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The Bank of Tanzania (BoT) as the Custodian of the Tanzanian Economy: Opportunities and Challenges

Conrad John Masabo, Mr.

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The Bank of Tanzania (BOT) as the Custodian of the Tanzanian Economy: Opportunities and Challenges

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Introduction

The Bank of Tanzania (BOT) was established in 1966 by the BOT Act of 1965. The Act provided for the establishment, constitution and functioning of BOT as a central bank to take over the functions and operations of the then East African Currency Board (EACB) founded in 1919 to manage currency supply and exchange in the then British colonies of East Africa and the countries adjacent to the region. The bank initially operated by using mainly instruments that one would consider indirect. Only eight months after its establishment, however, the Arusha declaration was announced in 1967.

This declaration proclaimed socialism and self-reliance as the official policy of Tanzania. The BOT reoriented its functions to reflect this change in political direction (Masawe, 2001: 4). However, the BOT Act of 1965 was repealed and replaced with the BOT Act of 1995. The BOT Act of 1995 was a landmark in Tanzania's monetary history by adopting a single policy objective, i.e., price stability; and thus it moved away from multiple-policy objectives.

The Bank of Tanzania is an independent central bank; its value improves with the passage of time; and over time it has gained more independence. In 1995 the Bank of Tanzania act was amended to give the bank greater autonomy, full independence, and more precision in the definitions corresponding to the functions of the central bank.

The maintenance of price stability was specifically mentioned as the central bank's priority. Besides protecting price stability, the Bank of Tanzania acts also as the lender and the last resort for other commercial banks. Among other functions of the Bank of Tanzania, one would include: the monitoring of the country's foreign exchange, providing the Government with economic advisors, supervising the bank itself and the entire financial system in the country, the forwarding and implementing of the macroeconomic program and policies that are currently operational. These are among the core functions of the central Bank of Tanzania.

In the recent past, that is to say, almost two decades ago, Tanzania embarked on a fundamental transformation of its economy. It is not surprising that on the top of the economic agenda was the need to overhaul the financial system. In view of the pivotal role that banks play in the country's economy, the banking sector was the first to undergo reform. Implementation of the reforms followed the recommendations of the Presidential Commission created to modernize the banking sector.

The Bank of Tanzania is an organization set up with well-defined structures, each corresponding to sets of duties and responsibilities in banking activities. At the top level, there is the Governor of the bank who is a presidential appointee. He/she must serve for five years and may continue in service for another five years if so appointed. Some of the Governor's duties include representing the Bank of Tanzania in all matters related to other Banks; and either alone, or jointly with other persons, may enter into agreements concluded on behalf of the Bank.

Second in the hierarchy of the Bank of Tanzania are three deputy governors who serve as acting governors when the Governor dies, or is removed from office, or vacates his office, or resigns. Each of these deputies is responsible for the day-to-day management of business and affairs of the Bank as ordinarily determined by the Governor.

Other structures include the Board of Directors, and the Accounting and Auditing units.

This paper therefore proposes to explain how the Bank of Tanzania serves as the custodian of Tanzania's economy, and at

the same time purports to expose the problems that the Bank of Tanzania faces in the management of the economy. It begins by a general introduction giving a brief background about how the Bank of Tanzania was established, and then delineates the functions as well as the structures of the bank.

The second part presents indications of the diverse sectors of the Tanzanian economy and their economic performance up to the year 2009.

The third part presents mechanisms that the Bank of Tanzania adopts to fulfill its basic function as the custodian of the economy.

The forth part presents the challenges that the Bank of Tanzania faces in the course of fulfilling its duty as custodian of the economy.

In the fifth and last part, we shall draw conclusions.

Indicators of the Diverse Sectors of the Tanzanian Economy and Economic Performance up to the Year 2009

Economy may be defined as the system of production, distribution and consumption of goods and services in the country, society or other designated entity. Thus, "the success of states in maintaining their authority and sovereign control is greatly affected by their ability to ensure that an adequate volume of goods and services is produced to satisfy the needs of their populations." (Kesselman, Krieger and Joseph, 2004:12). That is why most of the states or governments in the world struggle to achieve considerable levels of economic development in order to enjoy their status as governments or political agencies.

In our world today, economic performance has become one of the basic measures for evaluating a given leader, or even whole governmental bodies. In fact, effective economic performance is nearly at the top of every state's political agenda (*ibid*). For example, Tanzanians in "the first years following independence...believed that mass poverty could be attacked and eventually overcome by means of a natural growth in the

economy not involving major structural changes" (Legum and Mmari, 1995: 9).

Little was done, therefore, in terms of creating structures that would insure rapid and sustainable economic development. Probably this may be the rationale behind Tanzania's choice to continue with the colonial inherited economic system, a system that was externally oriented and that emphasized the production of agricultural raw materials.

This style of economy has not changed much over recent years; the World Bank report on Tanzania has mentioned this with the comment that "in value-added terms, agriculture generates 29 percent of GDP, industry 24 percent and services 47 percent ... the majority of Tanzania's population are employed in the agricultural sector..." (World Bank, 2009: 10). This indicator reveals the reality that agriculture remains the sole sector for Tanzania's economy.

There have been remarkable changes, on the other hand, in the expansion of the traditional sectors, that is, of agriculture and industry. There has been the emergence of a transport sector, a communication sector, a mining sector, and a construction and tourism sector with the additional entry into the economy of a private sector (cf. Maliyamkono and Manson, 2006). It is only in 2009 that the World Bank report praised Tanzania's performance in the economy as being among the best in Sub-Saharan Africa. It states:

> Economic performance in Tanzania has been solid in recent years, with high levels of growth, a steadily increasing share of exports, and significant financial deepening, following significant efforts since the mid-1980s, [and] ... since the mid-1990s has led to increased inflow of both foreign direct investment (FDI) and aid....Tanzania's ... economy has grown faster—in some years, significantly faster—than the Sub- Saharan African average for more than a decade, making Tanzania one of the fastest-growing nonoil economies in Sub-Saharan Africa. (World Bank, 2009: 9; cf. Maliyamkono and Manson, 2006: 63)

The general comment about the Tanzanian economy is that, the "government has been well accredited for achieving macro-economic stability shown by decline in inflation and increasing

trend in the grown of real GDP" (Maliyamkono and Manson, 2006: 63). What is common, then, is that "all countries are facing trade-offs between more market-driven and more state-regulated economic strategies" (Kesselman, Krieger and Joseph, 2004:13). Based on these arguments, it is obvious that the banks – and the central bank in particular – have an important role to play in supervising and taking care of the country's economy. I now proceed to an explanation of how the Bank of Tanzania is the custodian of the economy.

The Manner in which the Bank of Tanzania Is a Custodian of the Economy

The primary function of banks the world over is to play an intermediary role, i.e., to collect funds (through borrowing) from surplus households and invest the funds (for example, by lending) to deficit units. In this way, banks are considered the harbinger or buttress of economic development of any country. In this way, then, the economic growth of Tanzania depends largely upon the extent to which the Bank of Tanzania takes up this role.

The Bank of Tanzania Act of 2006, for example, provides for a more responsive and regulatory role of the Bank of Tanzania in relation to the formulation and implementation of monetary policy so as to provide for the supervision of banks and other financial institutions. In this regard, it is obvious that the Bank of Tanzania is vested with the role of guardian or custodian: it is the Bank that advises the government in matters related to the economy and economic progress.

The ways in which the Bank of Tanzania acts in the status of guardian for the Tanzanian economy are as follows (please note: this list is not exclusive):

One: To begin with, as a custodian of the country's economy, the Bank of Tanzania is responsible for formulating and implementing monetary policy in relationship to the economic objective of maintaining price stability. This, in turn, is conducive in balancing and strengthening the economic growth of Tanzania.

As a central bank, the Bank of Tanzania is the sole issuer of currency, the "banker of the banks", and advisor to the

Government in legal matters related to economic issues. Furthermore the Bank of Tanzania has been vested with the responsibility of supervising and regulating financial institutions so as to ensure the safety and the soundness of the Tanzanian financial and economic structures. It is by fulfilling such roles that the element of custodianship is rendered explicit. This has been the number one expectation and duty of the Bank of Tanzania since its inception. The bank has been always the sole mandatory government organ/ institution empowered and mandated to supervise the country's economy.

Such a function has been emphasized and given the utmost attention since its date of inauguration. The words from the inaugural speech by Mwalimu Julius K. Nyerere in 1966, the incumbent president at that time, are worth recalling here. He said:

> ... The Board and staff of the Bank of Tanzania are embarking on a very important job. They are to see that we get the money we need for our daily use and for development, and that our money is so managed that it foster growth of the economy in real terms and also maintain its international value (Nyerere, 1968: 76).

Such was the sole assignment given to the new bank which was formed following the end of the East African Currency Board (EACB). For Mwalimu Nyerere, such a board was handicapped and hence was unable to respond to the need of development at the speed people were hoping. One sees the clarity in what he said: "I am glad that at last, as far as Tanzania is concerned, we have now devised an instrument monetary and fiscal in nature, which can effectively contribute to our development without the unnecessary handicaps that result from uncoordinated ... economic policies of the three countries" of east Africa (ibid., 75). Such an expression reveals the extent to which, since the early years of independence, Tanzania's economy has been entrusted to the Bank of Tanzania.

In the years following the adoption of the market economy, the Bank has retained the same status; and even in the newly formulated strategy to make Tanzania into a semi-industrialized country, which suggests a middle-class economy, the Bank of Tanzania is earmarked to provide a leading role in the realization

of a commitment to the macro-economic. There is an emphasis on fiscal and monetary reforms in order to "... to ensure a stable and predictable macro-economic environment underpinned by a low inflation rate, increased domestic savings and investments, exchange-rate stability and sufficient foreign reserves," (URT, 2005: 24) all of which are key to the economic development necessary for the realization of the 2025 Tanzanian Vision. Thus, it is obvious that one looks to the Bank of Tanzania to provide the environment needed for the hoped-for economic growth.

Two: A second way in which the Bank of Tanzania functions as the custodian of the national economy is by supervising the national payment system. The Bank of Tanzania Act of 1995, amended in 2003, governs the national payment system in Tanzania. These amendments have granted explicit statutory powers to the Bank of Tanzania for overseeing, regulating, and conducting supervisory functions for the national payment system as one of the primary foci for controlling and nurturing the Tanzanian economy. According to the amended Bank of Tanzania Act, the bank is also empowered to issue regulations for the payment clearing and settlement system. In general, the Act gives norms and interprets the common law with its various relevant provisions as well as the clauses contained in diverse pieces of legislation that apply to establishing, operating and regulating the payment system.

When it comes to the banking sector, however, the pertinent pieces of legislation are: the Bank of Tanzania Act of 1995; the Banking and Financial Institutions Act of 1991; the Bills of Exchange Ordinance, Cap 215; the Cheques Act of 1969; and the Companies Ordinance, Cap 212.

Three: The Bank of Tanzania is the sole agent for interbank transactions. The responsibility of the Bank of Tanzania is to formulate and implement a monetary policy that has for its economic objective maintaining price stability. This objective governs the amount of currency in circulation so as to provide non-inflationary liquidity in the country's economy.

The country is now in the process of implementing the Tanzania Inter-bank Settlement System (TISS) which falls under the supervision of the Bank of Tanzania. Inter-bank clearing is

currently processed electronically at the Dar es Salaam Electronic Clearing House, which, in terms of volume, accounts for 80% of the country's inter-bank clearings while the remaining 20% is processed manually in the up-country clearing centres.

All this effort has been exerted to ensure a smooth control of the national economy especially when it comes to saving and issuing both domestic and foreign currency. The Electronic Fund Transfer System (EFTS), for example, which facilitates the credit clearing process for bulk transfer during the interbank transaction has been tested and then implemented since mid-2004. The system provides inter-bank fund transfers in the real-time framework under conditions of finality and irrevocability of settlement with alternatives of either a real time option or a deferred option.

The financial industry is gradually utilizing electronic payment instruments, such as credit and debit cards, as well as the use of Automated Teller Machines (ATMs). Commercial banks are making increasing use of ATM networks to the extent that there has cropped up the need to develop a national card switch, which will likely facilitate quick economic growth by avoiding red tape and by simplifying the deposit and withdrawal of money both within and outside the bank, and both within and outside the country.

Four: The Bank of Tanzania as the custodian of the economy is required to control the acceleration of inflation rates. According to Prof. Beno Ndulu, the inflation rate has remained above the medium term target of 6 percent. This is mainly due to anticipated rising inflation triggered by the rising prices of domestic oil in tandem with world market prices. Another factor is the increase in food prices during times of food shortages.

Evidently, high oil prices occasion other costs in the economy - such as costs of production and transportation – and so have contributed to the pressure on prices of the eleven most wanted consumer items to go upwards. These items include food, drinks and other manufactured products (BOT, 2008 12).

This state of affairs links to the fact that empirical evidence throughout the world is suggesting that it is excessive creation of money that causes inflation, hence implying that inflation is

a monetary phenomenon. In order to achieve price stability in our country, therefore, the Bank of Tanzania, like other central banks, by virtue of its ability to exert influence on the system of money supply, has been entrusted with the task of regulating the quantity of money in the economy (Masawe, 2001: 5).

In July, 2007, headline inflation reached a level of 9.0 percent, the highest level it's ever been since January 1999, when single digit inflation rates appeared for the first time. The Bank of Tanzania continued to tighten its monetary policy stance by moderating monetary expansion, while at the same time, the improvement of domestic food supply during 2006/07 exerted a favourable impact on food prices. As a result, headline inflation declined to 7.1 percent in October, 2007, and by December, 2007, annual inflation eased to the level of 6.4 percent (BOT, 2008, 12).

The World Bank, however, has been of the opinion that the Bank of Tanzania has not been so successful in controlling inflation in recent years. While policies during this time have allowed Tanzania to avoid the wide swings in inflation that several of its neighbouring countries have suffered, when one takes into consideration the time span from 2005 to the present, one would have to say that the central bank, the Bank of Tanzania, has not tamed the rising inflation trends: inflation, for example, crept upward in the six-month period between June and November, 2008, hitting double-digit figures for the first time in years (World Bank, 2009: 13).

Five: The Banks Act of 1991 empowers the Bank of Tanzania in its role as a government agent responsible for supervision of the economy to issue licenses, to supervise and to regulate other banks and financial institutions. The Bank of Tanzania Act of 1995 further consolidates these powers. Hence, the Bank of Tanzania is responsible for the regulation and the supervision of formal financial institutions, including community banks, bureaus de change and cooperative banks. The legal and regulatory framework has now been extended to cover micro-finance activities. Supervision and regulation of such institutions as the Saving and Credit Co-operative Societies (SACCOS), however, is the responsibility of the Registered Cooperatives, who operate through the Regional and District Cooperative Departments.

The bank of Tanzania, in its turn, has frequently been engaged in formulating programs and guidelines to ensure the survival of these micro-finance activities.

Six: The sixth way in which the Bank of Tanzania acts as a custodian of the national economy is through its monitoring and controlling of the Foreign Exchange Market. The Bank of Tanzania gradually began to ease foreign exchange controls after the enactment of the Foreign Exchange Act of 1992, by allowing the establishment of foreign exchange bureaus, a permission that was granted in April, 1992. The Bank introduced Foreign Exchange Bureaus in July, 1993, and created the Inter-bank Foreign Exchange Market (IFEM) in June, 1993 (cf. Masawe, 2001: 5).

The Bank of Tanzania is charged, too, with the duty of monitoring and controlling the Foreign Exchange Market within the domestic domain. This Market is composed of both wholesale and retail markets. The IFEM is the wholesale market, which plays an important role in the determination of the country's official exchange rate and the provision of funds for the accumulation of international reserves. Tanzania's trade and exchange system is completely free of restrictions when it comes to payments and transfers for current account transactions.

The current status of capital markets in Tanzania can be described as an "emerging market". At present, the number of securities listed at the Dar es Salaam Stock Exchange (DSE) is rather limited. The government securities are traded in the secondary market in DSE by primary dealers who act as either agents or market makers. It is therefore the responsibility of the Bank of Tanzania to develop necessary institutions such as the Capital Markets and Securities Authority (CMSA) which consequently becomes a key to the country's economy.

Seven: Last but not least, as a custodian of the economy, the Bank of Tanzania is entrusted with the task of issuing currency and maintaining the circulation of money. The bank uses reserve money as an operating focus to influence the desired growth of money supply compatible with the anticipated rates of inflation and economic growth. Generally speaking, the measures undertaken by the Bank recently succeeded in containing average

reserve money growth within projections, except for the first quarter of 2007/08. Consequently, extended broad money supply growth averaged at 21.2 percent between July and December, 2007, compared to the average of 24.1 percent anticipated for the period under review. The slow pace of Extended Broad Money (M3) growth is attributed to the appreciation of the shilling against the US dollar that subsequently reduced the growth of foreign currency deposits in banks. Growth of broad money supply, which excludes foreign currency deposits, averaged 26.5 percent, compared to the anticipated 30.3 percent. The increase in Broad Money (M2) was largely driven by a strong growth in time deposits, in line with improved interest rates, and growth in demand deposits reflecting robust business activities during the period under review (cf. Mkulo, 2008).

Challenges that the Bank of Tanzania Faces in Managing the Country's Economy

In spite of these responsibilities that the Bank of Tanzania is to exercise, it is still facing many challenges, most of which inhibit its proper functioning. These include but are not limited to tribalism, corruption, money laundering, currency devaluation, political pressure and interference and lack of expertise in economic projections.

First, during recent years the tendency to offer employment on the basis of merit has succumbed to a system based on patronage. The Bank of Tanzania, for example, has suffered the problem of employing bureaucrats on the basis of nepotism. Indeed, meritocracy in any scenario undercuts the red-tape and other bureaucratic manipulations often encountered where a horde of incompetent, compromised and self-indulgent characters is entrusted with the important responsibility of running public affairs (Tarimo and Manwelo, eds., 2009: 21); such is the case of the Bank of Tanzania.

This obviously weakens the performance of the bank in fulfilling the precious duty entrusted to her of taking care of the national economy. The ongoing claims of some officials'

daughters and sons who were employed by the bank with no qualifications are the manifestation of this reality.

A second, related challenge is corruption. Corruption has many forms or types, but "the most common form of corruption is bribery of different kinds aiming at giving ...certain privileges in obtaining something...whether it is money, career, protection from the authorities, or other things important to...a citizen" (Norlén, 2003: 333). It manifests itself in a variety of ways. According to *The Report of the Warioba Commission on Corruption*, for example, there are two categories of corruption. Tarimo explains them as follows:

> The first category includes those who give and receive bribes because of their low income and standard of living. What they receive and give only helps them to survive. The second category includes those who give and receive at high levels of administration. This category concerns particularly leaders and civil servants whose involvement in corrupt practices arises from greed for wealth and power (Tarimo, 2005: 95-96).

One perceives the corruption at high levels of administration by adverting to concrete examples. Paying a government minister a hefty kickback to facilitate a favorable review of a tendered application is a case of grand corruption. Another is the payment of comparatively large sums to senior customs officials to be allowed to import goods without paying tax or custom duty. This form of corruption is quite prevalent in the highest political offices. Commenting on how leaders perpetuate this, Wangari Maathai states: "Today's African leaders are comparable to the African slave barons who facilitated the capturing and the selling-off of millions of their fellow blacks to distant lands where they were subjected into slavery; only today they are subdued within their own borders" (Umeodum, 2008: 89). Such corruption, which is symptomatic of wide-scale political failure, is essentially cannibalistic because it undermines and eventually consumes the very state that enables it.

Looting corruption appears to be unique to sub-Saharan Africa; nevertheless, it is the most destructive kind of corruption prevalent in Africa.

The theft at the Bank of Tanzania (BOT) through various External Payment Arrears (EPA) accounts is one of the more remarkable indications of corruption in the Bank of Tanzania. Signs of corruption came to light in the Bank of Tanzania when the incumbent President fired the former Governor of the Bank of Tanzania and replaced him with an incumbent, who was one of his former two deputies. Before joining BOT, this former deputy was a senior official at the World Bank offices in Tanzania and lectured at the University of Dar es Salaam.

This re-organization came after an audit investigation that uncovered fraudulent transactions involved in the repayment of the countries external debt that was conducted through EPA accounts. The president revoked Balali's appointment after he received a damning audit report prepared by the global accounting firm *Ernest and Young* that revealed that more than $116 million had been improperly paid to 22 firms through BOT's External Payment Arrears (EPA) in only one financial year alone.

The scandal started after the Controller and Auditor General (CAG) finished its annual auditing of BOT books in August of 2005. The audit report, sanctioned by the Government Controller and Auditor General (CAG), pertained to the content of the Bank of Tanzania's 2005/2006 financial books. This report revealed that 13 companies used falsified records, claimed third party status, and received BOT payments; another 9 companies couldn't substantiate payments they received. Among these, 2 companies were not even registered by the Business Registrations and Licensing Agency (BRELA).

A third challenge is that of money laundering and terrorism. Until recently, the definition of money laundering was limited to the disguising of dirty money and property obtained through criminal activities. Since laundered money also finances terrorism, however, the definition has been widened to include legal or illegal funds laundered specifically for purposes of terrorism (Massawe, 2008:3).

The insertion of illegal money into the official money circulation has a detrimental effect on the economy of the country. It normally leads to crimes that can adversely affect the

nation's economy and eventually social and political instability. Thus, if money laundering is allowed to penetrate our society it can undermine development by promoting crime and eroding social and human capital, driving legitimate investment and businesses away from our country, and ultimately undermining the ability of the state to promote economic and social development (ibid.). The practice poses a challenge to the Bank of Tanzania because the community has a tendency to keep their savings at home: the reluctance to use financial structure forces the people to operate outside official markets and so to engage in illegal financial transactions, including money laundering.

A fourth challenge is that of political influence and interference. In principle all the top official posts in the Bank of Tanzania are filled by presidential appointment. This is detrimental to the freedom and ability of the appointees to act and give advice promptly in a way that is appropriate. Worse still, the ones who are seeking appointment to these posts are those who identify themselves with the ruling party, with so-called "party partisan".

The front page story in the Sunday Guardian of 25 January, 2009, published the extract of a memo from party officials that seems to have forced the governor to act under the party's influence. It read:

> Greetings from the party; I am introducing to you this gentlemen, who is among those seeking their payment from an EPA account. He has agreed to donate 40 percent to the party to cover expenses for financing our election campaigns; he is coming to see you for implementation; please do assist him (Mgamba, 2009: 2).

This shows how the party at times continues to control and bulldoze those who have been entrusted with an office. If the office, on the other hand, were to be rewarded on a competitive basis, such bureaucrats would not be made stooges of the party and the incumbent; not to mention that they also fear losing their job because at any time the incumbent can request removal from the office.

Last but not least is the lack of well trained economists to provide accurate actuarial data over the progress of the economy in the country. Last year before the world's economic meltdown

adversely hit Tanzania, in one of his monthly speeches, the incumbent president assured Tanzanians that they were not going to be affected by the economic meltdown suffered by the more developed countries. To the public surprise few days later the same incumbent admitted that there was no way that Tanzania could avoid it. This flip-flopping happened because of a lack of reliable actuarial data from the Bank of Tanzania.

Conclusion

Throughout this essay, the main thesis has been a demonstration of the diverse manners and mechanisms employed by the Bank of Tanzania in her service as the custodian of the economy. This essay has also provided a brief history of the establishment of the Bank of Tanzania and significant features of the economic sectors. This essay has concluded with the challenges faced by Bank of Tanzania in undertaking its custodian roles.

We are of the mindset that some of these challenges can indeed be overcome. But in order to make this possible a call must be issued for the establishment of the storied legal institutions, for strengthening the Prevention and Combating of Corruption (PCCB), for implementing the Anti-Money Laundering Act of 2006, and for adopting the merit system of employment – to mention but a few. Thanks to some measures that have been launched by the government precisely to overcome these problems, for example, the President directed the Board of Directors of the central bank to study all available reports and take appropriate action to reprimand all Bank officials involved in or supporting fraud. Some actions have been undertaken including the arrest of those suspected of conspiring to engage in scandalous activity.

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