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FINANCIAL LINKAGE AND DEVELOPMENT IN SUB-SAHARAN AFRICA:

THE ROLE OF FORMAL FINANCIAL INSTITUTIONS IN TANZANIA

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February 1996

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ISBN 0 85003 228 8

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Preface

As part of Structural Adjustment Programmes, many governments is sub-Saharan Africa initiated a large scale restructuring of the financial system in the 1980s. Emphasis in these programmes was placed on the need to i) adopt financial liberalisation measures, and ii) enhance regulatory and supervisory functions to ensure prudence of the financial institutions. Special Financial Sector Adjustment loans have been taken up to uphold reform measures and to restructure and strengthen distressed financial systems in several African countries. An improved regulatory environment with enhanced supervision is underscored in these operations, while the recent literature on the subject points to the need for careful design of the sequence, pace and timing of financial liberalisation and the importance of its coordination with changing macroeconomic conditions.

However, financial reform has at best had limited *developmental* effect in the region so far. It has been increasingly recognised that adoption of financial liberalisation policy alone has not been sufficient to generate a strong response in terms of increased savings mobilisation and intermediation through the financial system, wider access to financial services, and increased investment by the private sector. Fragmentation of financial markets persists, impeding efficient resource mobilisation and financial intermediation.

Given this background, a research project, 'Financial Integration and Development in sub-Saharan Africa' has been undertaken at ODI, with financial support from the World Bank and SIDA, to examine the performance of financial systems for resource mobilisation and intermediation for economic development in Sub-Saharan Africa. The field work has been conducted in Ghana, Malawi, Nigeria and Tanzania, based on common questionnaires addressed to formal, semi-formal and informal institutions and borrowers. The main objectives of research were to:

i) investigate the nature and degree of fragmentation and segmentation of financial markets in Sub-Saharan Africa;

ii) examine the sources of segmentation against several theoretical paradigms and evaluate the conditions under which linkages between segments utilise the comparative advantages of each, and obstacles to such linkages;

iii) examine operational constraints facing formal financial institutions and informal associations/lenders;

iv) evaluate the effects of financial liberalisation on the whole financial system; in particular, to provide understanding of the impediments to financial deepening in Africa and the extent to which they can be relieved through financial liberalisation and through active policies of positive interventions, technical assistance and infrastructure that support market development by facilitating information flows and lowering transaction costs and risks;

v) help the design of long-term policies towards financial sector development and evaluate which policy and institutional measures can most effectively accelerate the financial system's ability to mobilise resources and intermediate between saving and investment for broad-based development in Africa.

This present paper is one of a series that will provide initial presentation of results of the country case studies. It presents the *Tanzanian* case study, reporting the results of the field work on the behavioural characteristics of *formal* financial organisations/agents and the operational constraints in urban and rural areas.

Machiko Nissanke
(Project Coordinator)

May 1995

Contents

ANOVA - Analysis
BOT - Bank of
CCM - Chama c
CRDB - Cooperat
DJIT - Diamond
FFIs - Formal F
GDP - Gross Dc
IFIs - Informal
LART - Loans an
NBC - National
NIC - National
NMC - National
NCPI - National
NGO - Non Gov
NPF - National
PPF - Parastata
PBZ - People's
ROSCAs - Rotating
SSA - sub-Saha
TDFL - Tanganyi
THB - Tanzania
TIB - Tanzania Investment Bank
TPB - Tanzania Postal Bank
ZIC - Zanzibar Insurance Corporation

1. Introduction

1.1 Objectives

This study of formal financial institutions (FFIs) in Tanzania is part of a wider financial sector study which also covers the semi-formal and informal financial institutions (IFIs) in three other sub-Saharan African (SSA) countries – Ghana, Malawi, and Nigeria. The informal finance component of the Tanzanian study was completed during the first phase of the survey (Bagachwa, 1994). The principal objective of the broader comparative study is to identify policy, structural and institutional measures that can accelerate (or impede) the process of financial integration and improve intermediation in SSA in the context of the financial dualism that exists at present. Specifically, the objectives of the Tanzanian component of the formal finance study are to:

(a) investigate factors that can explain the existence and persistence of dualism in Tanzania's financial markets despite recent attempts to liberalise these markets, and

(b) identify policy, institutional and structural factors and measures that can accelerate (or impede) the process of financial market integration, deepening and improving intermediation in Tanzania.

1.2 Issues and hypotheses

The central issue of the study revolves around the determinants of the existence of dualism in Africa's financial markets and its persistence despite liberalisation of those markets. The overwhelming evidence that financial systems in SSA are dualistic (Seibel and Marx, 1987; Adams and Fitchett, 1992), as confirmed by the results of the recent surveys of informal finance carried out in the four countries covered by the study, provides the context within which there is little interaction between segments within the informal sector and formal and informal segments of the financial systems in the four countries (see Aryeetey, 1994 for Ghana; Bagachwa, 1995 for Tanzania; Chipeta and Mkandawire, 1995 for Malawi; and Soyibo 1995 for Nigeria). Evidence of absence of integration (i.e. fragmentation) was reflected in the normally observed and statistically significant differences in interest rates both between segments and between savers and borrowers. Interaction and linkages between the informal and formal financial sectors were also observed to be weak. One important finding of the informal sector studies is that the various financial market segments may, in fact, be representing efficient specialisation for different niches, suggesting the need for selective development rather than simply extending the formal sector's frontier.

Another revelation of the studies is that the financial repression hypothesis, which explains dualism in terms of restrictive financial policies and controls that shift investible resources from the market to the government, may not necessarily be the only cause of fragmentation. The four countries studied have all experienced repressive financial policies and attempted to liberalise them as part of structural adjustment reforms. However, the studies have revealed that significant expansion in the volume of informal credit and in the mobilisation of informal savings were taking place in a much more liberalised environment than previously. If the informal credit market was strictly a parallel market in the sense that it reflected solely a disequilibrium in the official credit market resulting from government control of interest rates, then liberalisation of interest rates would have eliminated this channel of credit (Bagachwa, 1995). Finally, there is evidence that informal financial institutions appear to be operating with low transaction costs.

The findings based on studies of informal financial institutions, though informative, are, however, partial. To be comprehensive and much more conclusive, their results should also be compared with the behaviour and changes in the portfolios of formal financial institutions. Within the Tanzanian context, given the extent and depth of state control and the excessive government intervention in the formal financial system, one can plausibly postulate that financially repressive policies may have stimulated the growth of the informal financial sector. Furthermore, and as implied by the earlier study on informal finance, the existence of financial market segmentation may also reflect the different advantages which formal and informal financial institutions have in dealing with different types of clients.

The persistence of fragmentation within and between formal and informal institutions can then be attributed to both structural and institutional factors. For example, lack of information, high risk perception, high transaction costs, expensive contract enforcement or lack of interest may prevent formal financial institutions from lending to informal units and other small borrowers. However, within formal units fragmentation may persist for various reasons. The short-term nature of commercial banks' assets and excess liquidity may provide little incentive for term lending or for mobilising term deposits (Nissanke, 1993). Likewise, the absence of developed money and capital markets and/or centralised decision-making may explain why formal financial units do not engage in active portfolio management.

1.3 Sample coverage and methodology

At the inception stage of the study in 1992, a preliminary review of the formal financial sector in Tanzania had considered the following major formal financial institutions.

One (Central) Bank of Tanzania (BOT).

Three Commercial banks:

- National Bank of Commerce (NBC).
- Co-operative and Rural Development Bank (CRDB).
- People's Bank of Zanzibar (PBZ).

Three Thrift institutions or near banks:

- Tanzania Housing Bank (THB).
- Tanzania Postal Bank (TPB).
- Diamond Jubilee Investment Trust (DJIT).

Two Contractual savings institutions:

- National Provident Fund (NPF).
- Parastatal Pension Fund (PPF).

Two Development finance institutions:

- Tanzania Investment Bank (TIB).
- Tanganyika Development Finance Company Limited (TDFL).

Two Insurance companies:

- National Insurance Corporation (NIC).
- Zanzibar Insurance Corporation (ZIC).

One Hire-purchase company:

- Karadha Company

From the outset it was decided that secondary information was to be collected on each of the above financial institutions. However, in anticipation of certain practical difficulties, especially non-availability of data, primary data were to be collected on the three commercial banks, the three savings institutions and the two development finance institutions. Unfortunately, the National Bank of Commerce and the Diamond Jubilee Investment Trust refused to co-operate. The People's Bank of Zanzibar and Tanganyika Development Finance Company Limited agreed to co-operate in principle but their branches did not respond to the questionnaires. The refusal to co-operate by the National Bank of Commerce meant that the sample branches were to be drawn mainly from urban areas since only the National Bank of Commerce has an extensive (about 144) rural branch network.

In view of these problems, no formal sampling procedure was adopted. Instead, questionnaires were sent to all of the existing 15 Co-operative and Rural Development Bank branches, all the 20 Tanzania Housing Bank branches, all the 19 Tanzania Postal Bank branches, three of the four People's Bank of Zanzibar branches, the single Tanzania Investment Bank branch and the only Tanganyika Development Finance Company Limited branch. Even then the response was not satisfactory. Of the 58 questionnaires distributed only 38 (about 65%) were returned. Of these 38, only 30 questionnaires could be described as being satisfactory in terms of the quality and quantity of responses. A major weakness of the sample is the absence of rural bank branches. Only 5 branches located in small rural towns have been covered.

The questionnaires sought very detailed information on deposit and loan characteristics, the nature and type of borrowers, loan processing, screening and monitoring procedures, repayment trends and associated costs. Thirty branches completed the questionnaires satisfactorily (almost half of those which received the questionnaires). These were distributed as follows: Tanzania Housing Bank (14); Tanzania Postal Bank (9); Co-operative and Rural Development Bank (6); and Tanzania Investment Bank (1). Five of the responding branches were based in the largest city Dar es Salaam, 20 were located in 13 regional headquarters and 5 came from small rural towns. The sample was scattered in 14 out of the 20 administrative regions in the country. Table 1 gives the distribution of the sample branches by type of institution and location.

Table 1 Distribution of sample bank branches by institution and location

Institution	*Location*			*Total*
	Dar es Salaam City	*Other Regional Towns*[a]	*Small Rural Towns*	
Co-operative and Rural Development Bank	1	3	2	6
Tanzania Housing Bank	1	13	0	14
Tanzania Postal Bank	2	4	3	9
Tanzania Investment Bank	1	0	0	4
Total	5	20	5	30

Source: Survey Data
Note: [a] regional headquarters

In addition to administering questionnaires at the branch level, structured interviews were carried out with the top management at the headquarters of the Bank of Tanzania, the National Bank of Commerce, the Co-operative and Rural Development Bank, the Tanzania Investment Bank and the Tanzania Postal Bank. Information sought related to deposit and loan characteristics, spreads and efficiencies, the management of non-performing loans, investment opportunities, liquidity and general portfolio management.

2. The formal financial system in Tanzania

2.1 The pre-reform financial superstructure (1965–91)

The Arusha Declaration of February 1967 required the Tanzanian Government to pursue policies that would transform the country into a socialist and self-reliant state. Subsequently, major industries, banking institutions, insurance and export–import businesses, most of which were foreign-owned, were nationalised. New financial institutions that were established after 1967 were to be publicly owned. The formal financial system that finally emerged in Tanzania was, for example, compared with that of neighbouring Kenya, relatively narrow and highly specialised[1]. Until recently (1991) it consisted of only 14 institutions. At the apex of the formal financial system is the Bank of Tanzania. The Bank was established in 1965 to combine both the conventional functions of the Central Bank e.g. issuing currency, regulating banking and credit, managing gold and foreign-exchange reserves and ensuring monetary stability, with a limited development role, i.e. the administrative allocation of credit and foreign exchange and managing loan guarantee schemes.

Until 1993 there were only three commercial banks. The National Bank of Commerce, the People's Bank of Zanzibar and the Co-operative and Rural Development Bank. These banks raised most of their funds through deposits of all types including current accounts. The National Bank of Commerce was established in 1967 following the nationalisation of nine foreign private banks. It is still 100% owned by the government. From 1967 to 1984 the NBC was the only commercial bank operating in Tanzania Mainland; the Co-operative and Rural Development Bank entered commercial banking only in 1984. The NBC with its 20 regional offices, 203 branches and 295 mobile agencies spread throughout the country, accounted for 85% of the national market for loans and deposits and 83% of total commercial banking assets in 1992. The Bank has continued to enjoy a monopoly on the Mainland.

The Co-operative and Rural Development Bank was established in 1971 as a rural development bank primarily to provide term finance for agricultural production and crop purchases. The government owns 67% of its shares, the Bank of Tanzania 25% and the Co-operative Union of Tanzania 8%. The Bank was reorganised in 1984, in the wake of the revival of co-operatives, to embark on commercial

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[1] In 1991 Kenya had a total 227 commercial banks, 57 non-bank financial institutions, 38 insurance companies, 11 operational building societies and over 2,000 savings and credit cooperative societies (Rutihinda, 1993).

banking operations. Its commercial banking network as of June 1992 comprised 15 regional offices, 17 branches, 9 agencies and staff of about 1,300, with 200 professionals.

The People's Bank of Zanzibar operates only in Zanzibar where it serves both as the sole commercial bank and as a quasi-central banker to the Zanzibar Government (except for issuing currency) and manager of its own official reserves. The Bank provides mainly short-term credit but since 1984 it has been providing a limited volume of long-term credit. The PBZ has three branches in Pemba and one in Zanzibar. It does not operate on the Mainland and therefore provides no competition on Tanzania Mainland.

In addition to the three commercial banks, there are two thrift (savings) institutions which raise part of their funds through public deposits, although they do not offer current accounts, namely, the Tanzania Housing Bank and the newly incorporated (1992) successor to Tanganyika Post Office Savings Bank, the Tanzania Postal Bank. The latter currently transacts only one type of banking business, namely, mobilisation of savings and fixed deposits with a view to investing in government securities. Before 1992 this was a secondary activity, the major one being the provision of postal services to the public. The newly incorporated bank has 86% of its shares owned by public corporations (Government of Tanzania, 41%; Tanzania Posts, 30%; Zanzibar Government, 10% with the remaining 19% reserved for the private sector). It intends to become a commercial bank in the near future. The Tanzania Housing Bank was established in 1972 to mobilise savings and finance investment in housing. So far, it has enjoyed a monopoly in the provision of loans for residential and commercial construction. The government owns 46.5% of the bank's shares, the National Insurance Corporation 30.2%, and National Provident Fund 23.3%. The resources of THB have been raised mainly through public deposits and borrowing from Workers and Farmers Housing Development Fund.

There are still only two major public insurance companies; the National Insurance Corporation with a virtual monopoly in Tanzania Mainland and the Zanzibar Insurance Corporation which operates in Zanzibar. There are also only two contractual savings institutions: the National Provident Fund and the Parastatal Pension Fund. These security institutions provide benefits for retirement, death, disability and unemployment. The most important development finance institutions, in addition to the THB, are the Tanzania Investment Bank and the Tanganyika Development Finance Company Limited. The Tanzania Investment Bank was set up as a statutory corporation in 1970, with 60% share holding by the government, 30% by the NBC and 10% by the National Insurance Corporation. The Bank has a near monopoly in the provision of development banking services, especially in the industrial corporate sector.

The Tanganyika Development Finance Company Limited was registered under the Companies Act in 1962. The government owns 24% of the company's shares; the remaining shares are held by foreign financial institutions. Neither the Tanzania Investment Bank nor the Tanganyika Development Finance Company Limited has access to short-term borrowing through deposits. They can only offer medium- and long-term credit. Two other less important financial institutions are the Diamond Jubilee Investment Trust which is a small financial institution (with about 600 accounts, mostly savings deposits) catering for the Ismaili-Asian community in Tanzania and the Karadha Company – a subsidiary of the NBC, which functions as the only hire-purchase company.

2.2 Main features of the pre-reform formal financial institutions: government-induced financial repression

The pre-reform financial policies in Tanzania can appropriately be described as financial repression (McKinnon, 1973; Shaw, 1973). The system was characterised by four salient features. A major feature of the system is that all the institutions except the Tanganyika Development Finance Company Limited and the Diamond Jubilee Trust are entirely or substantially owned by the government and their managements are under the government's direct control. As a consequence, government interference in day-to-day operations of FFIs has been pervasive. Directed credit has forced some institutions to extend credit to clients with little or no repayment prospects, thereby curtailing any proper assessment of the degree of risk and return.

A second feature is that the system was organised so that one institution generally had a virtual monopoly in its functional area. The state-owned National Bank of Commerce virtually monopolised commercial banking in Tanzania. Its total assets in 1992, were thirteen times larger than those of its next competitor – the Co-operative and Rural Development Bank. Government restrictions on entry and sectoral and functional specialisation, e.g. retail banking, rural banking, etc., further reduced the competitive pressure. Competition has thus been virtually absent, and this has meant lack of 'drive towards product innovation and customer orientation' (Kimei 1993:1).

A third feature is that each institution is governed by its own statute and the Bank of Tanzania's supervisory role over the totality of the financial system has been limited (Presidential Banking Commission, 1990). There was thus gross inadequacy of banking supervision. A fourth characteristic is that the environment in which the FFIs operated was also regulated by the state. Credit was allocated administratively by the Bank of Tanzania (BoT) which established legal ceilings on bank lending and deposits. The BoT also regulated interest rates in the form of a rigid schedule of fixed rates applicable to all kinds of deposits and advances, according to borrower category, purpose of loan, project location, and sector. There were restrictions on capital transactions with foreigners and there was no stock exchange market. In addition to fragmented interest rates within the formal financial sector, evidence has revealed the existence of a thriving informal sector which parallels and complements the formal one (Bagachwa, 1995; Hyuha et al., 1993).

Such a system of financial repression may be regarded as a form of taxation whereby the government extracts resources by direct borrowing from the banks at less than market rates through the imposition of interest-rate ceilings, levying an inflation tax on currency, or co-opting resources through unremunerated reserve requirements (Montiel, 1994).

2.3 Overall performance and constraints

The performance of the formal financial institutions in terms of resource mobilisation, credit operations, quality of service and profitability has been a major source of concern and dissatisfaction. A recent review of the financial system in Tanzania concluded that financial services had deteriorated to 'an unacceptable level' (Presidential Banking Commission, 1990:1). According to this report, savings mobilisation declined continuously between 1979 and 1986. Financial assets which were equivalent to nearly 50% of GDP in 1979, had fallen to 28% by 1986. The domestic savings rate which had peaked to 25% of GDP in 1977 fell thereafter to only 8% between 1983 and 1985. The commercial banks' role in mobilisation of deposits also declined. Bank deposits as a proportion of GDP declined from 31.2% in 1979 to 13.5% in 1987. Furthermore, currency in circulation came to account for a much larger proportion of total financial assets than previously. The currency–demand–deposit ratio rose from 0.59 in 1975 to 1.09 in 1987, suggesting a rise in the second or underground economy which uses mainly currency in order to escape detection (Maliyamkono and Bagachwa, 1990). Thus the commercial banking financial system had consequently failed in its role of savings mobilisation. Other non-bank institutions have also been performing poorly. The National Insurance Company's volume of business (under both general and life insurance) declined in real terms between 1978 and 1988. The Tanzania Postal Bank had failed to mobilise savings and fixed deposits to any significant extent, because of lack of commitment and of competent staff.

In addition, the formal financial institutions have not been effective and efficient in ensuring that the resources mobilised are productively deployed. The bulk of loans from commercial banks have gone to non-performing borrowers (mainly bankrupt co-operatives and marketing boards which have accounted for 69% of the loan portfolio, and industrial and commercial parastatals accounting for 17%). A large proportion of such loans are irrecoverable.

At the end of December 1988, for example, the National Bank of Commerce needed to make a total provision of TSh.34.6 billion (equivalent to 45% of its total portfolio) against loan losses. About 86% of the NBC's total outstanding loans were to co-operatives, the state-owned National Milling Corporation (NMC) and other parastatals. Only 14% was to private borrowers. Likewise, as of 30 June 1991, the Co-operative and Rural Development Bank's outstanding loans to the Co-operative Unions stood at TSh.6.13bn, i.e. 73% of the amount outstanding with the Unions or 92% of the bank's long-term capital (Keddie, 1992).

The portfolio of one of the major development banks, the Tanzania Investment Bank, contained 56% as bad loans, mostly to parastatal projects. The Tanzania Housing Bank also had to make provision for a total amount equivalent to 59% of its outstanding loans. Recent estimates put the non-performing assets of the major financial institutions on the Mainland (namely, the National Bank of Commerce, the Co-operative and Rural Development Bank, the Tanzania Investment Bank and the Tanzania Housing Bank) at TSh.200bn or equivalent to about 50% of their total assets or 50% of the government's total expenditure for 1993/94 (Kimei, 1993). This suggests that the major formal financial institutions were insolvent.

The other major institutions such as the insurance companies, the Tanzania Postal Bank and the National Provident Fund have invested most of their mobilised resources in low-yielding government bonds yielding negative returns in real terms to savers. For instance in 1989, about 90% of the National Provident Fund's social security funds and almost the whole of the then Post Office Savings Bank's investment funds were invested in government securities with an average return of only 7.5% against inflation of over 30% during most of the 1980s. The earnings from investments were lower than interest amounts paid on the Post Office Savings Bank's fund, resulting in a loss of TSh.440m. on total deposits of TSh.1,978 m.

In addition, the intermediation role of the formal financial system has been undermined by the absence of a capital market which could facilitate the development of modern businesses among private sector operators, and between domestic and foreign-owned joint ventures. None of the three development banks operate like capital market institutions. Up to 1993 the Companies Ordinance Act prevented both privately and publicly owned undertakings from floating shares for public subscription. This has prevented the development banks from mobilising long-term finance by operating in primary and security markets. As a result, they have depended heavily on foreign loans and grants. Similarly, other non-bank financial institutions like the National Insurance Corporation, the National Provident Fund and the Tanzania Postal Bank, which ideally should constitute part of the capital market, have been prevented by their legislation from operating in primary and secondary financial markets. Also lacking have been institutions which could provide risk capital for new ventures, and specialised institutions which could provide specialised assistance to special groups such as informal sector operators, first-generation and female entrepreneurs. With over 86% of the outstanding bank credit being channelled to co-operatives, marketing boards and parastatals, there are obvious gaps in the provision of term lending facilities to small-scale borrowers and the private sector in general for productive purposes.

The absence of prudential regulation (namely, laws and rules for minimising risk among transacting parties), strict supervision of FFIs and excessive Party and government intervention in these institutions' decision-making have been other sources of financial malfunctioning. For example, before 1991, there were no standard prudential ratios for FFIs specifying rules for the classification of credit according to risk, for the definition of delinquent loans and for making provision for them. Although the 1971 and 1978 amendments to the 1967 Bank of Tanzania Act empowered the Bank independently to supervise the other financial institutions, these powers have never been used effectively,[2] thus leading to very little public confidence in existing banks and a thriving informal banking system (Maliyamkono and Bagachwa, 1990). Moreover, the Bank of Tanzania did not rely on the traditional tools of monetary control; rather, it has always resorted to credit allocation according to priorities set up in the Annual Credit Plan or as dictated politically, and at administratively determined interest rates (Eriksson, 1993). Thus as Collier and Gunning (1991: 533) have put it 'lending is determined by government priorities rather than market criteria'. Evidence that the government directed banks to open branches in various areas and grant credit to certain institutions irrespective of the commercial considerations of risk and return is clearly reflected in the responses of bank officials during interviews and is well documented in the literature (Presidential Banking Commission, 1990; Collier and Gunning, 1991; Kimei, 1993).

The fixing of interest rates as inflation was escalating and the reliance on the Finance and Credit Planning Programme of the Bank of Tanzania undermined the competitive efficiency of the formal financial institutions. The programme set overall credit ceilings for the banks. These were not strictly enforced, however, and there has been a tendency to create exceptions to the ceilings to accommodate what are perceived to be special credit needs. Given that lending has largely been directed by the government, interest rates have played no role in the efficient allocation of financial resources. The fact that they were negative suggests their insensitivity to the underlying risk. Moreover, with prices and quantities of capital controlled by the Central Bank, the formal financial institutions had no incentive to mobilise resources competitively. The overall impact has been a decline, especially in long-term financial intermediation as reflected by the shrinking size of the balance sheets of the development banks.

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[2] Each financial institution was established under a specific statute that defined its objectives, area of operation and mode of accountability without reference to any common supervisory authority (Kimei, 1993).

Other factors accounting for the financial inefficiency of the FFIs were the lack of supportive financial and legal infrastructure, especially of a good and up-to-date information system and adequate legal and regulatory protection systems for both debtors and clients. There was no law governing trading in securities (stocks, debentures, equities, etc.) and rights and responsibilities under financial contracts were not spelled out and enforced (Kimei, 1993). The problem has been exacerbated by the persistence of ill-defined property rights[3] which do not make collateral easily available.

2.4 Recent financial, monetary and credit reforms

Formal financial institutions in Tanzania certainly needed comprehensive restructuring if they were to operate on a commercial basis. Alongside the market-oriented Economic Recovery Programme initiated in 1986, reform of the financial sector is currently being implemented following a report (published in July 1990) by the Presidential Commission of Enquiry into the monetary and banking system. The approved strategy has involved: (i) restructuring the existing FFIs through write-offs of a portion of their non-performing assets, provisioning for the remaining loans and recapitalisation; (ii) reforming the policy environment in which the existing FFIs are operating; (iii) fostering competition by encouraging the establishment of domestic and foreign-owned private banks including joint ventures with Tanzanian interests; (iv) strengthening the prudential role of the Bank of Tanzania in regulating and supervising the operations of other financial units; (v) interest-rate liberalisation; and (vi) fostering money markets by creating new instruments e.g. Bank of Tanzania securities, Treasury bills, etc., with flexible interest rates.

The 1991 Banking and Financial Institutions Act established the Loans and Advances Realisation Trust (LART) to which all non-performing credits of the public commercial banks were transferred. By October 1993 an almost complete clean-up of the balance sheets and recapitalisation of the National Bank of Commerce and the Co-operative and Rural Development Bank had been accomplished. Recapitalisation of the Tanzania Investment Bank and the Tanzania Housing Bank is still ongoing. At the same time, measures to streamline the branch network and operations, to strengthen internal controls and procedures, and to improve profitability have been initiated. The 1991 Banking Act also legalised the operations of private commercial banks. The Meridien *biao* Bank and the Standard Chartered Bank began commercial banking operations in September and December 1993 respectively. The Bergolaise Bank has been allowed to open a representative

[3] For example, in rural areas, most farmers have no legal, and hence transferable, rights over their landholdings.

office. Among the new non-bank financial institutions is the Tanzania Venture Capital Fund launched in October 1993.

In tandem with the restructuring of the existing FFIs and in order to reduce the budget deficit, curb inflation, stimulate savings and facilitate more effective allocation and utilisation of resources, the Bank of Tanzania since 1986 has relied much more on the use of indirect monetary policy instruments. These include more active use of discount policy, liberalisation of interest-rate policy, open market sale of certificates of deposits by the Bank of Tanzania, auctioning of Treasury Bills, US dollar auctions, and a tightening up of reserve requirements. In order to curtail inflation, the ceiling on the growth rate of money supply and credit was set at 15–20% during the 1986–9 period and 14% during 1990–92. The minimum reserve requirement was raised from a weighted average ratio of 0.4% on all deposits to 3% in 1988, and again to 8% in 1992. Up to 1985 real interest rates were negative, since 1985 they have been rising periodically, and by 1987 had reached near-positive levels. The Bank of Tanzania is in the process of strengthening its Banking Supervision Directorate and is reviewing the Central Banking Act. In addition, the Bank has issued licensing and policy guidelines for financial institutions, prudential guidelines on the classification of risk assets and a detailed regulation on adequate capitalization.

Furthermore, banks have been required to ensure that their clearing accounts are backed by credit balances at all times. They will have limited access to the Bank of Tanzania's discount facility. Liquidity ratios are also being planned to guide financial management policy. The existing banks are also required to undertake managerial and operational restructuring including rationalisation of staffing and branch networks, streamlining operations and strengthening internal controls. Some progress has been made in the reform programme. Lending patterns during 1993 and 1994 suggest that the banks do have greater autonomy in making loans. They have also established strict procedures for approving and extending credit to co-operatives (World Bank, 1993).

3. Deposit structure and mobilisation

3.1 Type and structure of deposits

The three commercial banks, namely, the National Bank of Commerce, the Co-operative and Rural Development Bank and the People's Bank of Zanzibar, mobilise savings primarily through three major types of deposits: demand deposits; fixed time deposits; and savings deposits. Demand deposits do not carry interest. The thrift institutions, namely, the Tanzania Housing Bank and the Tanzania Postal Bank, mobilise part of their funds through time and savings deposits, but do not offer current accounts. Instant cash withdrawal is allowed on demand deposit accounts only, while withdrawals from savings and time deposits require requisite notice by the depositor[4].

The commercial banks dominate deposit mobilisation. Their deposits accounted for 98.9% of the total deposits mobilised in 1992, with the NBC accounting for over 80% of the total deposits in the banking sector. In nominal terms, commercial banks' savings deposits have increased by 28.1 times between 1980 and 1992, fixed time deposits by 21.6 times and demand deposits by 11 times. As a consequence, the share of demand deposits in commercial banks' total deposits has dropped from 66.8% in 1980 to 44.8% in 1992. Meanwhile the share of time deposits has risen from 22.8% to 29.9% and that of savings deposits from 10% to 17.3%. The implied sluggish growth in demand deposits is largely due to the fact that they bear no interest. According to information generated by our branch-level survey, the CRDB's structure of deposits in 1992 comprised demand deposits 34%, savings deposits 62% and time deposits 4%. At the national level the structure was 36%, 63% and 1% respectively.

3.2 Trends in deposit mobilisation

In nominal terms, the total (national level) of commercial banks' deposits has increased by 10.5 times between 1979 and 1992, namely from TSh.10.5bn to TSh.110.9bn. However, the National Consumer Price Index (NCPI), which measures the rate of inflation, has increased from 120.3 to 2,972.2, i.e., by 24.7 times over the same period. Moreover, the average annual nominal growth of commercial banks' deposits has been substantially lower than the average rate of

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[4] A minimum of 7 days should be allowed before the next cash withdrawal in the savings account. For time deposits the interval is fixed at 3, 6 or 12 months, etc. depending on the agreed time.

inflation during the 1979–87 period. This implies that the real growth rates of deposits were negative in that period.

Table 2 confirms this declining trend. It shows that in real terms savings' mobilisation by the commercial banks and thrift institutions declined continuously between 1979 and 1988. Real deposits mobilised by the commercial banks in 1988 were just half the value of those mobilised in 1979. As a proportion of GDP, commercial banks' deposits declined from 32.6% in 1979 to 13.9% in 1988. Similarly, deposits mobilised by the Tanzania Housing Bank have declined by 37.8%, while those mobilised by the Tanzania Postal Bank have fallen by 10.3% over the 1979–88 period. The observed decline in real deposits is also implied by the rising currency demand–deposit ratio (Table 2) and the decline in the velocity of currency below its historical level, especially for the 1979–84 period (Maliyamkono and Bagachwa, 1990). The latter two tendencies suggest a preference of currency over bank deposits. The decline in the proportion of commercial banking deposits to total advances from 1.07 in 1987 to 0.72 in 1990 reveals that deposits have not kept pace with the expansion of lending operations. Since resource mobilisation has failed to keep pace with the growth in the banks' advances, this has caused the banks to run down their liquidity positions and has forced them to turn to the Bank of Tanzania to cover the shortfall. As a result, borrowing from the Central Bank, which was negligible prior to 1987, rose from TSh.1.2bn in 1986 to TSh.62.7bn in 1990, i.e. by about 52 times. This undesirable shift towards disintermediation has been exacerbated by the environment of high inflation and negative real interest rates.

Among the general factors put forward by officials of the National Bank of Commerce and the Co-operative Bank to explain the observed decline in real deposits are the following:

(i) inefficiency in the banking system, especially poor and cumbersome customer services[5] and hence distrust of the banks; (ii) the preference for physical over financial assets, given the high rates of inflation; (iii) the limited rural branch network; (iv) the lack of confidence in personal cheques; and (v) the overvalued exchange rate which creates an artificially high demand for foreign exchange. Officials of the Tanzania Postal Bank listed the following additional specific problems: (i) cumbersome procedures for withdrawing funds; (ii) inadequate specialised personnel to handle the needs of depositors; and (iii) delays (of 2–4 months) in the posting of amounts deposited in Post Office branches to the account in the Bank.

[5] Until 1993 the National Bank of Commerce had cumbersome cheque handling procedures and stringent rules for cashing cheques.

Table 2 Structure and evolution of bank deposits at national level (1976 prices; TSh.m.)

	Commercial Banks Deposits						*Tanzania Housing Bank*		*Tanzania Postal Bank*		*Currency Demand Deposit Ratio*
					Total						
	Demand Deposits	*Time Deposits*	*Savings Deposits*	*Other*	*Value*	*As % of GDP*	*Value*	*As % of GDP*	*Value*	*As % of GDP*	
1970	2,008	671	447	25	3151	17.0	-	-	-	-	0.89
1975	3,456	1430	596	32	5514	27.0	120	1.1	92	0.4	0.62
1979	4,906	1731	752	57	7446	32.6	256	1.1	116	0.6	0.64
1980	4,696	1600	708	21	7025	30.0	246	1.2	120	0.5	0.64
1981	4,047	1,732	689	18	6,486	27.8	231	1.2	128	0.4	0.77
1982	3,798	1,825	627	11	6,263	26.7	202	1.1	113	0.4	1.04
1983	3,434	1,680	632	14	5,760	25.2	176	1.1	106	0.1	1.01
1984	3,114	1,346	539	18	5,017	21.2	145	1.0	24	*	0.99
1985	2,141	1,461	553	13	4,168	17.2	136	0.9	12	*	1.04
1986	2,000	1,070	527	13	3,610	14.4	122	0.8	12	*	1.06
1987	2,003	1,122	533	26	3,684	14.0	91	0.6	13	*	1.08
1988	2,239	944	611	30	3,824	13.9	97	0.5	12	*	0.94
1989	2,184	1,088	594	76	3,942	13.9	90	0.5	26	*	1.00
1990	2,358	1,513	842	45	4,758	16.2	93	0.5	16	*	1.08
1991	3,089	1,804	1,089	237	6,219	20.5	94	0.3	76	*	0.87
1992	3,125	2,086	1,203	557	6,371	22.0	37	0.1	27	*	1.06

Sources: Bank of Tanzania: Economic and Operations Report (various years); Tanzania Housing Bank.

Note: * Insignificant amount.

Implementation of the financial and other macroeconomic reforms (since 1986), particularly the raising of deposit rates, have helped to arrest the decline in the real deposits of the commercial banks (Table 2). This has not been the case, however, for the Tanzania Housing Bank and the Tanzania Postal Bank whose real deposits have stagnated at their 1987 level. The macro-level evidence is somewhat corroborated by branch-level evidence from our survey (Table 3). Responses at the branch level indicate the rising number of depositors and the corresponding increase in the volume of deposits mobilised by the Co-operative and Rural Development Bank. For the period 1990–92, the number of depositors increased by 11 times in the largest city, Dar es Salaam, by 1.4 times in the regional towns and by almost 40 times in the small rural towns. Mobilisation of commercial bank deposits has also risen in real terms. Apart from the rural and regional branches, real deposits mobilised in Dar es Salaam by the Tanzania Housing Bank and the Tanzania Postal Bank have on average declined between 1990 and 1992. The improved performance of the commercial banks is largely due to the new deposit mobilisation initiatives by the banks. The National Bank of Commerce, for example, has launched new deposit mobilisation schemes. One scheme involves the payment of salaries and the proceeds of farmers' sales through the Bank. Another has been the linked deposit insurance scheme which is meant to enable small savers to insure themselves. The Bank has also strengthened its mobile agency scheme under which branches offer regular banking services to the public in rented premises at selected centres. Similarly, the Tanzania Postal Bank has been using mobile vans with audio-visual equipment to hold rallies with a view to attracting additional clientele and their deposits. The entry of the new banks has indeed introduced competition into the commercial banking industry. However, as will be shown later, growth in deposits has lagged behind increases in lending.

3.3 Major sources of deposits

The major source of bank deposits in Tanzania has been the private sector. Its share in total deposits has declined, however, from 75.8% in 1980 to 53% in 1992. On the other hand, the share of parastatal deposits has more than doubled from 20.2% in 1980 to 44.4% in 1992. The government's share has declined from 4% to 2.6% during the 1980–92 period. In view of the recent decision by the government to withdraw gradually from the directly productive sectors of the economy and the ongoing privatisation of parastatals, the share of private sector deposits is likely to rise substantially in the near future. The overall trend masks important variations, however. For example, in the case of the Tanzania Housing Bank the share of public sector deposits has declined from 70% to about 25% in 1990. As a consequence, the THB has become more dependent on loans and special funds than on public deposits to finance its lending operations (Nyagetera, 1992).

Survey responses indicate that the share of deposits held by informal financial institutions is negligible. Only 6 out of the 30 bank branches reported holding

Table 3 **Branch-level deposit mobilisation**

	Dar Es Salaam			*Regional Towns*			*Small Rural Towns*		
	1990	*1991*	*1992*	*1990*	*1991*	*1992*	*1990*	*1991*	*1992*
Depositor Per Branch									
CRDB	950	11,241	11,241	7,970	8,989	9,054	21	805	835
THB	25,655	30,570	33,835	4,357	6,320	7,665	-	-	-
TPB	4,115	5,120	5,500	2,500	2,960	3,750	462	590	650
Total Deposits Nominal TSh. M.									
CRDB	2,388	3,773	5,507	7,164	10,223	14,304	46	92	141
THB	895	1,168	1,000	2,604	2,750	3,460	-	-	-
TPB	16	29	27	6	12	18	8	15	15
Total Deposits Real TSh. M.									
CRDB	120	155	185	360	420	481	2.3	3.8	4.7
THB	45	48	34	107	113	116	-	-	-
TPB	0.8	1.2	0.9	0.3	0.5	0.6	0.4	0.5	0.5

Sources: Survey data.

deposits for some informal financial units; 4 of them belonged to the Co-operative and Rural Development Bank, the other 2 to the Tanzania Postal Bank. The holders of these accounts were mainly Savings and Credit Associations. The proportion of informal deposits in total branch deposits was very small, accounting for less than 2% in each case. This figure, however, appears to be an underestimate, since, with exception of Rotating Savings and Credit Associations (ROSCA) and Savings and Credit Associations, most IFIs, and especially money lenders, deposit their money in formal sector banks just like any other individual clients, and may be known to banks not as moneylenders but as individual customers. Moreover, the previous study on the informal financial sector had revealed that about 97% of urban informal lenders and 67% of rural informal lenders held accounts with formal sector banks (Bagachwa, 1995).

4. Lending operations

4.1 Major borrowers

Between 1984 and 1992 lending by the National Bank of Commerce accounted for between some 77% and 98% of total commercial bank lending. The main borrowers of commercial bank lending have been public sector institutions, which during 1980–87 accounted for about 90% of the commercial banks' loan portfolio. This share declined to an average of 78% between 1987 and 1990 and to about 60% thereafter. Within the public sector, the government was the principal recipient of commercial bank credit up to 1984. However, with the adoption of a structural adjustment programme and the subsequent implementation of the Economic Recovery Programme initiated in 1986, fiscal restrictions have reduced government borrowing and expenditure which has declined to an average of 3% since 1989. As a consequence the share of parastatals has almost doubled between 1984 and 1987 and has since then remained slightly over 70%.

Within the parastatal sector, the major recipients of commercial bank loans have been the state-owned marketing boards and the state-controlled co-operative unions[6]. Overdraft facilities to co-operatives and parastatals for the marketing of primary commodities accounted for 87% and 63% of the National Bank of Commerce's total loan portfolio in 1984 and 1992 respectively. About 50% of the Co-operative and Rural Development Bank's lending also goes to the co-operative and parastatal sector. The rest goes to private individuals. While agricultural marketing boards received most of the credit up to 1990, credit to co-operatives (reintroduced in the early 1980s) expanded rapidly, reaching the level of the marketing boards in 1990, and surpassing it in 1991.

An important feature of the NBC's portfolio of large loans outstanding (over TSh.10m.) is that it is concentrated in loans and overdrafts to the agricultural sector and to a small number of borrowers. As of June 1991, of the top 25 NBC clients with the largest loans outstanding, and accounting for 80% of the outstanding loans and advances, 10 were agricultural co-operatives, 12 were parastatals (of which 3 were agricultural marketing boards), 2 were private enterprises and 1 belonged to the ruling party (Eriksson, 1993).

[6] Co-operatives are not formally government-owned but have been patronised and controlled by the government and the ruling Chama cha Mapinduzi (CCM) Party.

Commercial bank lending to the private sector accounted for less than 10% between 1980 and 1988. It has risen rapidly[7] since then, reaching an average of 20% between 1990 and 1992. NBC lending to the private sector increased from 15% in 1980 to 37% in 1992, while Co-operative and Rural Development Bank lending to private individuals rose from zero to 80% during the same period. Thus until recently commercial lending overall has been characterised by the crowding-out of the private sector from access to credit (Nyagetera, 1992).

The major beneficiaries of Tanzania Investment Bank loans have also been parastatal organisations. In 1988 about 70% of the bank's loan portfolio was accounted for by the parastatal sector and 30% by the private sector. Equity participation in other enterprises has not made up a significant portion of the bank's portfolio. By 1992 the private sector's share had increased to about 40%. Private individuals, however, since 1980 to date, have been receiving about 85% of the state-owned Tanzania Housing Bank's low- and medium-cost housing loans

4.2 Sectoral distribution of loans

Asymmetry in the allocation of formal bank loans is apparent, with a concentration not only on certain borrower types but also on certain activities. Appendix Table A3 demonstrates the dominant but declining role of the agricultural sector as the consumer of commercial bank credit in Tanzania. Internal purchase and marketing of agricultural produce accounts for the largest share of the commercial banks' loan portfolio. However, this has declined from 58.8% in 1984 to 27.3% as of December 1992. Second in importance is mining and manufacturing, whose share rose from 10.3% to 21% in 1992. The share of agricultural production has risen from 5% to 8.2% during the same period. While the bulk (66% in 1984 and 48% in 1992) of the NBC's total loan portfolio has been in the form of overdrafts for crop purchase and distribution, a large proportion of its term loans (initiated in 1984) has gone to manufacturing industry. The NBC's lending to commerce rose from 19% in 1984 to 25% in 1992. Up to 1986 over 60% of Co-operative and Rural Development Bank loans went to finance agricultural seasonal inputs. This share had declined to 4.2% by 1992. Meanwhile, the Bank's financing of rural transportation has increased from 26.3% to 70.9% during the 1986–92 period. The decline in the financing of crop purchase and marketing, and in seasonal inputs, reflects a shift from government-directed credit towards market-based criteria, for the allocation of credit. Other areas financed by the CRDB include farm machinery, small-scale industries and livestock and fisheries development.

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[7] In 1992, for example, 80% of the Co-operative and Rural Development Bank's distribution of medium- and long-term loans went to private individuals, 17% to private companies, 2% to co-operatives and only 1% to villagers.

4.3 Lending to small enterprises and informal financial institutions

Only one of the 30 bank branches surveyed indicated that it had granted a loan to an informal lender. While generalisations cannot be made because of the smallness of the sample, other secondary sources of information reveal that the majority of smallholder farm enterprises and informal financial institutions have been largely excluded from the institutional market for credit. The Tanzania Investment Bank began to finance informal sector operators in the micro-enterprise sector only in 1990. The People's Bank of Zanzibar does not support small and informal sector enterprises. The National Bank of Commerce has been extending limited credit to small-scale registered enterprises since 1984 under its micro enterprise support programme, which has been funded through international aid agencies, mainly the Swedish International Development Agency (SIDA) since 1985, the KFW of Germany (since 1986), and through its internally generated funds.

However, this scheme has had limited impact. First, it had limited coverage. The NBC's share of small enterprise loans as a proportion of its total loans was less than 0.5% between 1977 and 1987 (Bagachwa, 1992). Secondly, by June 1990, a total of only 316 projects worth TSh.904m., with an average of TSh.2.6m. (about US$8,230) per project, had been approved. This suggests that the funding was of medium rather than small projects. Thirdly, the Bank's uncollateralised lending to informal sector units, which began in 1991, has been shelved due to the low (less than 50%) repayment rate. Fourthly, the Bank's loan conditions, which required a pledge of tangible legally acceptable and convertible security in real property or fixed assets, has been a deterrent to small borrowers' access to credit. Lastly, the Bank's approval process for small enterprise loans is time-consuming. According to a recent report (Swedish Development Consulting Partners, 1991), the average time lag from the date of receiving an application to disbursing a loan amounts to 79 weeks. In the face of mounting inflation and a depreciating local currency, this leads to the depletion of equity capital and higher overall cost.

The Credit and Rural Development Bank has also been extending limited credit to small enterprises in rural areas. However, the share of small industry loans in the Bank's total loans averaged only 1.5% between 1986/87 and 1989/90; it rose to 4.5% in the next year and to 5.7% in 1991/92. The CRDB also administers a number of special donor funds, some of which target smallholders and micro enterprises. The number of micro-project loans under the scheme rose from 100 in 1990 to 1,000 in 1991. In 1991 TSh.82m. were loaned to small enterprises under the new scheme; about 90% of these went to individuals, 9% to groups and 1% to co-operatives. The Bank has also tested a group-lending methodology among informal farmers. Members of the group were jointly and severally liable for the loans of all members, and in some instances were guaranteed by the village authorities or local co-operative societies. About TSh.65m. was advanced to groups largely for seasonal inputs. All is said to have been repaid by the end of the season (World Bank, 1993).

Interviews with bank officials revealed the following problems in the extension of credit to small enterprises and the informal sectors: (i) the CRDB has no special department to deal specifically with micro-project finance; (ii) it lacks extensive rural outreach (15 regional offices out of 20, with only 17 branches); (iii) it has not developed an effective lending methodology appropriate to small enterprises; (iv) it does not consider support to the informal sector a priority area; (v) it is reluctant to enter into uncollateralised lending; and (vi) it believes that high transaction costs are associated with lending small amounts to a large number of small borrowers who lack collateral.

Since 1990 the Tanzania Investment Bank has been setting aside about TSh.5m. annually from its local resources for lending to projects in the informal sector, and especially for women entrepreneurs. Coverage is very limited and in 1992 only TSh.14m. (about 0.8% of total loans) was approved for financing 15 informal sector projects (TIB, 1993).

The existing evidence appears to suggest that most of the small volume of formal credit that has been extended to the informal sector has gone to the micro-enterprise sector. The IFIs have almost been excluded from the institutional market for credit. This corroborates the earlier finding that, of the 9 out of the 59 IFIs which ever applied for formal loans, only 3 (i.e., 5%) managed to obtain a loan. It is also consistent with the finding that bank loans accounted for a negligible share (less than 1%) of current sources of capital for lending by informal lenders (Bagachwa, 1995). Thus, in general, linkages between formal and informal financial institutions remain weak.

A number of small non-governmental organisations have recently emerged to improve smallholder and informal sector access to formal credit. Two of these need special mention. One scheme – the Promotion of Rural Initiatives and Development Enterprises (PRIDE) – has just begun operations in Tanzania. It intends to establish two pilot branches, which will extend short-term loans (repayable over 50 weeks) to self-employed clients in the informal sector. Half of the clients will be women. Clients will be required to contribute to a Loan Insurance Fund which is intended to cover the risk of bad debts and also serve as a mandatory savings scheme. Participants in the scheme are expected to graduate to become clients of the formal banking sector. The second NGO is the Presidential Trust Fund for Self-Reliance. This has introduced a Grameen-type lending model, with group members using their loan shares individually but with mutual guarantees of each other's payment obligations. Loan repayment is estimated at 95%. The Trust has yet to develop a cost-effective scheme, however. In 1992 it issued TSh.9.6m. loans which yielded an income of TSh.0.99m. in interest against an operating cost of TSh.7.7m. (Keddie, 1992). But even these schemes have focused on lending to informal operators in the real sector and have not developed mechanisms for lending to the IFIs. One interesting lending initiative is that adopted by the Kenya Rural

Enterprise Programme (a Kenyan NGO) which issues loans at commercial rates of interest to ROSCAs (Chikola) for on-lending to their members.

4.4 Trends in bank lending

Commercial bank lending experienced a steady expansion between 1980 and 1992. During this period, the volume of credit increased by 25.5 times in nominal terms, or 1.3 times in real terms. Total NBC lending (in nominal terms) expanded rapidly from an annual rate of growth of 26% in 1985/86 to 97% in 1987/88. Since then the growth has been declining steadily and was -8% in 1991/92. The increase in lending is mainly due to increased demand for crop financing, following the upward review of producer prices as well as the higher costs of labour and inputs. Credit to the industrial sector has also increased with improved capacity utilisation and increased importation of raw materials.

The credit expansion is not entirely attributable to the granting of new loans. Part of the credit growth reflects the accumulation of interest arrears on old debts, due to the large amount of non-performing assets. The surge in commercial lending has not, however, been matched by a similar trend in deposits which increased by only 16.4 times during 1980–92. As a consequence, the lending-deposit ratio rose steadily from 50 in 1984 to 84.4 in 1986, and then shot up abruptly to 138.8 in 1989 (Appendix Table A2). This increasing divergence has been met by increased borrowing from the Bank of Tanzania. Commercial bank borrowing from the Central Bank increased by 50 times between 1986 and 1990. Thus, despite the 14% ceiling on the annual growth of money supply and the raising of the reserve ratio from 0.4% to 3% and then 8%, the ability to extend credit has not declined because of the increase in the monetary base made possible by increased borrowing through BoT's rediscounting window (Bhaduri et al. 1993).

The Tanzania Investment Bank's performance was outstanding in the 1970s. It's portfolio grew from TSh.20.3m. in 1970 to TSh.1.6bn by June 1980. Its accumulated profits amounted to TSh.67.1m. and its arrears were low at 14.3%. The bank's performance deteriorated in the 1980s and it has engaged in little new large-scale lending since 1988. For example, in 1986/87 115 large-scale projects were approved for funding. This contrasts with only one large project approved out of the 46 applications for term loans over the years 1991 and 1992. The low level of approval was mainly attributed to 'lack of resources for on-lending' (Tanzania Investment Bank, 1993). Since 1990 the bank has started lending to the informal sector.

Moreover, the surge in lending has failed to satisfy the growing demand for formal credit. Table 4 shows that, in all our sample branches, the number of applicants has been growing between 1990 and 1992. Demand appears to be growing faster in

Table 4 Average number of applications and approvals per sample bank branch

	Regional towns			*Small rural towns*		
	1990	1991	1992	1990	1991	1992
Applications						
CRDB	220	290	380	30	39	50
THB	28	40	55	15	18	20
TIB	410	560	618	-	-	-
Total	658	890	1053	45	57	70
Approvals						
CRDB	35	42	45	13	15	20
THB	9	9	7	5	8	6
TIB	60	63	52	-	-	-
Total	104	114	104	18	23	26
Application/approval ratio	6.3	7.8	10.1	2.5	2.5	2.7

Sources: Survey data

large towns (increased by 60%) than in small rural towns (where it increased by 55%). However, the number of approved loans has increased by only 29% in the case of the Co-operative and Rural Development Bank and declined in the case of the Tanzania Housing Bank and the Tanzania Investment Bank. What is striking, however, is the smaller number of approved loans in relation to total loan applications. In 1992 for example, the ratio of applications to approvals in the formal bank branches in our sample was 8.6, while that in the informal sector was 1.01. This ratio has, moreover, increased from 6.3 to 10.1 for the formal sample branches in the regional towns and from 2.5 to 2.7 for bank branches in small rural towns during the 1990–92 period. The extremely high ratio of application approvals in the formal sector partly reflects lack of resources for on-lending. But it also suggests the increasing difficulties of complying with formal sector loan requirements under the IMF–World Bank-inspired credit squeeze programme which is also characterised by high interest rates.

4.5 Principal sources of loan capital

The major sources of the banks' loan capital include: (i) deposits received by the banks; (ii) borrowed funds (from domestic and foreign sources); (iii) income generated from normal operations; (iv) equity from shareholders and (v) special funds from the government and/or donors. The National Bank of Commerce's major source of loanable funds has been its mobilised deposits. Deposits accounted for 80% of the NBC's total loanable funds in 1986. This declined to about 50% in

1992, however. On the other hand, the proportion of loans financed by borrowing from the Bank of Tanzania has increased from 0.8% in 1985 to 20.2% in 1992.

Although the Co-operative and Rural Development Bank has recently paid great attention to deposit mobilisation, the volume of its deposits remains rather modest. As a consequence, the CRDB has relied mainly on borrowing from the Bank of Tanzania to finance its lending operations. About 100% of the working funds of the TIB, and over two-thirds of those of the THB, are derived from the government in the form of equity capital, general reserves and grants. The balance comes as loans in the form of external credits and grants from friendly bilateral sources. This makes the TIB potentially ill-equipped financially. Reliance on Treasury and foreign grants and loans has proved unreliable and the government's recent withdrawal of such support has been one cause for the TIB's current financial distress.

At the branch level, responses to our survey indicate that, for the CRDB, over 60% of the funds for financing lending capital were obtained from deposits mobilised locally. All THB branches rely (100%) on transfers from head office for financing lending operations. The TIB has no branches and the Tanzania Postal Bank had not yet started lending operations at the time of the survey.

5. Review of loan portfolio

5.1 Types of loans

Tanzanian banks distinguish between short-, medium- and long-term loans. Short-term credit refers to loans with a maturity period of one year or less, medium-term to a period of more than one but up to five years, and long-term to more than five years. The National Bank of Commerce provides short-term loan financing in the form of overdrafts, packing credits etc. through its Advances Department. Long-term (mainly equipment) financing is provided through its Term Finance Department. The majority of the bank's facilities are short-term and intended to finance working capital, by buying debts in the form of Bills of Exchange, thus permitting the beneficiary of the bills access to finance before the bill matures. Typically overdrafts make up approximately three-quarters of lending with short-term loans accounting for most of the remainder. As of June 1991, the NBC's short-term financing amounted to TSh.133.9bn (i.e. 98.8%), compared with term loans worth TSh.1.6bn.

The loan portfolio of the Co-operative and Rural Development Bank is dominated by medium- and long-term loans for financing farm machinery and equipment, expansion or improvement in ranch development, fish and storage development, etc. The bank's medium- and long-term loans were estimated at TSh.7,185m. (i.e. 99.6%), while its short-term loans stood at TSh.28m. as of June 1992. Survey responses from the CRDB's branches revealed these proportions to be 96% and 4% respectively. Short-term loans mainly finance crop purchases and distribution, and seasonal inputs. The Tanzania Housing Bank offers medium- and long-term loans for residential housing and commercial buildings and loans for the production of building materials. The Tanzania Investment Bank mainly provides medium- and long-term loans to clients in the industrial sector. The bank may draw on its ordinary resources (up to 40%) to invest in the equity capital of enterprises, and may furnish guarantees.

5.2 Size and maturity of loans

The analysis of variance (ANOVA) confirms the existence of significant variations in formal loan sizes by type of loan (whether short/long-term), location of client, and type of lender. In general, average short-term loans are consistently smaller than medium- and long-term loans. The CRDB's shorter-term loans, for example, averaged to TSh.0.35m. compared to TSh.7.3m. for medium- and long-term loans.

In 1992, the TIB had the largest average long-term loan amount of TSh.111.5m., while the THB had the smallest (TSh.2.7m.).

Similarly loan maturity periods vary enormously, but typically range between 1 and 12 months for short-term loans, 2 and 5 years for medium-term and 5 and 36 years for long-term loans. Tanzania Housing Bank loans have the average longest maturity period of 30 years. The longest maturity period recorded was on a CRDB 36-year loan. Typically, however, short-term loans average one year, medium-term loans three years and long-term loans 12 years.

5.3 Cost of borrowing

Until 1986 interest rates were set centrally by the Bank of Tanzania. Thus banks had no discretion to: (i) vary rates offered to savers so as to attract more depositors; (ii) differentiate or amend the pricing of credit so as to reflect the differences in the degree of risk by borrower type, location and sector; (iii) set credit terms so as to strike a balance between the funds available and the volume of loans made. Lending rates have therefore been strictly controlled in terms of sector; borrower type; size of enterprise; maturity; and by rural/urban location. In general, *ujamaa* villages, co-operatives, and small-scale enterprises were charged lower rates of interest compared with other borrowers in similar activities. Rural clients and parastatals were also charged lower interest rates than urban and private sector clients respectively. This made interest rates highly fragmented. However, such fragmentation is neither a reflection of differences in transactions costs, nor is it due to differences in access to information. Rather, it is simply politically induced. Furthermore, compared with the prevailing rates of inflation, interest rates have generally been negative in real terms over the last several years (see Appendix Table A.6). They did not allow for adequate financial spreads and were heavily subsidised for what the government regarded as key sectors.

Between 1980 and 1986 interest rates ranged between 11% and 16% for agriculture and industry, while inflation averaged about 30% per annum. Maximum lending rates were raised to between 18% and 19% in 1987 and subsequently to a range of 20–31% in 1989. The rates on savings and fixed-time deposits were also raised to 16% and to between 17% and 29% respectively. In July 1991 multiple fixed rates were replaced by a single maximum lending rate, subsidies on credit were eliminated and banks were allowed to set their own deposit rates, provided that the 12-month deposit rates were positive in real terms. The maximum lending rate was set at 31%. With inflation at about 22% per annum this implied a positive real rate of 9%. To enable the emergence of a free and automatic interest-rate regime, the Central Bank has ceased, since 1993, to fix the maximum lending rate and the discount rate has been pegged to the yields of the Treasury Bill market instead. Results of the survey suggest that all branches of the CRDB and TIB have adopted the 31% interest rate on their medium- and long-term loans, irrespective of the type of borrower or location. The THB charges 29% on its housing loans. Even under the liberal interest-rate regime, branches are not yet allowed to set their own rates but take as given the rates set at their head offices.

The long-term effects of interest-rate liberalisation in Tanzania are not yet clear. However, six tendencies seem to be emerging in the short term. First, higher interest rates have not been accompanied by substantial increases in the rate of growth of formal bank deposits. This is because the banks' unrestricted access to the Bank of Tanzania's refinancing (rediscounting) facilities has obviated the need for them to mobilise their own resources. Their increased access to borrowing is reflected in the increase in the ratio of their rediscount borrowing to their reserves at the Bank of Tanzania from 1.4 in 1986 to a peak of 10.25 in 1989 (Bhaduri et al., 1993). This is consistent with the banks' lending–to–deposit ratio which has shown an increasing trend since 1986 (Appendix Table A2).

Secondly, as shown in Table 2, the currency–to–deposit ratio, which is determined by the economic agents' preference for holding money balances in the form of either bank deposits or currency, has not declined but has been fluctuating with an upward trend. This suggests that economic agents have been shifting between holding currency and holding deposits, and as inflation has remained high, people have preferred to hoard cash, while looking for opportunities to switch into real assets.

Thirdly, the raising of interest rates has forced lenders to ration credit on the basis of the client's perceived risk of default. The hardest hit clients are smallholder farmers and informal sector operators who cannot provide acceptable collateral, and insolvent and highly indebted public sector institutions. Fourthly, higher interest rates have tended, in the case of heavily indebted and illiquid real sector parastatal firms, to compound their debt repayment problems by adding substantial sums of interest to their initial debts. Fifthly, there is some doubt as to whether the returns on investment in the agricultural sector are sufficiently attractive to prompt investors to borrow at the nominal rate of 31% to finance them (e.g. commercial bank lending to agricultural production declined by 22% between 1991 and 1992). One could, however, expect interest rates to fall once inflation moderates and as the domestic banking sector is increasingly subjected to competition from new incoming foreign banks.

Finally, the liberalised formal lending rates, though still much lower (at an average 2.58% per month in 1992) than those charged by informal moneylenders (which varied between 5 and 9% per month), have not been accompanied by reductions in the volume of informal credit and in the mobilisation of informal savings. On the contrary, demand for informal credit has been increasing at 22% per annum, and the total volume of deposits mobilised by informal lenders increased by 57% in real terms between 1990 and 1992 (Bagachwa, 1995). Furthermore, the average annual rate of increase in real savings mobilisation in the informal financial sector was faster (at 28.5%) than that in the formal sector (which grew at 23%) for the period 1990–92. This suggests that informal credit markets in Tanzania do not strictly constitute a parallel market; otherwise the liberalisation of interest rates would have eliminated them.

6. Loan processing, screening and monitoring

6.1 Loan approval procedures

The loan approval process is similar for both the National Bank of Commerce and the Co-operative and Rural Development Bank. Typically a customer submits recent financial statements, cash flow projections, and other financial details to the local branch where the account is held. In the case of a short-term loan, the customer will most probably have maintained overdraft facilities with the bank, and historical data on the performance of the loan will be scrutinised. The bank's project officers and the accountant will then examine the customer's application and his ability to repay. If the amount requested is within the branch manager's discretion, the decision to lend can then be taken. If the amount is above this limit, the application is sent on to the next authorising officer, usually the regional loans board or committee.

The requirements for acceptance of the application are almost identical across banks. The major considerations in order of importance are: (i) economic viability and financial and technical feasibility of the project as reflected in a detailed feasibility study; (ii) a pledge of tangible, legally acceptable and convertible security in real property, stocks or other fixed assets; (iii) an equity contribution of at least 15–25% of the fixed assets; and (iv) a licence and/or certificate of registration. In addition, a bank may require guarantees from parent companies or the government. For all term loan applications, the branch manager is responsible for advising the client on certain detailed aspects of the feasibility study and for forwarding it to the regional office for further scrutiny. The NBC, CRDB and THB do not have extension officers as such. Rather, each bank has at least two project officers (four at the NBC) at the regional office who can provide more detailed technical advice and can put the application into a standard format. This role is an expansion of their role as bankers, not as extension staff. These project officers are too few for it to be practicable for them to visit project sites; 70% of CRDB and 63% of THB branch staff indicated that they had never visited projects.

According to the legislation establishing the two publicly-owned commercial banks, the NBC and the CRDB are expected to apply prudent criteria, namely, financial viability, acceptable security, managerial capability, willingness and ability to repay, etc, in assessing the creditworthiness of all types of applicants for loans. In practice, it appears that banks are more rigorous in their approach to extending and refinancing private lending facilities than with public sector facilities. While the NBC requires all private borrowers to provide an adequate level of security in the form of debentures and/or personal guarantees, public sector borrowers are allowed

Table 5 **Average screening and monitoring costs for FFIs, 1992**

	Large Towns			*Small Rural Towns*		
	Average Loan Value TSh. 000	*Average Screening Costs*		*Average Loan Value Tsh. 000*	*Average Screening Costs*	
		Value TSh. 000	*as % of Loan*		*Value TSh. 000*	*as % of Loan*
(a) Screening Costs						
CRDB	7,300	650	8.9	4,600	437	9.5
THB	2,750	179	6.5	-	-	-
TIB	111,500	12,265	11.0	-	-	-
(b) Monitoring Costs						
CRDB	7,300	256	3.5	4,600	184	4.0
THB	2,700	108	4.0	-	-	-
TIB	111,500	10,370	9.3	-	-	-

Source: Survey data.

to provide lower-grade security or simply government guarantees which in practice have been difficult to call in and are unlikely to materialise. Similarly, whereas private borrowers are required to provide projected results, cash flows and audited accounts, most public sector borrowers, especially co-operative unions, are behind hand in the preparation of year-end accounts. This sort of credit rationing is not based on the perceived risk of the potential borrower but is simply government-induced.

The authorization process within the NBC, CRDB, THB and TIB is generally centralised at Head Office where large loans over TSh.20m. (US $4,000) are sanctioned. The discretionary limits of branch managers and regional loans committees differ by type of bank. For the NBC the limit is TSh.2m. for the CRDB TSh.1.5m. and for the THB TSh.0.5m. In the case of the NBC, regional boards can approve loans up to TSh.15m. and the managing director up to TSh.25m. and for the Board of Directors the amount is unlimited. Thus the functioning limit for branch managers is very low (ranging from US$100 for the THB to US$4,000 for the NBC). This has meant that most term loans have to be approved at Head Office, which is another source of delay. A review of some NBC loans revealed that such delays could be considerable. Using the NBC's own record a recent study revealed that the average time lag from application to loan approval was 32 weeks (Swedish Development Consulting Partners, 1991). In a situation of high inflation such delays can easily impair the economic viability of a project.

6.2 Screening costs

Costs associated with the screening process for loan applications and applicants constitute an important category of administrative costs. Unlike informal lenders who know most of their loan applicants personally, bank managers do not, in most cases, have detailed knowledge about the character of the borrower. All branches ranked project returns as the first priority when assessing creditworthiness, followed by collateral. Personal integrity and attitude to debt are apparently ranked low because bank officials do not know the borrower personally. No serious attempts are made to get to know the borrower's character. Enquiries to third parties about loan applicants were sought by only 3 of the 30 bank branches in our sample. However, all but one indicated that customers had to save with the branch for a minimum of 12 months before their loan applications would be considered.

In estimating screening costs the most important costs taken into account were the cost of time spent on the screening process, estimates of transport costs and allowances and other overhead expenses. Screening costs as a proportion of the average value of loans were highest for TIB branches (11%) and lowest for THB branches (5.6%) (Table 5). For the CRDB, screening costs were lower in larger towns (8.9%) than in smaller rural towns (9.5%). A similar pattern holds for project follow-up or loan monitoring costs. Comparing these findings with those of the informal sector study, it is obvious that formal financial institutions tend to have relatively higher transaction costs than informal financial institutions. Average screening costs per average loan in the informal sector were highest for landlords (2.6%) and lowest for urban trader-lenders (1.29%). This is consistent with our postulated hypothesis that fragmentation of the financial market in Tanzania may be partly a reflection of the advantages which formal and informal financial institutions have in dealing with different types of clients. Monitoring costs were almost zero in the informal financial sector.

7. Loan repayment and contract enforcement

Poor loan repayment and enforcement characterise the formal financial institutions. A recent analysis covering 79% of the credit portfolio of the NBC, including both loans and advances and related off-balance sheet accounts, revealed that, by the end of December 1991, almost the entire portfolio (about 94%) was adversely classified, i.e. it consisted of loans considered to be sub-standard, doubtful or rated as loss (Eriksson, 1991).[8] The standard of the NBC's contingent liabilities is considered to be almost equally poor; about 91% of the total contingent liabilities are adversely classified, with 63% rated as loss. NBC records show that, of the 25 clients with the largest loans outstanding at the end of June 1991, 10 were co-operatives, 12 parastatals, 2 private enterprises and 1 belonged to the ruling CCM party, thus confirming the previous statement that loans were generally granted to poorly performing clients. Appendix Table A7 confirms this rather unfavourable performance; the NBC's loan recovery on crop finance has averaged 27.1% between 1985 and 1990.

A similar disturbing picture is true of the CRDB, whose recovery on seasonal inputs is estimated to average 29.1% between 1985 and 1990. As of 30 June 1993, about 86% of the bank's outstanding overdraft portfolio was classified as non-performing. The TIB's loan performance shows that, as of June 1992, 75% of its loans were classified as sub-standard, doubtful or loss (TIB, 1993). Simple computations based on our survey show that the CRDB had a loan recovery rate of 33%, the THB 22% and the TIB 23%.

None of the banks appear to have efficient control mechanisms in terms of well-established procedures for the monitoring and supervision of credit. It was only in 1992 that the NBC established a unit for monitoring and supervision. Furthermore,

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[8] According to the Bank of Tanzania's new (1991) policy of provisioning for losses, loans are categorised as unclassified and classified loans. Unclassified loans are those having a low risk of default and where the borrower has the ability to satisfy his obligation in full and no loss is expected. Classified loans possess certain weaknesses and are categorised as follows: (a) loans specially mentioned: these lack collateral, have limited credit information or documentation and therefore require management supervision; (b) sub-standard loans which entail a substantial and unreasonable degree of risk to the bank because of unfavourable records or unsatisfactory characteristics and where there is a possibility of loss; (c) doubtful loans , which are sub-standard but in addition are not well secured, collection in full is highly improbable and possibility of loss is high; and (d) loss loans which are considered as uncollectible or worthless, although such loans may have some recovery or salvage value.

a review of individual NBC loan files by the Presidential Banking Commission revealed the following weaknesses: (a) a large number of the NCB's borrowers in the parastatal and co-operative sectors had a poor history of repayment and unsound financial conditions, abused the terms of their loans by diverting the proceeds of sales away from overdrawn accounts, lacked up-to-date financial information, and were characterised by poor management; (b) some public sector borrowers exceeded the agreed credit limits, as interest rates continued to be accrued on the open facilities of earlier years; (c) although overdrafts are granted in practice for short-term working capital requirements, there was an increasing tendency to roll them over as a substitute for permanent or long-term capital; (d) there were difficulties in the valuation of security, especially stocks (Presidential Banking Commission, 1990).

Poor repayment rates are also partly a result of poor contract enforcement. In general, there is very little evidence indicating that legal action has been undertaken against serious loan defaulters. In spite of the high default rates, only 2 out of the 30 branches surveyed indicated that they had taken defaulters to court. Most branches (18 out of 30, or 60%) preferred to resort to the threat of legal action and 6 of the 30 branches appealed for management assistance to forestall default or ensure payment. From our discussions with CRDB and NBC officials it became clear that the legislation made it difficult for banks to foreclose on security or to realise the value from such assets once foreclosed. It was even more difficult to resort to legal action. The legislation prohibits the banks from making individuals destitute. Further difficulties relate to the length of time taken to complete the foreclosure through the legal system – as long as 4–6 years; and since most fixed assets owned by parastatals have little or no second-hand value it may not be easy to sell the assets once foreclosed. In addition, neither the CRDB nor NBC has the power to appoint liquidators, receivers or administrators to borrower companies in difficulties.

To a large extent, however, the low repayment rates are a reflection of the cross-indebtedness of public sector borrowers. Most of the delinquent parastatals and co-operative unions are technically insolvent. Of the 25 NBC clients with the largest loans outstanding as at 30 June 1991, at least 14 had their debts ranked as loss and the debts of 7 others were regarded as doubtful; 11 of these were co-operatives and 10 were parastatals (confidential report cited in Eriksson, 1993: 47–8). Insolvency is partly due to poor management practices among borrowers and partly to the adverse effects suffered by the Tanzanian economy during the early 1980s.

There is thus political pressure on the banks not to foreclose, as this could lead to many of the clients ceasing to operate or being forced into liquidation. There are also fears that refusal to lend to co-operatives, for example, could cause undue hardship to peasants who are dependent on the (co-operatives) borrowers purchasing their produce. As a result, the banks are pressurised to lend to borrowers with poor credit risks or to accept as security Treasury guarantees which are generally rescheduled on terms unfavourable to the banks.

8. Conclusion

The pre-reform formal financial system in Tanzania fits well with the McKinnon-Shaw paradigm of financial repression. All the major FFIs were entirely or substantially owned by the government and their management was under direct government control. The state-owned National Bank of Commerce dominated the commercial banking sector, accounting in 1992 for 85% of the national market for loans and deposits and 85% of total commercial banking assets. Non-bank FFIs were very few and very small. The government maintained this monopolistic structure by imposing restrictions on entry into the banking system and by assigning each financial institution a narrowly defined sectoral or geographically specialised role. These further reduced the competitive pressure. The regulatory framework was not well defined either. It lacked commonality and coherence, and was grossly inadequate. Each institution appeared to be guided by its own establishment legislation, and the Bank of Tanzania's supervisory role was never exercised effectively. Similarly, prudential ratios were poorly designed and ineffective, as credit allocation and ceilings were dictated by the government and the ruling political party. Interest rates were administratively determined and took the form of rigid schedules of fixed rates, which favoured public sector borrowers but were much lower than the prevailing rates of inflation. The differential and preferential interest-rate structure was an important source of fragmentation within the formal sector. In addition, there were restrictions on capital transactions with foreigners, and there was no stock exchange market. These restrictive policies seriously undermined the performance of FFIs in the mobilisation of savings and fostered the misdirection of credit.

A number of financial liberalisation measures have been adopted since 1986. These include the removal of interest-rate ceilings; introducing indirect instruments of monetary control; increasing competition by granting more bank licences; permitting the entry of private (domestic and/or foreign) banks; expanding the scope of permissible activities for different FFIs; restructuring, rationalising and recapitalising FFIs; fostering money markets by creating new instruments like Treasury bill auctions, etc.; minimising credit allocation directives; and attempting to restore exchange-rate macro economic equilibrium.

The reforms have reversed some elements of the wrong policies. However, up to the time of writing (1994), the process of credit intermediation in Tanzania continues to be dominated by the existing state-owned FFIs. Only two private commercial banks have recently started operations and they are at present confined to Dar es Salaam city. Competition is still restricted. The impact of contractionary monetary policies on the expansion of credit has been obviated by increases in the monetary base made possible by increased bank borrowing through the Bank of Tanzania's unrestricted rediscounting window.

There is evidence that the government is gradually reducing its pressure on the commercial banks to lend to public sector clients which are not creditworthy. The decline in the share of public sector institutions from 90% in the early 1980s to 60% in the early 1990s, and the subsequent doubling of the private sector's share in total lending from 10% to 20% respectively, is indicative of this trend. Nevertheless, private borrowers still remain marginal players, accounting for only 20% of the total loan portfolio. There appears to be no significant reallocation of bank credit in favour of the private sector.

Interest-rate liberalisation has helped to check further decline in real deposit mobilisation. However, it has not been accompanied by substantial increases in the rate of growth of formal bank deposits. In fact, growth in deposits has lagged far behind growth in lending. To some extent, however, higher interest rates appear to have forced lenders to ration credit on the basis of the client's perceived risk of default. The hardest hit clients are smallholder farmers and micro enterprises which cannot provide acceptable collateral, and insolvent and heavily indebted public sector firms. Moreover, the liberalised interest rates in the formal sector are still much lower than those in the informal sector and have been accompanied by a rapid increase in the demand for informal credit and informal savings mobilisation. This suggests that dualism still persists in Tanzania's financial markets. But at the same time it dispels the belief that informal credit markets in Tanzania are strictly a parallel market, otherwise the liberalisation of interest rates would have eliminated them.

The persistence of low loan recovery rates is a manifestation of a number of institutional and policy weaknesses. These include: (a) continued government pressure, or moral suasion, used to induce banks to relax their lending criteria so as to accommodate certain types of borrowers who are not creditworthy; (b) cross-indebtedness and insolvency of the public sector borrowers who are the dominant clients; (c) lack of an adequate bank supervisory and monitoring framework and hence absence of prudential guidelines; (d) an inappropriate legal framework, including lack of well-established property rights as well as an efficient judicial system; (e) poor management practices among borrowers; (f) the effects of the economic crisis suffered by Tanzania in the early 1980s; and (g) lack of competition because of the small number of banks and the continued dominance of government-owned FFIs.

Excessive government intervention in the financial system has undoubtedly created structural distortions and market fragmentation. In Tanzania, much of the fragmentation within the formal financial system appears to be mainly government-induced. However, its persistence within the formal sector and between formal and informal institutions cannot be explained solely in terms of government-induced financial repression. Part of the explanation for the financial dualism and fragmentation seems to lie in the inherent differences in the characteristics of credit, credit transactions and access to the institutional infrastructure.

In particular, the lack of financial innovation, the persistence of ill-defined property rights, the ineffective banking and legal regulations and the poor enforcement mechanisms, the excessive bureaucracy, the political interference, and the institutional and infrastructural deficiencies have fostered imperfections within the formal credit market which in turn have given rise to excessively high transaction costs (i.e. costs associated with screening, information gathering, negotiation, monitoring and enforcement). In the circumstances, the constraints on the growth of the FFIs in Tanzania, as in most developing countries (Yotopoulos and Floro, 1992: 143), are thus not merely an artificial creature of government regulation; they are also an outcome of the inadequate development of markets and market support infrastructure.

The relatively lower transaction costs of the informal financial institutions are largely attributed to their ability to evolve a number of innovative informal arrangements through which externalities that are intrinsic to the highly imperfect residual market are internalised (e.g. strong interpersonal relationships, market interlinkage, credit layering and specialised and localised customer-tailored small-scale services in which FFIs have a cost disadvantage). This web of informal infrastructure has been the major source of trust enhancement between the transacting parties, and an important asset in overcoming the problems associated with moral hazard and adverse selection. It has also enabled informal financial units to extend credit beyond the narrow confines of project feasibility and bankability that characterise the rigid and over-regulated formal financial institutions. The co-existence of formal and informal financial institutions reflects the fact that the two systems face different prices, offer differentiated services and serve different market segments. This implies that the various segments of the financial market may in fact be representing efficient specialisation for different niches, suggesting the need for selective development rather than simply extending the frontier of the formal sector.

Appendix Tables

Appendix Table A1 Commercial bank's deposits 1980–92 (TSh.m.)

End of Period	*Central Government*	*Local Government*	*Public Enterprises*	*Parastatals*	*Other Domestic*	*Foreign*	*Total*	*of which*			
								Demand	*Time*	*Savings*	*Other*
1980	521.0	-	2,539.1	65.6	9,672.6	114.9	12,910.9	8,630.9	2,940.4	1,301.2	30.8
1981	789.0	-	3,055.7	13.7	11,009.3	118.2	14,985.9	9,348.0	4,003.7	1,591.6	42.6
1982	1,437.8	-	5,034.9	29.3	11,675.7	473.0	18,650.8	11,311.5	5,433.4	1,872.3	33.6
1983	807.1	-	5,342.0	8.2	15,592.0	52.2	21,801.5	12,997.6	6,359.0	2,392.7	2.2
1984	844.7	871.5	649.2	6,662.6	16,816.4	-	15,844.4	16,934.9	6,934.9	2,776.2	92.6
1985	787.8	1,046.8	2,425.6	9,682.1	14,670.6	-	28,612.9	14,697.9	10,029.9	3,798.6	86.5
1986	730.4	753.3	1,496.2	10,163.1	19,685.3	-	32,828.2	18,186.5	9,730.5	4,793.1	118.1
1987	1,653.6	1,180.9	5,536.2	11,739.6	23,129.0	306.0	45,545.7	23,675.1	13,263.1	6,301.1	306.4
1988	1,225.9	1,494.4	4,065.3	18,194.0	34,353.1	-	59,332.7	34,736.7	14,645.4	9,480.2	470.4
1989	1,737.8	1,750.7	11,290.8	18,672.3	43,486.4	-	76,938.0	42,621.4	21,234.5	11,593.6	1,488.5
1990	2,238.1	2,074.3	29,562.7	27,562.7	49,499.1	-	110,936.9	55,083.3	35,333.7	16,998.5	3,521.4
1991	3,485.3	1,849.3	24,159.8	26,666.6	95,298.7	-	151,459.7	75,198.2	43,991.8	26,508.5	5,761.2
1992	5,435.9	18.2	60,978.0	33,039.4	112,435.8	-	211,907.3	94,830.9	63,485.8	36,633.0	16,957.6

Source: Bank of Tanzania.

Appendix Table A2 Commercial banks – lending and holdings of securities (TSh.m.)

End of Period	*Overdrafts*	*Commercial bills*	*Other loans*	*Total*	*Foreign loans and bills*	*Total lending*	*Lending to deposit ratio*	*of which*		
								Treasury Bills	*Other Govt. Securities*	*Total*
1980	6,543.4	415.8	440.9	7,400.8	0.7	7,400.8	57.3	2,850.0	1,968.1	4,818.1
1981	5,340.4	533.6	2,677.0	8,551.0	1.2	8,551.0	57.1	4,228.6	2,347.7	6,576.3
1982	6,115.9	773.8	2,689.6	9,579.3	3.1	9,579.3	51.4	6,748.9	2,698.9	9,447.5
1983	6,416.8	840.9	3,385.5	10,642.8	1.3	10,642.8	48.8	8,050.0	3,497.8	11,547.8
1984	8,154.9	1,140.9	3,416.0	12,711.8	174.5	12,711.8	49.9	9,050.0	3,617.0	12,667.0
1985	12,443.6	1,051.3	3,935.7	17,430.6	-	17,430.6	61.1	5,050.0	3,349.4	8,399.4
1986	21,530.3	2,052.9	4,104.6	27,689.6	-	27,689.6	84.4	-	3,723.4	3,723.4
1987	47,476.8	2,574.4	4,991.5	55,042.5	-	55,042.5	126.4	-	3,641.5	3,641.5
1988	64,380.6	3,731.8	5,345.8	73,458.2	-	73,458.2	123.9	-	3,588.8	3,588.8
1989	94,510.2	3,822.7	8,428.5	106,761.4	-	106,761.4	138.8	-	3,588.8	3,588.8
1990	118,855.8	8,270.3	18,341.4	145,467.5	-	145,467.5	131.1	-	3,588.8	3,588.8
1991	166,874.1	11,975.0	19,303.5	198,152.6	-	198,152.6	30.8	-	3,486.8	3,486.8
1992	153,893.2	13,489.8	21,900.2	189,283.2	-	189,283.2	89.3	-	22,348.1	22,348.1

Source: Bank of Tanzania

Appendix Table A3 Commercial banks - domestic lending by borrowing sectors (TSh. m.)

End of Period	*Public administration*	*Agricultural production*	*Mining and manufacturing*	*Building and construction*	*Transportation*	*Tourism*	*Marketing of agricultural produce*	*Export of agricultural produce*	*Trade in capital goods*	*All other trade*	*Specified financial institutions*	*Other*	*Total*
1984	45.0	652.6	1,331.5	333.3	252.7	16.5	7,579.6	590.3	100.4	1,649.1	6.5	397.1	12,954.6
1985	97.5	642.5	1,443.2	313.5	367.3	30.9	9,788.9	446.7	81.9	3,973.1	0.2	339.7	17,528.5
1986	117.8	1,362.3	1,451.3	426.5	414.2	51.3	5,149.6	220.7	265.2	16,309.0	22.0	2,063.0	27,852.9
1987	29.9	4,039.4	6,262.8	522.2	1,096.9	158.0	35,220.7	300.5	71.6	6,594.9	54.0	721.4	55,072.3
1988	71.7	6,020.2	14,429.8	634.3	1,539.0	276.2	37,324.1	617.5	133.0	10,951.8	87.1	1,445.2	73,529.9
1989	93.7	6,612.4	22,429.8	2,541.8	2,223.9	543.5	48,360.5	743.7	213.3	15,910.5	100.7	6,893.7	106,666.7
1990	80.0	13,224.7	35,562.7	1,564.7	3,837.7	1,260.2	49,220.4	2,084.9	425.5	32,306.5	96.4	4,466.1	144,129.8
1991	530.0	20,074.2	43,855.3	2,592.9	4,632.9	1,986.1	76,530.5	2,833.8	661.5	24,780.8	320.3	19,682.6	198,682.6
1992	737.1	15,617.9	39,874.7	3,879.7	4,225.1	3,700.1	51,858.4	5,942.0	1,252.3	46,914.1	154.6	15,864.3	190,020.3

Source: Bank of Tanzania.

Appendix Table A4 **NBC lending portfolio (TSh. m.)**

	1986/87	*1987/88*	*1988/89*	*1989/90*	*1990/91*
Marketing of Primary Products	18,871	36,800	48,654	58,368	68,877
Agriculture	640	1,400	3,284	5,215	6,154
Commercial	n.a	n.a	2,389	3,820	3,374
Exports	295	635	600	1,337	1,578
Industry and Manufacturing	4,730	10,100	19,785	23,304	27,499
Construction	291	325	814	1,093	1,290
Imports/Distribution	2,361	4,650	8,523	11,334	13,374
Hotels/Tourism	89	190	350	607	717
Financial Institutions	69	49	89	265	313
Sub-Total	28,300	56,194	87,104	108,740	127,089
Commercial Bills	1,044	2,110	3,215	3,998	4,508
Grand Total	29,344	58,304	90,319	112,738	131,597

Source: National Bank of Commerce.

Appendix Table A5 **Co-operative and Rural Development Bank. loan portfolio by sector and lender**

BY SECTOR:	*1986–1987*		*1987–1988*		*1988–89*		*1989–90*		*1990–91*		*1991–92*	
	No. of Loans	*Amount (TSh.m.)*	*No. of Loans*	*Amount (TSh.m.)*	*No. of Loans*	*Amount (TSh.m.)*	*No. of Loans*	*Amount (TSh.m.)*	*No. of Loans*	*Amount (TSh.m.)*	*No. of Loans*	*Amount (TSh.m.)*
Seasonal inputs	34	1272	64	1805.7	36	2376.7	313	1543.3	47	967.6	30	307
Farm machinery	83	116	37	45	13	66.6	63	492.8	63	277.9	96	570
Farm development	24	27	112	16.9	34	11.2	255	771.3	8	16.3	22	357
Small scale ind.	110	28	173	36.5	64	32.8	110	86.1	112	194.2	160	411
Rural Transport	143	528	52	191.6	52	423.8	159	2330.7	177	2679.8	450	5096
Livestock	87	24	527	87.6	451	93.5	582	98.4	88	138.8	116	118
Fisheries	15	12	19	12.2	68	28.8	14	11.2	2	3.7	20	43
Storage	0	-	0	0	1	11.6	-	-	-	-	1	7
Commerce	1	0.1	65	7.4	16	0.7	251	29.4	-	-	77	276
TOTAL	497	2010.56	1049	2203	735	3046	1747	5363.5	497	4278.3	974	7185
BY BORROWER:												
Villages	32	27.8	23	29	20	23	29	149	78	388.6	14	50
Indiv./Partnership/Priv. cos	394	326.4	970	337	653	311	1435	3350	407	2924.9	948	6985
Parastatals	36	131.9	18	112	8	24	5	331	1	10	1	17
Co-op. societies/co-op. unions	35	1524.2	38	1724	54	2686	278	1532	11	954.8	11	133
TOTAL	497	2010.56	1049	2203	735	3046	1747	5363.5	497	4278.3	974	7185

Source: Co-operative and Rural Development Bank.

Appendix Table A6 Inflation and interest-rate structure 1980–92 (% p.a.)

TYPE OF RATE	*1980*	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*
A.Deposit rates													
1.Savings	5.00	6.00	7.50	7.50	7.50	10.00	10.00	21.50	21.50	26.00	26.00	26.00	24.00-26.00
2.Short-term (31–91 days)	3.15-3.50	3.15-3.50	3.15-3.50	3.50	3.50	5.00	5.00	14.50	14.50	16.00	16.00	16.00	16.00-18.00
3.Fixed (3–60 months)	4.00-7.00	4.00-8.50	4.00-10.25	4.00-11.00	4.00-11.00	6.00-14.00	6.00-14.00	15.50-27.00	15.50-27.00	17.00-29.00	17.00-29.00	17.00-29.00	17.00-30.00
B.Lending rates													
1.Short-term	7.50-12.00	7.50-12.50	8.00-12.50	9.50	9.50	11.00-16.00	11.00-16.00	18.00-29.00	18.00-29.00	20.00-31.00	20.00-31.00	20.00-31.00	18.00-31.00
2.Medium & long term	5.00-11.00	4.00-12.00	5.00-13.50	9.00-13.50	9.00-13.50	11.00-16.00	11.00-16.00	19.00-29.00	19.00-29.00	21.00-31.00	21.00-31.00	21.00-31.00	29.00-31.00
3.Housing mortgages	5.00-11.00	4.00-11.00	5.00-13.50	13.50	13.50	8.00-16.00	8.00-16.00	7.00-29.00	9.00-29.00	9.00-29.00	9.00-29.00	9.00-29.00	29.00
C.Government securities													
1.Direct advances	4.77	4.77	4.77	4.00	4.00	5.00	5.00	11.25	11.25	14.50	14.50	14.50	14.50
2.Treasury bills	4.27	4.27	4.27	4.95	4.95	5.33-6.00	5.33-6.00	11.25-12.00	11.25-12.00	14.50-15.50	14.50-15.50	14.50-15.50	12.50-13.50
3.Treasury notes	5.00	5.00	5.00	5.00	5.00	10.00	10.00	18.75	18.75	23.00	23.00	23.00	-
4.Stocks	6.00-7.50	6.75-7.50	7.00-7.50	7.25-7.75	7.50-8.50	7.50-8.50	12.00-16.00	21.50-17.50	21.50-17.50	24.00-29.00	24.00-29.00	24.00-29.00	15.00-24.50
5.Tax reserve certificates	4.00	4.00	4.00	4.00	4.00	6.00	9.50	13.00	13.50	16.50	16.50	16.50	16.50
Inflation Rate*	30.3	25.7	28.9	27.1	36.1	33.3	32.4	29.9	31.2	25.8	14.7	22.3	22.1

Source: Bank of Tanzania.

Note: * As measured by changes in the National Consumer Price Index.

Appendix Table A.7 NBC loan recovery (crop finance) summary[a] (TSh.m.)

Season	*Amount Approved*	*Total Repayment*	*Total Outstanding*	*Recovery Rate %*
1984/85	669.2	203.5	465.7	30.4
1985/86	4,369.7	2,168.2	2,201.5	49.6
1986/87	6,107.5	1,132.0	4,975.5	18.5
1987/88	9,933.2	1,594.0	8,399.2	16.0
1988/89	10,881.0	2,619.4	8,261.6	24.1
1989/90	8,673.5	3,295.1	5,378.4	38.0
Total	40,634.1	11,012.2	29,621.9	27.1

Source: National Bank of Commerce.
Note: [a] End of season position.

Appendix Table A.8 CRDB loan recovery (seasonal inputs) summary (TSh m.)

Season	*Principal*	*Interest*	*Repayment*	*Balance*	*Recovery Rate %*
1984/85	530.1	39.9	225.5	344.5	39.6
1985/86	1,061.1	183.6	613.6	631.1	49.3
1986/87	1,801.2	444.7	674.2	1,571.7	30.0
1987/88	1,139.2	132.2	87.2	1,184.2	6.9
1988/89	250.0	42.5	34.9	257.6	11.9
1989/90					
Total	4,781.6	843.1		3,989.1	29.1

Source: Co-operative and Rural Development Bank.

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