INSTITUTE OF SOCIAL STUDIES

Working Paper Series No. 177

IMPORT SUPPORT AID: EXPERIENCES FROM TANZANIA AND ZAMBIA

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August 1994

WORKING PAPERS

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Import Support Aid:
Experiences from Tanzania and Zambia

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Abstract

Import support has become an important form of aid - accounting for more than half of all aid from some donors to Tanzania and Zambia. However, there has been little analysis of import support in the aid effectiveness literature. This paper finds that import support aid is largely effective: (i) there is no evidence that the money is used for undesirable luxury imports; (ii) beneficial effects on capacity utilisation and output can be observed; (iii) it is a form of aid which manages to reach the private sector; and (iv) donors have adopted procedures to avoid potential adverse consequences of counterpart funds. The management of import support schemes is also discussed - market-based schemes being preferable to administrative ones, and market-oriented reforms being required for a well functioning import support system. The paper concludes by arguing that donors should not place controls on the use of aid for import support, but rather devote their resources to assisting in the successful implementation of government activities which are supported by the counterpart funds.

1. Introduction

During the 1980s donors have increasingly resorted to programme aid - of which import support has been a major component. This importance has not been reflected in increased attention in the academic literature, with little work addressing the problems of import support *per se* (exceptions are Winpenny, 1989; Doriye and

*This paper is partly based on work undertaken for SIDA and the Secretariat for the Appraisal of Swedish Development Assistance (SASDA) and draws on fieldwork in 1993 (Tanzania) and 1994 (Zambia). All views expressed are those of the author.

Wuyts, 1992; and de Vlyder, 1993). This paper helps redress the balance.

The scope and purpose of import support are laid out in Part 2 of the paper and different forms of import support discussed in Part 3. Economic issues relating to the use of import support - (a) the impact on import composition, (b) effects on capacity utilisation and growth, (c) forex and credit allocation, and (d) the collection and use of counterpart funds - are analysed in Part 4. Part 5 discusses the management issues which arise out of the preceding economic analysis. Part 6 concludes with a proposal for a new mechanism for the disbursement of import support funds.

2 Scope and purpose of import support aid

The importance of import support aid can be judged from the figures given in Table 1, which shows share of import support from selected donors to Tanzania and Zambia. These figures are for import support only and exclude the other main component of programme aid - debt relief. Increased debt relief in recent years is a contributory factor to the declining share of import support. Fungibility may result in the economic effects of import support and debt relief being similar, but the issues of analysis and management differ.

Two observations may be made from the data shown in Table 1. First, import support is an important form of aid in both countries, having been in some years over half the aid Tanzania has received from Norway and the UK, and averaging at around one third for each donor. Import support was 8 per cent of all aid to Tanzania in 1981/2, but had risen to 44 per cent by 1986/87 (Mbelle and Karamagi, 1992: 18). These figures might be contrasted with those for food aid - which is typically only 10 per cent of total (global) aid, but which has excited far more academic attention.

Second, the share of import support has varied. Changes in

Table 1 Share of import support in aid from selected donors to Tanzania and Zambia (per cent)

	1986	1987	1988	1989	1990	1991	1992	1993
Norway								
Tanzania	40.3	36.6	37.0	25.5	50.7	38.6	12.2	9.5
Sweden								
Tanzania	n.a.	29.0	26.7	27.0	34.6	40.8	17.3	n.a.
Zambia	n.a.	41.3	21.0	7.8	30.7	21.4	14.2	n.a.
United Kingdom								
Tanzania	2.8	57.7	51.3	62.2	24.7	n.a.	n.a.	n.a.
Zambia	40.3	10.4	0.0	0.0	41.4	n.a.	n.a.	n.a.

Note: Swedish data are for financial years.

Sources: Bhaduri *et al.* (1993: 10-11); NORAD office, Dar es Salaam; *British Aid Statistics; Sweden's Development Assistance in Figures and Graphs* ("BSD").

disbursements of import support can be directly linked to recipient policy performance. Zambia broke with the Bank and Fund in the years 1987-1989, and the share of import support in Swedish and British aid declined accordingly. The reaction from the UK in Zambia was particularly marked, as was the UK's endorsement of Tanzania's adjustment programme begun in 1986. Commitments of import support from all donors more than doubled due to additional commitments linked to the Tanzanian recovery programme (Skarstein *et al.*, 1988: 35). By contrast, Norwegian aid shows far less variation in response to changing recipient policy stance.

In Zaire in 1960 there were 88,000 miles of motorable road; in 1985 there were only 12,000 miles (Davidson, 1992). The World Bank's 1989 Report, *Sub-Saharan Africa: From Crisis to Sustainable Growth*, pointed to African "de-industrialisation", with 10 countries experiencing a decline in manufacturing output during the 1970s and another 11 doing so in the early 1980s: some of these reported manufacturing capacity utilisation rates of as low as 30 per cent (World Bank, 1989: 110). Facts such as these provide the main rationale for import support. The tightening foreign exchange constraint in developing countries has meant they have been unable to finance the recurrent import requirements to utilise existing investments. Further project aid only further extends capacity, with existing capacity going under-utilised. Import support is thus intended to provide the finance for spare parts and intermediate goods to rehabilitate and utilise existing capacity. Beyond this basic rationale the following other advantages of import support may be identified (the list is drawn from Winpenny, 1989: 262; and de Vlyder, 1993): (i) disbursements are not limited by recipient absorptive capacity; (ii) non-project aid enables rapid disbursement of substantial amounts of aid; (iii) the aid can be readily linked to policy conditionality (it is easier to turn "on and off" than project aid); Norway and Sweden have both recently put a substantial share of their import support outside of the usual "country frame" aid budgeting process to increase this flexibility; and (iv) the countervalue from the sale of goods or forex have a beneficial impact on the government's budget.

3 Types of import support

Two different modes of import support may be identified (i) administrative systems (commodity import support); and (ii) market based systems (which can be sub-divided into Open General Licence Systems and forex auctions).

Early import support was most commonly commodity aid, with a donor providing a particular commodity (e.g. fertilizer or paper), either supplying the commodity directly or making the payment for the procurement from a third country. The commodity would have been agreed as an "essential import" with government, and its use agreed between donor and recipient. Frequently the goods were used by government agencies (e.g. pharmaceuticals) or parastatals, and the issue of payment in local currency for these goods did not arise. In some cases when the goods went to parastatals and in all cases when the goods were subsequently distributed to the private sector then the ultimate recipient of the goods was expected to pay the local currency equivalent (called countervalue or counterpart funds). This is the meaning of the sentence in SIDA's *Principles of Import Support* that "import support is a grant to the country, but not to the importing agent or agency" (SIDA, 1993: 12).

The development of import support in the 1980s in Tanzania formalised the commodity aid model in a system known as commodity import support. Whilst some of the commodity aid remained targeted to particular sectors or firms a substantial part was "free quota", which was allocated by a Treasury committee. Potential importers had to apply to the committee for access to the funds for a specified purpose. Except for government ministries (which accounted for a very low percentage of successful applications) all importers were required to pay cash cover at the official exchange rate once notified of the allocation. Both Tanzania and Zambia had already adopted administrative systems for foreign exchange allocation during the 1970s and the administrative system of import support did not depart radically from these procedures.

A number of perceived problems with the administrative system resulted in a move toward a more market based system. These problems are discussed in more detail below, but they include the potential for corruption in the administrative system, the use of import support to subsidise ailing parastatals and low collection rates of counterpart funds. Market-based systems seek to avoid such problems by removing government from the allocation process.

Under Open General Licence (OGL) systems importers buy the foreign exchange from a commercial bank, which is meant to consider applications on a first come, first served basis. During the period in which import licences were required (which they no longer are in either country) then importers granted OGL funds were automatically granted a licence (with donors to OGL specifying how long this process should take). The importer pays the bank local currency for the forex as a regular commercial transaction. When the forex is actually utilised then the commercial bank pays the Central Bank - Bank of Tanzania (BOT) and Bank of Zambia (BOZ) - the countervalue and the Central Bank passes the funds to Treasury. These transactions take place at the official exchange rate and donors place restrictions on the goods procured. Restrictions may be both on the type of good - though such restrictions have become laxer as positive lists expanded and have now been replaced with "negative lists" of restricted items - or on source. For example, EC import support must be used to purchase goods from EC-ACP countries, though waivers may be granted - EC funds can be used for purchase of South African goods by Zambian importers. To meet these restrictions centralised systems have been implemented of allocating actual transactions against available OGL funds *ex post*.

An OGL system was established in Tanzania in 1988 and by 1990 most major donors (with the important exception of USAID) were channelling money through or (in the case of Sweden) in parallel to the OGL. The EC operated its own, but similar, system. By late 1992 dissatisfaction was being expressed amongst donors about the scheme, the Dutch reverting to administrative allocation. In August 1993 OGL was abolished and replaced by a forex auction.

Under OGL systems banks pay the cash cover *ex post* once it has been allocated to importers, with auction systems they pay for the forex *ex ante* - buying it from the Central Bank and then selling it to importers as they please. Auctions may either be open to a range of forex users (as in the Zambian auction from 1985 to 1987) or restricted to retailers of foreign exchange (as in the current Zambian system) - these retailers are not only commercial banks but also the forex bureaux which have operated a legal parallel market for the last few years. Donors clearly have less control over the funds with an auction system, indeed the importer need not be aware of the origin of the funds. Hence there must be a single exchange rate for all transactions covered by the commercial banks and restrictions on the use of funds cannot exceed those placed on other forex from this source (though restrictions are "imposed" *ex post* when donor funds are accounted against actual transactions).

The Zambian auction begun in 1985 was a radical departure from the more cautious exchange rate policy adopted in many other adjustment programmes at the time and resulted in a substantial depreciation - from a pre auction rate of K 2.2 per US$ to a peak of K 21 per US$. Discontent with the adjustment programme came to focus on the auction, which was held to be responsible for high inflation and seen only to benefit the better off, and government itself took a number of steps to undermine the system (including not accepting bids above a certain level!). The abandonment of the auction in May 1987 marked the end of Zambia's adjustment effort and a return to a control economy. But two years later policy dialogue had been picked up and in 1990 the new programme included an OGL system. Although initially the OGL window covered only 10 per cent of imports it was progressively expanded to cover 92 per cent by March 1991 (Aron and Elbadawi, 1992: 9). An auction system was re-established in December 1993, with the commercial banks being able to buy foreign exchange from BOZ three times a week. As in Tanzania, the auction system in Zambia has led to a reduced role for OGL.

The auction and OGL systems in Tanzania and Zambia have operated under the auspices of the World Bank and IMF - which has had the advantage of meaning that funds channelled through these systems have been subject to common procedures. Donors channelling funds through other mechanisms complicate matters with different procedures, accounting requirements etc. Attempts have been made to standardise practice through a system of Joint Evaluation Missions (JEMs) and through guidelines from a Special Programme for Africa (SPA) working group (see Part 5 below).

4 Economic issues

Market-based allocation systems have been controversial in the recipient countries. From the criticisms which have been made the following main points may be extracted: (i) market-based systems favour the importation of unnecessary luxury consumer items, whilst essential goods are in short supply; (ii) corruption pervades these systems as much as it does administrative ones, so that the rich and powerful get preferential access to the funds; and (iii) these powerful individuals do not pay the counterpart funds which are due. Each of these points is discussed here, comparing administrative and marked-based import support systems, and examining the usefulness of import support in general. Also discussed are the impact of import support on capacity utilisation and the role of incentive goods and the use of counterpart funds by government.

a) *Import composition*

A common criticism of import support schemes is that the aid pays for "non-essential" luxury imports which do not contribute to recipient growth. One agency official in Lusaka commented that OGL money is used for "beer and biscuits"; others point to the increasing number of Mercedes and BMWs seen in African capitals and say "that's OGL money". In fact, this criticism may be one of three arguments: (i) corruption - malpractice in administering the import support allow it to be used for luxury goods which are on the negative list (e.g. Mercedes); (ii) categorical fungibility - because of the import support government can now allow free forex to be used for luxuries; or (iii) opposition to negative list - if import support is used for Mercedes this fact must arise either from corruption or fungibility, since these are on the negative lists of countries operating OGL schemes; but if the argument is against "beer and biscuits" this is an argument against an OGL system which is functioning entirely in accordance with its rules, since these are not prohibited uses of the funds.

The arguments concerning corruption and about the inappropriateness of some goods allowable with current negative lists are considered below, where allocation mechanisms and economic effects are discussed. As a background to these discussions, and to pursue the fungibility argument, data are presented here on import composition.

Table 2(a) shows the allocation of funds from Zambia's auction in the mid-1980s (the data refer to the first year of the auction) and Table 2(b) shows the use of OGL funds provided by the Norwegians to Tanzania. The share of auction funds being used for consumer goods was small indeed - only 6 per cent. The vast majority appears to have been used for intermediate and capital goods. More detailed data were available for the Tanzanian case, and these data have been summarised as showing:

> ... about a third goes to each of the manufacture of incentive goods and to support other industrial production. The remaining third splits roughly equally between agriculture, transport and miscellaneous items.
>
> (Doriye *et al.*, 1993: 33)

Table 2(a) Allocation of auction funds by end-use Zambian auction, 1985-86

	US$ million	Per cent
Consumer	20.6	6.0
Intermediate	159.2	46.6
Machinery and equipment	53.6	15.7
Miscellaneous goods	14.9	4.4
Services	53.5	15.9
Allocation to banks	40.3	11.4

Source: World Bank (1993: 142).

Table 2(b) Allocation of Norwegian OGL in Tanzania by type of good

Type of good	Share (per cent)
Agricultural implements and parts	5.5
Other agricultural goods	1.1
Food and agricultural processing	7.5
Inputs for manufacture of soft drinks	2.7
Bikes and parts thereof	10.7
Soaps and inputs for soap production	5.7
Radios, cassettes, batteries and parts	2.6
Medicines	8.2
Vehicles and parts thereof	13.5
Other engines and parts thereof	4.1
Computers and accessories	0.8
Office equipment and educational supplies	2.7
Construction materials	3.8
Electrical machinery, goods and components	7.5
Other industrial intermediate goods	19.3
Other goods nes	4.4
Total	100.0

Source: NORAD OGL database, Norwegian Embassy, Dar es Salaam

The consumer goods being imported are not luxury ones but the basic necessities that became in short supply under the control regime. Moreover, it is frequently not finished products which are being imported but raw materials for the production of these goods.

Although the actual import funds may be accounted for against desirable imports, fungibility may allow funds which would otherwise have been used for these goods to be used for the luxury consumer items pointed to by critics. To assess this question it is necessary to examine data on import composition. Before doing so it should be mentioned that both countries have also introduced "own funds" imports schemes - by which importers may import goods using their own forex with no questions asked as to the origin of those funds (the intention being to bring in to the legal market funds from capital flight and illegal exports). Gulhati (1989) suggests that Zambia's own funds imports scheme should be held responsible for any shift in import composition to consumer goods in the mid-1980s, rather than the auction.

In fact, as Table 3 shows, neither country has experienced such a shift. In Tanzania the share of consumer goods has not increased since the increase in import support with the 1986 reforms, nor (so far as the available annual data show) has there been any marked change in this pattern since OGL has taken over from CIS. The share of intermediate goods in imports does decline between the two periods; but this decline is wholly attributable to oil (which was relative expensive in the early 1980s), with the share of other intermediates rising from 15.3 to 20.1 per cent. For the Zambian case, Table 3(b) shows that the share of consumer goods remained more or less stable throughout the three periods shown (in fact being slightly higher in the non-auction periods).

Table 3(a) Tanzanian import composition, 1980-91

	1980-85	1986-91
Capital	43.1	46.6
Intermediate	39.2	35.3
o/w oil	24.0	15.2
other intermediate	15.3	20.1
Consumer	17.5	17.8
Unclassified	0.1	0.2
Total	100.0	100.0

Source: *Economic Survey* (various issues)

Table 3(b) Zambian import composition, 1980-90

	1980-84	1985-87	1988-90
Total (Kwacha million)			
Consumer	188	936	3,694
Intermediate	546	2,245	6,483
Capital	212	1,886	7,163
Shares (per cent of total imports)			
Consumer	19.9	18.5	21.3
Intermediate	57.7	44.3	37.4
Capital	22.4	37.2	41.3

Note: 1980-84 is the three years 1980, 1981 and 1984.

Source: World Bank (1993, Statistical Appendix: Table 17).

A shift in import composition did take place in favour of capital goods in both countries, which is contrary to expectations. This oddity may be explained by two factors. One possible factor is a classification problem. Many goods needed to utilise spare capacity - generators, particular items of machinery etc. - may well be classified as capital goods, even though they are having the intended impact of import support: a single machine may be necessary in order for a whole plant to be operational. The second possible explanation relates to own-funds imports. Impressionistic evidence suggests that a part of these funds are used for vehicles, which are classified as capital goods.

(b) Foreign exchange and credit allocation

The requirement on importers to pay cash cover links the credit and forex allocation systems - those getting access to credit thus have access to the domestic currency to purchase forex. In both Tanzania and Zambia the commercial banking sector has historically been an arm of government, which has directed the credit allocation process. So long as this remains the case then a free forex market may be subverted by government's role in credit allocation. This fact has not been lost on donors, who sought to separate government and the banks through policy conditionality.

Government's role has been justified in terms of making strategic interventions in the economy's development - but donors have taken a different view. World Bank reports on both countries have been very critical of the administrative allocation of foreign exchange. A report on Tanzania's industrial sector concluded that a purely random allocation of the forex amongst firms would have yielded a more efficient outcome (World Bank, 1984a). In a similar vein, a report on Zambia notes the administrative costs and uncertainty surrounding the procedures, going on to say that the:

> most important failure of the present system [is] its failure to allocate import licenses on a rational and

efficient basis...

> Although it is not possible to document the impact of misallocations of foreign exchange on the macroeconomy, examples of arbitrary or irrational allocations at the micro level are numerous... [For example] importing new vehicles because import licences for tires are unavailable.. adding hundreds of thousands of dollars to the foreign exchange cost of a raw material because the authorities insisted that it be imported directly from the supplier rather than through a local subsidiary.
>
> (World Bank, 1984b: 147-48)

In the light of criticisms of OGL that it supports the importation of luxury goods, it is interesting to note that the report also points to the socially "pernicious effects" of the administrative system since those who can afford it have access to forex through the black market and use it to import luxury items, whilst inputs for essential consumer goods, such as soap and cooking oil, are in short supply.

Since CIS has followed in the footsteps of administrative schemes it must be questioned if it can break with the practices of the past. In Tanzania donors became increasingly concerned at the large share of their import support being directed to propping up parastatal enterprises. Hence, although import support is associated with policies for structural adjustment, the funds themselves might be used to stave off restructuring. Table 4 shows that, for some donors, the share of parastatals was large - however, Canada, the UK and US managed to ensure that the vast majority of their CIS went to the private sector. In addition, a large part of CIS has been to trading and infrastructural firms (Doriye *et al.*, 1993: 79). Hence, we should conclude that CIS has displayed some tendency to go disproportionately to government, but that donors have room for manoeuvre on this front. Although evidence is less readily to hand, it does seem plausible that (as has been claimed in the Tanzanian press) use of CIS funds has been permeated by corrupt practices. Similar allegations have arisen over recent CIS-type Japanese finance in Zambia.

Table 4 Allocation of CIS in Tanzania by importing agency

<table>
<tr><th></th><th></th><th>Government</th><th>Parastatal</th><th>Private</th></tr>
<tr><td>OGL</td><td>1991-92</td><td>3.4</td><td>28.9</td><td>67.7</td></tr>
<tr><td>Norwegian OGL</td><td>1990-91</td><td>6.1</td><td>43.7</td><td>50.1</td></tr>
<tr><td>Swedish CIS</td><td>1988-92</td><td>2.1</td><td>74.0</td><td>23.9</td></tr>
<tr><td>USAID CIS</td><td>1991-93</td><td colspan="2">16.5</td><td>83.5</td></tr>
<tr><td>CIDA CIS</td><td>1987-92</td><td colspan="2">21.0</td><td>79.0</td></tr>
<tr><td>UK ODA CIS</td><td>1987-92</td><td colspan="2">8.0</td><td>92.0</td></tr>
</table>

Source: Doriye *et al.* (1993: 25 and 78).

Within OGL systems governments have sought to affect allocation of funds by differential cash cover requirements. In Tanzania trading companies were required to pay 100 per cent cash cover up front, whereas manufacturers need pay only 70 per cent. This preference reflects a neo-physiocratic concern that the productive sectors must be supported - see, for example, the report on Tanzanian import support by Bhaduri *et al.* (1993). It is this concern which have led the Japanese in Zambia to revert to an administrative system - so that the aid can benefit the "three pillars of the economy: agriculture, mining and manufacturing".

There are two reasons why such arguments may be misplaced. First, the trading company is not the final user - in Tanzania traders have used OGL to import intermediate goods and spare parts, engines, yeast and other items which are sold to producers (Doriye *et al.*, 1993: 34). It is the goods which are imported which matters, not the channel through which they come. Second, consumer goods can play an important part in economic recovery through their role as incentive goods - this argument is considered below.

(c) Capacity utilisation, incentive goods and output

A major role of import support was to allow increased capacity utilisation. Has it achieved this result? Direct evidence from two studies of Norwegian import support in Tanzania suggest that it has. A study of CIS compared 39 firms, 12 of which had received no import support, 19 of which received it once in the years 1984-86 and 7 which received it in at least two of these years (Table 5a). Throughout the period 1984-87 the first group had the lowest rate of capacity utilisation and the group which received the most import support the highest. Capacity utilisation for the first two groups fell from 1984 to 1987, but did not do so for the group receiving import support at least twice. From their survey of 100 recipients of Norwegian OGL, Mbelle and Karamagi were able to report data on capacity utilisation for 41 of these (Table 5b). Capacity utilisation

Table 5(a) Capacity utilisation in Tanzanian firms receiving Norwegian CIS (per cent)

Number of years in which received import support	Number of firms	1984	1985	1986	1987
None	12	32	34	30	24
At least once	19	42	42	31	36
At least twice	7	53	53	37	51

Source: Skarstein *et al.* (1988: 53).

Table 5(b) Capacity utilisation amongst sample of Tanzanian recipients of Norwegian OGL (number of firms)

Capacity utilisation	1990	1991
10-30	14	6
31-60	18	23
61-100	9	12
Total	41	41

Source: Mbelle and Karamagi (1992: 48)

appears to have improved between 1990 and 1991 with increases in the number of firms reporting the highest and middle ranges of utilisation and the number reporting the lowest rates dropping by more than half.

These data refer to manufacturing firms - but in both countries the agricultural sector supports a large share of the population and must play an important part in economic recovery. Agricultural production is less import intensive (Table 6), though the difference is less marked in Zambia where the sector has been dominated by large farms. The need for import support to directly support production is therefore less in the agricultural sector. But there is a role to play through the provision of incentive goods. Under the control regime basic consumer items became scarce, and often unavailable in rural areas. Peasants have little incentive to produce if there are no goods to buy (even if they had access to credit markets to save, real interest rates were highly negative). The range and availability of these goods has increased greatly with the introduction of reform - and the analysis of the use of OGL funds above suggests that import support has played a part in this greater availability.

Import support can also assist increased agricultural production through improving supply infrastructure. The agricultural marketing parastatals of the two countries were increasingly unable to collect and distribute output (see, for example, Geisler, 1991). Yet the private sector can only develop in this role if it has the transport to do so. That part of import support used for vehicles, or to keep vehicles running, can thus support agricultural production and diversification - and this use is clearly evident in Tanzania. Zambia had the opposite experience with its 1993 maize crop going uncollected by a private sector still inexperienced in this task.

Import support is also criticised for supporting deindustrialisation: the goods imported with donor finance

Table 6 Import intensity of agriculture and manufacturing

	1980	1985	1990
Tanzania (imports/gross output)			
Agriculture	2.8	1.0	n.a.
Manufacturing	96.9	84.9	n.a.
Zambia (imports/sectoral value added)			
Agriculture	14.3	18.3	7.0
Manufacturing	65.1	55.6	19.4

Source: *Revised National Accounts of Tanzania*; World Bank (1993: Tables 7 and 17).

displace domestic production (e.g. Bhaduri *et al.*, 1993). Aggregate data do not support this proposition, since manufacturing output has continued to rise. In Tanzania there has been real growth in manufacturing since 1986, deindustrialisation having in fact occurred in the pre-adjustment period of the early 1980s (Doriye *et al.*, 1993: 95-6). The post-adjustment manufacturing growth record in Tanzania also provides indirect evidence of the beneficial effects of import support, since the growth has been associated with improved efficiency (lower ICORs) rather than higher investment (Doriye *et al.*, 1993: 96). Growth in Zambian manufacturing has not been so marked, but real output has increased in some years and not declined below pre-adjustment levels.

The argument that import support displaces domestic output appears to have more force if taken to the level of specific goods. Table 7 shows the change in output of selected goods in Tanzania from the years 1981-83 to the years 1989-91. Production of some of the goods for which output has increased - e.g. soap and paint - has been supported by import support. Conversely, funds have also been used for finished parts which may have offset domestic production - e.g. batteries and bike tyres and tubes. Even if these declines are attributable to import support a final assessment need take account of the viability of domestic production of these goods: for example, the cessation of production by the Tanzania Fertilizer Company was almost certainly a net benefit to the Tanzanian economy, given the company's notorious inefficiency.

(d) Counterpart funds

There are four controversial aspects of counterpart funds: (i) the exchange rate to be used in calculating the importer's cash cover obligations; (ii) collection rates; (iii) use of countervalue by government; and (iv) potential inflationary impact of the funds.

Choice of exchange rate

Many developing countries have dual, or even multiple,

Table 7 Output of selected goods in Tanzania: percentage change 1981-83 to 1989-91

Good	Percentage change
Cement	121.4
Containers	109.2
Soap	104.3
Paint	57.7
Fishnets	36.4
Tyres and tubes	32.9
Motor batteries	19.6
Sisal ropes	-15.9
Cigarettes	-16.1
Blankets	-18.6
Textiles	-23.3
Beer	-23.4
Batteries	-40.5
Fertilizer	-40.4
Shoes	-83.0
Bike tyres and tubes	-87.5

Source: Bank of Tanzania *Economic and Operations Report* (various) exchange rate regimes. Import support funds will normally be sold at or close to the official rate - thus making the imported goods cheaper than if the forex had to be purchased on the open market. This implied subsidy opens the system up to rent seeking behaviour, and the possibility for the government to support the ailing parastatal sector. Hence, as mentioned above, some donors have expressed concern that the import support may inhibit, rather than encourage, restructuring.

A point often not appreciated is that donor accounting requirements and restrictions on the use of forex provided as import support (see Part 5 below) can drive a wedge between the market and official rates. The wedge may arise either because of the additional transaction costs associated with procuring import support forex or because of the market segmentation created by restrictions on use. The demand for free forex (that which may be used for importation of any goods and services or for capital account transactions) will exceed that for forex which may only be used for a certain set of goods. Thus the market clearing exchange rate for the former category of forex may be higher than for the latter (if the share in total forex use of imports permitted under import support is less than the share of import support in total available forex). This argument provides one possible reason why black market premia have often been resilient in the face of substantial devaluations of the official rate. It also explains why the move to a unified rate has been associated with an abandonment or reduction in OGL systems in favour of auctions.

In Tanzania the subsidy offered by cheaper OGL funds was quite substantial, but this subsidy narrowed as the exchange rate premium was eliminated. By the time that the premium was reduced to around 10 per cent there was no evident excess demand for OGL funds - suggesting that this margin was just sufficient to cover the extra costs involved in the use of OGL. The move to an auction system eliminates the problem of the choice of exchange rate since a single rate must apply to all forex transactions through the commercial banks.

In Zambia the exchange rate system has been unified since December 1992, with the official rate calculated as the weekly average market rate. (In fact, there was initially a 15 per cent premium on the OGL, but this premium was soon abolished). During the 1985-87 adjustment episode, import support was channelled through the auction - the rate from which led the way in setting much needed devaluations of the exchange rate (as the auction rate was used for all official transactions).

Collection of counterpart funds

Recipients of import support may receive a "double subsidy". In addition to the subsidy implicit in the choice of exchange rate, companies have often not paid the cash cover anyhow, or at least not in full. In countries in which governments are trying to collect payments arrears of counterpart funds the issue also arises of the exchange rate used to value the arrears - should it be the current rate or that at the time of the transaction (possibly plus some late-payment penalty) - given the rate of depreciation in some countries, this decision can affect the amount to be paid to a very considerable degree.

Administrative schemes are more prone non-payment of countervalue for a variety of reasons: (i) they are more open to corrupt practices; (ii) governments have used them to assist parastatals whose financial state that does not permit them to pay; and (iii) the government does not have the administrative machinery to enforce collection. Under market systems, the commercial bank pays the government (*via* the Central Bank) for the forex up front, and then it is their responsibility to collect payment from the importer as part of the commercial transaction.

Hence, as of mid-1993, arrears from previous CIS transactions in Tanzania stood at around 50 per cent, whereas those from OGL were only about 8 per cent. In the latter case the arrears are of the commercial bank with the Central Bank, not the arrears of the importer. The pursuit of those in arrears has been controversial - with donors applying a "blacklist" so that no firm in arrears on countervalue payments from any previous CIS from any donor may access new import support funds from any donor. The blacklist cannot be applied with the move to an auction system so that in Tanzania collection is now being pursued through the courts.

In Zambia the longer reliance on market-based scheme has minimised the problem of arrears. The Japanese are believed to be experiencing cash cover collection problems with their recent administrative scheme.

Use of counterpart funds by government

Counterpart funds are raised either by the sale of forex or commodities - debates surrounding the problems of counterpart funds initially arose over PL480 from the United States in the 1960s, particularly in India which was the largest recipient of such aid. Initially a part of the food aid was sold to the recipient in return for local currency for the US' own use in the country (e.g. mission costs) - the balances of such funds rapidly accumulated, so an increasing part was loaned or granted to the government for developmental uses. Over time, it became standard practice to allocate the counterpart funds, usually held in separate accounts, to agreed development projects.

However, that practice is now frowned upon as "double tying". The use of the foreign exchange is tied to particular uses (even if only through a negative list), and accounted for as the use of the donor funds. Hence it is double tying if the donor then also specifies the use of the counterpart funds. The practice is contrary to OECD Guidelines (OECD, 1991: 17), but still engaged in by some donors. One reason for not wanting to double tie the funds in this way is the perceived inflationary impact which may result.

Whilst donors vary, all major donors in both Tanzania and Zambia now show a large degree of flexibility on their part about the handling of, and accounting for, counterpart funds, so that problems of double tying do not arise. From an anti-inflationary point of view it is important that the counterpart funds should not be used to finance incremental expenditures, hence donors which need "something to show" for their counterpart funds (e.g. USAID and the Japanese) allow the funds to be allocated against expenditures already in the budget (with certain guidelines - e.g. no wages).

The inflationary impact of counterpart funds

The possible inflationary impact of the expenditure of counterpart funds was a central part of the Indian debate, and has now re-emerged in the African context - despite the fact that the consensus reached in the Indian debate was that there had not been an inflationary impact and the theoretical and empirical arguments advanced for a similar conclusion in the African context (Roemer, 1989; and Bruton and Hill, 1990a and 1990b).

As demonstrated most clearly by Bruton and Hill, we would not in general expect the use of counterpart funds to be inflationary. The payment for the forex by the importer to the government is a reduction in the money supply - the subsequent expenditure of these funds restores the money supply to its previous level - hence there is no overall impact on the money supply. There are a number of caveats to this simple argument. An important one is that the cash cover may not be collected, but if there is double tying the donor may still require government expenditure to take place.

But increasingly - and as is the case for all donors in Zambia and most in Tanzania - donors do not require any incremental expenditure for their counterpart funds. Since the adoption of the cash budget in Zambia in January 1993 the counterpart funds are in "blocked accounts", i.e. they do not constitute a part of the cash budget and so cannot be spent.

Rather the funds should be set against expenditures which would have occurred anyway (or even *ex post* against expenditures which have already been made). This practice means that the funds are in practice reducing the need for deficit funding - a usage of counterpart funds explicitly endorsed in SIDA's *Principles of Import Support*. Hence the counterpart fund procedure has a deflationary impact, and so is helpful in restraining inflation when there are other pressures on monetary growth.

4 Management of import support schemes

SPA working groups have developed guidelines to improve the effectiveness of the use of both import support and counterpart funds. In this section these guidelines are outlined, and the performance of the different import support schemes operating in Tanzania compared against these standards. The guidelines for import support (adopted by donors at the SPA meeting of April 1992) identified four important areas for import support programmes: (a) enterprise efficiency; (b) foreign exchange market efficiency; (c) procurement and payment practices; and (d) transparency and accountability. The separate SPA guidelines governing counterpart funds are also discussed. Each of these points is discussed in turn, the practice of various donors being summarised in Table 8.

(a) *Enterprise efficiency*

To ensure that import support is used efficiently it should be used in an environment in which firms can compete according to the criterion of economic efficiency. The guidelines do not recommend that sectors or firms be precluded on the grounds of inefficiency, but rather that programmes should be in the context of agreed reforms (e.g. elimination of market distortions and subsidies to parastatals) that will ensure efficiency.

In Tanzania, OGL funds (and so, therefore, money from the World Bank, Norway, UK and other donors putting money through this channel) <u>have</u> been linked to various sectoral adjustment credits, and so satisfy the enterprise efficiency condition.

Table 8 Comparison of import support programmes with SPA Guidelines

	OGL	Sweden	US	Netherlands	EC
Enterprise efficiency					
Policy conditionality	√	√	√	√	x
Foreign exchange market					
Market-based allocation	√	√	x	x	√
Unified rate/common procedures across windows	x	x	x	x	x
Common negative list	√	√	x	x	√
Apply blacklist	√	√	√	√	√
Procurement and payment					
Standardised procurement	√	x	x	x	√
Standardised audit	√	√	x	x	√
Untied	√	√	√	√	x
Counterpart funds					
Standardised procedures	√	√	x	x	√
Allocated within context of government budget	x	x	x	x	√
No earmarking	√	√	x	x	x

Although Sweden has put its finance parallel to the OGL, with a separate agreement with the government, the conditionality has been of the same type (linked to meeting the targets laid out in the Policy Framework Paper). The USAID import support programme, whilst very different from the OGL in most respects, is linked to policy conditionality - for example, the first tranche of USAID's private sector import support programme was conditional upon the BOT restricting itself to the functions of a central bank, and the commercial banking sector being allowed to operate in a genuinely commercial way.

(b) Foreign exchange market efficiency

Efficiency in the forex market has two essential features: (i) a "realistic", preferably unified, market rate; and (ii) procedures for processing applications should be transparent, not unduly bureaucratic and uniform. The period since the introduction of OGL has seen a narrowing of the premium between the official and bureaux and parallel rates. Moreover, the allocation system is market-based, and intended to be open to all importers. Whilst administrative schemes use the official rate, market based schemes assist the establishment of a functioning forex market, and so have been associated with much needed devaluation. Therefore donors supporting the OGL - but not those retaining some form of CIS (Netherlands and US) - satisfy in part the forex market guidelines.

The guidelines are not satisfied to the extent that the OGL system still allows (in fact creates) a degree of market segmentation. Goods on the negative list and services may not be imported with OGL funds, whereas they can with own funds or through the bureaux - this fact drives a potential wedge between the official (OGL) and bureaux rates. (Although it is the case, at least, that donors supporting the OGL adopt a common negative list, as suggested by the guidelines - but again this is not so for donors using CIS). With an auction system, with *ex post* accounting for donor funds, this segmentation will not exist so long as the demand for eligible imports exceeds the value of import support funds. Also the problem would not exist if the negative list were to be abolished.

Table 9 shows the items on the negative list (as of July 1993) and the value of these goods imported in 1990, as well as their share in total negative list imports. Petroleum accounts for 60 per cent of negative list imports. It is a matter of policy if petroleum imports should continue to be controlled - but such a policy could be controlled by means other than the negative list. Nearly another 25 per cent is accounted for by luxury vehicles, which includes four wheel drive vehicles with a carrying capacity of less than nine persons; another 1.7 per cent is contributed by boats. It is not clear that any vehicles should appear on the negative list. What is left after taking away these items is less than 15 per cent of negative list imports. Since such imports are less than 15 per cent of total imports, the excluded items are around 2 per cent of total imports.

The negligible importance of these imports, combined with the fact that no system can safeguard against fungibility, suggest that abandonment of the negative list is desirable. The bureaucracy required to administer the list will impose greater costs than any conceivable benefits. Discouragement of the consumption of certain luxury items can be ensured by a differential sales tax.

One area of agreement amongst all the donors has been on the blacklist, which excludes any importer in default for cash cover payments from having access to new funds. In fact, this issue is not so clear cut. At the time the policy was being applied there was no agreement on the exchange rate to be applied (with different donors and government all having different views) and no explicit agreement as to the cut-off date - some donors wanted those in arrears from the 1970s to be pursued, whereas other used a cut-off date in the later 1980s. When the Treasury did issue a list of outstanding payments the cover due was calculated on

Table 9 Negative list imports, 1990

Items	Value ('000s TShs)	Share (%)
Fruit, vegetables and plants	76,029	0.3
Food industry residues	65,446	0.2
Asbestos and fabricated asbestos	65,248	0.2
Ores, slags and ash	43,929	0.2
Wood tar and oil	58,165	0.2
Worn clothing and textiles	1,020,331	3.8
Coal lignite, peat, coke etc.	405,855	1.5
Crude oil petroleum	16,235,297	60.6
Explosives	330,913	1.2
Unused postage stamps, cards etc.	910,339	3.4
Guns, armoured vehicles etc.	140,181	0.5
Alcoholic beverages	318,311	1.2
Perfumes and cosmetic oils	88,450	0.3
Luxury vehicles	6,480,309	24.2
Boats	447,709	1.7
Cameras	70,415	0.3
Other items	15,142	0.1
Total	26,772,070	100.0

Source: Bureau of Statistics

the amount which had been committed, not that actually utilised - so some firms were blacklisted even though the had paid for all the forex they had used. Some donor officials were also sympathetic to the argument that arrears should not be collected from parastatals which were undergoing restructuring and whose future viability would be undermined by burdening them with old debt. The application of such a blacklist system needs on the one hand clarity on issues of who has to pay how much, but flexibility in assisting parastatals to a competitive footing.

(c) Procurement and Payment Practices

In countries in which there is functioning forex market donors should not link their funds to specific imports but account for these funds *ex post* against documentation provided by commercial banks and/or customs. Donors should also agree standardised procedures regarding requirements for *pro formas* and international competitive bidding (ICB). Finally, additional monitoring should be provided through a functioning pre-shipment inspection (PSI) system and a service provided to importers to permit access to lowest-cost sources of goods.

In practice donors required accounting procedures which differed from one another and which were burdensome to the recipient. Winpenny (1989) reached the same conclusion, arguing that donors should put more trust in the market. Flows of import support have been halted on the procedural grounds that accounting requirements within the Central Bank are not being satisfied. But OGL systems have required the Central Banks to establish procedures in areas in which their staff are not qualified - such as checking *pro forma* invoices. Closer supervision revealed considerable abuse, with a significant number of cases of over-invoicing - indicating that OGL was being used as a means of capital flight. Adequate technical assistance must accompany the move to new systems, rather than withholding funds when domestic institutions prove unable to cope with donor regulations.

Tanzania has been moving towards a fully market-based allocation of forex and the system adopted in August 1993 allows for *ex post* accounting for funds as suggested by the guidelines. Donors supporting OGL and also the EC have adopted common procedures for procurement - with the exception that EC import support is tied to the purchase of EC-ACP goods, whereas OGL funds are not procurement tied. Proposals for a service to importers, operating through the Chamber of Commerce, had come to nothing (as of late 1993).

(d) Transparency and accountability

The guidelines state that independent auditing of the forex provided and counterpart funds collected are an important part of a good import support programme. Donors should facilitate the practice by adopting common accounting procedures - it is also recommended that the World Bank take the lead in monitoring audit compliance. Once again, funds through the OGL do have a common audit procedure, but the CIS programmes of course do not.

(e) Counterpart funds

An earlier set of guidelines (adopted at the April 1991 SPA meeting) laid out principles for the use of counterpart funds. These guidelines cover two basic areas: (i) standardising procedures of the system of collecting, using and monitoring counterpart funds across donors; and (ii) the use of counterpart funds should be within framework of government budget. If the recipient has acceptable public expenditure planning then donors should allow counterpart funds to be general budget support - in other cases regular consultations with government should agree and monitor the use of the funds.

If the system of counterpart funds used by the OGL is taken as the standard then donors operating CIS - under which payment of funds is direct to the Treasury, rather than *via* the Central Bank - can be said to not be operating with standardised systems. Judging the use of the funds is less simple. It does <u>not</u> appear to be the case the donors have consciously planned the volume and use of funds within the context of the overall government budget planning. (Indeed, the government and World Bank estimates of financing requirements differed quite considerably). However, there is some consensus that counterpart funds should be used to offset the need for deficit financing, rather than for incremental expenditures. However, funds raised through US import support are earmarked to specific expenditures (and ones which are mostly quite clearly incremental, such as a Business Services Bureau). Dutch funds are linked to social sector expenditures, although through a system of "soft tying" rather than earmarking to specific expenditures.

(f) Implementing the guidelines

A number of actions have been agreed to help implement the guidelines: the focus here is on one of these which appears to have been neglected. In addition to Joint Evaluation Missions (JEMs) and the *aide memoir* they produce, country status reports should be prepared indicating the extent to which recipients are implementing the guidelines, and the extent to which donors' import support programmes are consistent with them. Since it is the donors that take the lead in determining what system is adopted, it is the latter if these - the consistency of donor programmes - that deserves the more immediate attention. No such an assessment (similar to that in Table 8) has been made for either Tanzania or Zambia. Given the apparent discrepancies that exist between donors it would be helpful for such reports to be made to facilitate the move towards a standardised system.

6 Conclusions: a new form of import support

Import support is an important form of aid in both Tanzania and Zambia, but it has been quite neglected in the aid literature. This paper explored economic and management issues related to the use of import support. The overall assessment of import support is positive, though in this conclusion it is argued that the form of import support should be changed. It is proposed instead that donors should concern themselves with the use of the counterpart funds, not the forex. Donor funds will be accounted against the foreign currency <u>value</u> (not component) of planned social sector and infrastructural expenditures. The foreign currency part of these expenditures will be paid by the donor in the usual way. The donor also makes available the foreign currency equivalent of local expenditures, the local currency being raised by the sale by auction of the forex. Why is such a proposal preferable to present arrangements?

The evidence shows that import support - either through CIS or market-based schemes - is being used for the "right sorts" of good. Market-based schemes are to be preferred over CIS since they avoid the potential for inefficiency, misuse and corruption which has plagued administrative mechanisms. Neither country has experienced a shift in import composition toward consumer goods, and those consumer goods which are imported often play an important part in facilitating the agricultural supply response (as incentive goods). Despite these successes donors continue to impose substantial reporting requirements on the use of import support. These requirements impose unnecessary costs on government and, depending on the scheme, importers.

The rationale for continuing these controls is so donors can show what their money is being used for - it is considered that it would be politically unacceptable for aid funds to be used for, say, VCRs. The data from Tanzania show the volume of imports which might be considered an undesirable use of aid funds to be negligible - about 2 per cent of total imports. Far too many donor resources are being directed to ensuring that no aid pays for any of this 2 per cent. It would be far simpler for both donor and government officials if the Central Bank were allowed to auction the forex with no special reporting requirements.

Donors could then turn their attention to the use of the counterpart funds. Double-tying is not recommended - under the mechanism proposed here there is no tying of the forex. Nor will there necessarily be any incremental expenditure on the activity against which donor generated counterpart funds are earmarked - but donor attention can be turned to the quantity and quality of social services, which is more in keeping with their declared poverty orientation then worrying about the accounting procedures of the Central Bank.

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