amount (%):	Nov-91:	59.3
	Nov-92:	79.0
Principal Arrears Relative to Balance Outstanding (%):	Nov-91:	67.8
	Nov-92:	90.4
Total Arrears Relative to Balance Outstanding (%):	Nov-91:	78.5
	Nov-92:	114.1
Pricipal Repaid Relative to Loan Amount as at Nov-92 (%):		12.6
Total Repaid Relative to Balance Outstanding as at Nov-92 (%):		15.1

to be continued...

Loan No.	Recipient Parastatal	Loan Amount Nov-91	Loan Amount Nov-92	Interest Rate %	Interest Rate (Penal)	Repayment Period	Outstand Nov-91[a]	Arrears as at Nov-91 Princ	Arrears as at Nov-91 Inter	Arrears as at Nov-91 Penal	Arrears as at Nov-91 Total	Outstand Nov-92[a]	Repaid as at Nov-92 Princ	Repaid as at Nov-92 Inter	Repaid as at Nov-92 Total	Arrears as at Nov-92 Princ	Arrears as at Nov-92 Inter	Arrears as at Nov-92 Total
1	East African Commun.*	0.7	0.7	3.0	-	Sep-70 - Mar-82	0.7	n.a.	n.a.	-	n.a.	0.7	-	-	-	0.7	0.4	1.1
4	State Trading Corp.@@	<0.1	<0.1	4.0	-	Feb-70 - Feb-74	<0.1	n.a.	n.a.	-	n.a.	<0.1	<0.1	<0.1	<0.1	<0.1	<0.1	<0.1
6	CRDB	2.4	2.4	5.0	-	Nov-66 - Nov-70	2.4	n.a.	n.a.	-	n.a.	2.4	-	-	-	2.4	3.1	5.5
12	Farmers in North Region*	0.2	0.2	5.0	-	Jun-67 - Jun-88	0.2	n.a.	n.a.	-	n.a.	0.2	0.1	<0.1@@	0.1	0.2	0.2	0.4
13	Farmers in North Region*	0.2	0.2	6.0	-	Jun-67 - Jun-88	0.2	n.a.	n.a.	-	n.a.	0.2	-	-	-	0.2	0.3	0.5
14	Tangany. National Trans.	2.0	2.0	-	-	Jun-68 - Jun-69	2.0	n.a.	n.a.	-	n.a.	2.0	-	-	-	2.0	-	2.0
19	LIDA	1.4	1.4	6.8	-	Apr-74 - Apr-93	1.4	n.a.	n.a.	-	n.a.	1.4	-	-	-	1.3	2.2	3.5
22	LIDA	1.7	1.7	4.0	-	Jun-75 - Jun-84	1.7	n.a.	n.a.	-	n.a.	1.7	-	-	-	1.7	1.5	3.2
23	Tanz. Tobacco Board	4.0	4.0	4.0	-	Jun-75 - Jun-84	4.0	n.a.	n.a.	-	n.a.	-	4.0	2.6	6.6	-	-	-
25	LIDA	1.2	1.2	-	-	Mar-72 - May-73	1.2	n.a.	n.a.	-	n.a.	1.2	-	-	-	1.2	-	1.2
26	TEXCO	40.0	40.0	6.0	-	Dec-74 - Dec-88	12.0	n.a.	n.a.	-	n.a.	12.0	28.0	6.9	34.9	12.0	14.0	26.0
27	Tanz. Tourist Corp.	6.1	6.1	-	-	Dec-78 - Dec-93	5.6	n.a.	n.a.	-	n.a.	5.6	0.5	-	0.5	5.1	-	5.1
28	Tanz. Tourist Corp.	18.2	18.2	- **	-	Dec-68 - Jun-92	4.5	n.a.	n.a.	-	n.a.	4.5	13.6	-	13.6	4.5	4.9	9.4
29	TWICO/Tanz. Timber Markt.	3.1	3.1	-	-	Mar-79 - Apr-82	2.1	n.a.	n.a.	-	n.a.	2.1	1.0	-	1.0	2.1	-	2.1
32	Tanz. Tourist Corp.	4.2	4.2	-	-	Jul-80 - Jun-82	3.9	n.a.	n.a.	-	n.a.	3.9	0.4	-	0.4	3.9	-	3.9
34	Friendship Textile Mill	7.0	7.0	2.5	-	Sep-80 - May-90	0.4	n.a.	n.a.	-	n.a.	0.4	6.7	1.0	7.7	0.4	0.7	1.1
89	HANDICO	2.5	2.5	8.0	-	Aug-87 - Jul-89	2.5	n.a.	n.a.	-	n.a.	2.5	-	0.2	0.2	2.5	0.9	3.4
110	Cashewnut Markt. Board##	656.7	111.2	-	-	Oct-73 - Oct-74	655.5	n.a.	n.a.	-	n.a.	110.7	0.5	0.4	0.9	110.7	-	110.7
112	TEXCO##	699.3	93.2	-	-	Oct-73 - Oct-74	582.7	n.a.	n.a.	-	n.a.	86.7	6.5	-	6.5	86.7	-	86.7
114	TEXCO	20.0	20.0	-	-	Oct-87 - Oct-88	20.0	n.a.	n.a.	-	n.a.	20.0	-	-	-	20.0	-	20.0
160	National Developm. Corp.	10.0	10.0	-	-	Dec-74 - Dec-75	10.0	n.a.	n.a.	-	n.a.	10.0	-	-	-	10.0	-	10.0
230	Tanz. Investment Bank	87.2	87.2	10.0	-	Jul-89 - Jan-90	87.2	n.a.	n.a.	-	n.a.	87.2	-	-	-	87.2	29.1	116.3
238	Fibreboards Africa	162.6	162.6	10.0	-	Aug-89 - Jul-94	114.5	n.a.	n.a.	-	n.a.	89.9	72.7	23.3	96.0	35.7	13.8	49.5
243	TPC	13.2	13.2	-	-	Jan-80 - Jan-81	13.2	n.a.	n.a.	-	n.a.	13.2	-	-	-	13.2	-	13.2
254	National Transport Corp.	42.2	42.2	-	-	Apr-90 - Mar-91	-	n.a.	n.a.	-	n.a.	-	42.2	-	42.2	-	-	-
255	National Transport Corp.	45.9	45.9	-	(15.0)	Mar-90 - Apr-92	36.4	n.a.	n.a.	n.a.	n.a.	34.5	11.5	-	11.5	34.5	-	34.5
268	National Transport Corp.	717.0	717.0	-	-	Nov-91 - Oct-94	717.0	n.a.	n.a.	-	n.a.	717.0	-	-	-	258.9	-	258.9
279	Morogoro Canvas Mill	115.1	115.1	-	-	Aug-90 - Aug-91	111.2	n.a.	n.a.	-	n.a.	111.2	3.9	-	3.9	111.2	-	111.2
	Sub-Total 28 Loans	**2,664.1**	**1,512.5**				**2,392.5**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**1,321.2**	**191.6**	**34.4**	**226.0**	**808.3**	**71.1**	**879.4**
	Less Loans 110 & 112:	**1,308.1**	**1,308.1**				**1,154.3**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**1,123.8**	**184.6**	**34.0**	**218.6**	**610.9**	**71.1**	**682.0**

to be continued...

Loan No.	Recipient Parastatal	Loan Amount Nov-91	Loan Amount Nov-92	Interest Rate %	Interest Rate (Penal)	Repayment Period	Outstand Nov-91[a]	Arrears as at Nov-91 Princ	Arrears as at Nov-91 Inter	Arrears as at Nov-91 Penal	Arrears as at Nov-91 Total	Outstand Nov-92[a]	Repaid as at Nov-92 Princ	Repaid as at Nov-92 Inter	Repaid as at Nov-92 Total	Arrears as at Nov-92 Princ	Arrears as at Nov-92 Inter	Arrears as at Nov-92 Total
287	National Transport Corp.	-	153.7	15.0	(30.0)	Jan-92 - Dec-94	-	-	-	-	-	153.7	-	-	-	47.0	30.7	77.7
290	Mbeya Cement Co.	-	150.0	-	(1.0)	Sep-91 - Feb-92	-	-	-	-	-	150.0	-	-	-	150.0	-	150.0
293	NAFCO	-	250.0	-	-	Dec-90 - Apr-91	-	-	-	-	-	-	250.0	-	250.0	-	-	-
294	Tanz. Cordage Ngomeni	-	250.0	20.0	(24.0)	Feb-92 - Jan-93	-	-	-	-	-	250.0	-	-	-	208.3	37.5	245.8
295	National Developm. Corp.	-	85.4	20.0	(24.0)	Nov-91 - Jun-92	-	-	-	-	-	85.4	-	-	-	85.4	18.5	103.9
296	CMB Packaging Tanz.	-	205.1	20.0	(24.0)	Nov-91 - Jun-92	-	-	-	-	-	205.1	-	-	-	205.1	44.4	249.5
305	Tanganyika Packers	-	25.0	-	-	Mar-91 - Jun-91	-	-	-	-	-	25.0	-	-	-	25.0	-	25.0
307	Nyanza Salt Mines (?)#	-	15.0	5.0	-	Jun-91 - Dec-95	-	-	-	-	-	15.0	-	-	-	4.5	1.1	5.6
308	NAPOCO	-	45.0	20.0	-	Jan-93 - Oct-93	-	-	-	-	-	45.0	-	-	-	-	3.0	3.0
309	Tanz. Packages Manuf. Co.	-	70.0	20.0	-	Jan-93 - Oct-93	-	-	-	-	-	70.0	-	-	-	-	4.5	4.5
310	New Safari Hotel	-	20.0	20.0	-	Jan-93 - Oct-93	-	-	-	-	-	20.0	-	-	-	-	1.3	1.3
311	Tanz. Sisal Markt. Board	-	45.0	20.0	-	Jan-93 - Oct-93	-	-	-	-	-	45.0	-	-	-	-	3.0	3.0
312	Tanz. Tourist Corp.	-	11.5	-	-	Dec-79 - Dec-80""	-	-	-	-	-	11.5	-	-	-	11.5	-	11.5
313	Auto Mech	-	150.0	20.0	-	Sep-93 - Jun-96	-	-	-	-	-	150.0	-	-	-	-	5.0	5.0
	Sub-Total 14 Loans:	-	1,475.7				-	-	-	-	-	1,225.7	250.0	-	250.0	736.8	149.0	885.8
	TOTAL 73 LOANS:	4,102.7	4,426.8				3,650.7	n.a.	n.a.	n.a.	n.a.	3,804.9	622.2	43.6	665.8	2,682.0	518.4	3,200.4
	Less Loans 110 & 112:	2,746.7	4,222.4				2,412.5	n.a.	n.a.	n.a.	n.a.	3,607.5	615.2	43.2	658.4	2,484.6	518.4	3,003.0

to be continued...

With Respect to All 73 Loans:

Increase in Loan Amount from Nov-91 to Nov-92 (%):	7.9	
Increase in Balance Outstanding from Nov-91 to Nov-92 (%):	4.2	
Balance Outstanding Relative to Loan Amount (%): Nov-91:	89.0	
Nov-92:	86.0	
Principal Arrears Relative to Loan Amount as at Nov-92 (%):	60.6	
Principal Arrears Relative to Balance Outstanding as at Nov-92 (%):	70.5	
Total Arrears Relative to Balance Outstanding as at Nov-92 (%):	84.1	
Pricipal Repaid Relative to Loan Amount as at Nov-92 (%):	14.1	
Total Repaid Relative to Balance Outstanding as at Nov-92 (%):	17.5	
No. of Loans with Repayment Period Longer than Five Years (% of Total No.):	11	(15.1)
No. of Loans with Zero (0) Interest Rate (% of Total No.):	26	(35.6)
No. of Loans with Interest Rate < 10 Per Cent (% of Total No.):	42	(57.5)
No. of Loans with Interest Rate < 20 Per Cent (% of Total No.):	64	(87.7)
No. of Loans with Penal Interest (% of Total No.): Nov-91:	11	(18.6)
Nov-92:	16	(21.9)
No. of Loans Fully Paid as at Nov-92 (% of Total No.):	6	(8.2)
No. of Loans with No Arrears as at Nov-92 (% of Total No.):	7	(9.6)

Notes: For better readability, the value zero (0.0) is represented by a dash (-).
* These recipients are not parastatals.
** A 'second' rate of interest of 8.0 % was reported for loan no. 28, but the implication of this is unknown.
\# It is uncertain whether this is a bridging-finance loan or not.
It may be noted that the loan amounts of the two loans differ between November 1991 and November 1992. Whether this difference is due to mere printing errors, whether the debts have been restated, e.g. because of conversion of the debt into equity, or whether there are other explanations, is unknown.
@ Includes principal only.
@@ Because of the small amounts involved, they have been excluded from the total.
" These figures are, for unknown reason, incompatible.
"" The correctness of this repayment period may be questioned, provided that the loan numbers are in chronological order.

Sources: Own calculations based on Ministry of Finance (1991c), (1992c) and (1992d).

Table A.26: Government Bridging Finance by Recipient and Sector in Tanzania (Million TSh)

RECIPIENT PARASTATAL	Loan No.	Loan Amount Nov-91	Loan Amount Nov-92	Interest Rate %	Interest Rate (Penal)	Repayment Period	Outstand Nov-91[a]	Arrears as at Nov-91 Princ	Arrears as at Nov-91 Inter	Arrears as at Nov-91 Penal	Arrears as at Nov-91 Total	Outstand Nov-92[a]	Repaid as at Nov-92 Princ	Repaid as at Nov-92 Inter	Repaid as at Nov-92 Total	Arrears as at Nov-92 Princ	Arrears as at Nov-92 Inter	Arrears as at Nov-92 Total
AGRICULTURE & LIVESTOCK:																		
Cashewnut Markt. Board[##]	110	656.7	111.2	-	-	Oct-73 - Oct-74	655.5	n.a.	n.a.	-	n.a.	110.7	0.5	0.4[aa]	0.9	110.7	-	110.7
Farmers in North Region*	12	0.2	0.2	5.0	-	Jun-67 - Jun-88	0.2	n.a.	n.a.	-	n.a.	0.2	0.1	<0.1[aa]	0.1	0.2	0.2	0.4
Farmers in North Region*	13	0.2	0.2	6.0	-	Jun-67 - Jun-88	0.2	n.a.	n.a.	-	n.a.	0.2	-	-	-	0.2	0.3	0.5
Sub-Total:		0.4	0.4				0.4	n.a.	n.a.	-	n.a.	0.4	0.1	<0.1	0.1	0.4	0.5	0.9
NAFCO (Agric. & Food)	293	-	250.0	-	-	Dec-90 - Apr-91	-	-	-	-	-	-	250.0	-	250.0	-	-	-
NAPOCO (Poultry)	240	2.5	2.5	10.0	-	Jul-89 - Jun-90	2.5	2.5	0.5	-	3.0	2.5	-	-	-	2.5	0.8	3.3
NAPOCO (Poultry)	278	29.8	29.8	15.0	(27.0)	Aug-91 - Aug-93	29.8	-	1.5	-	1.5	29.8	-	-	-	19.1	7.8	26.9
NAPOCO (Poultry)	308	-	45.0	20.0	-	Jan-93 - Oct-93	-	-	-	-	-	45.0	-	-	-	-	3.0	3.0
Sub-Total:		32.3	77.3				32.3	2.5	2.0	-	4.5	77.3	-	-	-	21.6	11.6	33.2
Tanganyika Packers	305	-	25.0	-	-	Mar-91 - Jun-91	-	-	-	-	-	25.0	-	-	-	25.0	-	25.0
Tanz. Cordage (Ngomeni)	294	-	250.0	20.0	(24.0)	Feb-92 - Jan-93	-	-	-	-	-	250.0	-	-	-	208.3	37.5	245.8
Tanz. Hides & Skins	171	12.0	12.0	10.0	(2.0)	Nov-87 - Apr-88	10.8	10.8	4.6	-	15.4	10.8	1.2	-	1.2	10.8	6.5	17.3
Tanz. Sisal Markt. Board	265	73.0	73.0	-	-	Mar-90 - Jun-90	73.0	73.0	-	-	73.0	73.0	-	-	-	73.0	-	73.0
Tanz. Sisal Markt. Board	311	-	45.0	20.0	-	Jan-93 - Oct-93	-	-	-	-	-	45.0	-	-	-	-	3.0	3.0
Sub-Total:		73.0	118.0				73.0	73.0	-	-	73.0	118.0	-	-	-	73.0	3.0	76.0
Tanz. Tobacco Board	23	4.0	4.0	4.0	-	Jun-75 - Jun-84	4.0	n.a.	n.a.	-	n.a.	-	4.0	2.6	6.6	-	-	-
TPC (Sugar)	243	13.2	13.2	-	-	Jan-80 - Jan-81	13.2	n.a.	n.a.	-	n.a.	13.2	-	-	-	13.2	-	13.2
TOTAL (Agri. & Livest.):		**791.6**	**861.1**				**789.2**	**n.a.**	**n.a.**	**-**	**n.a.**	**605.4**	**255.8**	**3.0**	**258.8**	**463.0**	**59.1**	**522.1**
Less Loan No. 110:		**134.9**	**749.9**				**133.7**	**n.a.**	**n.a.**	**-**	**n.a.**	**494.7**	**255.3**	**2.6**	**257.9**	**352.3**	**59.1**	**411.4**
COMMUNICATION:																		
National Transport Corp.	254	42.2	42.2	-	-	Apr-90 - Mar-91	-	n.a.	n.a.	-	n.a.	-	42.2	-	42.2	-	-	-
National Transport Corp.	255	45.9	45.9	-	(15.0)	Mar-90 - Apr-92	36.4	n.a.	n.a.	n.a.	n.a.	34.5	11.5	-	11.5	34.5	-	34.5
National Transport Corp.	268	717.0	717.0	-	-	Nov-91 - Oct-94	717.0	n.a.	n.a.	-	n.a.	717.0	-	-	-	258.9	-	258.9
National Transport Corp.	287	-	153.7	15.0	(30.0)	Jan-92 - Dec-94	-	-	-	-	-	153.7	-	-	-	47.0	30.7	77.7
Sub-Total:		805.1	958.8				753.4	n.a.	n.a.	n.a.	n.a.	905.2	53.7	-	53.7	340.4	30.7	371.1
Tangany. National Trans.	14	2.0	2.0	-	-	Jun-68 - Jun-69	2.0	n.a.	n.a.	-	n.a.	2.0	-	-	-	2.0	-	2.0
TOTAL (Communication):		**807.1**	**960.8**				**755.4**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**907.2**	**53.7**	**-**	**53.7**	**342.4**	**30.7**	**373.1**

to be continued...

RECIPIENT PARASTATAL	Loan No.	Loan Amount Nov-91	Loan Amount Nov-92	Interest Rate %	Interest Rate (Penal)	Repayment Period	Outstand Nov-91[a]	Arrears as at Nov-91 Princ	Arrears as at Nov-91 Inter	Arrears as at Nov-91 Penal	Arrears as at Nov-91 Total	Outstand Nov-92[a]	Repaid as at Nov-92 Princ	Repaid as at Nov-92 Inter	Repaid as at Nov-92 Total	Arrears as at Nov-92 Princ	Arrears as at Nov-92 Inter	Arrears as at Nov-92 Total
MINERAL RESOURCES:																		
Buckreef Gold Mines	242	15.0	15.0	10.0	-	Jun-89 - May-90	9.5	9.5	2.0	-	11.5	9.5	5.5	-	5.5	9.5	3.3	12.8
Nyanza Salt Mines	280	56.0	56.0	-	(1.0)	Mar-91 - May-91	-	-	-	-	-	-	56.0	-	56.0	-	-	-
Nyanza Salt Mines (?)#	307	-	15.0	5.0	-	Jun-91 - Dec-95	-	-	-	-	-	15.0	-	-	-	4.5	1.1	5.6
Sub-Total:		56.0	71.0				-	-	-	-	-	15.0	56.0	-	56.0	4.5	1.1	5.6
Tangany. Meerschaum Corp.	286	10.0	10.0	20.0	(27.0)	Dec-91 - Jun-92	10.0	-	-	-	-	10.0	-	-	-	10.0	1.8	11.8
Tanz. Gemstone Ind.	n.a.	2.0	2.0	-	-	Feb-88 - Jun-88	-	-	-	-	-	-	2.0	-	2.0	-	-	-
TOTAL (Mineral Res.):		**83.0**	**98.0**				**19.5**	**9.5**	**2.0**	**-**	**11.5**	**34.5**	**63.5**	**-**	**63.5**	**24.0**	**6.2**	**30.2**
FINANCE:																		
Coop. & Rural Dev. Bank	6	2.4	2.4	5.0	-	Nov-66 - Nov-70	2.4	n.a.	n.a.	-	n.a.	2.4	-	-	-	2.4	3.1	5.5
National Lottery of Tanz.	275	33.2	33.2	15.0	-	Dec-90 - Mar-91	-	-	-	-	-	-	33.2	3.6	36.8	-	-	-
Tanz. Investment Bank	230	87.2	87.2	10.0	-	Jul-89 - Jan-90	87.2	n.a.	n.a.	-	n.a.	87.2	-	-	-	87.2	29.1	116.3
TOTAL (Finance):		**122.8**	**122.8**				**89.6**	**n.a.**	**n.a.**	**-**	**n.a.**	**89.6**	**33.2**	**3.6**	**36.8**	**89.6**	**32.2**	**121.8**
INDUSTRIES & TRADE:																		
National Development Corporation (Metal & Engineering):																		
CMB Packaging/Metal Box	296	-	205.1	20.0	(24.0)	Nov-91 - Jun-92	-	-	-	-	-	205.1	-	-	-	205.1	44.4	249.5
National Developm. Corp.	160	10.0	10.0	-	-	Dec-74 - Dec-75	10.0	n.a.	n.a.	-	n.a.	10.0	-	-	-	10.0	-	10.0
National Developm. Corp.	295	-	85.4	20.0	(24.0)	Nov-91 - Jun-92	-	-	-	-	-	85.4	-	-	-	85.4	18.5	103.9
Sub-Total:		10.0	95.4				10.0	n.a.	n.a.	-	n.a.	95.4	-	-	-	95.4	18.5	113.9
Light Source Manuf. Co.	185	15.0	15.0	10.0	-	Nov-87 - Jun-88	15.0	15.0	5.4	-	20.4	15.0	-	-	-	15.0	7.5	22.5
Steel Rolling Mills	209	28.1	28.1	10.0	-	Jun-89 - Dec-93	28.1	14.1	5.6	-	19.7	28.1	-	-	-	19.7	9.6	29.3
SUB-TOTAL (Metal & Eng.):		**53.1**	**343.6**				**53.1**	**n.a.**	**n.a.**	**-**	**n.a.**	**343.6**	**-**	**-**	**-**	**335.2**	**80.0**	**415.2**

to be continued...

RECIPIENT PARASTATAL	Loan No.	Loan Amount Nov-91	Loan Amount Nov-92	Interest Rate %	Interest Rate (Penal)	Repayment Period	Outstand Nov-91[a]	Arrears as at Nov-91 Princ	Arrears as at Nov-91 Inter	Arrears as at Nov-91 Penal	Arrears as at Nov-91 Total	Outstand Nov-92[a]	Repaid as at Nov-92 Princ	Repaid as at Nov-92 Inter	Repaid as at Nov-92 Total	Arrears as at Nov-92 Princ	Arrears as at Nov-92 Inter	Arrears as at Nov-92 Total
National Textile Corporation (Textiles):																		
Friendship Textile Mill	34	7.0	7.0	2.5	-	Sep-80 - May-90	0.4	n.a.	n.a.	-	n.a.	0.4	6.7	1.0	7.7	0.4	0.7	1.1
Friendship Textile Mill	229	66.0	66.0	10.0	-	Jan-89 - May 89	25.6	25.6	4.3	-	29.9	25.6	40.4	3.3	43.7	25.6	8.0	33.6
Sub-Total:		73.0	73.0				26.0	n.a.	n.a.	-	n.a.	26.0	47.1	4.3	51.4	26.0	8.7	34.7
Musoma Textiles	198	65.0	65.0	10.0	-	Dec-88 - Dec-89	65.0	65.0	16.3	-	81.3	65.0	-	-	-	65.0	25.5	90.5
Tanz. Packages Manuf.	182	10.0	10.0	10.0	-	Dec-88 - Jun-90	10.0	10.0	2.5	-	12.5	10.0	-	-	-	10.0	3.9	13.9
Tanz. Packages Manuf.	309	-	70.0	20.0	-	Jan-93 - Oct-93	-	-	-	-	-	70.0	-	-	-	-	4.5	4.5
Sub-Total:		10.0	80.0				10.0	10.0	2.5	-	12.5	80.0	-	-	-	10.0	8.4	18.4
TEXCO	26	40.0	40.0	6.0	-	Dec-74 - Dec-88	12.0	n.a.	n.a.	-	n.a.	12.0	28.0	6.9	34.9	12.0	14.0	26.0
TEXCO[##]	112	699.3	93.2	-	-	Oct-73 - Oct-74	582.7	n.a.	n.a.	-	n.a.	86.7	6.5	-	6.5	86.7	-	86.7
TEXCO	114	20.0	20.0	-	-	Oct-87 - Oct-88	20.0	n.a.	n.a.	-	n.a.	20.0	-	-	-	20.0	-	20.0
TEXCO	170	80.0	80.0	10.0	-	Apr-88 - Jun-88	42.3	42.3	13.2	-	55.5	42.3	37.7	2.3	40.0	42.3	19.2	61.5
TEXCO	277	520.0	520.0	14.5	(27.0)	Mar-91 - Aug-91	520.0	346.7	37.7	13.4	397.8	520.0	-	-	-	520.0	144.5	664.5
Sub-Total:		1,359.3	753.2				1,177.0	n.a.	n.a.	13.4	n.a.	681.0	72.2	9.2	81.4	681.0	177.7	858.7
SUB-TOTAL (Textiles):		**1,507.3**	**971.2**				**1,278.0**	**n.a.**	**n.a.**	**13.4**	**n.a.**	**852.0**	**119.3**	**13.5**	**132.8**	**782.0**	**220.3**	
																		1,002.3
Less Loan No. 112:		**808.0**	**878.0**				**695.3**	**n.a.**	**n.a.**	**13.4**	**n.a.**	**765.3**	**112.8**	**13.5**	**126.3**	**695.3**	**220.3**	**915.6**
Tanzania Leather Associated Industries (Leather):																		
Morogoro Canvas Mill	276	120.0	120.0	14.5	(27.0)	Mar-91 - Dec-91	120.0	48.0	4.4	1.7	54.1	120.0	-	-	-	120.0	29.0	149.0
Morogoro Canvas Mill	279	115.1	115.1	-	-	Aug-90 - Aug-91	111.2	n.a.	n.a.	-	n.a.	111.2	3.9	-	3.9	111.2	-	111.2
Sub-Total:		235.1	235.1				231.2	n.a.	n.a.	1.7	n.a.	231.2	3.9	-	3.9	231.2	29.0	260.2
Morogoro Shoe Co.	179	15.0	15.0	10.0	(1.0)	Dec-88 - Dec-90	15.0	15.0	4.1	-	19.1	15.0	-	-	-	15.0	6.5	21.5
Morogoro Tanneries	181	10.0	10.0	10.0	-	Feb-88 - May-88	9.5"	10.0"	3.2	-	13.2	9.5	0.5	-	0.5	9.5	4.5	14.0
Mwanza Tanneries	195	20.0	20.0	10.0	-	Dec-88 - Dec-90	20.0	20.0	5.0	-	25.0	20.0	-	-	-	20.0	7.8	27.8
Tanz. Shoe Co. (Bora)	178	16.0	16.0	-	-	Aug-87 - Jul-88	16.0	16.0	-	-	16.0	16.0	-	-	-	16.0	-	16.0
SUB-TOTAL (Leather):		**296.1**	**296.1**				**291.7**	**n.a.**	**n.a.**	**1.7**	**n.a.**	**291.7**	**4.4**	**-**	**4.4**	**291.7**	**47.8**	**339.5**
Tanzania Saruji Corporation (Cement, Ceramics & Glass):																		
Mbeya Cement Co.	290	-	150.0	-	(1.0)	Sep-91 - Feb-92	-	-	-	-	-	150.0	-	-	-	150.0	-	150.0
Tanz. Saruji Corp.	63	0.6	0.6	12.5	-	Jul-84 - Jun-85	0.6	0.6	0.5	-	1.1	0.6	-	-	-	0.6	0.6	1.2
Tanz. Saruji Corp.	266	100.0	100.0	-	-	Mar-90 - Jun-90	100.0	100.0	-	-	100.0	100.0	-	-	-	100.0	-	100.0
Sub-Total:		100.6	100.6				100.6	100.6	0.5	-	101.1	100.6	-	-	-	100.6	0.6	101.2
SUB-TOTAL (Cement etc.):		**100.6**	**250.6**				**100.6**	**100.6**	**0.5**	**-**	**101.1**	**250.6**	**-**	**-**	**-**	**250.6**	**0.6**	**251.2**
Trade:																		
CORETCO (Region. Trade?)	66	2.5	2.5	7.5	-	Dec-83 - Dec-86	1.9	1.9	1.1	-	3.0	1.9	0.6	-	0.6	1.9	1.3	3.2
State Trading Corp.[aa]	4	<0.1	<0.1	4.0	-	Feb-70 - Feb-74	<0.1	n.a.	n.a.	-	n.a.	<0.1	<0.1	<0.1	<0.1	<0.1	<0.1	<0.1
SUB-TOTAL (Trade):		**2.5**	**2.5**				**1.9**	**n.a.**	**n.a.**	**-**	**n.a.**	**1.9**	**0.6**	**-**	**0.6**	**1.9**	**1.3**	**3.2**

to be continued...

RECIPIENT PARASTATAL	Loan No.	Loan Amount Nov-91	Loan Amount Nov-92	Interest Rate %	Interest Rate (Penal)	Repayment Period	Outstand Nov-91[a]	Arrears as at Nov-91 Princ	Arrears as at Nov-91 Inter	Arrears as at Nov-91 Penal	Arrears as at Nov-91 Total	Outstand Nov-92[a]	Repaid as at Nov-92 Princ	Repaid as at Nov-92 Inter	Repaid as at Nov-92 Total	Arrears as at Nov-92 Princ	Arrears as at Nov-92 Inter	Arrears as at Nov-92 Total
Other Industries & Trade:																		
Auto Mech (Motor)***	313	-	150.0	20.0	-	Sep-93 - Jun-96	-	-	-	-	-	150.0	-	-	-	-	5.0	5.0
HANDICO (Handicrafts)	89	2.5	2.5	8.0	-	Aug-87 - Jul-89	2.5	n.a.	n.a.	-	n.a.	2.5	-	0.2	0.2	2.5	0.9	3.4
TACONA (Concrete)	236	1.2	1.2	-	-	Feb-87 - Jan-88	1.2	1.2	-	-	1.2	1.2	-	-	-	1.2	-	1.2
SUB-TOTAL (Other Ind.):		**3.7**	**153.7**				**3.7**	**n.a.**	**n.a.**	**-**	**n.a.**	**153.7**	**-**	**0.2**	**0.2**	**3.7**	**5.9**	**9.6**
TOTAL (Ind. & Trade):		**1,963.3**	**2,017.7**				**1,729.0**	**n.a.**	**n.a.**	**15.1**	**n.a.**	**1,893.5**	**124.3**	**13.7**	**138.0**	**1.665.1**	**355.9**	**2,021.0**
Less Loan No. 112:		**1,264.0**	**1,924.5**				**1,146.3**	**n.a.**	**n.a.**	**15.1**	**n.a.**	**1,806.8**	**117.8**	**13.7**	**131.5**	**1,578.4**	**355.9**	**1,934.3**
NATURAL RESOURCES & TOURISM:																		
TAFICO (Fisheries)	83	4.5	4.5	8.0	-	Mar-86 - Feb-87	1.2	1.2	0.6	-	1.8	1.0	3.5	-	3.5	1.0	0.6	1.6
Tanzania Tourist Corporation (Tourism):																		
Mikumi Wildlife Lodge	241	10.0	10.0	10.0	-	Jul-89 - Jul-93	10.0	4.0	1.9	-	5.9	10.0	-	-	-	8.0	3.3	11.3
New Safari Hotel	310	-	20.0	20.0	-	Jan-93 - Oct-93	-	-	-	-	-	20.0	-	-	-	-	1.3	1.3
Tanz. Tourist Corp.	27	6.1	6.1	-	-	Dec-78 - Dec-93	5.6	n.a.	n.a.	-	n.a.	5.6	0.5	-	0.5	5.1	-	5.1
Tanz. Tourist Corp.	28	18.2	18.2	- **	-	Dec-68 - Jun-92	4.5	n.a.	n.a.	-	n.a.	4.5	13.6	-	13.6	4.5	4.9	9.4
Tanz. Tourist Corp.	32	4.2	4.2	-	-	Jul-80 - Jun-82	3.9	n.a.	n.a.	-	n.a.	3.9	0.4	-	0.4	3.9	-	3.9
Tanz. Tourist Corp.	312	-	11.5	-	-	Dec-79 - Dec-80""	-	-	-	-	-	11.5	-	-	-	11.5	-	11.5
Sub-Total:		28.5	40.0				14.0	n.a.	n.a.	-	n.a.	25.5	14.5	-	14.5	25.0	4.9	29.9
SUB-TOTAL (Tourism):		**38.5**	**70.0**				**24.0**	**n.a.**	**n.a.**	**-**	**n.a.**	**55.5**	**14.5**	**-**	**14.5**	**33.0**	**9.5**	**42.5**
Tanzania Wood Industries Corporation (Wood):																		
Fibreboards Africa	238	162.6	162.6	10.0	-	Aug-89 - Jul-94	114.5	n.a.	n.a.	-	n.a.	89.9	72.7	23.3	96.0	35.7	13.8	49.5
KILTIMBER	282	100.0	100.0	15.0	(27.0)	Feb-94 - Aug-98	100.0	-	-	-	-	100.0	-	-	-	-	-	-
TWICO/Tanz. Timber Markt.	29	3.1	3.1	-	-	Mar-79 - Apr-82	2.1	n.a.	n.a.	-	n.a.	2.1	1.0	-	1.0	2.1	-	2.1
SUB-TOTAL (Wood):		**265.7**	**265.7**				**216.6**	**n.a.**	**n.a.**	**-**	**n.a.**	**192.0**	**73.7**	**23.3**	**97.0**	**37.8**	**13.8**	**51.6**
TOTAL (Nat. Res. & Tour.)		**308.7**	**340.2**				**241.8**	**n.a.**	**n.a.**	**-**	**n.a.**	**248.5**	**91.7**	**23.3**	**115.0**	**71.8**	**23.9**	**95.7**

to be continued...

RECIPIENT PARASTATAL	Loan No.	Loan Amount Nov-91	Loan Amount Nov-92	Interest Rate %	Interest Rate (Penal)	Repayment Period	Outstand Nov-91[a]	Arrears as at Nov-91 Princ	Arrears as at Nov-91 Inter	Arrears as at Nov-91 Penal	Arrears as at Nov-91 Total	Outstand Nov-92[a]	Repaid as at Nov-92 Princ	Repaid as at Nov-92 Inter	Repaid as at Nov-92 Total	Arrears as at Nov-92 Princ	Arrears as at Nov-92 Inter	Arrears as at Nov-92 Total
OTHERS:																		
AICC (Conference Centre)	64	5.6	5.6	5.0	-	Mar-86 - Feb-88	5.6	5.6	2.1	-	7.7	5.6	-	-	-	5.6	2.6	8.2
AICC (Conference Centre)	65	5.6	5.6	-	(5.0)	Jun-86 - Dec-88	5.6	5.6	1.4	-	7.0	5.6	-	-	-	5.6	1.8	7.4
AICC (Conference Centre)	224	10.0	10.0	-	(5.0)	Jan-89 - Jul-89	10.0	10.0	1.2	-	11.2	10.0	-	-	-	10.0	1.9	11.9
Sub-Total:		21.2	21.2				21.2	21.2	4.7	-	25.9	21.2	-	-	-	21.2	6.3	27.5
East African Commun.*	1	0.7	0.7	3.0	-	Sep-70 - Mar-82	0.7	n.a.	n.a.	-	n.a.	0.7	-	-	-	0.7	0.4	1.1
LIDA (?)	19	1.4	1.4	6.8	-	Apr-74 - Apr-93	1.4	n.a.	n.a.	-	n.a.	1.4	-	-	-	1.3	2.2	3.5
LIDA (?)	22	1.7	1.7	4.0	-	Jun-75 - Jun-84	1.7	n.a.	n.a.	-	n.a.	1.7	-	-	-	1.7	1.5	3.2
LIDA (?)	25	1.2	1.2	-	-	Mar-72 - May-73	1.2	n.a.	n.a.	-	n.a.	1.2	-	-	-	1.2	-	1.2
Sub-Total:		4.3	4.3				4.3	n.a.	n.a.	-	n.a.	4.3	-	-	-	4.2	3.7	7.9
TOTAL (Others):		**26.2**	**26.2**				**26.2**	**n.a.**	**n.a.**	**-**	**n.a.**	**26.2**	**-**	**-**	**-**	**26.1**	**10.4**	**36.5**
TOTAL 73 LOANS:		**4,102.7**	**4,426.8**				**3,650.7**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**3,804.9**	**622.2**	**43.6**	**665.8**	**2,682.0**	**518.4**	**3,200.4**
Less Loans No. 110 & 112:		**2,746.7**	**4,222.4**				**2,412.5**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**3,607.5**	**615.2**	**43.2**	**658.4**	**2,484.6**	**518.4**	**3,003.0**

Notes: For better readability, the value zero (0.0) is represented by a dash (-).
* These recipients are not parastatals.
** A 'second' rate of interest of 8.0 % was reported for loan no. 28, but the implication of this is unknown.
*** State minority share holding.
\# It is uncertain whether this is a bridging-finance loan or not.
\#\# It may be noted that the loan amounts of the two loans differ between November 1991 and November 1992. Whether this difference is due to mere printing errors, whether the debts have been restated, e.g. because of conversion of the debt into equity, or whether there are other explanations, is unknown.
@ Includes principal only.
@@ Because of the small amounts involved, they have been excluded from the total.
" These figures are, for unknown reason, incompatible.
"" The correctness of this repayment period may be questioned, provided that the loan numbers are in chronological order.

Sources: Own calculations based on Ministry of Finance (1991c), (1992c) and (1992d).

Table A.27: Government Loans to Parastatals in Tanzania, 1979/80-1991/92 (Million TSh)

Year	Issued/ On-Lent (1)	Change (%) (2)	Amount Repaid (3)	Balance Outstand. (4)	Change Amount (5)	Change (%) (6)	Forex* Fluctu. (7)	(7)/(4) (%) (8)	(7)/(5) (%) (9)	Principal Arrears (10)	(10)/(4) (%) (11)	Interest Arrears (12)	(12)/(4) (%) (13)	Tot. Arr. (10)+(12) (14)	(14)/(4) (%) (15)
1979/80	0.1	-	65.0	1,038.9	-	-	-	-	-	31.8	3.1	30.9	3.0	62.7	6.0
1980/81	-	-	47.8	1,502.0	463.1	44.6	-	-	-	52.2	3.5	-	-	-	-
1981/82	392.8	-	12.0	1,882.3	380.3	25.3	-	-	-	89.1	4.7	59.1	3.1	148.2	7.9
1982/83	-	-	31.0	-	-	-	-	-	-	-	-	-	-	-	-
1983/84	-	-	61.5	1,824.0	-	-	-	-	-	-	-	-	-	-	-
1984/85	33.6	-	29.9	1,827.7	3.7	0.2	-	-	-	212.8	11.6	136.2	7.5	349.0	19.1
1985/86	0.0	-	4.4	1,704.1	-123.6	-6.8	-	-	-	221.3	13.0	213.6	12.5	434.9	25.5
1986/87	1,612.0	-	49.0	11,218.0	9,513.9	558.3	-	-	-	1,673.3	14.9	1,656.3	14.8	3,329.6	29.7
1987/88	648.4	-59.8	174.9	80,953.8	69,735.8	621.6	-	-	-	6,167.1	7.6	7,242.6	8.9	13,409.7	16.6
1988/89	2,187.1	237.3	475.1	119,638.6	38,684.8	47.8	-	-	-	17,157.6	14.3	19,951.3	16.7	37,108.9	31.0
1989/90	6,836.4	212.6	421.3	183,651.8	64,013.2	53.5	-	-	-	33,019.8	18.0	37,924.6	20.7	70,944.4	38.6
1990/91	14,954.2	118.7	1,017.3	224,002.7	40,350.9	22.0	26,414.0	11.8	65.5	49,336.9	22.0	57,184.6	25.5	106,521.5	47.6
1991/92	36,249.1	142.4	1,188.0	340,088.5	116,085.8	51.8	81,024.7	23.8	69.8	78,869.1	23.2	92,282.1	27.1	171,151.2	50.3

Notes: A dash (-) indicates that data are unavailable.
* The Exchange Rate (Forex) Fluctuations are taken into account in the Balance Outstanding (Column 4).

Source: Own calculations based on Ministry of Finance (1992e).

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