Policy brief TZ.10/2010E

Should Tanzania Borrow Commercially?

1. Introduction

In her much discussed book, "Dead Aid: Why aid is not working and how there is a better way for Africa" Dambisa Moyo[1] has a suggestion about how African countries could get themselves out of the mess created by the aid industry: borrow commercially, and take charge of own development. Could Tanzanian Government be taking notice of this message?

Tabling the budget proposals for 2010/11 to the Parliament in June of 2010, the Minister for Finance announced the Government's intention to borrow, not only from traditional sources but also commercially. The idea to borrow commercially was earlier considered in 2007/08 but put aside due to unfavourable conditions in the international financial markets at the time. Now the idea is back.

2. Debt stock: where does Tanzania stand?

At the end of June 2010, Tanzania's debt stock was 9.9 billion US dollars. At June exchange rates this amount is equivalent to 13.6 trillion shillings (Figure 1). It is the same as saying that as of June 2010 every Tanzanian owed the lenders roughly Tsh 332,000 in public debt.

This fiscal year (2010/11) the Government will borrow Tsh. 2,128.832 billion (2.1 trillion) on commercial terms domestically and from abroad. Of this amount, Tsh 797.62 billion will not be new debt: the government will be selling new treasury securities (bills and bonds) to pay for the redemption of maturing ones. This typically keeps debt at more or less the same level. The other Tsh. 1.3 trillion shillings will be new debt which according to the Minister for Finance will pay for infrastructure developments. With an additional Tsh. 1.21 trillion net borrowing on concessional terms (soft loans) the stock of debt is expected to grow by about Tsh. 2.54 trillion or Tsh. 54,300 per Tanzanian, give or take a few shillings, by June 2011.

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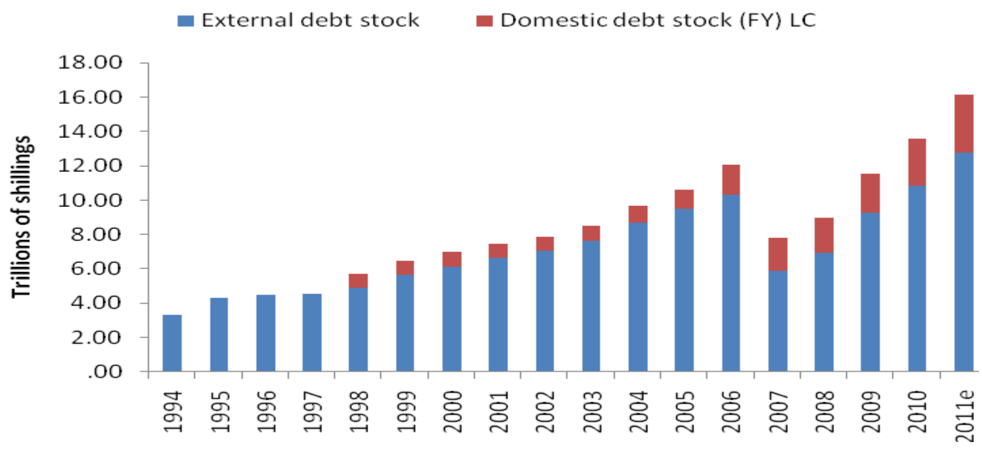
Figure 1: Public debt stock

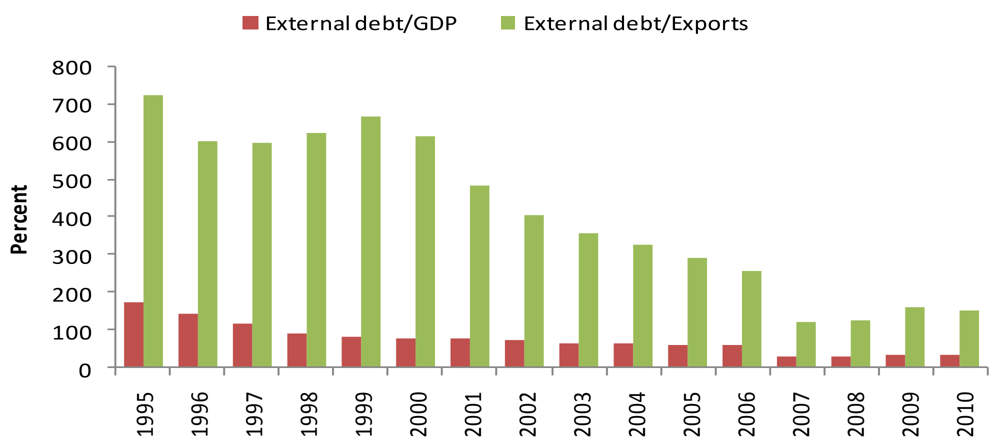


Source of data: Authors' calculations based on Bank of Tanzania Statistics bulletins

3. Commercial borrowing, a possibility again

The possibility of Tanzania borrowing on commercial terms has opened a new window of opportunity that was unavailable for quite some time. Without massive debt relief, largely delivered between 2000 and 2007 under the Highly Indebted Poor Countries (HIPC) initiative and Multilateral Debt Relief Initiative (MDRI), international commercial loans to Tanzania would have remained a farfetched dream because Tanzania was debt stressed and therefore not a creditworthy borrower. There was a time in late 1990s when the ratio of external debt to GDP shot up to above 100 percent and the external debt to exports ratio was well above 500 percent (Figure 2). Commercial lenders simply refused to extend credit to Tanzania. Consequently soft loans and grants from bilateral donors and multilateral financial institutions became Tanzania's main source of deficit financing.

Figure 2: Debt to GDP and external debt to export ratio



Source of data: Author's calculations based on Bank of Tanzania's statistics bulletins

Thanks to debt relief Tanzania's debt service indicators improved. High GDP and export growth further helped the debt-GDP and debt to export ratios to improve to the point where a recent Joint debt analysis of Tanzania by the IMF and the World Bank suggests that the risk of debt distress is low. With that, Tanzania now qualifies for commercial loans.[2]

4. Tanzania can borrow commercially, but should it?

Should the opportunity for commercial borrowing be embraced? And what are the chances of Tanzania plunging back into another unsustainable debt situation?

Current statistics do not indicate Tanzania plunging into an unsustainable debt situation shortly in the future: both debt-GDP and debt-export earnings ratios are at sound levels. However the Government must not lose sight of the fact that each shilling it borrows is a liability Tanzanians will have to bear through more taxes. For that matter, debt sustainability indicators must be kept healthy by sustaining strong growth of exports as well as GDP.

In addition, investments made on borrowed money ought to achieve value for money spent and benefit its people equitably. If they fail to meet this criterion at planning stage and in the course of implementation, Tanzania is likely to plunge in debt distress again in the future. History has an important lesson to teach here. A good part of the debt accumulated in the pre-debt relief era was not effectively used, and the benefits to society were skewed to certain groups or localities. The significant infrastructure shortfalls facing Tanzania despite a huge debt it accumulated in those years indicates this actuality. Nevertheless, the debt had to be serviced, except of course where lenders were willing to write it off.

5. Not paying one's debt is expensive

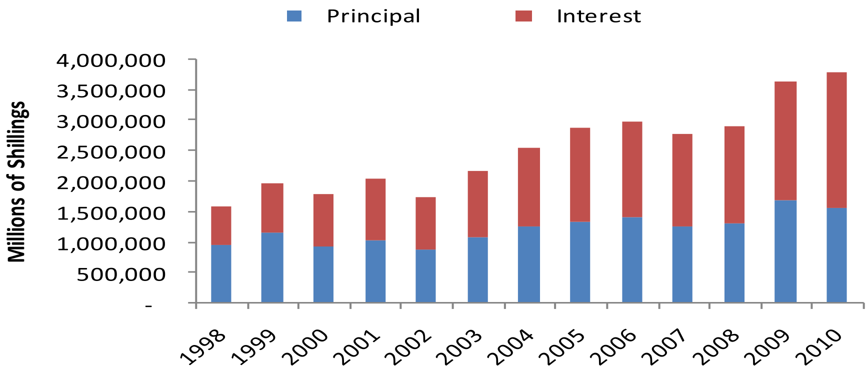
In the 1980s Tanzania borrowed Tsh 49 billion from Brazil to finance a road project connecting Morogoro and Dodoma. The debt was never serviced. By 2010, it had accumulated to USD 240 million. Fortunately for Tanzania, after long negotiations, the Brazilian authorities recently agreed to waive it.[3]

If the Tsh 2,128.8 billion that the Government will borrow on commercial terms in 2010/11 is not serviced, it could in a decade also balloon to an amount too painful to service. For instance, if the loan is charged a 5 percent interest rate per year, payable monthly and is not serviced, in 10 years this amount will have increased by 65% and will have more than doubled in 15 years.

Not paying one's debt is expensive. The longer maturing obligations are not serviced the higher the interest accumulated become. The debt owed to Brazil just demonstrates how bad this can be. Such a risk is also more pronounced in the case of foreign borrowing on commercial terms, which normally does not have grace periods and charges relatively higher interest rates.

Another concern is whether Tanzania will be able to manage its debt service obligations. At present, not all existing debt is serviced, and more commercial borrowing could cause additional strain. As of June 2010, the country had debt service arrears comprising principal and unpaid interest worth USD 2,760.8 million (or Tsh 3.8 trillion). Unpaid interest accounts for the bulk of the arrears (Figure 3).

Figure 3: Tanzania debt service arrears 1998-2010



Source of data: Bank of Tanzania statistics bulletins

Selling new securities to redeem maturing debt is straightforward when dealing with domestic debt since the transactions are based on the same currency. It is not however a solution that can be relied upon in the case of foreign debt because foreign debt must be paid in foreign currencies and is prone to exchange rate risk. The new commercial debt must be serviced steadfastly.

6. Tanzania could become more transparent

There may be an up-side to commercial borrowing, in terms of transparency about public assets, liabilities, as well as the budget. Commercial borrowers are much more likely to demand strict adherence to transparency and disclosure of financial obligations than bilateral or multilateral donors whose actions are subject to political considerations.

By dealing with commercial lenders, the Government is likely to tie its hands and be forced to provide reliable and perhaps more detailed information and statistics about its budget, budget composition, obligations, assets and liabilities, guarantees, etc in a manner that is more transparent than at present.[4]

7. Conclusion

New commercial debt is certainly a possibility but one that should not be embarked on lightly. It is not evident that in the future lenders would be prepared to go through another round of debt relief. Beyond that National pride should prevent Tanzania from having to ask lenders again for forgiveness. This implies that when contracting new obligations Tanzania needs to make sure that it is more careful in negotiating the terms, utilises it to effectively benefit its people, and strives to keep the debt indicators healthy.

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1 Dambisa Moyo (2009). Dead Aid: Why aid is not working and how there is a better way for Africa, London, Allen Lane

2 The IMF/WB assessment is subject to Tanzania maintaining a sound debt management strategy, a conservative approach to non-concessional borrowing, and rigorous evaluation of the quality and feasibility of investment projects IMF (2010), IMF Country report No. 10/173.

[3] http://www.thecitizen.co.tz/component/content/article/37-tanzania-top-news-story/2836-brazil-leader-offers-240m-debt-waiver.html

[4] For instance the Open Budget Index (OBI) finds Tanzania to have only a minimal level of budget transparency. See: http://openbudgetindex.org/files/cs_tanzania.pdf