RURAL FINANCIAL MARKETS IN TANZANIA:

An Analysis of Access to Financial Services in Babati District, Manyara Region.

By

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DECLARATION AND COPYRIGHT

I, FAUSTINE KARRANI BEE do hereby declare that this Doctoral Thesis titled ***"RURAL FINANCIAL MARKETS IN TANZANIA: An Analysis of Access to Financial Services in Babati District, Manyara Region"*** is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references. In addition, I also declare that this work has not been submitted elsewhere for a similar or any other educational or non-educational award.

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Finally, I am personally responsible for the contents and facts.

Faustine Karrani Bee
Moshi, Tanzania,
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ABSTRACT

Tanzania is among the poorest countries in the world, with most of its population living in rural areas. Like most other developing countries, rural households' access to financial services is very limited. The government has adopted series of economic reform measures since mid-1980s that include financial liberalization. Liberalization of the financial sector facilitated participation of private financial institutions, restructuring of public financial institutions and privatization, elimination of interest rate controls, credit allocation and targeting. In addition, the role of the Bank of Tanzania in supervision and regulation of financial institutions was strengthened.

Following the privatization of the financial sector, the number of financial service providers increased and diversified, which include commercial banks, development banks, insurance and social security funds, and capital markets. The role of the central bank was re-defined and strengthened in terms of price stability, supervision and regulation. Although there is an increase in financial sector service providers and products, rural households' access to financial services did not improve. To the contrary access to formal financial services is diminishing significantly, hence making poverty reduction initiatives more difficult.

This study analyzed constraints to access to rural financial services, examined its impact on rural households' livelihoods, and recommended appropriate financial sector development strategies. The data for the study were collected from various sources – both primary and secondary. Primary data were collected from selected thirteen villages in Babati and government offices in the district through interviews, focus group discussions, questionnaire, and observation. Secondary information was gathered from documentary sources in the form of reports, records and review of literature. A combination of analytical tools was used – qualitative and quantitative.

The study observed that history of rural finance in Tanzania is associated with colonialization of Tanganyika. The German colonial administration was the first to introduce establishment of modern commercial banking in the country in 1905

when the *Deutsche Ostafrikanische* bank opened a branch in Dar es Salaam. The British colonial administration, after the defeat of Germans in World War I, promoted establishment of commercial banks in Tanganyika in order to support commercialization of the economy. Consequently, German banks were replaced and commercial bank branches were established in other parts of the country. The independent government undertook massive re-organization of the financial sector and much attention was put on agricultural credit. Agricultural credit was organized through specialized agricultural credit organizations that corroborated with state owned commercial banks. However, the co-operative movement were assigned important role in credit administration on the ground as they are closer to the beneficiaries.

The financial structure after independence up to the 1990s, when reforms were ushered in, is characterized by state owned financial institutions with pervasive interference. Credit was directed on the basis of the government priorities with little regard to credit worthiness analysis. The National Bank of Commerce (NBC) and Co-operative and Rural Development Bank (CRDB) were the dominant banks that implemented the government monetary policy. Emphasis was put on credit and savings mobilization was neglected. The CRDB operated mostly on managing donor funds meant for rural development.

Liberalization of the financial sector was introduced through the Banking and Financial Institutions Act (BAFIA) of 1991 to address the weaknesses observed in the financial sector. It was envisaged to improve access to financial services through enhanced competition, increased and diversified financial products and providers, and improved integration of the financial system. However, assessment of the impact of the financial liberalization has mixed results. While there are distinct expansion in financial institutions, products and services; these are more concentrated in urban areas and accessed mostly by wealthy clients. Consequently, rural households’ access to finance is diminishing. On the other hand, most financial institutions continue to employ traditional banking approaches - of insistence on collateral, preference for less risky category of clients, bias towards large loans, and bureaucratic procedures in providing loans. Besides, there are limited initiatives in product innovation, design of appropriate delivery mechanisms, and high interest rates spreads that discouraged potentials borrowers and depositors.

As a result of poor access to financial services, most households have strengthened self-financing mechanisms through the informal arrangements. Although, the semi-formal - especially member based financial institutions and some Financial NGOs (FiNGOs) are attempting to correct the financial imbalances, their outreach, products and services are still limited. While there are improvement in supervision and regulation of the financial sector, it must be noted that prudential regulation and supervisions as part of the financial infrastructure if not carefully used, will undermine the efficiency of the financial market.

The study concludes that rural households need a variety of financial products that include savings facilities, loans, insurance, leasing, and means of transfer payments. The degree of demand for these products is, however, determined by household's level of poverty, household size, level of education and skills, life cycle needs, and local market opportunities. However, financial sector reforms had little impact on households' livelihoods. Its implementation is associated with an increase in inequalities and poverty. Besides, there is a reduced funding as well as investment in agriculture, which forms the key sector of the economy. Consequently, the performance of the agricultural sector has been declining although its contribution to GDP is still significant.

Assessing the supply and demand for rural financial services, it is concluded that rural areas are hardly served by banks hence limiting access to financial services. Prior to liberalization, government owned financial institutions provided limited financial services to rural areas organized through co-operatives and specialized credit agencies. CRDB was responsible for organization of credit for farm inputs, while NBC provided crop finance. In addition, CRDB also facilitated rural development programmes through donor funds. With the liberalization of the financial sector – co-operatives have collapsed, development banks are no longer active, and commercial banks have withdrawn from serving rural areas, thus creating a "supply gap" that is being replaced by informal finance.

Furthermore, the study observed that demands for financial services is determined by age of the borrower, household size, and distance from a financial institution, the cost of borrowing that include loan transaction costs plus interest rate charged, bank procedures and conditions, policy and regulatory framework and institutional and infrastructural conditions.

The study recommends the following:

(i) Continued efforts for establishment of supportive macroeconomic and sectoral policies – financial, fiscal, monetary & rural development - and legal and regulatory framework that facilitates the growth of the rural financial markets,

(ii) A facilitative intervention by the government in the development of the financial markets that addresses the national poverty reduction development objective through economic growth is required. The desired actions are those that focus on improvement in demand for financial services, reduced bureaucratic banking conditions, reduced transactions costs, improved infrastructure, and reduction of other structural bottlenecks limiting access to financial services,

(iii) Development of appropriate financial institutions and products relevant for the rural sector requires government guidance through policy, development of appropriate financial infrastructure (legal, regulation and information), and incentive mechanisms.

(iv) Intervention by the government in institutional and infrastructural development is required so as to facilitate the functioning of markets. There must be purposive investment strategy that supports development of the public infrastructure – such as transport and communication, electricity, security system, and research and development. Institutional development - judiciary machinery, credit bureaus, and property rights and business registry are required. Furthermore, training and capacity building so as to change peoples' mindsets concerning loans and savings mobilization, and

(v) There is a need for building up a “New Role” for financial institutions. Financial institutions need to revisit their financial terms and conditions in favor of the development of RFMs, especially in terms of bank conditions, interest rate spreads, demand for collateral, and requirements for addressing the needs of the poor and rural population, Furthermore, financial institutions need to become more innovative in developing new products and services, improvement in organization of rural financial institutions, delivery mechanisms, and establishment of the institutional framework for integration of MFIs into the national financial system in the country.

The following areas require further studies:

(i) development of realistic rural development strategy that covers, among others, the development of the financial markets,

(ii) institutionalization of the rural property ownership rights in order to establish how these can be used productively, through say mortgage, collateral, and/or sale for cash income, and

(iii) Mechanisms for enforcement of loan repayments in rural areas – especially the lessons from informal operators. Experiences have shown that under informal credit arrangements, there are few default cases as opposed to formal commercial credit practices.

KEY TERMS – Rural Finance, Financial Liberalization, financial markets, financial deepening and widening, and households’ livelihoods, Tanzania.

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LIST OF GLOSSARY

Kujitegemea	Self-reliance
Minada	Cattle auction
Ujamaa	African Socialism
Ujamaa na Kujitegemea	Socialism and self-reliance
Ushirika	Co-operation
Wananchi	Citizens

COUNTRY FACTS

Local Currency:	Tanzanian Shilling abbreviated as Tshs.
Exchange rate used:	US $ 1 equivalent to Tshs. 1,280
National language:	Kiswahili and English as an official second language
Capital city:	Dodoma, with Dar es Salaam as commercial city.

Village the lowest unit of local government administration. Several villages form a Ward, which in turn constitute a division. Several divisions form a district headed by a District Executive Director (DED) who reports to District Council a democratic body elected to represent Wards.

LIST OF ACRONYMS

ABEDIA	Arab Bank of Economic Development in Africa
ACA	Agricultural Credit Agency
ACB	Akiba Commercial Bank
AEZs	Agro - Ecological Zones
AGITF	Agricultural Input Trust Fund
AMCOS	Agricultural Marketing Co-operative Societies
AMSDP	Agricultural Marketing Systems Development Programme
APLF	African Productivity Loan Fund
BAFIA	Banking and Financial Institution Act, 1991
BoT	Bank of Tanzania
CAMEL	Capital Adequacy, Asset Quality, Management Quality, Earnings Capability, and Liquidity
CBT	Co-operative Bank of Tanganyika
CDC	Commonwealth Development Corporation
CMSA	Capital Markets and Securities Authority
COASCO	Co-operative Audit and Supervision Corporation
CGAP	Consultative Group to Assist the Poorest
COCOBAS	Community Conservation Banks
CUT	Co-operative Union of Tanganyika
CRDB	Co-operative and Rural Development Bank
CRMP	Co-operative Reform and Modernization Programme
DANIDA	Danish International Development Agency
DC	District Council
DFID	Department for International Development, UK
DFIs	Development Finance Institutions
DED	District Executive Director
DLCs	District Loan Committees
DJTF	Diamond Jubilee Trust Fund
DJITF	Diamond Jubilee Investment Trust Fund
DSE	Dar es Salaam Stock Exchange
EAC	East African Community
EACB	East African Currency Board
EACSO	East African Common Services Organizations

EAHC	East Africa High Commission
EIB	European Investment Bank
ERB	Economic Research Bureau
ERP	Economic Recovery Programme
ESRF	Economic and Social Research Foundation
FDI	Foreign Direct Investment
FINCA	Foundation for International Community Assistance
FiNGOs	Financial Non Governmental Organizations
GDP	Gross Domestic Product
GBT	Gaming Board of Tanzania
GEPF	Government Employees Provident Fund
GSD	Grain Storage Department
GTZ	Gessellschaft für Technische Zusammenar beit
HIPC	Highly Indebted Poor Country Initiatives
HITAL	Humber Institute of Technology and Advance Learning, Toronto Canada
HPI	Heifer Project International
ICA	International Co-operative Alliance
IDA	International Development Assistance
ILO	International Labor Organization
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
KNCU	Kilimanjaro Native Cooperative Union
KNPA	Kilimanjaro Native Planters Association
LAPF	Local Authorities Provident Fund
LBT	Land Bank of Tanganyika
LDLF	Local Development Loan Fund
LISO	Local Initiative Support Organization
LCH	Life Cycle Hypothesis
LDCs	Least Developed Countries
MEDA	Mennonite Economic Development Associates
MFIs	Micro-finance Institutions
MIS	Management Information Systems

MKUKUTA	Mpango wa Kukuza Uchumi na Kupunguza Umaskini Tanzania
MKURABITA	Mpango wa Kurasimisha Rasilimali na Biashara za Wanyonge
MUCCoBS	Moshi University College of Co-operative and Business Studies
NAFCO	National Agriculture and Food Corporation
NAFCREP	National Food Credit Programme
NBC	National Bank of Commerce
NBS	National Bureau of Statistics
NCB	National Co-operative Bank
NCDB	National Co-operative and Development Bank
NDCA	National Development Credit Agency
NEDF	National Entrepreneurship Development Fund
NIC	National Insurance Corporation
NICO	National Investment Company
NPF	National Provident Fund
NPES	National Poverty Eradication Strategy
NORAD	Norwegian Agency for Development
NSGRP	National Strategy for Growth and Reduction of Poverty
NSSF	National Social Security Fund
NMB	National Microfinance Bank
NMC	National Milling Corporation
NMP	National Maize Programme
NGOs	Non Governmental Organizations
PBZ	Peoples Bank of Zanzibar
PC	Planning Commission
PIM	Programme Implementation Manual
PPF	Parastatal Pension Fund
PRIDE	Promotion of Rural Initiatives and Development Enterprise
PRSP	Poverty Reduction Strategy Paper
POSB	Postal Office Saving Bank
PSB	Postal Savings Bank
RIVACU	Rift Valley Co-operative Union

ROSCAs	Rotating Savings and Credit Association
RC	Regional Commissioner
RDS	Rural Development Strategy
RFF	Rural Finance Fund
RFMs	Rural Financial Markets
RFSP	Rural Financial Services Programme
RH	Rural Household
RLFC	Regional Loan Fund Committees
SACCOS	Savings and Credit Co-operative Societies
SACAs	Savings and Credit Associations
SAP	Structural Adjustment Programme
SAYE	Save As You Earn
SEDA	Small Enterprises Development Agency
SIDA	Swedish International Aid Agency
SIDO	Small Industries Development Organization
SCCULT	Savings and Credit Co-operatives Union League of Tanzania
SELF	Small Enterprise Loan Fund
SELFINA	Sero Lease and Finance Company
SME	Small and Medium Enterprises
SFCI	Specialized Farm Credit Institutions
SLF	Sustainable Livelihoods Framework
SUDECO	Sugar Development Corporation
TBC	Tanzania Bank of Commerce
TBL	Tanzania Breweries Limited
TDV	Tanzania Development Vision
TFC	Tanzania Federation of Cooperatives
TAFCO	Tanganyika Finance Company
TDB	Tanzania Development Bank
TDFL	Tanzania Development Finance Limited
THB	Tanzania Housing Bank
TIB	Tanzania Investment Bank
TPB	Tanzania Postal Bank
TPC	Tanganyika Planting Company
TRA	Tanzania Revenue Authority

TRDB	Tanzania Rural Development Bank
TTCL	Tanzania Telecommunication Company Limited
TTCIA	Tanzania Chamber of Commerce, Industries and Agriculture
UCSC	Unified Co-operative Service Commission
URT	United Republic of Tanzania
USA	United States of America
USAID	United States Agency for International Development
VICoBA	Village Community Bank
WADU	Weka Akiba Daima Upatapo
WB	World Bank
WOCCU	World Council of Credit Unions

CHAPTER ONE
INTRODUCTION

1.1 Background to the problem

Tanzania is among the developing countries categorized as the poorest country in the world with a GDP per capita of US $ 321 (URT, 2006b:21). The country is made up of Tanganyika and Zanzibar - two sovereign states that united in 1964 to form the present United Republic of Tanzania. Historically, Tanganyika was ruled by the Germans from 1891 to 1920, but after their defeat in World War I, Tanganyika was from 1920 to 1961 put under the British protection by the United Nations. Administratively, Tanzania is divided into twenty six regions, of which twenty one are on the mainland and five in the Islands of Zanzibar. According to the national population census in 2002, Tanzania had a total population of 34,569,232 growing at an average rate of 2.9% per annum (URT, 2003b:2-3). Based on this growth rate, the country's population is projected at 36,321,000 people by the end of 2005.

Like in most other developing countries, the degree of rural households' access to financial services in Tanzania is significantly low. According to a study commissioned by the Bank of Tanzania (1997:2-10) the unmet demand for rural financial services by formal financial institutions was significantly high, thus forcing rural households to rely on informal financial services by 82%. Of those operating bank accounts, they only saved 12% of their total savings. In addition, about 94% of the total households were willing to borrow if there were available resources and appropriate products and delivery methodologies. A follow up survey conducted in 2002 revealed that only between 6%-8% of the total rural credit demands were met by the existing formal financial institutions (IFAD, 2002b:19; URT, 2002b:15).

Agriculture forms the key sector in rural economy upon which rural households depend for their livelihoods. However, most studies reveal that with the liberalization of the financial sector, financing of this main sector declined precariously (Moshi, 2003; Bee, 1997; Kashuliza, 1994; Nyagetera and Kilindo, 1995; Ndanshau, 1995). According to Moshi (2003:15) liberalization of the financial sector and subsequent privatization, led to a significant decrease in commercial bank lending to agriculture from 12% of the total domestic lending volume in 1996 to 6% in 1999. Furthermore, the share of commercial bank loans for agricultural marketing fell from 19.7% of the total in 1995 to 0.8% in 1999. However, liberalization of the financial sector increased actors in the financial market and improved business efficiency through enhanced competition. The number of commercial banks, for instance increased from two in 1991 to 23 by 2004. Other types of financial institutions emerged, which include non-bank financial institutions, microfinance institutions, development banks, bureau de change, and capital markets with one stock exchange characterized by few brokers/dealers (BoT, 2006c: www.BOT-tz.org/BankingSupervision/registered_banks.htm visited on January 4, 2006).

Governments, donors and policy analyst are all concerned with the state of poverty in the world. It is a wide consensus now that rural households' access to financial services opens up productive opportunities, creates jobs, and builds up assets base. This is a new development paradigm that is built on market principles. Access to financial services unleashes economic potential to a greater proportion of the population, who are in most cases bankable but underserved. In this context, access to financial services enables rural households to improve their livelihoods. Rural households demand variety of financial products that include savings facilities, credit, insurance and provident funds, lease, means of payments and transfer services. Whereas availability of well-managed savings facilities enable households to build up funds for future investment, and/or consumption; access to credit augments own financial resources.

Rural households are expected to obtain these various financial products through the Rural Financial Markets (RFMs). RFMs may be classified into two operationally different sub-sectors, but serve the same purpose namely formal and informal financial markets. According to Kashuliza, Hella, Magayane, and Mvena (1998:1) informal financial services refer to all transactions, loans and deposits that take place outside the regulated monetary system or the formal financial system, while formal financial markets are establishments such as banks that are regulated and specialized in such transactions as accepting deposits and granting credit. In addition to these two sub-systems, there are few financial institutions that are partially regulated through registration or licensing, which, are in some literature referred to as semi-formal finance. In Tanzania such institutions include Savings and Credit Co-operative Societies (SACCOS), Savings and Credit Associations (SACAs) and some Non-governmental Financial Organizations (Financial NGOs or FiNGOs) (Kashuliza, *et. al.* 1998:1; von Pischke, Adams, and Donald, 1983:227-233; Thillairajah, 1994:20).

Rural Financial Markets (RFMs) in the developing countries are generally underdeveloped (Kashuliza, 1994:33-35; Bee, 1996:38; Jafferis, 1995:346; Bee, 1997:69-71; Thillairajah, 1994:11-14). As a result, the majority of the rural people have inadequate access to formal financial services. In Sub-Sahara Africa for example, the bank density ratio is between 100,000 and 420,000 inhabitants per bank branch, while in other developing economies of Latin America and Asia the situation is relatively better off in that there are 8,000 to 30,000 inhabitants per bank branch (Kashuliza, *et. al.*, 1998:1).

Various studies have attempted to explain the reasons for the underdevelopment of the RFMs in the developing countries (Kashuliza, *et.al*, 1998; Kashuliza, 1994; Belshaw, 1988; Jafferis, 1995; von Pischke, *et. al.,* 1983; and Moll, 1989). Jafferis (1995:346-347) attributes this partly to the smallness of the developing countries' economies, which make it difficult for a broad - based development of financial markets. Kashuliza (1994:34) points out three reasons for the underdevelopment of RFMs. First, the developing countries' economies are agriculture based and, therefore, much of the capital formation that takes place in the sector come mainly from land and labour rather than from capital obtained from financial intermediaries. Second, as also expounded by Jafferis (1995:346-347), the development of the financial markets were state-dominated, forced to provide agricultural credit mainly for farm inputs and implement, and provide support to the development of rural infrastructure at subsidised interest rates. Third, the smallness of markets in LDCs inhibits opportunities for profitable investment by financial institutions in the rural sector[1].

[1] Kashuliza (1994) called this "capital shortage illusion" depicting a lack of effective demand for capital.

In their attempts to correct the underdevelopment in the financial markets, most governments in the developing countries intervened substantially in the financial markets through the establishment of commercial banks, development banks, co-operatives, and specialized credit agencies. The justification for intervention is varied and ranges from the need for governments to influence and direct economic development to their desire to improve households' welfare by managing allocation of financial resources. However, experiences show that state interventions went beyond managing the formal financial institutions. According to Moll (1989:6-7) government development policies also involved setting interest rates, determination of foreign exchange rates, allocation of credit to priority areas/sectors, and even at times managing credit recovery.

1.2 Statement of the Research Problem

The financial sector reform and liberalization implemented in Tanzania aimed at creating effective and efficient financial markets through participation of the private sector, enhanced supervision and regulation, reduced risks and administrative costs, improved access to financial markets by poor and private sector. Thus, financial sector reforms were expected to increase outreach and sustainability of access to financial services. While the performance of the financial market has improved significantly as a result of its liberalization, rural households' access to financial services has, to the contrary, diminished.

Whereas the government realises the need for rural people's access to financial services, there remain a financial gap in many places. The implementation of financial reforms and the subsequent privatisation of government owned financial institutions have made things worse for the majority of the rural households and entrepreneurs. While banking systems are being strengthened through better supervision, they have so far tended to focus their efforts on low risk urban based clients in order to improve their portfolio performance rather than reach out smaller clients located in rural areas.

Although Micro-finance institutions (MFIs) are emerging to provide financial services at grassroots level, their outreach is still limited. It is generally observed that most MFIs are weak, fragmented into isolated market segments with little or no connection with the rest of the commercial sector. The resulting inefficiencies inhibit rural development as potential households' savings go untapped and profitable rural investments remain largely unfunded. In other countries, for example, Kenya, Uganda, Ghana, and Nigeria the MFIs have emerged to support the financial needs of micro - and small entrepreneurs. In Tanzania, however, such moves have been inadequate or are lacking such that financial gaps have remained pronounced even after the introduction of economic and institutional reforms. It is, therefore, logical to attempt to find out why access to financial services for the rural households is declining while supposedly financial service providers and services are increasing. Thus, this study is an attempt to explore this mismatch.

1.3 Objectives and Significance of the Study

The aim of this study is to assess the inherent weaknesses in the development of the financial markets within the context of the financial sector reforms implemented as part of the wider socio-economic reform measures. Thus, the study traces the problems of the financial sector in historical context, analyzes policies, regulatory and supervisory framework as implemented by the government. The study also explores structural problems and institutional weaknesses, which inhibit access to financial services among rural households. The need for this study has its origin, therefore, in the quest for rural development with a view of poverty reduction through access to rural finance in a sustainable manner.

Specifically the study objectives were:

(i) to analyze constraints to the development of Rural Financial Markets in Tanzania,

(ii) to assess the impact of Tanzania's financial sector reforms on growth of RFMs and improvement of rural households' livelihoods,

(iii) to assess constraints to supply and demand for financial services among rural households and enterprises, and

(iv) to recommend strategies for development of an efficient, integrated and sustainable rural financial markets.

The justification of this study is based on the presumption that the development of efficient financial markets results into economic growth that in turn further stimulates development of the financial market. There is a general consensus that capital is one of the important ingredients in economic development and growth. Today, shortage of capital is a limiting factor to socio-economic development and growth in many developing countries. As a result, poverty reduction initiatives are constrained by inadequate access to financial services.

The government of Tanzania is committed to poverty reduction among its citizens. According to Tanzania's Development Vision (TDV 2025), the government intends to eradicate poverty by creating employment opportunities, facilitating increase in productivity in the agricultural sector and diversification of the national economy (URT, 2000a:4). To achieve the desired economic transformation, the government realises the importance of access to financial services by the rural households. The drive for poverty reduction initiatives hinges on the private sector although the government is leading it at the moment. In this context, the main development focus is placed on promotion of income generating activities and development of a diversified micro and medium scale enterprises. Whereas access to financial services by private entrepreneurs is an important component in the realization of development goals, in itself it cannot be a panacea to rural poverty. It calls for the wider conceptualisation of the private sector development that has been constrained by the government policies hitherto.

Economic reforms being implemented in Tanzania give the private sector an upper hand in driving economic growth. Since the majority of the rural people are small and medium entrepreneurs, it is logical that their access to financial services improves their savings and investment capacities. The Rural Development Strategy (RDS) spells out the link between economic growth, employment and poverty reduction through the development of Small and Medium Enterprises (SMEs). The RDS was drawn out of the National Poverty Reduction Strategy Paper framework (URT, 2000b:6).

This study, therefore, is an attempt to contribute to the debate in development literature on financial liberalization and observed constraints to access financial services among rural households in developing countries (Nyagetera and Kilindo, 1995; Shaw, 1973; McKinnon; 1991; Sowa, 1994). Such information is vital for policy makers, government and donor agencies involved in the design and support for rural development. Thus, the intentions of the study is to come out with suggestions on appropriate interventions by civil organizations, research and academic institutions, financial institutions, and other rural development stakeholders in addressing issues of access to finance for poverty reduction through growth initiatives.

1.4 Research Questions

The study assumes that given an enabling environment, rural financial institutions play a significant role in the mobilization of financial resources for the development of the rural areas, and thus contributing to poverty reduction through economic growth. At individual levels, access to finance builds up productive asset levels, reduces risks, and increases wealth. Furthermore, the study assumes that rural financial services can provide a broad range of financial services targeting its clientele efficiently in order to expand their incomes and reduce poverty through increased investments.

Within the context of the above assumptions, the following research questions were asked:

(i) What are the constraints to the development of Rural Financial Markets in Tanzania?

(ii) What is the impact of Tanzania's financial sector reforms on growth of financial markets and improvement of the rural households' livelihoods?

(iii) What are the limitations to supply and demand of financial services in rural areas?

(iv) Which strategies are more practicable and sustainable for the development of an all-inclusive financial market in Tanzania?

1.5 The Scope of the Study

There is a growing literature on financial liberalization in developing countries (Nyagetera and Kilindo, 1995; Shaw, 1973; McKinnon; 1991; Sowa, 1994; Kashuliza, 1994; Ndanshau, 1996). Debates on financial liberalization have become topical with contradicting empirical evidences as evidenced by studies undertaken by McKinnon (19973); Shaw (1973), McKinnon (1991), Sowa (1992) and Fischer (1993). Implementation of appropriate monetary policies focused on economic stability reflected in stable prices, lower inflation, increased GDP growth, and reduced unemployment is the target of financial liberalization. According to Nyagetera and Kilindo (1995:123) the arguments by McKinnon-Shaw contend that:

> …an increase in real interest rates will have strong positive effects on savings by shifting them from unproductive assets towards financial assets and thereby raising the volume of productive investment.

Whereas studies by Fry (1997) that involved a wide range of countries in Latin America, Asia and Pacific supports the McKinnon – Shaw hypothesis of existence of strong correlation between financial growth and economic growth, a similar work by Fisher (1993) in Indonesia, Malaysia, Taiwan and Korea) produced mixed results (Nyagetera and Kilindo,1995:124). Whereas Fisher (1993) argued that financial liberalization will lead to a stable macro-economic environment, the development of financial sector in Tanzania has failed to enhance households' access to financial services in rural areas.

This study scrutinized these arguments for financial liberalization in a specific situation of a developing country environment by drawing lessons from Tanzania (see Figure 1.1 for details). The study contends that improvements in access to financial services is felt in urban areas and among wealthy households, but excludes rural and poor people. In order to substantiate this argumentation, the study carried out survey of thirteen villages of Babati District in Manyara region in northern Tanzania[2]. The villages covered are Seloto, Bermi and Bashanet in Bashanet division; Babati Township, Gallapo and Mamire from Babati division; Bonga, Riroda, and Singe from Gorowa division; and finally Gichameda, Mwada, and Magugu township from Mbugwe division. Chapter three provides detailed description of the study area and methodology.

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[2] A district is an administrative boundary that is made up of divisions, which are sub-divided into several Wards that is further sub-divided into villages, which is the lowest unit of local government administration.

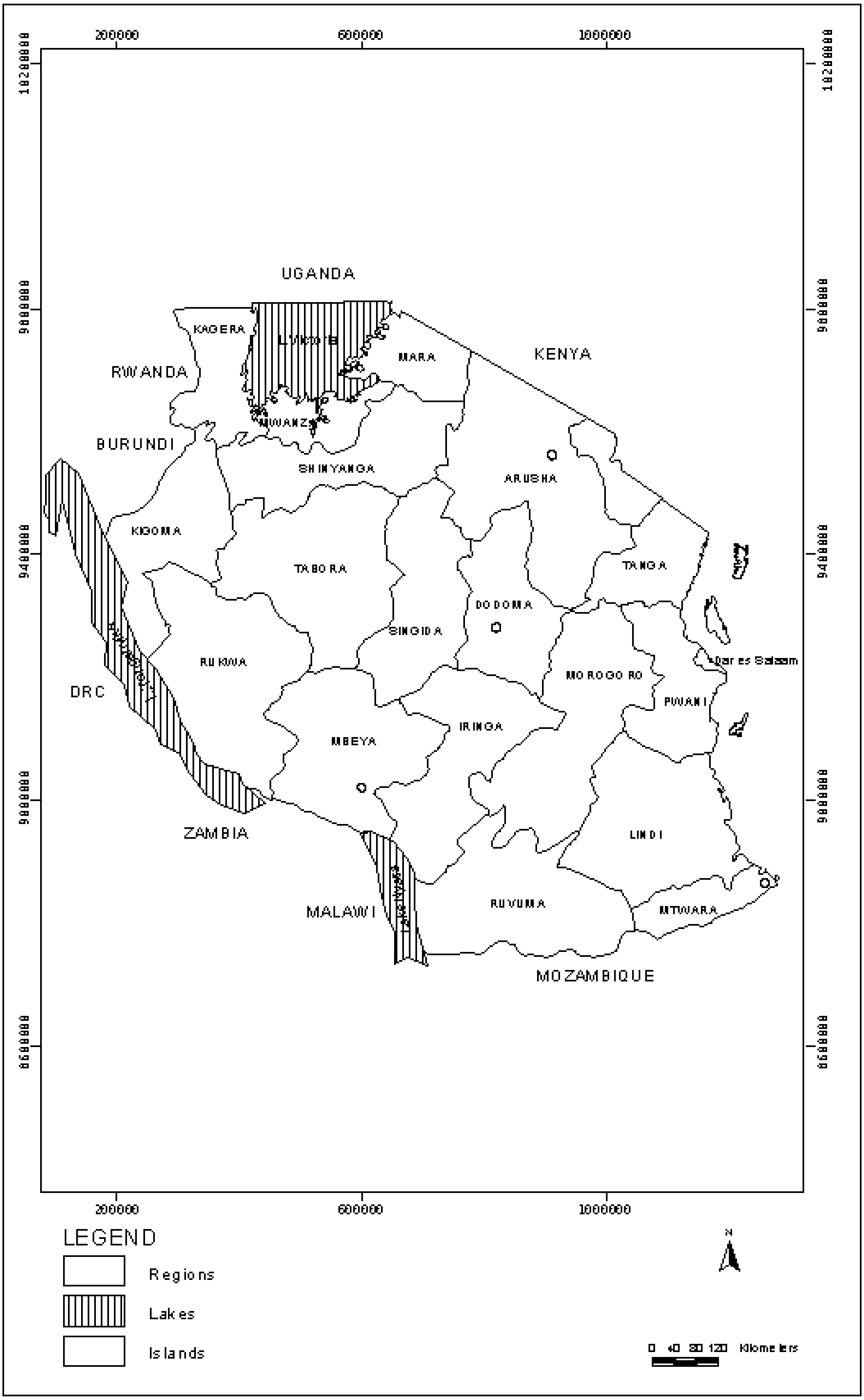


Figure 1.1: Map of Tanzania showing Regional Divisions before the split of Arusha

The choice of Babati district was dictated by several considerations. First, like many other rural districts, Babati experiences the problem of underdeveloped RFMs. Secondly, Babati district is among the major food crop producing districts in Tanzania, but has no reliable agricultural credit system. Thirdly like many other districts, Babati experiences the problem of commercial financial institutions pulling out from serving rural areas, especially after the liberalisation of the financial sector. Fourthly, the growth of financial NGOs and co-operatives have not picked up as expected to fill the vacuum. Thus, the surveyed villages were selected to provide a true representation of the rural villages as each agricultural ecological zone was represented.

1.6 Limitation of the study

The constraint faced in this study was access to reliable data as rural households often do not keep records. However, efforts were made to collect data from different sources and compare it with available regional and national statistics. This strategy of collecting information from different sources in order to ensure the quality of information gathered is known as triangulation technique (Stake, 1995:42). Triangulation is necessary because of ethical needs to confirm the validity of the processes and data collected. In this respect, the researcher is confident that the data and information used in this study present a fair view of the rural Babati.

1.7 Organisation of the Thesis

This thesis is organized into eight chapters, with chapter one providing the background information, statement of the problem, study objectives and significance. In addition, it delineates the study limitation and describes the organization of the thesis. The second chapter concentrates on theoretical issues underpinning the rural finance in developing countries. It reviews the relevant literature, and provides a conceptual framework for analysis of rural finance.

On the other hand, the third chapter presents a profile of the study area and describes the study methodology. In chapters four, five, six and seven the thesis addresses the research questions advanced. Chapter four discusses the development of the financial sector in historical context. In this chapter, five historical periods were identified. These are introduction of commercial banks by the German colonial administration (1905-1920), the expansion of the financial sector by the British (1920-1961), financial sector growth under independent government (1961-1966), and the central planning and financial sector (1967-1990).

Chapter five discusses issues of regulation and supervision of the commercial banks and financial institutions. Chapter six provides the analysis of the financial structure under the market economy and its impact on rural livelihoods. In chapter seven the fifth period of the Tanzania's financial sector development is presented. Finally, chapter eight presents summary and main conclusions of the study. In addition, it identifies policy recommendations and areas for further research.

CHAPTER TWO
RURAL FINANCE: THEORY AND LITERATURE REVIEW

2.1 Preamble

This chapter attempts to review the relevant literature on rural finance. In addition, it also discusses the theoretical framework of analysis for access to rural finance and its role in economic growth. It must be realized from the onset that this study is not about choosing between financial markets paradigm and state controlled credit system, but rather about how rural financial markets (RFMs) can develop in order to provide efficient financial services to rural households. The study contends that financial markets liberalization implemented in Tanzania have not improved rural households' access to financial services and hence their livelihood.

2.2 Financial Services and Economic Development

2.2.1 Financial Development and Economic Growth

Development analysts and practitioners have all along been interested in the contribution of finance to the development process. Among the early contributors to this debate is Arthur Lewis (1955) who came up with an idea of a two-way relationship between financial development and economic growth. According to Kirkpatrick and Green (2002:207) this theory postulates that financial markets develop as a result of economic growth, which in turn stimulates the growth of real economy. This thinking attracted many researches and analysis in order to (i) test empirically the causal relationship between finance and development, and (ii) understand the functions of the financial system in the development process (Levine, 1997; Levine, Loayza, & Beck, 2000; World Bank, 2001a).

Traditionally, poverty was perceived as a problem of people earning low income, which lead them to consume too little to attain the minimum socially determined standard of living, and owning too few assets to protect themselves against future uncertainties[3].

[3] Most empirical studies measured poverty levels in terms of income, consumption or expenditure levels. Poverty measurements call for wider considerations that go beyond the material well-being. Human beings also require an array of non-material needs e.g. rights or access to public provided goods and services such as defence, freedom, and esteem.

Following this line of argument, most poverty reduction strategies focused on employment creation, skills development, and redistribution of assets from rich to poor (Meyer, 2001:1-2). Consequently, government sponsored poverty reduction programmes included packages that involved the widely discredited targeted credit, and technological packages. However, poverty is a complex and multi-dimensional phenomenon, which requires a holistic analytical approach as depicted in figure 2.1. Poverty is about material deprivation reflected through low food consumption, and poor housing condition; low human development resulting from inadequate education, poor health and nutritional status; lack of voice and ability to influence decisions; and acute state of vulnerability to adverse shocks such as illness, economic crimes, and natural disasters.

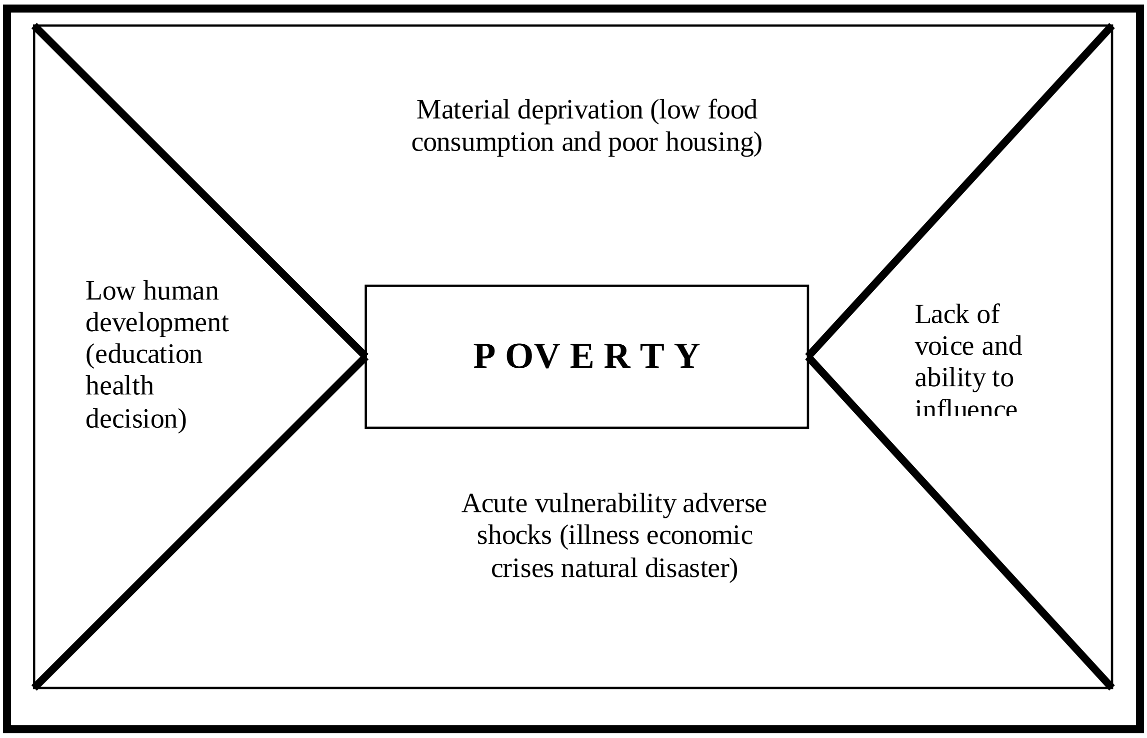


Figure 2.1: Poverty is multi-dimensional
Source: MUCCoBS-HITAL (2003:6)

Since majority of population in developing countries live in rural areas and depend mainly on agriculture, poverty reduction in these countries depends on agricultural revolution. Consequently, the literature on supply-led approach to agricultural credit dominated development debates during the Green Revolution era of the

1960s through 1970s (Adams and Graham, 1984; Meyer and Larson, 1997; Meyer and Nagarajan, 2000). During this period the emphasis was on agricultural credit rather than rural finance. Agricultural credit was envisaged to lead to an increased production and raise income, allowing for improved consumption and savings, hence facilitating more investment. It is, however, important to note that access to financial services can not on its own be a panacea to all poor peoples' problems. It is because of this fact that the debate on rural poverty has now shifted towards markets paradigm, where the cause of poverty is attributed to failure of markets. Stiglitz (1994), for instance contends that the imperfect financial markets in developing countries inhibit poor peoples' access to financial services.

2.2.2 Rural Finance and Sustainable Livelihoods Framework

The relationship between poverty and access to financial services is best explained by the theory of Sustainable Livelihoods Framework championed by many authors (Ashley and Carney, 1999; Scoones, 1998; DfID, 2001). Building on the preceding theoretical context, the use of the sustainable livelihoods framework (SLF), as applied by a number of research and development organizations, helps in addressing some of the weaknesses inherent in the agricultural credit paradigm. The framework relates the causes of poverty to households' access to resources and their diverse livelihoods strategies. The framework evolved over years as perceptions on poverty reduction, how poor people live, and inclusion of structural and institutional issues were changing (Ashley and Carney, 1999:1-7). Today, the concept of household livelihoods has become popular in the development literature.

Livelihood activities may vary from one area to another and even among households in the same location. Under the SLF, the analysis of poverty and its reduction strategies goes deeper into the understanding of the nature of households' activities and sources of vulnerability[4] they face.

The overall conceptual framework for sustainable livelihoods is illustrated in figure 2.2. The uniqueness of the sustainable livelihoods framework is that it negates the

[4] Whereas poverty is defined in terms of a socially defined minimum level of well being, vulnerability is about the likelihood of falling below (or further below) that socially acceptable minimum level in the future.

traditional perception of poverty that is based on income considerations. Following the sustainable livelihoods approach, it is clear that poor people do not only lack income; but face inadequate food, poor shelter, and lack access to education and health. In this context, they are vulnerable to ill-health, economic displacement, and natural disasters (Ashley and Carney, 1999:47; Meyer, 2001:2). Furthermore, they are also prone to government policies, regulations and actions to which they are powerless to influence its decisions.

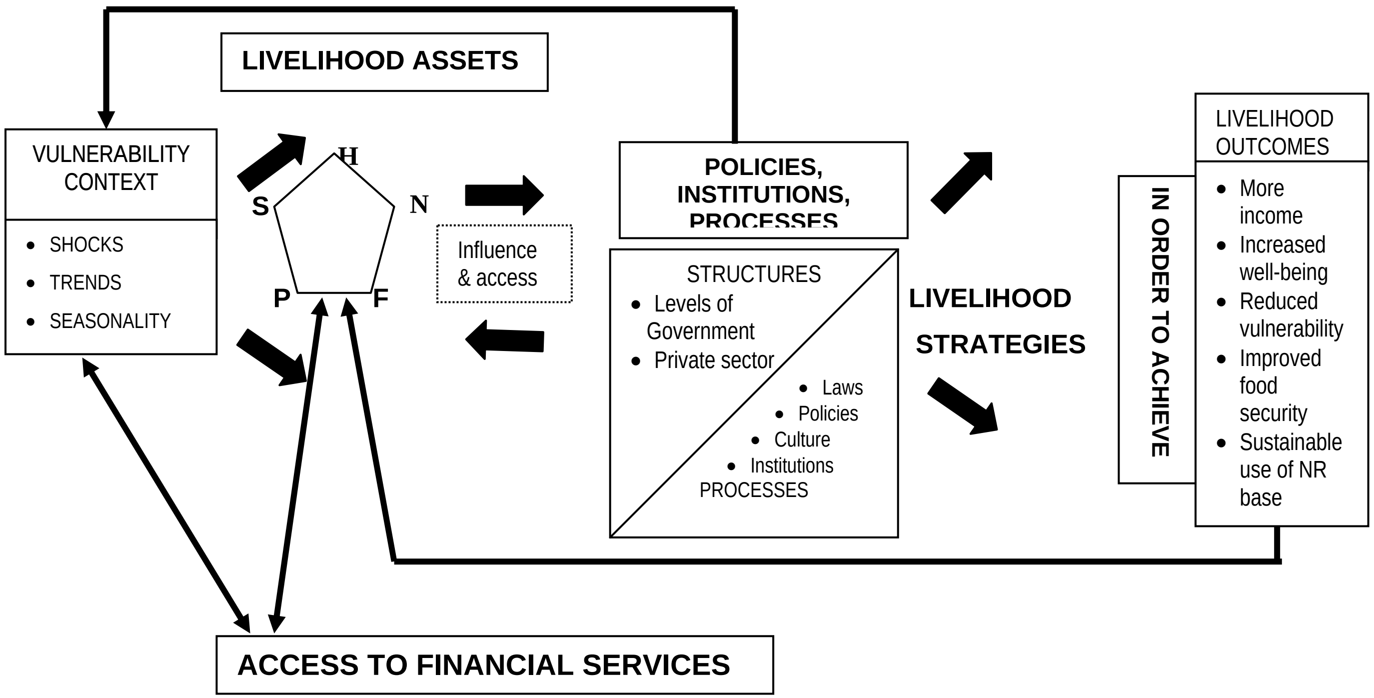


Figure 2.2: The Sustainable Livelihoods Framework and access to finance
Source: Adapted from Ashley and Carney (1999: 9) figure 3.

Key: P-Physical capital; N-Natural capital; F-Financial capital; H-Human Capital; and S-Social Capital

The choice of households' livelihood strategies are, therefore, influenced by the households' level of assets; their access to resources (natural resources, physical capital, financial capital, human capital, and social capital); and the structures and processes within which they operate. According to SLF, poor households' access to financial services – such as savings facilities, credit and insurance, build up their productive assets and hence improve productivity. This new line of argumentation on poverty reduction considers financial capital as playing multiple roles in development. The premises behind this thinking are that development of the financial market is an important element in any country's economic growth. Access to financial services unleashes the economic potential to a greater proportion of the population who are in most cases bankable but underserved. In addition, formation of new enterprises and modernization of the existing ones is also facilitated through a functioning financial market. In this context households increase their opportunities for achieving sustainable livelihoods, and reduction in their vulnerability status.

Figure 2.3 elaborates further this relationship between poverty and access to financial services. The figure shows that access to financial services increases the levels of incomes, expands households' assets base and improves food security.

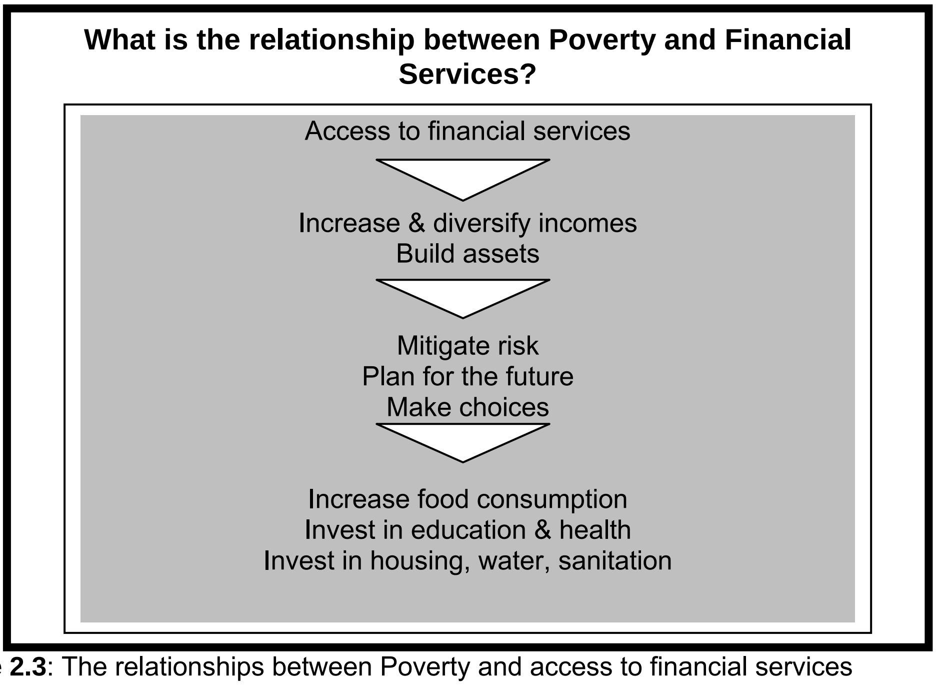


Figure 2.3: The relationships between Poverty and access to financial services
Source: MUCCoBS-HITAL (2003:8)

According to Zeller, *et. al. al*. (1997) quoted in Meyer (2001:3-4) access to financial services can bring impact on food security in three ways. First, through an improved income generating method as loans provides relief in the short run. Secondly, a household's access to finance reduces the costs of self-insurance and hence induces changes in the household's asset base and level of liabilities. Consequently, "precautionary savings" in the form of non-productive assets, which are held to cushion adverse shocks such as illness, and bad weather, is made available for productive investments. Thirdly, credit enhances consumption. According to Meyer (2001:4):

> formal credit, savings and insurance services may help households' smooth consumption so they use fewer traditional methods, which are often inefficient and bind households into unproductive social relationships that discourage savings and wealth accumulation.

2.3 Rural Financial Markets: The Analytical framework

2.3.1 The Concepts: Rural Finance, Agricultural Finance and Microfinance

The debates on rural finance calls for a clear distinction between three overlapping concepts: Rural Finance, Agricultural Finance, and Microfinance. According to the Rural Finance Knowledge Management (2005:11) Microfinance refers to provision of financial services to low income people irrespective of where they are, rural or urban at more affordable terms, whereas Agricultural Finance is essentially a subset of rural finance dedicated to financing agricultural related activities such as input supply, production, distribution, wholesale, processing, and marketing. Hospes (1996:9) defined Rural Finance as:

> the complex of decisions of individuals and groups regarding savings, financing and insurance; institutionalization of financial services and changing conditions that affect the decisions and institutional arrangements of people related to savings, financing and insurance"

Thus, Rural Finance in this context is perceived as the intermediation process through which financial assets and debts are exchanged and re-allocated among rural economic entities. Schematically the relationship between the three concepts is presented as in figure 2.4.

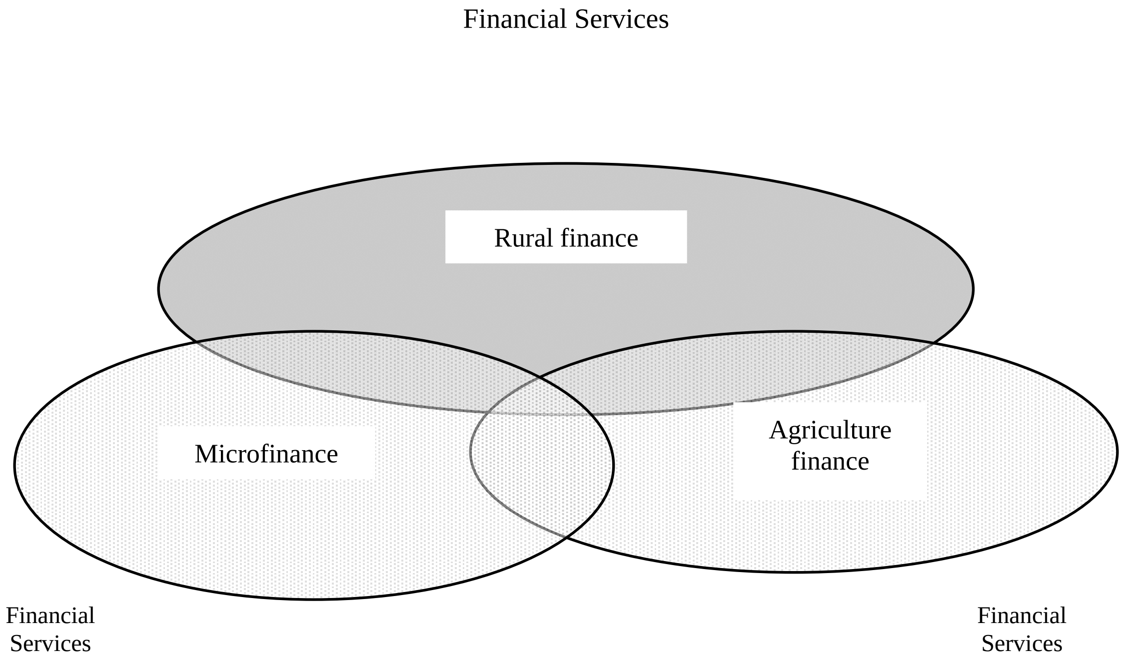


Figure 2.4: Schematic representation of Rural Finance, Agricultural Finance, and Microfinance
Source: Rural Finance Knowledge Management (2005:11)

The operations of Rural Finance take place within the framework of the Rural Financial Market. The concept of Rural Financial Markets (RFMs) has been used by various authors to define the relationships between buyers and sellers of financial assets in rural economies[5] (Moll, 1989:7; von Pischke, *et. al*., 1983; Kumar, *et al.*, 2002:214-218). According to von Pischke, *et al.,* 1983) these relations involve a wide range of institutions: formal and informal intermediaries, enterprises and households. The basic functions of a financial market are, therefore, mobilization of savings and provision of credit. In this regard, financial institutions perform the function of financial intermediation. The financial intermediation process has costs, which have to be met by its actors. Such costs possess certain advantages as well as disadvantages, which act as incentives and/or disincentives to the end users.

[5] These are, nothing but financial products that include borrowing, lending, and transfer of ownership of financial assets such as debt claims, promises to pay; and ownership claims, giving the holder the right of access, use, or control.

The definition of RFMs reveals two kinds of relationships. One is the relationship between the actors: households, enterprises, financial intermediaries and the regulator. Two, is the transactions between parties involved. For financial transactions to be effective, however, parties involved must be confident to the system and to one another. This is possible if collateral exists, lender has knowledge of the borrower, there is a possibility for legal action, and local leaders can reinforce the agreement.

The financial markets in most of the developing countries are said to be underdeveloped. The debates on the underdevelopment of the rural financial markets in developing countries are well documented (Hoff and Stiglitz, 1990; Besley, 1994b; Yaron, 1997; Thillairajah, 1994; Seibel, 1986). Rural Financial Markets are characterized by certain unique features that reflect their underdevelopment. These characteristics, according to some literature, can be summed up into three groups: limited collateral security; insufficient complementary institutions; and covariant risks (Besley, 1994b:31; Hoff, and Stiglitz, 1990: 237-245). Most Rural Households (RH) have none or few assets that can be collateralised to secure loan default-risks. In a way, this is also a reflection of the underdevelopment of property ownership rights as understood in modern world. However, property ownership rights and inheritance in most African culture is based on an elaborate family-hood systems and norms, which are unfortunately not acceptable to the standard banking practises as understood in the business sense.

On the other hand, there is inadequate loan repayment enforcement capacity as well as insufficient insurance services. Mitigation of credit default is a major issue of concern as there are no well-established insurance facilities to secure incomes from whatever shocks. Moreover, there are inadequate records of individual credit histories, as is the case in many of the developed countries (Besley, 1994a:31). Furthermore, there are no means for enforcing loan repayments[6] due to

[6] Enforcement of loan repayment after default has occurred can be strengthened if there is an active local leadership. However, for such enforcement to be beneficial the benefits must be greater than the costs. In most cases, though, when local leaders are involved, there are political costs, which might not be quantifiable but for certain such costs are very important.

inadequately developed local leadership capacities with reliable systems of communication, upon which financial system may rely on.

Furthermore, there is an inadequate effective rural communications and transport infrastructure, which are critical for the development of rural financial markets. The situation is further complicated by the degree of illiteracy and innumeracy among the rural population that impede their ability to undertake business between, on one hand, financial institutions, and on the other, with rural households and rural enterprises.

Most of the developing countries are also faced by the problem of covariant risk and segmented markets. Majority of rural households depend on agriculture, which is risk prone. Risks involved include weather and price fluctuations, floods and pests. These shocks affect the agricultural credit repayment if not properly planned. One way to minimize this effect is for lenders' to diversify their loan portfolios. However, according to Besley (1994a: 32) this might be impossible as credit markets in rural areas tend to be segmented, i.e. lenders' loans portfolio is concentrated on a group of people facing similar income shocks, as they either produce under the same geographical and/or climatic conditions, cultivate same crops, or borrowers are from the same kinship. A survey conducted in northern Nigeria revealed that credit markets are segmented along geographic lines and kinship groups, and hence information is hardly available to other outside borrowers. These practices threaten the very existence of the credit market (Hoff, and Stiglitz, 1990:241).

The functioning of RFMs is dictated by assumptions underlying the Rural Household and Economic Environment model as derived by Moll (1989:25). Rural Households make various decisions related to allocation of resources for varied purposes, which are primarily concerned with production and consumption. These decisions are usually made under conditions that are characterized by seasonality, uncertainty and imperfect factor and product markets. However, households' decisions regarding savings patterns are influenced by its demographic and wealth factors. This type of relationships is aptly explained by the Life-cycle Hypothesis (LCH) that was developed by Modigliani and Brumberg (1954) and further improved by Ando and Modigliani (1963).

The LCH postulates that households do not depend entirely on absolute income but rather on wealth and the expected income stream from labour and households' assets. An individual experiences uneven flow of income over their life cycles, which portray three stages of a regular pattern in the flow of consumption expenditure. Stage one is when an individual is young and hence does not earn wage income or earns very little. At this stage what happens is dis-saving as consumption expenditures are based on previous savings or accumulated wealth. Stage two, also known as the middle age, is the most critical stage as at this level an individual earns more income from work. This income is used partly to meet consumption expenditures, partly saved for retirement age and partly used to pay previous debt obligations, if any. It is also at this stage investment expenditures are made. The third stage, which is the retirement stage, is an aging phase where an individual is no longer capable of doing gainful work, hence depend on accumulated savings to finance own consumption expenditures[7].

The application of LCH in a peasantry economy is appropriate as it attempts to explain how poor households' access lump-sum money that they need to meet their life cycle needs, emergencies and demand for investments. In other words, it describes the relationships between income stream of households to consumptions and savings. Households are able to meet their variety of needs through different ways, such as selling of assets both current and expected, savings, and loans through mortgage of assets. In addition, peasants' households have elaborate reciprocities mechanisms as well as inheritances, which sustain their livelihood in difficulties and at old age. It is, therefore, because of this recognition that the LCH becomes appropriate in studies related to peasant economies as it attempts to describe rural financial market in simple ways based on demographic and wealth considerations.

[7] The LCH portrays the relationships between individuals' savings behaviour and their age profiles. It denotes savings as an increasing and decreasing function of age.

In its undertakings, households can be seen as economic unit faced by series of complex decisions internally, and externally with other economic agents. Decisions have to be made concerning the use of resources for consumption and production purposes, which are likely going to lead into changes in the households' resource base. It is this outcome that will determine the continuity of the household's future production and consumption levels. Although, household's resource basis is reflected in the form of assets, households can also access additional resources from external sources repayable in future. In addition, households could at the same time extend excess resources to others through an intermediary agency, be it formal or informal.

Figure 2.5 depicts the financial relationships of a rural household. According to the theory of liquidity management as developed by Baker and Bhargava (1974), household's resource basis can be measured in terms of production value and liquidity value. In this respect Moll (1989: 25) identified four types of household's resource basis. First, households' assets such as land, livestock, labour and implements are productive assets. Second, assets such as consumer durables and prestigious goods are non-productive but are considered to have liquidity value.

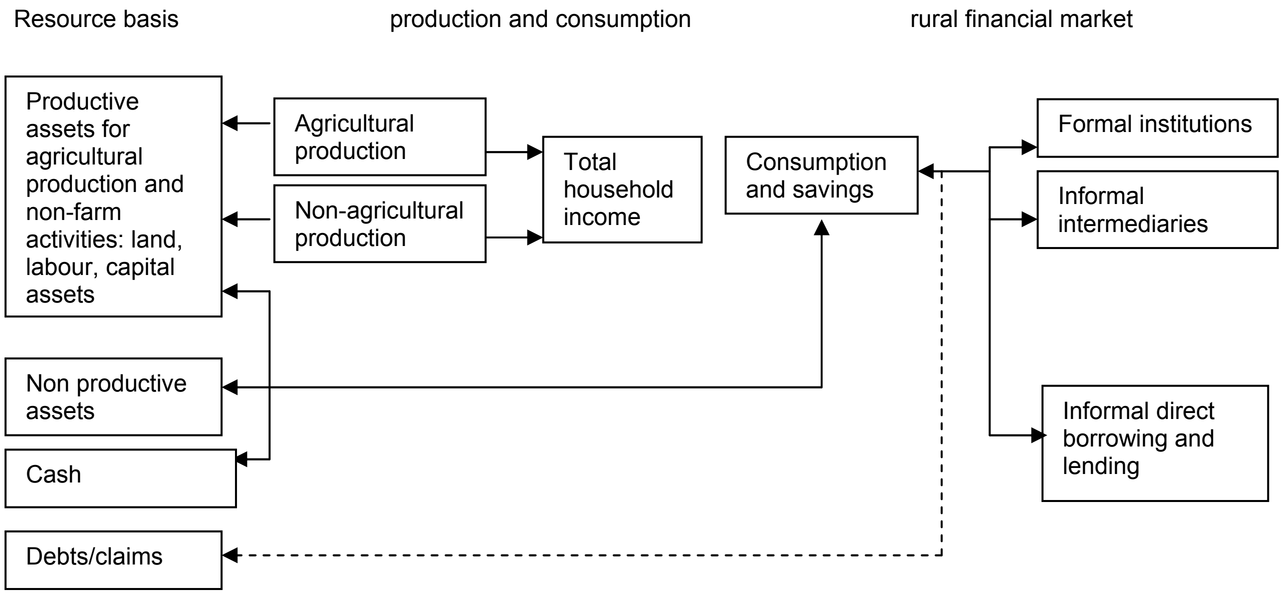


Figure 2.5: Rural household and economic environment
Source: Adapted from Moll (1989: 25) figure 2.2

Third, cash as an asset can be used for both consumption and production and it is highly liquid as it has no transaction costs involved in transforming it to other forms of assets. The fourth type of asset, debts and claims results from households' external relationships based on mutual exchange; informal arrangements and/or contracts with formal institutions. According to Moll (1989:26) these external households' relations are determined by a number of factors, which in his opinion includes: social factors and the stage of development. Relating the stage of development to institutional financial services, von Stockhausen quoted in Moll (1989:26) distinguishes three stages, namely subsistence, agricultural investment and non-agricultural investment stages. However, the issues that are not involved in these debates are the questions of government policies and regulatory frameworks and how these influences households' relationships with financial intermediaries.

2.3.2 Rural Financial Markets and Financial Intermediation

As already stated in the previous sections, RFMs consists of relationships between buyers and sellers of financial assets. These actors include both informal and formal intermediaries. According to von Pischke, *et. al.* (1983:4-5) financial markets are characterized by intermediaries between savers and borrowers, who constitute the market. The development of RFMs is very critical for developing countries as put forward by Schreiner (1997:1-2). First, RFM are essential for the rapid and sustained transformation of the rural sector in general and the agriculture sector in particular, where majority of the people resides and sustains livelihoods. Second, sustained economic growth calls for an increased domestic savings mobilisation, a function central to the rural financial institutions, which are part of the wider country's financial system. Third, the level and degree of poverty is deep in the rural areas. Thus, facilitating rural households' access to financial services will contribute towards poverty reduction initiatives.

Fourth, access to financial services facilitates efficient domestic production system, as it reduces risks and investment of excess current resources. Fifth, finance affects equity. Access to finance facilitates the accumulation of wealth, but access to finance requires wealth. If loans are based on large assets that are possessed by the few households, then finance will decrease rural equity. Thus, it is commendable to link credit to small collaterals that are easily available at poor households' levels for each one to have an equal access to loans. Sixth, access to finance expands rural investments and hence creation of rural employment opportunities. Seventh, access to credit is considered as right to every human being.

In terms of financial intermediation, most of the developing countries are characterized by weak competition in the financial sector resulting from the underdevelopment of the sector itself, inadequate financial institutions, poor infrastructures and lack of support services (Schreiner, 1997: 2-5; Bee, 1996:38). In most of these countries their financial markets exhibits dual character of financial institutions: formal and informal institutions. There are opposing views on the role of these forms; there are those who view them as competing financial institutions, whereas there are some who argue that these complement one another. Examining conditions for accessing credit at both formal and informal institutions, one sees that the degree of competition is low due to:

(i) variations in conditions, though there are certain commonalities,

(ii) informal institutions target market segments that are not well served by the formal institutions, and

(iii) informal players use services of formal institutions, hence in a way supporting savings mobilizations in small ways.

Most literatures in rural finance have delineated five forms of financial intermediaries, which are adopted in this study (Moll, 1989; Yaron, 1997; Thillairajah; 1994). These forms of intermediaries are:

(i) Commercial Banks: Subsidized and target credit programmes,

(ii) Specialized farm credit institutions,

(iii) Co-operatives financing,

(iv) Group lending approach, and

(v) Informal financing.

2.3.2.1 Traditional credit approach

The subsidized and targeted credit approach has been widely documented and referred to differently by many writers. It is known as agriculture finance[8], or traditional credit approach (Yaron, 1997:3; Thillairajah, 1994; Aryeetey, 1996; Besley, 1994a). The traditional rural finance (TRF) approach is aptly characterized by government interventions in rural credit markets. Interventions were justified on the grounds of market failure to deliver the needed financial services to the rural people to support their development initiatives. In order to realize the desired effects, governments in most developing countries started to own commercial banks through the nationalization of existing private banks or establishing own banks. According to Besley (1994:27) India and Mexico, nationalized their banks in 1969 and 1982 respectively in order to force the banks to open up rural branches that would serve the rural people. Tanzania also underwent similar practice, whereas it nationalized private commercial banks in 1967 and established public financial institutions instead, partly to address the credit need of farmers. In other countries such as Nigeria, regulations were put in place for the banks to serve rural areas. In almost all cases, credit were issued at subsidized interest rates, a situation that called for credit rationing/targeting as demands exceeded supply.

The main reason for government interventions in rural financial markets is based on the perceived market failure especially by commercial banks' inability to serve rural people. Most commercial banks operate in urban areas where customers are easily accessible and infrastructure more developed. Those with branches in semi-rural areas are mostly targeting similar group of clients in the peripheries of cities/urban centres as those addressed by their regional branches or head offices. Services offered are mostly short-term credit, deposits and money transfers, and in most cases the category of small farmers was out of their scope of business.

[8] Agriculture in some literature is used interchangeably with rural development, as it forms the main activity of the rural population. Today, however, it is appropriate to distinguish between the two as slowly other income generating activities are gaining importance.

Interest rates charged for targeted loans were also controlled by the state so as to allow borrowers to repay. Thus, central banks were charged with setting low interest rates on both credit and deposits. Whereas credit was encouraged savings were demotivated through lower interest rates.

2.3.2.2 Group lending approach

According to Paxton (1995:5) the idea of group lending was modified from the informal lending practices. It was first practiced by few NGOs in the 1970s but accelerated during the 1980s through the 1990s. In almost all the programmes the emphasis was on “credit-first”. However, over the past few years, the group lending approach has gained popularity especially among the donors and financial NGOs. This has partly been prompted by the stories of success of the Grameen Bank model of micro-credit implemented in Bangladesh.

There is enormous literature on the successes of this model, and some scholars and policy makers have even recommended for its replications elsewhere (Yaron, 1992; Vogel, 1984; Berenbach, *et al*, 1997). The justifications for group lending are based on: (i) transactions costs are low, (ii) poor people prefer group approach[9] for all sorts of actions, and (iii) repayment rates are more favourable when they borrow and repay as group (Paxton, 1995:1). The main premise behind the group model is the presumption that homogeneous groups exhibit higher degree of group solidarity and pressure. Under this system, groups apply and receive small amounts of loans that in turn are distributed to each individual member in the group, but the larger group remain liable for the repayment of the total sum. In modern banking sense, there is no physical collateral, but rather group liability and hence the lender relies on social pressure/cohesion for loan recovery.

Many interventions using the Grameen style have heralded the role of group solidarity for good loan recovery rates, but there are some unanswered questions concerning the groups’ dynamism as raised by Paxton (1995:2).

[9] Through the group approach they tend to minimize risks by spreading it over individual members.

These doubts emanate from the difficulties involved in measuring the degree of group cohesiveness, homogeneity, and group pressure on loan repayment. Indeed, while these issues need to be dealt with, there are other facilitating factors in loan repayment, such as economic performances, and history of the group, existing informal rules/regulations/cultural norms and the possibility for being reinforced through the prevailing country laws.

2.3.2.3 The Co-operative Finance Paradigm

Co-operatives have played very crucial roles in the provision of agricultural finance. There are also reports that, they have been misused by the rural elites to amass both political and economic power (van Cranenburgh, 1990: 54; Holmen, 1990:25). A co-operative Society may be defined as a voluntary, democratically controlled association of people with specific purpose of conducting some kind of business for serving its members[10]. In most countries, co-operatives are legal entities registered under co-operative societies' statutes. They operate in variety of fields: marketing, input supply, finance, and housing to mention but a few.

Many governments in the developing countries, Tanzania inclusive, have used co-operatives to achieve a broad array of objectives (Bee, 1996:8; Holmen, 1990:30-31). Moll (1989:16-17), for instance, pointed out that both governments and international donor agencies took co-operatives as appropriate instruments for rural transformation in general and agricultural development in particular. As a result, co-operatives were given a broad range of development objectives to fulfil. These ranged from mobilization of resources for the state, organization of rural credit, provision of marketing facilities, and politization of the rural communities. In this regard, co-operatives were considered as business entities on one hand, but also as instruments for implementation of public policies[11].

[10] Co-operation has been defined in various ways to suit particular ideological standing, but in all cases there are certain peculiarities. In economic sense, the definition provided by the ILO (1966) and modifications made thereafter, is adopted. For more details see Bee (1996:4 -5).

[11] Whenever assessing performances of co-operatives in LDCs it is important to examine the dual roles played by the state sponsored co-operative institutions.

A typical co-operative society is a self-financing organization. A financial co-operative means, therefore, members contributing to a common fund to be loaned to its members. However, in many instances governments and donors financed co-operative activities with the intention of attaining rural development. In other instances, the rural credit component was made part of a marketing society, or at times input supply on credit to farmers was facilitated through co-operatives. In Tanzania, marketing societies were at first charged to administer farm credit to their members from public financial institutions. During the 1980s, however, Savings and Credit Schemes were introduced to facilitate credit distribution and payments of crop sales proceeds to farmers. The savings and credit schemes were made units of marketing societies. In Kenya, almost during the same time, Union Banking Sections were introduced under marketing societies in order to mobilize savings and administer credit.

Of all the various forms of co-operatives promoted in Tanzania (marketing societies, housing, industrial, and production); perhaps the most important co-operative financial institution is the Savings and Credit Co-operative Societies (SACCOS)[12]. Historically, SACCOS were first developed in Germany by a progressive village Mayor known as Raiffeisen in 1846. After several initial trials, formal savings and credit co-operative society was established in 1850. From Germany the idea spread to other countries of Europe, and later North America. In Canada, a Parliamentary reporter by the name of Alphonce Desjardins introduced credit unions in Quebec Province where he established the *Peoples' Bank of Levis*. His interest was to establish credit unions in order to overcome usurious rates of interest in Canada. Desjardins later on also introduced first credit unions in the U.S.A. in 1909.

There are growing empirical evidences that Savings and Credit Co-operatives or Credit Unions have made substantial contributions to rural finance. The performances of co-operatives in the field of rural financing in Korea, Taiwan, and Kenya are well documented (Von Pischke, *et. al*, 1983; Lele, *et. al*., 1979; Adams,

[12] SACCOS are mutual membership organizations that involve pooling together of voluntary savings and on-lending the same to members in order to fulfil common goal (s).

1979). SACCOS/Credit Unions as specialized form of co-operatives are depending largely on own financial arrangements. In this respect, co-operatives can be autonomous and self-regulating financial institutions. However, according to Moll (1989:17):

> Credit unions typically flourish in urban areas where wage-earners, able to make regular contributions, constitute the main part of the membership.

The role of SACCOS in rural areas is limited reflecting partly the existence of covariant risks and market segmentation. This outcome may be explained by three elements: ability to save, incentive to save, and secure and dependable opportunities to save. In many cases, these elements are lacking in rural areas. Finally, it could also be a reflection of the presence of informal financial arrangements that sufficiently meet the financial needs of the rural people.

2.3.2.4 Specialized Farm Credit Institutions (SFCI)

The Specialized Farm Credit Institutions (SFCI) is another window created by many governments[13] in developing countries to finance agricultural credit. The debate on the roles and performances of SFCI is well documented (Von Pischke, 1981; Donald, 1976; Moll, 1989; Belshaw, 1988). According to Von Pischke (1981) SFCIs are specialized government credit institutions providing farm loans to farmers. The reason behind the significance of SFCI is well summed up by Moll (1989:13):

> The establishment of SFCI is based on a number of almost universal assumptions regarding farmers, agriculture and finance: farmers are poor, hence do not save and thus, are unable to help themselves; the supply of institutional credit is an essential requirement for agricultural development or, in other terms, to increase the standard of living of farmers, this credit should be cheap because farmers are poor; the government should promote rural welfare, and the supply of credit is an instrument to do this, existing institutions or intermediaries are unable, or unacceptable, to perform the role of supplier of additional credit.

The discussions on SFCIs need to take into account three things: credit policy, lending policy and operations of SFCIs. Provisions of credit at reasonably affordable rates to poor farmers' means that, interest charged are lower than the real rates. This practice does not motivate farmers to save; hence poor farmers

[13] In certain cases the SFCIs were established with a help from donors through some programmes targeting agricultural productivity and the rural welfare.

save elsewhere or in other forms such as in physical assets. As further pointed out by Moll (1989:13) this practice undermined the development of the rural financial market, as the SFCI do not cultivate farmers' linkages to the wider national financial markets, and also excludes possibilities of attracting rural savings. Equally important is the availability of information concerning borrowers' behaviour, characteristics and business performances. Besley (1994a:34-35) contends that imperfect market information can hamper credit markets, especially if actors' characteristics, behaviour, and business performances are not well known.

SFCIs experienced serious shortcomings in terms of its targeting operations. Most of these operated with losses, as they were primarily concerned with credit disbursement at low interest rates, without creating own financial resource base. As a result they increased pressures on government budgets. Thus, it is obvious that lack of best banking practices among SFCIs made them to collapse, as most governments were unable to sustain them. On the other hand, their operations did not benefit the targeted group of poor farmers. Whereas, these were designed to serve the poor farmers, it always turned out that large-scale farmers benefited the most. Most literature on SCFI indicate that this outcome is a contradiction with the objectives that SFCIs were established for, that could partly be explained by the political manipulations or corruptions (Binhammer, 1975:58-90; Ndashau, 1996; Kimei, 1987; Moll, 1989:14; Aryeetey, 1996:14-22).

Loan disbursement procedures were also full of flaws. There were no proper appraisals done by the facility, probably due to the costs involved in assessing the small amounts of loans to be administered to widely dispersed populations, and/or inadequate staff and skills. Furthermore, loans also did not take into account individual farmers' needs, their financial means, vagaries of agricultural production and change in production technology.

2.3.2.5 Informal finance

Informal finance plays an important role in many rural communities in the developing countries, and these are well documented (Kashuliza, 1993; Ndanshau, 1994; Elhiraika, 1999; Mavrotas and Kelly, 2001). As a result it has of late attracted many studies in the developing countries. Informal finance may be defined as “agreements conducted without reference or recourse to legal system to exchange cash in the present for promises of cash in the future” (Schreiner, 2000:2).

Operations of the informal finance is less costly and location specific. It is a more preferred form even in cases where the cost of accessing it is higher than in formal institutions. According to Schreiner (2000:2) Informal finance possesses certain unique qualities that include:

(i) sequences of repeated transactions,
(ii) provide not just loans but also savings facilities, and implicit insurance,
(iii) reduces transaction costs,
(iv) provide services that are sensitive to constraints faced by women,
(v) substitute confidence in character for physical collateral, and
(vi) socially enforced and/or self-enforced contracts.

The operations and practices of informal finance vary widely in terms of forms and nature. In many cases, though, the credit system is built around friends, relatives, local moneylenders, kinships arrangement (reciprocities arrangements), and in a slightly more advanced form of credit associations popularly known as Rotating Savings and Credit Associations (ROSCAs)[14]. Martin, *et. al. (*2002:278-279) grouped the providers of informal finance into five categories namely: (i) lending by individuals on a non-profit (and often reciprocal) basis, (ii) direct but intermittent lending by individuals with a temporary surplus, (iii) lending by individuals specialized in lending, (iv) individuals who “safe keep” others money, and (v) group finance. In most cases there are all elements of formal finance: savings, credits, and insurance all fuzzed up in informal arrangements.

Although the studies on informal finance are growing, there are a lot of untold stories due to complexity involved in the relationships between actors. Their operations have no office, documentation, and in some instances such

[14] Studies have shown that most informal credit facilities are largely based on mutual goodwill, and knowledge of character and status of a borrower, which befits the Raiffeisen model of credit unions.

arrangements are temporary and illegal. Thus, the operations of informal finance are full of ambiguities.

2.4 Policies and Regulatory Framework for Rural Finance

Rural Financial Markets (RFMs) is a new perspective that evolved out of the narrowly focused agricultural credit. Most governments in the developing countries have over years attempted to influence the functioning of the financial markets through policies and regulatory framework. There are justifications for such interventions, but these are associated with advantages and disadvantages. However, what is important is how the public policies affect or influence the behaviour, attitude and welfare of the rural population that can be observed in the way they respond to changes in policies.

The changes in poverty at household level is influenced by a set of factors, both policy and non-policy determinants. However, there are controversies on the degree of influence of these factors on changes in the levels of poverty (Rutasitara, 2002:11). There are two set of policies, which can have effect on the household's welfare. These are macro-economic policies and sectoral policies. According to Rutasitara (2002:11-14) the macro-economic policies include financial sector policy, fiscal and monetary, trade, labour and income policies. Sectoral policies are more focused on specific sectors such as agriculture, industry, tourism, finance, education and health. Sectoral policies are established in order to attain the desired outcomes of macro policies. Figure 2.6 show in details the possible links between macro-economic policy and household welfare.

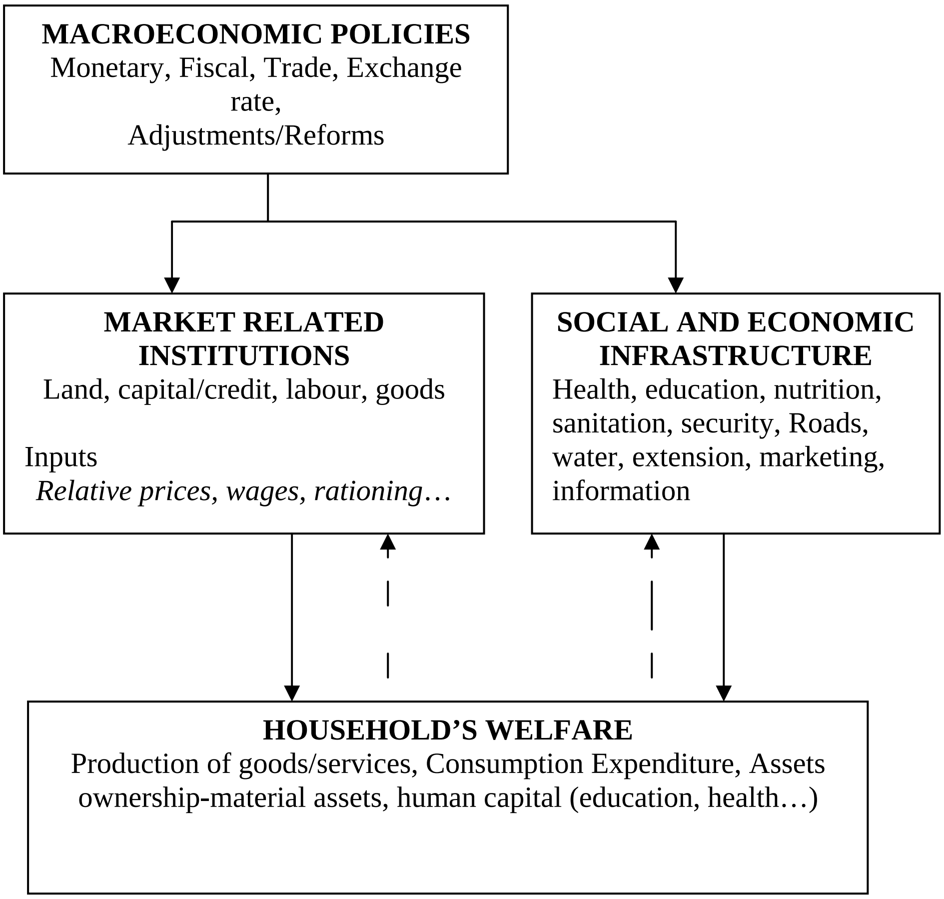


Figure 2.6: Links between macro-economic policy and household welfare
Source: Rutasitara (2002:13) figure 2.1

According to the figure, macro-economic policies influences market related institutions, as well as social and economic infrastructure and these in turn influence the household's welfare levels through a variety of market based incentives such as: incomes, access to finance, economic and social services. Although, these effects are well understood, there are no standard empirical models that have been established to unravel all interactions and effects at national and sectoral levels. However, the relationships elaborated in figure 2.6 above, help in understanding how households and rural firms respond to policy changes in terms of complying, reallocation of resources, and the degree of vulnerability. Assessing the behaviour of rural households and firms over period can assist in understanding the way they behave in relation to policy changes.

Thus, an attempt is made to review various reforms/adjustment programmes and how these influence rural household's livelihoods.

In most developing countries, governments have attempted to develop their economies in order to reduce poverty among their people by, among other things, regulating the financial sector, administering subsidized and targeted credit mostly through public financial institutions. According to many observers, such practises ignored domestic resource mobilization, informal financial systems, and neglected the viability of financial institutions (Bee, 1996; Bee, 1997:71-73; Wenner, 2001:1).

In the financial sector, government interventions through policy and regulatory guidelines has been criticised by different experts (Chaves & Gonzalez-Vega, 1994; Hanning & Wisniwski, 1999:14-15; Adams, 1995; Yaron, 1997:3; Thillairajah, 1994; Aryeetey, 1996; Besley, 1994b). In their view inappropriate policy and regulatory framework tend to repress financial system and hence impede financial intermediation. Certain government interventions such as setting interest rate ceilings, minimum reserve requirements, and excessive market entry restrictions are likely to constrain credit provisions and savings mobilizations in a financial market.

However, in most literature, some degree of regulation and a conducive policy environment is recommended so as to create a financial system that operates following the principles of "best practices". There are two types of prudential regulatory frameworks, namely:

(i) Preventive regulations. These provide for appropriate incentives to reduce moral hazards. In other words these types of regulations focus on protecting the country's financial system by preventing failure of any financial institution, and

(ii) Protective regulations. These serve to protect depositors in emergency cases when a financial institution gets into trouble.

There are also non-prudential regulations which deal with the conduct of business, such as enabling the formation and protection of micro lending institutions, protecting consumers, preventing fraud and financial crimes, policies with respect to interest rates, taxes, and accounting systems.

For the semi-formal financial institutions such as financial NGOs certain level of regulation is called for. According to Hanning & Wisniwski (1999:15-16) it is practicable to have certain minimum banking standards that befit the microfinance system without major effects on the larger country's macro-economic variables. For instance the use of forced savings practised by some non-deposit taking NGOs, are some of the innovations under the best practices. Risk management is another issue for considerations. These could be mitigated through insurance schemes, and/or considering operations of lender of last resort facility for short-term financial support for solvent and sound financial institutions suffering from a temporary liquidity shortages.

In the case of informal financial institutions, self-regulation seems to be working, especially in the co-operative system. However, experiences have shown that as these institutions grow, there are possibilities for them to fail to self-regulate their own operations especially when divergence of interests occurs between borrowers and depositors. These may be reduced through member empowerment through training, encouraging such informal financial institutions to establish own network or create a peer monitoring system. A radical move is to transform these into formal financial institutions so as to allow for growth through a formal regulatory framework.

On the other hand, the development of an appropriate financial system regulatory framework calls for an integrated financial system analysis/approach that is holistic/comprehensive and full of trials and errors. It involves a painstaking process that is not only time consuming but costly. In this regard, researches and advisory services need to go hand in hand with rural peoples' empowerment processes.

2.5 The Current Perspectives on Rural Finance

Financial market liberalization has not been very effective in improving the functioning of financial markets due to the fact that the constraints to market development are not simply policy-induced but have structural and institutional origins as well. As a result these weaknesses must be addressed in an integrated manner and not policy reforms alone. This means that the problem of how to reach out the majority of the poor rural households who constitute potential savers and borrowers is yet adequately addressed.

The literature on the economic theory on financial markets is growing. Although, the dominant thinking was on market failure to provide financial services on a cost-effective way, there is emerging new line of thinking that goes beyond the simple paradigm of competitive equilibrium that suggests a new theoretical foundation for policy intervention in order to correct the market failures (Aryeetey, 96:3; Besley, 1994b; Stiglitz and Weiss, 1981). This study, therefore, is an attempt to contribute towards this new line of argumentation.

Table 2.1 provides comparisons between the narrow view and broader perspectives on the role finance play in poverty reduction.

Table 2.1: Changing Perceptions of Poverty and Finance

Poverty	Finance	Expected Results of Finance
Narrow view: Income/consumption Assets	**Single role:** Small production loans for food production	**Production and investment:** Virtuous circle of investment, production, income, consumption, savings, and investment
Broad view: Income/consumption Assets Vulnerability Health Education Voicelessness Powerlessness Food insecurity	**Multiple roles:** Loans for wider uses, leasing, savings, insurance, payment/money transfer, and financial intermediation	**Multiple results:** Virtuous circle of investment, production, income, consumption, savings and investment Consumption smoothing (food security) Capacity to bear risk Empowerment Education Health Nutrition Contraceptive use and other social impacts

Source: Adopted from Meyer, 2001: 30

The role of the government in financial markets has been questioned seriously in most studies. However, the need for interventions in the markets was justified by persistence market failures, yet intervention is further justified even after reforms and liberalization. The current perceptive stands on two pillars. One, liberalization of financial markets allows market forces to take their course. The second pillar is that propagated by the Ohio State University group (also shared by others such as Besley, 1994b; Jackelene and Rhyne, 1991; Hoff and Stiglitz, 1990), government interventions should be limited to few cases where genuine market failures have been spotted. The idea is to correct the market imperfections observed so as to support it to perform well. Economies moving from centrally planned to market based demand an efficient financial sector, which calls for a lesser government role. Markets for productive factors such as land, labour, capital, and farm inputs (fertilizers, seeds, farm machinery, and infrastructure) must be functioning smoothly to support the development of the private sector. These need to be directed and managed somehow by the government, at least in the medium term.

Another emerging debate in rural financial services is the question of outreach. Outreach is a key factor in the process of market development and integration. Outreach can be defined in terms of wide, depth, and quality. According to Kimei[15] (1987:18) financial widening involves the growth in the number of actors in the financial market: savers, borrowers/investors, and financial intermediaries. The financial lengthening is concerned with the growth in number of types of financial instruments (products) offered by financial institutions. Financial deepening is a growth of total financial assets offered by the sector relative to growth in national wealth. The presumption is that greater financial deepening increases aggregate income and accelerates economic growth. In addition, the quality of outreach is important so as to act as an incentive. Quality of outreach is reflected in terms of loan administration costs.

2.6 Summary and Conclusions

The main thrust of this chapter is to review relevant literature and present the theoretical framework for analysis of the rural financial systems in a developing country environment. The review situated the access to financial services in the poverty reduction context by employing sustainable livelihood framework,

[15] This analytical framework is based on other works such as those of Gurley and Shaw (1955, 1956); Goldsmith (1969); McKinnon (1973); and Shaw (1973).

augmented by life-cycle theory, liquidity management theorem, and economic and policy analysis framework.

The use of Sustainable Livelihood Framework considers households' access to finance as of paramount importance in the development of the RFMs. Rural households' access to financial services builds up their productive assets and hence improves productivity, and increases opportunities for achieving sustainable livelihoods. The premise behind this thinking is that development of the financial sector is an important element in any country's economic growth and development. Access to financial services unleashes the economic potential to a greater proportion of the population who are in most cases bankable but underserved. Besides, rural households' vulnerability can be reduced substantially through their improved access to financial services.

The developments of the Rural Financial Markets in the developing countries are faced by four broad challenges, namely: (i) how to overcome obstacles to, and shortcomings of, financial markets in general; (ii) how to change repressive policies; (iii) how to overcome structural weaknesses of rural financial markets; and, (iv) how to improve poorly designed development policy interventions. The review of literature has unveiled studies done by others and how they are relevant to this work. In terms of institutional approach, five approaches have been delineated, namely: commercial banking approach focusing on targeting and subsidies credit; specialized farm credit institutions, co-operative financing, group lending approach, and Informal financing.

Finally, the study realizes and appreciates the emerging new perspectives in Rural Finance that relate to the role of governments, especially those moving from centrally managed economies to market economies. There are also questions of how to treat the informal sector. Moreover, issues of regulation and supervision of financial institutions and banks is identified as appropriate for further analysis. Outreach debates as it relates to widening, deepening and services quality concerns, and its contributions to the development of the financial sector have also been examined.

CHAPTER THREE

DESCRIPTION OF THE STUDY AREA AND RESEARCH METHODOLOGY

3.1 Preamble

This chapter describes the study area: its demographic patterns, economic activities and economic infrastructure. It also explains the study methodology: data sources, collection and sampling techniques, organization and conduct of the study, and finally it provide the analytical techniques employed.

3.2 Choice of the Area

The choice of Babati district as an area of study was dictated by several considerations, which include: (i) underdevelopment of Babati – hence an ideal representative of most rural districts of Tanzania, (ii) Babati district is among the major food crop producing districts in the country, which have no reliable agricultural finance system, (iii) Babati experienced the problem of commercial financial institutions pulling out from participation in providing financial services in rural areas, especially after the liberalization of the financial sector, and (iv) financial NGOs and co-operatives are not growing fast enough to meet the observed “demand gap” in provision of financial services.

3.3 The Profile of the Study Area

3.3.1 The geographical location and Administrative divisions

Babati is one of five districts of Manyara region. The other districts are Kiteto, Simanjiro, Mbulu, and Hanang. Manyara region was established in 2002, when the government split the former Arusha region into two regions - Manyara and Arusha – each with five districts respectively. Geographically, Manyara region lies in the northern part of Tanzania bordering Arusha region to the north, Kilimanjaro and Tanga regions to the east, Morogoro and Dodoma regions to the south, and Singida and Shinyanga regions to the west (for details refer Figure 3.1). Babati district shares borders with Hanang and Mbulu districts to the west, Karatu, Ngorongoro and Monduli districts to the north, Simanjiro district to the east and Kondoa district to the south (RC and Planning Commission, 1998:15; NBS and RC Manyara, 2005:1).

Babati district has a total land area of 6,069 square kilometres covering about 6% of the former Arusha regional total land area. Farming activities take up about 35% of the total district land, while other uses are grazing 30%, game reserves 23%, and forests 5%. The remaining balance of 7% is utilized for buildings, occupied by water bodies, mountains, and roads. Arable land is estimated at 180,000 hectares, of which only 111,840, equivalent to 62% was under cultivation in 1997 (DC, 2001:13; NBS and RC Manyara, 2005:1-2).

3.3.2 Demographic Patterns

According to the Population Census of 2002 (URT, 2003b:171), Babati district has a population of 303,013 (men 156,169 and women 146,844) constituting about 29% of the total Manyara regional population. Comparatively, Babati district is more populated than any other district in the region. The district population is found in 59,970 households with an average size of 5.1 people, as compared to the regional total households of 199,860 with an average households' sizes of 5.2 persons[16] (URT, 2003b:2-9).

In terms of growth and density, the district population is growing at a higher rate of 3.8% and a density of 50 persons per square kilometre as compared to the national figures of 2.9% per annum and a population density of 39 persons per square kilometre[17]. Table 3.1 below provides summary of some selected population indicators for the region.

Table 3.1: Selected population data for Manyara region, 2003

DISTRICT	POPULATION NUMBER			HOUSEHOLDS	
	Male	Female	Total	Number	Average Size
Babati	156,013	146,844	303,013	59,970	5.1
Mbulu	120,535	117,347	237,882	38,729	6.1
Hanang	104,492	100,641	205,133	36,597	5.6
Kiteto	76,616	76,141	152,757	31,982	4.8
Simanjiro	76,753	64,923	141,676	32,582	4.3

Source: URT (2003:171-176) Tables 21.1-21.5

[16] According to the National Census 2002 Tanzania has a total population of 34,569,232 found in 6,996,036 households with an average household size of 4.9 persons.
[17] When compared to regional figures, population growth rate is the same at 3.8% per annum, but the district has a population density of 50 compared to regional average of 23 people per square kilometre.

Administratively, districts in Tanzania are sub-divided into Divisions that are further sub-divided into Wards that are made up of villages. Villages constitute the lowest unit of local government administration. Babati district is comprised of four divisions made up of twenty-one wards, and eighty-two villages (RC/Planning Commission, 1998: 255, for details see Figure 3.3). Babati division, which has six Wards that are composed of twenty-eight villages, has a population of 102,849. Bashanet division, which comes second, has 90,826 people dispersed into six wards made up of twenty-two villages, followed by Mbugwe (56,408) and Gorowa (52,930). Table 3.2 contains summary of basic indicators for the district.

Table 3.2: Babati District Administrative Profile and Population Distribution

Divisions	Population (2002)	Wards	Villages
Bashanet	90,826	6	22
Babati	102,849	6	28
Gorowa	52,930	5	18
Mbugwe	56,408	4	14
TOTAL	**303,013**	**21**	**82**

Source: RC/Planning Commission (1998: 255).

Babati is a rural district with about 85% of its population living in the rural areas. The district population is comprised of diverse ethnic groups, with the Iraqw tribe being the majority constituting over 40%, followed by the Gorowa/Fiome (35%). The remaining 25% is made up of the Mbugwe, Maasai, Barbaigs, Waasi, and few other tribes.

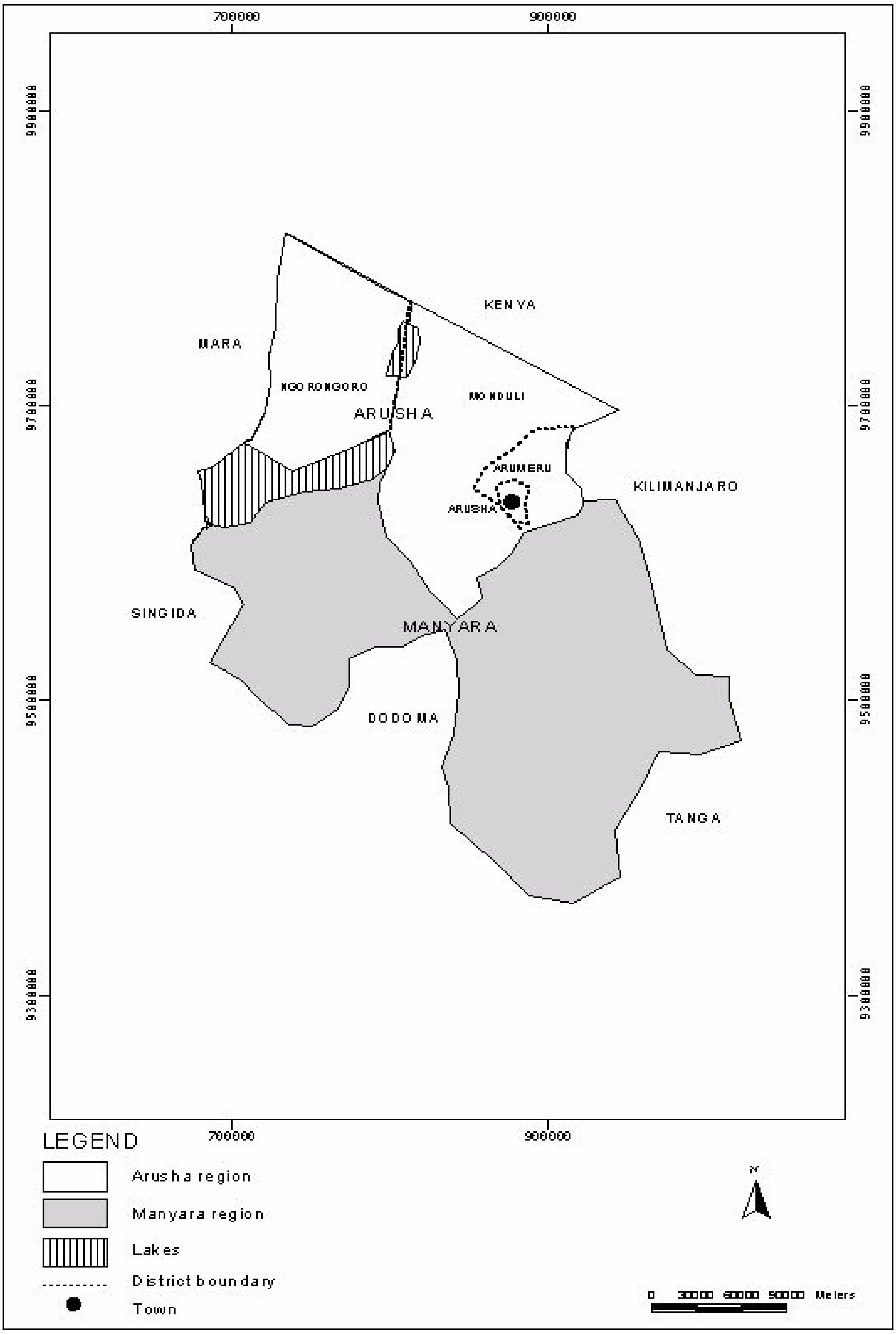


Figure 3.1: Map of Arusha and Manyara Regions

3.3.3 Description of the Rural Economy of Babati

The economy of Babati district depends mainly on agriculture and livestock keeping. The majority of the rural households practice agro-pastoralism for their living. The district's agricultural contribution to total regional GDP is estimated at about 40%. In terms of employment, when lumped together, agriculture and livestock keeping employ more than 85% of the rural population. Other economic activities are fishing, mining, tourism, craftsmanship, commerce and employment (NBS and RC Manyara, 2005:32).

3.3.3.1 Agricultural Production and Farming Systems

There are two main agricultural crops in the district: cash crops and food crops. Cash crops are those crops produced by farmers solely for the purposes of cash income earnings whereas food crops are for subsistence. In most cases these are crops which have ready markets[18]. Based on these classifications, cash crops produced include: coffee, maize, pigeon peas, groundnuts, simsim, paddy, sugar cane, cotton, sunflower, wheat, seed beans, pyrethrum, and vegetables and fruits. Although pyrethrum and cotton grow well in some parts of the district, farmers are reluctant to grow them due to lack of market, or at times fetch low prices. Major food crops produced are maize, seed beans, paddy, sorghum and millet, sweet/round potatoes, cassava, bananas, leguminous crops, and vegetables and fruits (DED, 2001:3).

In terms of cropping patterns smallholder farmers are the majority owning between less than one to five hectares growing variety of crops. Majority of households in Babati division, have an average farm sizes of three hectares as opposed to Mbugwe and Gorowa, where average farm sizes are two and five hectares respectively. In land constrained parts of the district such as in Bashanet division, average farm sizes are as low as one hectare while in areas such as Gallapo, Qash, Mamire, and parts of Mbugwe farm sizes are as big as ten hectares due to availability of land (DED, 2001:4).

[18] The distinction between food and export crops is arbitrary as in practice both crops are commercial crops.

Apart from smallholder producers, there are few large-scale farmers who own estates, specializing in production of single variety of crops solely for commercial purposes. These are mainly found in the Kiru valley occupying about 32,345 hectares producing sugar cane. There are few others in Gorowa and Bashanet divisions where wheat and barley are cultivated and grown commercially. Maize, pigeon peas and beans are other types of crops grown for commercial purposes in Gallapo, Mamire, Dareda, and Qash. These crops are mostly produced through intercropping system (DED, 2001: 6-7).

Tractor ploughing is the dominant form of land tilling, while weeding is done exclusively by hand hoe. Discussions with interviewed farmers and agricultural extension officers revealed that about 60% of the land is tilled by tractors-disc ploughs, 30% by oxen ploughs, and the remaining 10% worked upon by hand hoe. Weeding is done with a hand hoe, thus making it labour intensive in addition to harvesting.

Babati district has good climatic conditions and fertile soils that are suitable for agriculture. Table 3.3 summarizes five agro-ecological zones (AEZs) of the district with different characteristics in terms of rainfall, landscape, altitude, types of soils and crops grown. The upland agro-ecological zone, which includes parts of Bashanet and Gorowa divisions, such as uplands Bashanet, Dareda, Haraa, and Singu have loamy soils and receive reliable rainfall of over 1,000 mm annually. In these areas, people grow potatoes, maize, beans, pigeon peas, pyrethrum, and wheat[19].

The middle belt that covers Gallapo, Babati, Riroda, Dabil, Arri, Duru, Bacho, Kiru, Sigino and Gajal villages gets around 700 mm of rainfall annually. With the exception of Gallapo and Mamire that have black soils, much of the lowland areas are composed of volcanic soils that are rich and fertile for agricultural production. Crops grown in these areas are maize, pigeon peas, seed beans, and sunflower.

[19] Wheat as a commercial crop is produced in Singu (Gorowa Division), Loxmanda, Sechek and Sabilo (Bashanet division). However, it is also produced on a small scale for domestic use in areas such Guse, Bashanet and Madunga.

The southern parts of the district – the Gorowa division - receives well over 1,000 mm of rainfall annually, with a bimodal distribution pattern that is ideal for coffee and banana production in the highland areas, and maize, beans, sunflower, and pigeon peas in the lower parts (DED, 201:7).

Table 3.3: The basic characteristics of AEZs and crops suitability, 2003.

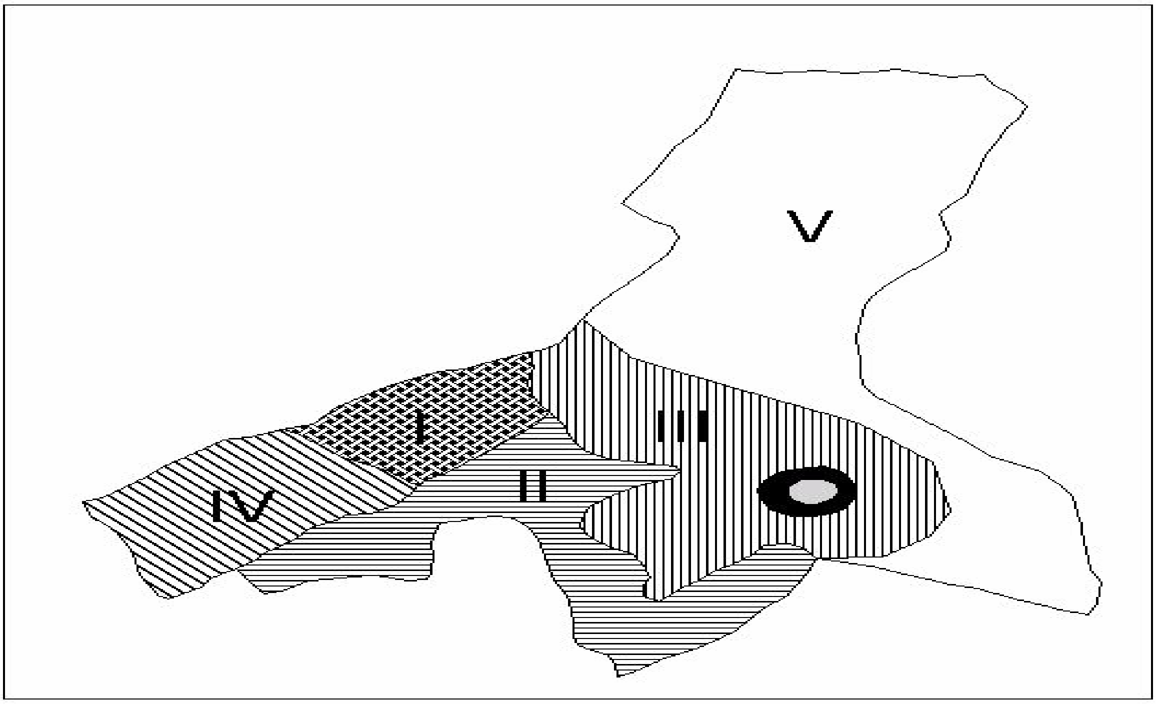
ZONE	ALTITUDE (m)	RAINFALL (mm)	TYPE OF SOIL	SUITABLE CROPS
Highlands with humidity	2,150-2,450	1,200	Loam, forest soils, sandy loams	Maize, pigeon peas, potatoes, onions, coffee, bananas
Sub-humidity highlands	1,850-2,150	1,100-1,200	Sandy loams with medium fertility	Wheat, beans, maize, onions, coffee, bananas
Semi-humid uplands	1,500-1,850	900-1,100	Volcanic and silt loam soils	Maize, bananas, sugar canes, beans and pigeon peas
Semi humid, semi-arid midlands	1,200-1,500	750-900	Sandy	Maize, beans, pigeon peas, sugar cane, sunflower, finger millet, vegetables and fruits
Semi arid lowlands	950-1,200	500-750	Alkaline sandy, alluvial and clay soils	Paddy, groundnuts, cotton, sugar cane, maize, cassava and finger millet

Source: Babati District Council, 2001

According to Agricultural Extension Officers Babati division, which has extensive plains extending around mount Kwaraa through Gallapo to Mamire in the east, though receives less reliable rainfall, is famous for medium and large scale farming of maize, pigeon peas, and sunflower. The Kiru valley, along Lake Manyara, has alluvial and clay soils, where irrigation is undertaken. Here there are few estate growers, where sugar cane production is the dominant crop.

The lowlands of Mbugwe division that receives low rainfall: around 500 mm annually, are prone to droughts. However, Magugu produces local variety of rice[20] through irrigation, while Mwada and Nkaiti areas are good for cotton, groundnuts and simsim. Minjingu, which is another dry area, is predominantly a grazing area that extends to Maghara and Lake Manyara to the north and to Tarangire National Park to the south. Figure 3.2 shows the district's AEZs.

[20] Magugu rice is very famous in that it has a good aroma taste and traders from distant areas of Dar es Salaam, Zanzibar and Arusha come to buy especially during harvest season when prices are low. There are few traders who export to United Arab Emirates through Zanzibar.



NO	KEY	AGRO ECOLOGICAL ZONE (AEZs)	ALTITUDE (M)	RAINFALL
I		Humid Highlands	2150 - 2450	1200mm
II		Sub Humid Highlands	1850 - 2150	1100 –1200mm
III		Semi Humid uplands	1500 - 1850	900 – 1100mm
IV		Semi Humid, Arid midlands	1200 – 1500	750 – 900mm
V		Semi Arid Lowlands	950 - 1200	500 – 750mm

Figure 3.2: Map of Babati District showing different Agro-Ecological Zones

Table 3.4 summarizes production of various crops grown in the district between 1994/95 and 2003/2004 crop seasons. The table reveals that there are substantial fluctuations in crop production over the period. For instance maize production, which is a dominant food as well as cash crop, dropped from 134,449 tonnes in 1994/95 to 45,004 tonnes in 1997/98. Although there were some improvements in the subsequent years, production did not reach the previous records. Generally speaking all crop yields are potentially below the potential levels, indicating that there are rooms for improvement in productivity.

Table 3.4: Production of selected major agricultural crops, 1994/95-2003/04 ('000 tons)

CROPS	94/95	95/96	96/97	97/98	98/99	99/00	00/01	01/02	02/03	03/04
FOOD CROPS										
Maize	134.40	77.60	73.00	45.00	60.30	49.70	97.10	90.40	60.50	97.60
Sorghum	18.20	11.50	7.60	6.10	5.20	6.50	3.60	5.50	2.60	3.70
Bulrush Millet	0.30	0.05	0.01	0.50	0.04	0.20	0.60	0.20	0.40	0.10
Green Gram	0.06	0.06	0.20	0.01	-	0.05	0.20	0.04	0.01	0.05
Bananas	4.00	6.71	5.43	5.83	4.13	4.40	4.50	4.70	1.90	9.90
Sweet Potatoes	9.50	7.20	19.40	15.10	4.13	4.40	4.50	4.70	1.90	10.00
Round Potatoes	6.50	3.30	7.20	7.40	1.50	7.10	8.00	0.20	1.30	1.10
Beans	12.10	11.50	13.80	13.20	17.44	16.42	15.60	13.74	11.33	14.20
Peas	0.08	0.02	0.02	0.03	0.01	0.04	0.06	0.01	0.02	0.03
Cassava	1.62	2.30	0.96	1.60	0.70	1.73	0.71	11.23	0.97	2.20
Paddy	16.00	19.30	9.44	9.60	2.80	3.90	8.24	3.70	22.20	6.40
CASH CROPS										
Cotton	1.81	0.90	-	0.30	-	0.01	0.09	0.10	0.10	0.50
Coffee	0.12	0.20	0.20	0.20	0.23	0.16	0.47	0.17	0.20	0.20
P. Peas	17.00	16.64	11.50	8.70	10.80	14.20	16.44	17.51	11.78	15.66
Sunflower	2.00	3.20	1.17	1.84	3.40	2.40	6.55	3.13	2.12	6.80
Simsim	0.08	0.06	0.00	0.01	0.01	0.01	0.23	0.10	0.20	0.54
Sugarcane	6.00	0.80	0.06	6.00	-	6.75	0.01	0.03	-	8.00
Gr'ndnuts	0.33	1.10	1.00	0.90	0.90	0.90	5.50	0.14	0.22	0.40
Wheat	1.64	3.28	0.74	1.80	2.72	1.67	1.20	0.40	0.90	1.40
Pyrethrum	1.64	3.30	0.74	1.79	2.72	1.67	1.13	0.40	0.90	1.40
Fing. Millet	4.76	3.94	2.87	2.00	1.40	1.15	0.50	0.73	0.33	0.33

Source: Babati District Council, Agriculture Department files, 2005

The fluctuations in crop yields are as a result of combination of factors. A fluctuation in climatic conditions is one of the main reasons for this pattern of output. Much of the agricultural production depends on rainfall, where shortage or excessive rainfall affects the levels of outputs. The district experienced *El Nino* in 1997/98 and droughts in 2002/2003, and as a result there were decrease in crop outputs.

Inadequate farm credit, especially during farming seasons is another constraint in terms of increased productivity. During planting/farming seasons most farmers are cash constrained and hence can not afford to buy seeds, and other necessary inputs such as fertilizers. Availability of rock phosphate at Minjingu in the district is a big complement, but it is neither widely available nor popularized by the extension staff. On the other hand, a local investor has not been willing to sale the rock phosphate to local farmers except to a fertilizer company in Tanga mainly due to the involved distribution costs (DED, 2001:10).

Agricultural marketing is mainly done through Private Crop Buyers, though few large-scale farmers in Gallapo, Mamire, Bashanet, Dareda, and Magugu sell their crops in distant markets such as Arusha where they fetch relatively higher prices. Wheat and barley have stable markets. Wheat producers sell their produce to Tanganyika Farmers Association in Arusha, whereas barley is produced under contract farming by smallholders and sold to the South African managed Tanzania Breweries Limited. Coffee is mostly auctioned at Tanzania Coffee Board in Moshi by producer associations/co-operatives. There are also few private companies involved in coffee marketing; these are Dorman (T) limited; and Victory Coffee Company limited. The Rift Valley Co-operative Union (RIVACU) is organizing marketing of cereals, especially maize, and legumes such as beans, and pigeon peas on a limited scale. However, RIVACU is constrained by inadequate capital and management capacity. In addition, it is suffocated by stiff competition from private buyers (RC/Planning Commission, 1998:20).

According to Babati District Executive Director (2005) since smallholder producers are not well organized, private buyers dictate prices of agricultural crops. During harvest periods, when farmers are in need for cash and at the same time lack storage facilities and incapable to meet storage costs, they sell their crops at low prices offered by buyers. Cotton and pyrethrum, which are grown in limited amounts, are bought by private traders and/or Tanzania Cotton Board and the Arusha based Pyrethrum Growers and Processors Company respectively.

3.3.3.2 Livestock keeping

Livestock keeping is another important economic activity practised by many households in the district. Livestock kept include cattle, goats, sheep, donkeys, and poultry. In addition, there are few improved livestock (goats and cattle for dairy and beef as well) that have been introduced recently, albeit on small scale. According to Kahurananga (1992:23) livestock keeping is an important part of the agro-silvo-pastoral farming systems found in Babati area. As it can be discerned from table 3.5, most of the cattle kept are of traditional species, which have low yield of milk and meat but withstands environmental stress and can survive on rough grazing.

According to the District Livestock Officer, the district's livestock statistics is based on estimates as no census was carried out since 1984. In 2001 the district had an estimated total livestock population of 567,177 comprised of 221,700 cattle, 142,000 goats, 64,000 sheep, 135,000 donkeys, 11,400 pigs and 3,902 dairy cattle and 575 dairy goats (District Council, 2001:4). Table 3.5 provides some indication in terms of livestock population in the district.

Table 3.5: Livestock statistics, 2003

S/N	Type of Livestock	2001 (Estimates)	1984 Census
1	Cattle	221,700	371,719
2	Goats	142,000	232,141
3	Traditional Goats	64,000	-
4	Exotic Goats	575	-
5	Dairy Cattle	3,902	-
6	Donkeys	135,000	9,235
7	Pigs	11,400	18,357
8	Poultry	150,000	134,630

Source: Babati District Council (DC), Livestock Development Department files, 2004

Cattle provide an important source of households' livelihoods[21] especially among the agro-pastoral communities. Cattle are not only source of income, but have social values, as traditionally they are a source of pride and status. Livestock are important for: provision of food: meat (protein), milk, and blood, skin and hides as important raw materials in the manufacturing of leather goods, manure for improvement of soil fertility and plastering of traditional crop storage structures, source of power for ploughing, and transportation; source of income and store of wealth (livestock banking); and finally have high social-cultural value (in terms marriage, rituals, and as symbol of wealth and prestige) (NBS and Manyara region, 2005:69).

According to the District's Livestock Officer, the livestock system in the district can be categorized into three groups, as related to the agro-ecological zones. These are intensive/zero grazing, semi-intensive, and free range. Under intensive or zero grazing livestock keeping system, animals are mostly confined indoors and feeds and water are made available within their confinement. In many cases these are dairy animals. This system is common in zones characterized by intensive agricultural production without communal grazing areas. Households in such areas are keeping dairy cows and goats with a support from FARM Africa and Heifer Project International. This is a common practise in the semi-humid uplands of Dareda and Haraa areas.

Semi-intensive livestock keeping practises is undertaken where there are communal lands set aside for grazing e.g. around Lake Babati and Gorowa areas, or where agriculture is not a dominant activity. Under this system animals are fed indoors and at times grazed outside during part of the day. This system is practised in the Sub-humid Highlands and Semi-humid, semi-arid Midlands of Babati and Gorowa divisions.

Finally, the extensive or free range system, where animals are grazed freely in natural pastures and sometimes associated with shifting is commonly practised in the semi-arid lowlands of Mbugwe. These areas are dry during most of the year,

[21] Agro-pastoralist depends on their cattle for households for sustenance in the event of crop failure or food shortage.

but rivers from other zones pour their waters in this flat land making it an ideal grazing area during raining season and hence appropriate for fattening animals.

Table 3.6 shows average meat and milk production levels for different type of animals. The statistics indicate that productivities are very low, and there is a room for improvement with better husbandry practises. According to the survey carried out in 1996 by the livestock department, it was observed that about 72% of households in the district own livestock.

Table 3.6 Average Meat and Milk production in the District, 2003

No.	Types of livestock	Meat production (carcass weight kg)	Milk production (litres/day)
1.	Cattle	110	2
2.	Dairy Cows	-	10
3.	Improved zebu	-	3
4.	Goats	10	-
5.	Dairy goats	-	2
6.	Pigs	50	-

Source: District Council, Livestock Development Department files, 2004.

It was also found out that on average, households de-stock their livestock at an average rate of 15% annually. In 1996 about 36% of total livestock were sold. It is important to note that the rate of de-stocking depends on the availability of alternative sources of income, emergence of drought or other unforeseen emergencies e.g. food shortages, sickness, court cases, school expenses, etc. By nature pastoralist would always wish to increase livestock instead of reducing. Under normal conditions, pastoralist would only sell old and/or sick animals (DED, 2001:29).

Livestock marketing is mostly done through livestock auction markets or *minada*[22] that are held once every month in specified locations within the district. Licensed buyers purchase animals through auctioning system. The auctioning practises do not consider the weight of an animal, but rather on the general appearance of an animal. Thus, under this practise farmers do not get fair prices for their livestock.

[22] Currently there are fourteen primary markets in the district located at: Dareda Kati, Dabil, Bashanet, Gendi, Gidas, Gallapo, Kiru, Magugu, Riroda, Ufana, Maghara, Mdori and Minjingu.

These stocks are thereafter trucked[23] to secondary markets at Themi, Mbauda and Meserani in Arusha; Weruweru in Kilimanjaro and Pugu in Dar es Salaam. Table 3.7 shows the number of cattle, goats and sheep marketed through the *minada* system between 1991 and 2002. During the survey it was hinted that, there are few occasions where cattle from outside the district are sold in the district's *minada,* when prices are relatively better in comparison with those obtaining in neighbouring districts.

Table 3.7: Livestock marketed through the *minada* system, 19991-2002

Type	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Cattle	5,441	4,532	5,314	7,957	7,779	6,558	4,444	5,810	7,503	9,504	7,214	3,422
Goats	2,171	2,458	2,221	2,613	3,510	3,372	3,231	1,820	2,336	2,334	2,229	1,036
Sheep	963	995	966	1,066	1,601	1,876	1,832	1,155	1,483	1,313	1,443	675
TOTAL	8,575	7,985	8,531	11,636	12,890	11,806	9,507	7,785	11,322	13,151	10,886	5,133

Source: Babati district livestock office, 2003

According to the district livestock extension staff, livestock production is constrained by a number of factors. These are: low yields due to poor management and types of species kept, shortage of grazing land/feeds, animal diseases, low prices, and inadequate access to financial services.

3.3.3.3 Other Sources of Households' Livelihoods

Other sources of households' livelihoods are commerce, tourism, use of natural resources (mining, fishing, forest products, bee-keeping, etc), employment, remittances from distant friends and relatives. Commercial activities are mostly prevalent in town centres or its satellites, and not very much pronounced in rural areas. In the rural areas, perhaps the monthly market days, popularly known as *minada*, are very important as buyers and sellers come to a common place for selling and buying all sorts of goods, including livestock.

According to Babati District Executive Director (2005) Babati is a growing tourism destination. Tarangire National Park is in Babati and the district controls a great portion of Lake Manyara Game Park. The hot and warm springs along and within

[23] Formally these buyers trek animals bought from these auctions to secondary markets. Recently, the government barred animal trekking between districts and instead they must be trucked in order to get quality meat, and to improve security of both properties and that of trekkers.

the Manyara basin are in Babati. Lake Babati is a tourist attraction as well. The Lake Babati apart from fishing is also known for its hippopotamus.

According to the district's Natural Resources Officer, the district is endowed with a multitude of natural resources: minerals, wild animals, fish, and forestry. The two national parks found in the district - Tarangire and Manyara - provide employment as well as income to small businesses and contribute to the government revenue through taxation. Babati has phosphate deposits mined at Minjingu for fertilizers making, in addition to salt, limestone, and gemstones (alexandreanite and ruby) on the shores of Lake Manyara. Fishing is important at Lake Babati, Lake Manyara, lake Bubu, and several streams and households/community ponds. Recently, with a support from donors such as Heifer Project International (HPI), individual households have started constructing fishponds primarily for improved domestic protein intake (DED, 2001:33).

Forests provide variety of products: timber, building poles and fire wood/charcoal. In addition, beekeeping is an important forest activity in the district especially in the extensive bush-lands where there are trees and flowers to sustain beekeeping (Kahurananga, 1992: 26). However, commercial exploitation of these natural resources is done on a small-scale due to capital constraint, poor economic infrastructure and low technical knowledge.

Employment, both formal and informal, constitutes another important source of households' livelihoods. In this category we have teachers, hospital workers, local government employees, extension staff, and employees in the national parks of Tarangire and Manyara. There are also several NGOs and member centred organizations such as co-operatives. The private sector is equally another important employment provider, though underdeveloped. In the large scale farms there are estate/farm workers in different capacities (DED, 2001:34).

Manufacturing activities are very limited to few small scale agro-processing ventures. There is a sugar production in Kiru area by the Manyara Sugar Company from sugar cane produced in the area. Others are grain mills, timber mills, seed oil extraction, and other SMEs undertaking (NBS and RC Manyara, 2005:94-95).

Besides, there are illegal economic undertakings that are performed in the districts. Illegal activities or dirty activities may be defined as those activities that are socially and morally unacceptable to the community, which are also officially forbidden by the government, such as sex workers, production and selling of illicit drink (*gongo*), and smuggling of minerals. Brewing, selling and drinking *gongo* in Tanzania is regarded as an illegal activity, but it is a widespread phenomenon both in urban and rural areas, which is carried out under cover. Gongo is a type of a locally produced gin, which has not been tested clinically and approved for human consumption. Its ingredients are molasses, sugar, maize flour, and water. There are additional ingredients that are added, which vary from place to place.

3.4 Research Methodology

3.4.1 Sample size and Sampling techniques

This study covered thirteen villages that were systematically selected to represent the various Agro-Ecological Zones of the district. The selection was necessary since it was not possible to cover the whole district, as one does not necessarily need to eat the whole ox to be able to know that it is tough (Wonnacott quoted in Mashindano, 1996:7). From these 13 villages, a sample of 300 households was again systematically selected to represent farmers, businessmen and rural employees. The selection of respondents was done with the help of the village leadership. Selection of respondents was guided by the following attributes - occupation, education, age, household size, and distance from financial institution, and they were drawn from the villages as follows:

(i) Seloto, Bermi, Qameyu and Bashanet from Bashanet division;
(ii) Babati Township, Gallapo and Mamire from Babati division;
(iii) Bonga, Qash, and Singe from Gorowa division; and
(iv) Magugu township, Gichameda, and Mwada from Mbugwe division

Figure 3.3 shows villages of Babati districts, and the shaded ones are those covered in this study. Of the 300 earmarked households for interviews, the study managed to cover 285 households. The non-achievement of the target was as a result of some households being absent on agreed interview dates. In this study, sampled household focused on interviewing heads of the households[24]. The list of the successfully interviewed households was comprised of 178 farmers, 70 businessmen and 37 rural workers. Following the 2002 census, the sampling fraction of the household survey is 0.004, which according to Ndanshau (1996:135) favourably compares with a sampling fraction of 0.001 for the National Household Budget Survey of 1969 and 1991/92.

[24] In this respect a household is defined as a group of family members who sleep within the same roof or compound, share a common source of food, and have a common source of income (Kashuliza, 1994: 74).

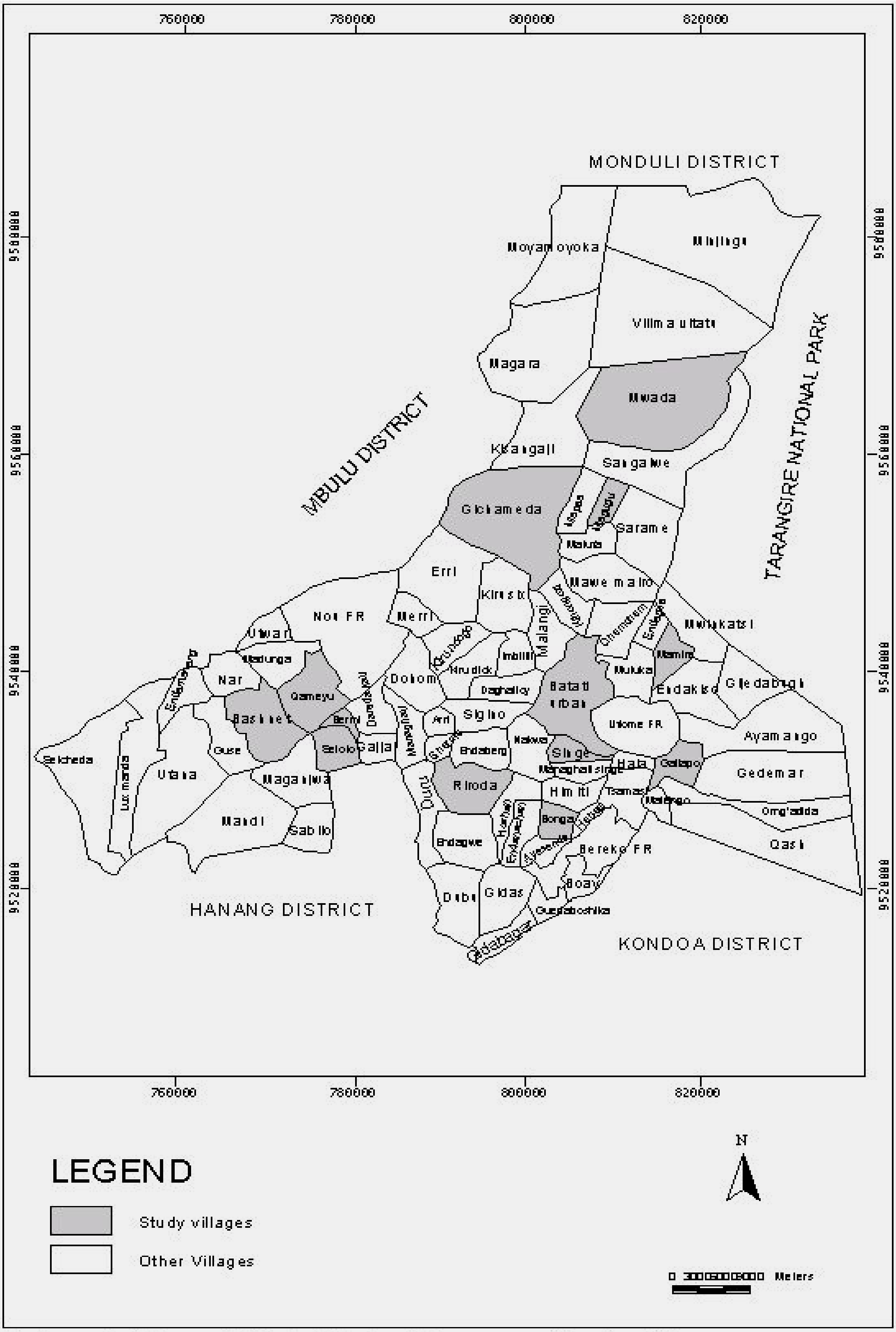


Fig: Layout of villages of Babati district and villages covered by the study.

Figure 3.3: Layout of Villages of Babati and those covered by the study

Apart from individual households, the study also involved a total of 98 respondents drawn from financial institutions, leaders, local government officials, extension workers, and officials of MFIs and NGOs as elaborated below. From commercial banks, and rural institutions operating in the district forty one respondents were covered. Babati branch managers of the National Microfinance Bank and the Tanzania Posts Office (acting as an agency for the Tanzania Postal Bank) were interviewed. In addition, the study also involved 13 Savings and Credit Co-operative Societies (SACCOS) as follows: Babati Teachers, Lake Teachers, Gallapo Teachers, Bogi Teachers, Mamire Teachers, Adada Teachers, Masabeda Teachers, Ufana Teachers, Madunga Teachers, Magugu Teachers, Mwankama Teachers, Mshikamano, and Maqbemi SACCOS (see Appendix 7.1 and 7.2 for details)[25]. In each case three people were selected to participate in a focus group discussion - Secretary/Manager, Chairperson, and a representative of Board of Directors.

Furthermore the following categories of MFIs and other service providers were interviewed: 3 Women Economic Groups, 3 Youth Economic Groups, and 3 Non Governmental Organizations (Local Initiative Support Organization, Friends in Development, and FARM Africa). In addition 2 Village Community Banks of Mwangaza (Mwada Ward) and Dareda (Dareda Ward) were interviewed. A total of 11 people from these institutions were interviewed.

The study also involved local government officials and extension workers at the district, ward and village levels. The District Executive Director (DED) and the departmental heads (agriculture, livestock, co-operative development, community development, and natural resources departments) provided much of the statistics and information required. At grassroots level local leaders – Village Executive Officers (VEO), Village Chairpersons and Councillors constituted another important group of informers in their respective areas.

[25] Most of the SACCOS were established by Teachers at mostly Ward levels but membership is open to all residents in the Ward. However, Maqbemi and Mshikamano SACCOS are community based.

Thus, 16 district officials (DED, Heads of Departments and agricultural extension workers), 6 Councillors, 13 VEOs and 11 Village chairpersons were involved.

3.4.2 Data Sources and Collection Methods

This study obtained data and information from two major sources: primary and secondary sources. Primary data and information were collected through a combination of techniques: personal interviews; focus group discussions; questionnaires; and observations. Two sets of questionnaires were administered to rural households and financial institutions respectively (see Appendices 3.1 and 3.3). In the case of rural households, personal interviews, focused group discussions and observations supplemented the questionnaires. The researcher assisted by two research assistants administered questionnaires to the selected heads of households. In addition, a pre-prepared checklist of issues was used to guide cross-sectional interviews involving individuals representing categories of leaders, politicians and extension workers at district, ward, and village levels (see Appendix 3.2).

Secondary information and data were obtained from various sources in the form of publications, records or official statistics. Much of these data were obtained from the office of the District Development Director in Babati, Regional Commissioner's Offices in Babati and Arusha[26], Planning and Privatisation Commission, Commercial Banks (NMB and CRDB), Financial NGOs, Government programmes and institutions dealing with Microfinance. Others sources were the Bank of Tanzania, Government Ministries (Ministry of Agriculture and Food Security, and Ministry of Co-operative and Marketing). Information gathered from the later group were mainly on policies and regulatory issues, practises and experiences, and interventions made so far.

Literature reviews were undertaken at various places including libraries of the University of Dar es Salaam, Sokoine University of Agriculture in Morogoro,

[26]Since the split of Manyara from Arusha region occurred in 2002, Manyara is yet to have a complete regional data base of its own. Some information is still with the former regional secretariat in Arusha.

University of South Africa (UNISA), Economic and Social Research Foundation (ESRF) in Dar es Salaam and MUCCoBS.

3.4.3 Organization of the field Survey

Before the commencement of the fieldwork, the researcher had a series of consultative meetings with the co-supervisor to share the study framework and methodology. This was followed by mapping out the study area, and selection of the sample frame. The recruitment of research assistants and their training followed. The researcher and assistants carried out reconnaissance visits to four villages of Singe, Mamire, Seloto, and Bonga to carry out practical training for the assistants and to test the questionnaire[27]. This pre-survey exercise was necessary in order to make sure that the questions and the prepared checklist of issues as well as the gist of the study are well understood by both enumerators and respondents.

3.4.3 Data Analysis techniques

Data analysis followed a two-pronged approach by making use of both qualitative and quantitative methods. The data was collected and summarized in a database template containing the variables identified. Descriptive statistics such as percentages, mean, and frequencies, and cross-tabulations were used to decode the data from the database template. According to Kanbur (2001) there is a growing recognition that sensible combination of qualitative and quantitative methods help to solve problems that are associated with each type of method taken separately. Booth, Itolland, Hentschel, Lanjow, and Herbert (1998) urge that qualitative technique is often more appropriate for capturing the social and institutional context of people's lives than the quantitative technique.

Some quantitative analysis was done in assessing factors influencing rural households' access to credit using Tobit regression analysis. An econometric model was developed and estimated using the collected data. It was assumed that the demand for credit is influenced by age of the head of the household; main

[27] This process facilitated improvement in the types of questions to be asked and data collection techniques.

occupation of the household; education level of the head of the household; household size; and proximity of the household to a financial institution.

With this type of data, Tobit analysis was found more appropriate as it predicts the maximum likelihood of a set of variables that are dichotomous. The main interest of the model is the likelihood or probability of the outcome, and therefore, the binary response is whether the respondent has access to credit from formal financial institution or not.

If Y is taken as a random variable, it can then be assumed that Y_i takes on the values of 0 or 1, where 0 denotes the no access to credit and 1 access to credit. Access to credit from formal financial institutions is assumed to be influenced by the age, occupation, education, and distance from the location of a financial intermediary. Thus, the loan demand equation was specified as follows:

$$L_i = \beta_0 + \beta_i A_i + \beta_i O_i + \beta_i E_i + \beta_i D_i + \beta_i H_i + e_i \text{ --- } (1)$$

Where: L_i = Amount of loan accessed by households i
A_i = Age of head of household i
O_i = Occupation of head of household i
E_i = Education of head of household i
H_i = Household size of household i
D_i = Distance of household i from the nearest financial institution
β_0 = constant
β_i = coefficients for the respective explanatory variables
e_i = random error residual

3.4.5 Data Accuracy and Reliability

Much has been said about the degree of accuracy and reliability of data collected in most of the developing countries, Tanzania inclusive, and how this can constrain the value of socio-economic research due to lack or inadequate records and reliance on recall (Casley and Lury, 1987; Kashuliza, 1994:81; Ndanshau, 1996:135-137). This study was not an exception, and thus efforts were made to supplement quantitative data with qualitative data so as to minimize biases and distortions. Whenever possible, information gathered in the villages was counter checked at other possible sources. In this way, the degree of reliability and accuracy of data used were greatly enhanced.

3.5 Summary and Conclusions

This chapter focused on describing the study area and methodology employed. These are critical elements as they make the study more focused in terms of its methodological approaches and location specific. The understanding of the study area was important in that it provided basic information that was useful for the analysis of the development of rural financial markets in Tanzania in general and rural Babati in particular. Finally, the study methodology described the sampling procedure, sources of data, collection instruments, and the analytical framework employed.

CHAPTER FOUR
THE DEVELOPMENT OF RURAL FINANCE IN HISTORICAL PERSPECTIVE

4.1 Preamble

This chapter reviews the development of Rural Finance by analyzing the evolution of financial institutions such as commercial banks, specialized financial institutions, Central Bank; and non-bank financial institutions - pension and insurance institutions, development banks, co-operatives financial institutions; and financial instruments developed since the colonial period. The chapter categorises the history of the development of financial sector into five phases, namely (i) the introduction of commercial banks by the Germans (1905 – 1920[28]; (ii) expansion of the financial sector by the British (1920 – 1961); (iii) Independent government: growth of nationalism(1961 – 1966); (iv) the State and financial market – the Central Bank and central planning (1967-1990); and (v) the Financial Sector Reforms and Liberalization (1991 – to date).

4.2 The German Colonial Period and the Evolution of Banks: 1891-1920

The development of the rural finance in Tanzania is well documented by Caselli (1975); Binhammer (1975); Kimei (1987); Kashuliza (1994); Ndanshau (1996), BoT (1997); and ESRF (2003). However, much attention in the rural finance was given to agricultural finance or farm finance (Kashuliza, 1994:67-68). According to most literature agricultural finance approach was supply driven, and as such it relied on public financing through state controlled financial institutions (Ndanshau, 1996; Kashuliza, 1994; Egaitsu, 1988; Meyer, 1991; von Pischke, *et al*., 1983). Thus, under the agricultural credit approach, rural finance was viewed as synonymous to supply of credit to the agricultural sector.

Tanganyika became the German colony in 1891 after the German East African Company had successfully concluded a deal with local chiefs and signed treaties of protection. The German's interests centred on exploitation of raw materials and cheap labour (Illife, 1972a:9; Ndanshau, 1996:54). Consequently, the German colonial administration introduced cultivation of the so called "strategic crops"

[28] Although the Germans were in Tanganyika from 1891, the first commercial bank branch by the *Handelsbank fur Ostafrika* bank was opened in Dar es Salaam in 1905.

(sisal, tea, coffee, cotton and rubber) by encouraging estate growers and native smallholder farming (Bee, 1996:14; Illife, 1972a:9; Hyden, 1980:34).

The colonial government encouraged the integration of peasantry in the world economic system through participation in cultivation of export crops by force, food incentive, and supply of labour force to the expatriate settler farms and mining (Hyden, 1980:43; Illiffe, 1972a:9; and Bee, 1996:14). This was reinforced through mandatory payment of local taxes (popularly known as hut-and poll-taxes), which had to be paid in cash by the natives. To earn cash income for tax purposes, one had to produce cash crops or work as a labourer in settler farms (Kimei, 1987:43).

The colonial government encouraged and supported expatriate farmers to cultivate export crops in fertile and climatically favourable areas of the country. To support their commercial farming, the colonial administration improved rural transport infrastructure by constructing railway lines to settler farming areas and encouraged foreign commercial banks to open up business in those areas in order to provide financial services to the growing commercial activities, including agriculture[29]. As a result, the first commercial bank branches were opened by the *Deutsche Ostafrikanische* bank in Dar es Salaam in 1905 and the *Handelsbank fur Ostafrika* bank in Tanga in 1912 (Binhammer, 1975:38; Ndanshau, 1996:54).

The *Deutsche Ostafrikanische* bank was appointed by the colonial administration to perform the functions of the central bank of fiduciary issue and banker to the government[30], while the second German Bank - *Handelsbank fur Ostafrika* was denied to play the role of a Central Bank, and hence had to work closely with the former. A third bank modelled along the lines of a co-operative banking undertaking, a replica of that established in the then German South-West Africa (now Namibia), was proposed by a group of settlers in Tanga, but was turned down by the Imperial German Exchequer. In addition to the two German Banks,

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[29] German settlers experimented with many export crops in different parts of Tanganyika. However, with the exception of sisal, other experiments were not successful. Cultivation of coffee, cotton, and rubber picked up after their defeat in the World War I in 1918. Apart from introduction of cash crops, construction of the transport infrastructure for the "export enclave" was undertaken where two main railway lines from Dar es Salaam port to the hinterland - the central and the northern lines were constructed.

[30] In this regard the *Deutsche Ostafrikanische* Bank acted as the first Central Bank in Tanganyika.

there was an official Savings Bank that was established in Dar es Salaam (Binhammer, 1975:38).

These first commercial banks mobilized capital in the form of savings, grants and loans from both within and outside Tanganyika with the aim of giving credit to, mainly settler farmers and trading communities. However, settler farming communities, were at first not able to access credit due to lack of title deeds to be provided as security, thus forcing the colonial government to extend a short term interest free loans to settlers (Illiffe, 1965:278). Smallholder farmers received no institutional credit from the colonial administration or commercial banks that could transform their backward production techniques, serve for the limited cases of crop seeds for cotton, coffee seedlings, and sharecropping contract practises in few pockets. On the other hand, the German colonial administration did not attempt to promote local financial institutions to support natives' commercial agriculture. In this regard, the degree of commercialization of the rural economy was very much limited (Illiffe, 1969:135; Ndanshau, 1996:53-55).

4.3 The British Colonial Rule and Expansion of the Financial Sector

When the Germans lost the World War I (1914 – 1918), Tanganyika was put under the mandate of the League of Nations (now United Nations) with Britain given the mandate to administer it. However, the political status of Tanganyika remained unclear until after the WW II in 1946 when it was officially declared a United Nations Trust Territory under the British administration (Kimei, 1987:42). Due to the political status of Tanganyika, the British colonial administration was less interested in its development, and therefore, did little to improve smallholder production techniques (Hyden, 1980:48; Ruthenberg (1964:46). Consequently, its administration adopted an indirect rule policy[31], where Native Authorities were established. These were required to persuade their people to diversify their sources of income by either working on estates, producing cash crops or working on new enterprises. This intervention by the colonial government aimed at commercialization of the peasant economy, and to diversify their sources of incomes so as to facilitate payment of local taxes.

[31] British colonial administration introduced indirect rule in Tanganyika due the colonial status of the country, and as a result did not want to invest, but to reap as much as possible.

The colonial government failed to address certain basic structural weaknesses. Whereas for instance, it wanted increased agricultural output, it did not address the question of agricultural credit for the natives who were being pushed to enter into production of new crops that are associated with high production and marketing risks. Besides, local authorities themselves were not capable of extending financial support as well as providing extension services. Above all, the Native Authorities were already overburdened by tasks of policing natives, collecting taxes, and pushing for increased cash crop production (Illife, 1972b: 34; Ndanshau, 1996:57). Since, the colonial government wanted increased exports and improved domestic food situation, it enacted the *Increased Production Ordinance in* April 1944[32]. This resulted into an influx of settler farmers into Tanganyika, creating land crisis in certain parts of the country as land alienation was experienced (Seidman, 1972:41).

4.3.1 Commercial Banking and Rural Finance: Post World War I

After WW I, the assets of the German banks were auctioned off by the British administration as enemies' properties, and three bank cartels from Britain were established to replace them. This development marked the beginning of phase two of the development of financial institutions in the country. The commercial banks that replaced German banks, which came to be known as "The Big Three", were the National Bank of India (later the National and Grindlays)[33], the Standard Bank of South Africa (later the Standard Bank), and the National Bank of South Africa that was later replaced by the Barclays D.C.O (Kimei, 1987:71; Binhammer, 1975:39). Slowly banking network spread over the country and by 1923 the branch distribution were as follows: Dar es Salaam (4 branches), Tanga (3), and one each in Tabora, Lindi, Mwanza, Bukoba, and Kigoma.

Before the WW-II, more branch networks were opened in Moshi, Arusha and Iringa (Binhammer, 1975:38-39). In addition a Belgium Bank operating in Congo-

[32] This ordinance was partly necessitated by the serious drought that affected the country causing shortages of both food crops and raw materials. Furthermore, the WW II had just ended, where the British government had spent fortune to finance the war. Increased domestic production in the colonies was, therefore, necessary to pay for war debts and meet food import expenses to avert food shortages.
[33] National and Grindlays (N&G) Bank first established its branch in Zanzibar in 1893 under the name of the National Bank of India. This was the time when Tanganyika was under the German administration.

the *Bangue du Congo Belge* was also allowed by the British colonial government to operate in Tanganyika, and as a result it opened branches in Dar es Salaam and Kigoma (Binhammer, 1975:38).

The operations of commercial banks were biased mostly towards industry, trade and wealthier class, thus creating two distinctive classes of those who have access to financial institutions and those without. In order to address the financial needs of the poor people, the idea of establishing Postal Savings Bank (PSBs) was introduced in Tanganyika in 1926. Postal Banks were originally conceived to address the financial needs of the low income people by encouraging, collecting, and safeguarding low income peoples' resources in order to ensure financial deepening. According to Friedman (1957:13) the PSB were first established in Great Britain in 1861, followed by Japan 1875, The Netherlands 1881, Austria 1883, and United States of America in 1910. The idea was later brought to the developing countries by the colonial masters - in South Africa in 1883, Nigeria 1886, Ghana 1888, and in East Africa by 1910.

In East Africa POSB were first established in Kenya in 1910, and later in Tanganyika by 1926, followed by Uganda in 1927 (Lewins, 1935:17; Kimei, 1987:78). In Tanganyika the colonial government passed an Ordinance establishing the Tanganyika Post Office Savings Bank (POSB) in 1926, which according to Kimei (1987:78) was statutorily charged with the function of "providing a ready means for the deposit of savings and so encourage thrift". Perhaps of all the banks, POSB was the only bank that opened up branch network countrywide including the rural districts hence facilitating financial intermediation especially among the low income earners.

The period between 1950s and 1960s saw a steady growth in establishment of commercial bank branch networks. In 1951 the *Nederlansche Handel-Maatschappj* (later on renamed as the General Bank of The Netherlands) opened up two branches in the country. In 1953 and 1954 two more banks from India - the Bank of India and the Bank of Baroda, respectively opened branches in Dar es Salaam and later expanded to Mwanza and Moshi as well. These were followed by the Ottoman Bank that opened branches and in Kigoma, Dar es Salaam, and

Moshi in 1958. The Commercial Bank of Africa and the National Bank of Pakistan each opened a branch in Dar es Salaam in 1961 and 1962 respectively (Kimei, 1987:72).

Since all the three East African countries of Uganda, Kenya and Tanganyika fell under the British administration after the WWI, the colonial administration decided to establish the East African Currency Board (EACB) in 1919 that became operational in 1920 (Kimei, 1987:57-58). Although the EACB was originally intended to serve the three East African countries, other colonies joined overtime. Zanzibar was the first to be admitted in 1936, followed by Ethiopia, British Somaliland, Italian Somaliland and Eritrea in 1942/43. In 1945 Ethiopia, however, withdrew followed by Italian Somaliland and Eritrea in 1950 and 1952 respectively. Aden joined in 1951, but withdrew together with British Somaliland in 1965 and 1961 respectively (Caselli, 1975:27-28).

The EACB operated as a Central Bank for the member states, where it aimed at providing for and supply of currency in a manner that would ensure automatic redemption against pound sterling (Kimei, 1987: 58). When the EACB started work, there were four currencies in use in Tanganyika in addition to shells and cattle, namely Indian rupees, silver coins, German token coins and local coins expressed in rupees issued by the British Currency Commissioners that were replaced by the East African Shilling (Binhammer, 1975: 6; Kimei, 1987:58-60).

In 1955 the constitution of the EACB was amended to allow for member states to borrow from the Board amounts confined to what was called “the fiduciary issue limits”, which is the Board’s issuing of currency within the specified limits measured against the securities of the member states and their other specified inter-governmental organizations. When Tanganyika became independent in 1961, further amendments were made to contain the intensive capital flight, and the need for crop finance facility upon which banking system could meet seasonal demand for credit to finance agricultural inputs and purchases of export crops (Kimei, 1987:62). Consequently, the Board’s headquarters were moved from London to Nairobi so as to bring it closer to its owners; and representatives from member countries were appointed into the Board so as to increase influences of the member states in managing the Board.

Commercial banks in Tanganyika operated without legal framework until 1960 when the first Banking Ordinance[34] came into force. According to Kimei (1987:73) the major reason why Tanganyika had no banking legislation up to 1960 was that all the banking institutions that were operating in Tanganyika were foreign owned and hence strictly controlled from their headquarters located outside Tanganyika. The Ordinance came into operation even before the establishment of the enforcing organ - the Central Bank. However, the enactment of this legislation was important in order to protect depositors.

4.3.2 Specialized Financial Institutions: Loan Funds and Land Bank

During the 1950s through 70s, much emphasis was placed on agricultural credit in most developing countries (Schmidt and Kropp, 1987:18-19). It was envisaged that rapid economic development can be realized through an increased agricultural productivity facilitated by enhanced access to technology and subsidized credit. The need for a subsidized agricultural credit had, therefore, its origin in two closely related agricultural policies and strategies: (i) massive infusion of capital and transfer of technologies from developed countries, and (ii) job-creation through rural investment in non-farming activities. Increase in agricultural output through infusion of capital and transfer of technologies[35] targeted medium and large scale farmers, leaving smallholder producers to adopt the new techniques through demonstration effects – in other words smallholder farmers were expected to modernize their farming through the "trickle down effect". Besides, it was envisaged that non-farming businesses would flourish in the rural areas due to improved farm incomes and large-scale farming job-creating effects, hence facilitating rural development. The focus on job creation in the non-farming activities or sideline activities was essentially meant to compensate the

[34] Uganda and Kenya were much ahead in this respect. Uganda was the first in E.A. to introduce a banking legislation: Uganda Laws Cap. 88 in 1955; followed by Kenya: Kenya Act No. 62 of 1956.
[35] In many respect the agricultural policy followed at that time was synonymous to the industrialization policy for the urban areas.

rural sector for having been overtaxed and/or of its surplus having being "misdirected" to finance industrialization programmes and hence urban development at the expense of the underdevelopment of the rural sector.

According to Schmidt and Kropp (1987:19-20) these policies were founded on the following assumptions: (i) farmers are too poor and cannot invest to improve agricultural production, (ii) advancement and innovation in agriculture can only come with the support of cheap and subsidized credit, (iii) there is an acute shortage of credit in the rural areas, (iv) informal money lenders are expensive and exploitative, and (v) the government must intervene through specialized credit approach to stimulate demand and induce investment in agriculture.

4.3.2.1 Specialized Loan Funds

The emergence of the Specialized Farm Credit Institution in Tanganyika is associated with the passing of the "Increased Production Ordinance in 1944" by the colonial administration. It was at this time the idea of formal agricultural credit was accepted and conceived by the colonial government so as to support the move to increase agricultural production among the smallholder producers principally to alleviate food shortages. As a result two agricultural loan facilities[36] were established, namely: the Local Development Loan Fund (LDLF) and the African Productivity Loan Fund in 1947 and 1955 respectively (Binhammer, 1975:58-59).

LDLF was a revolving fund established by the government with initial funding from the Agricultural Development Reserve Fund in order to provide credit mainly to the natives' smallholder producers (Binhammer, 1975:59). Since smallholder farmers have no collateral, the LDLF was to issue loans through local authorities as it was believed that by the later being closer to the producers, loan recovery would be much easier. Local Authorities were better placed to circumvent problems arising from asymmetric information and enforcement in smallholder credit programmes. However, by 1952 this arrangement proved failure as the Native Authorities were reluctant to assume the risks involved since crop marketing was done under the

[36] These were the first Specialized Credit Institutions to be established and managed by the government.

aegis of marketing co-operatives for which local authorities had no direct control or information. As a result LDLF had to redesign its loan delivery mechanism by entering direct contracts with agricultural producers provided that local authorities were willing to guarantee 50% of the loan amount[37]. It was also at this time that the fund was mandated to extend loans to Native Authorities, Co-operatives, and other approved bodies for local development in addition to individual smallholders (Binhammer, 1975:58-59; Kimei, 1987:83-84).

According to Kimei (1987:84) in 1955 the government, with support from the USAID, established the second revolving fund - the African Productivity Loan Fund (APLF), for the purposes of organizing finances for acquisition of agricultural machinery and milling machines. Thus, the establishment of LDLF and APLF targeted the foundations of village industries; improvement of the farms, particularly the mixed farming, the provision of tools and equipment to craftsmen and artisans (Ndanshau, 1996:59).

Both funds were managed by the District Loan Committees (DLCs), where the following criteria were used in approving loans: (i) project economic viability and loan benefit to the borrower, (ii) applicant's know-how, ability and initiative to use the loan effectively, and (iii) applicant's ability to provide security. Besides managing distribution of loans, the DLCs also educated borrowers on the advantages and disadvantages of credit. These efforts by the Committee had positive impact among the rural population, for instance it is reported that by 1957, there were some indications that some progressive and efficient African entrepreneurs were capable of obtaining loans from normal commercial sources, partly reflecting that the Funds had achieved their objectives of linking smallholder farmers with commercial banks (Binhammer, 1975:60).

The two funds were also criticized for creating social differentiation in the rural areas between rich and poor farmers. Nonetheless, it is argued that there were inadequate credit demands from the natives. For instance, it is observed that

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[37] In 1953 the guarantee requirement was further reviewed and only loans exceeding Tshs. 10,000 was required to be guaranteed. Most loans were for expansion of farm holdings and repayable over a period of three years.

there were unutilized balances for both funds indicating that demands were short of the available money. According to Kimei (1987:84) at the end of the 1959, about 27.5% of the total available funds (APLF and LDLF together) were uncommitted. Some observers (Binhammer, 1975:60; Ndanshau, 1996:64-67; Kimei, 1987:84) attribute this to, (i) the demand for loan collateral, (ii) demand for down payments of 25% of the total project costs before one gets loan, (iii) cumbersome loan application procedure and slow processing, (iv) inadequate staffing of central and area committees.

Another problem that was associated with the two funds was poor loan repayment. Default on loan repayment was high as a result of lack of security and natural hazards that affected smallholders' loan repayment capacities (Kimei, 1987:85).

4.3.2.2 The Land Bank of Tanganyika (LBT)

In another move, the government established the Land Bank of Tanganyika (LBT) in 1947 with the purpose of providing long term loans (15-30 years) for acquisition and clearing of land, construction of buildings, and other land improvement related investments. The bank was also to provide medium and short term loans for the purchase of agricultural machinery and equipment, meet costs of seeds, cultivation, harvesting, processing and marketing of crops (Kimei, 1987:85-86). Loans were available to individual farmers, marketing co-operatives and local authorities.

The sources of the bank's capital were from: government subscription; commercial bank overdrafts; and short-term deposits from the public allowed as from 1955. Besides, there was additional government support in periods of emergencies, for instance when commercial banks were experiencing capital flights in 1960 as Tanganyika was coming closer to independence, the government had to come to the rescue of the LBT (Binhammer, 1975:61-62). Initially, the bank's capital funds were inadequate; as a result the bank had to search for additional sources of capital through bank overdrafts from other commercial banks and mobilize more deposits from the public. Bank lending was impressive as compared to those by the loan funds. According to Caselli

(1975:146) out of the total East African Shillings 60 million loaned out by the bank between 1948 and 1960, 40% went to finance long-term agricultural projects, 32% was used to purchase land and land ownership transfers, and 28% to meet farm cultivation and marketing costs (Kimei, 1987:86-87). However, the bank's lending procedure was cumbersome and it favoured mostly estate growers who were mostly white settlers. Thus, the bank loans neglected smallholder producers.

The bank's loan structure changed over years reflecting more of short term loans rather than long-term orientation. This was, however, not by accident, but partly attributable to the capital structure of the bank - where short term liabilities (overdrafts from commercial banks and short - term deposits) were on the rise over years, coupled with capital flight being experienced by the banking industry at the time. In this regard, the LBT experienced similar problems as those of predecessors - the Loan Funds.

According to Binhammer (1975:61-62) the LBT and Loan Funds were conceived by the colonial administration as instruments for the initiation of the peasants into the use of commercial banks credit facilities for commercialization of agriculture. This was clearly reflected in the conditions set for one to qualify for loans. In this respect, the LBT and Loan Funds were used to bridge the gap between potential African borrowers and the normal sources of credit in Tanganyika (Ndanshau, 1996:65). Another interesting feature of loans issued by the Loan Funds and the Land Bank is that loans were mainly directed to the export growing areas of Kilimanjaro, Arusha, Bukoba, and Rungwe for coffee; Tanga for cardamom; and Mwanza for cotton as detailed in Appendix 4.2. Food crop growing areas were less favoured including Babati district.

4.4. Co-operative Societies and Agricultural Marketing Boards

Co-operative organizations are primarily unique enterprises that cannot be fitted into the classical economics theory of the paradigm of a firm that is modelled as a profit maximizing entity. In contrast, co-operatives are "associations of owner-patrons with divergent, sometimes contradicting individual interests" (Bee, 1996:4). Co-operative organizations have been nurtured, promoted and supported by governments worldwide to achieve an array of socio-economic development objectives obtaining under different political and ideological context.

Co-operative societies were first established in Kilimanjaro in 1925 when coffee producers formed the Kilimanjaro Native Planters Association (KNPA) that was subsequently transformed into the Kilimanjaro Native Co-operative Union (KNCU)[38]. The colonial government formally recognized co-operative movement in 1932 when the first Co-operative Ordinance was formulated, with the aim of promoting production and marketing of export crops by the African peasants. It is, therefore, not a wonder that the first co-operative societies were established and registered in the cash crop growing areas of coffee (Kilimanjaro, Bukoba, Arusha and Rungwe); tobacco (Songea); and cotton (Lake Zone) (Kimario, 1992:7-8; Bee, 1996:6-7).

On the other hand, Agricultural Marketing Boards that were established under the African Agricultural Products (Control and Marketing) Ordinance of 1949[39] played a significant role in rural financial intermediation as well. Boards extended significant amounts of finance to the agricultural sector mostly through the marketing co-operatives, which were sourced from accumulated surpluses, revenues from fees, licenses, rents and use of godowns, interest from loans and investments, and grants.

According to Kimei (1987:82) the marketing co-operatives and marketing boards facilitated mobilizations of savings for the state. In addition, the co-operative movements acted as channels through which credit institutions could reach smallholder producers in the rural areas. Co-operative societies extended productive credit for purchasing of farm inputs (seeds, fertilizers, farm equipment);

[38] The Kilimanjaro Native Co-operative Union like most other co-operatives has undergone a series of transformations through changes in government policies and regulations, but it still retains its name and some of its properties.

[39] These include Lint and Seed Marketing Board (1952); Tanganyika Tea Authority (1950); Tanganyika Coffee Board (1957); and Grain Storage Department (1949). The GSD was established to control supply of foodstuffs in the face of periodic droughts and famine. Thus, it acted like a reserve or grain bank, rather than a marketing board, although it controlled the marketing of strategic food crops such as maize, millet, wheat, paddy, cassava and mixed beans (Livingstone and Ord, 1980:173).

purchasing of land, costs related to land preparations, harvesting and marketing. Few other societies (for example the Bukoba Native Co-operative Union) provided general credit to its members, which were distinguished from agricultural productivity loans and emergency loans respectively (Kimei, 1987:83).

The Savings and Credit Co-operative societies (SACCOS) are the important form of financial co-operatives. The history of SACCOS in Tanzania can be traced way back in 1938 when the Ismailia communities established the first thrift and credit societies in Dar es Salaam, Moshi, Mwanza, Dodoma, and Tanga towns (Ngeze, 1975:34). It was, however, the Late Cardinal Rugambwa of the Roman Catholic Church who spearheaded the promotion of SACCOS[40] in Tanganyika (ILO, 2002:10-16). After his tour of the United States in 1948, the late Cardinal was convinced that credit unions, as operated in the USA, were important tools for poverty reduction. Consequently, he sent two priests to America in 1959 to study the Credit Unions. On their return, these were posted to parishes in Dar es Salaam, Bukoba, Iringa and Kilimanjaro regions to introduce and mobilize establishment of SACCOS in those areas. Subsequently, two SACCOS were established and registered in Kilimanjaro in 1961, namely Kianga SACCOS and Mawela Mission SACCOS in 1961 (Bee, Chambo, and Mtenga, 2003:10).

Table 4.3 summarizes the growth of the Co-operative Movement in Tanganyika between 1950 and 1964. The number of registered co-operative movement increased over time since their establishment in the 1920s.

Table 4.1: Growth of the Co-operative Societies, 1950-1964

YEARS	**1950**	**1954**	**1957**	**1960**	**1962**	**1963**	**1964**
Total Registered Societies: Of which:	121	243	474	691	974	1,201	1,358
Banking	-	-	-	-	-	1	2
SACCOS	5	5	5	-	10	19	41

Source: Extract from Kimei (1987:83) table 4.5

[40] These are known by different names in different countries. In Latin America, USA and Canada they are called Credit Unions; in the UK as Thrift and Credit societies; in France as *Credit Mutual; Raiffesein Banks* in Germany and in other places as Peoples Banks.

By 1950 the number of registered societies had reached 121 of which 5 were SACCOS. The number of registered societies increased further to 691 in 1960 and 1,358 by 1964. However, the number of Savings and Credit Societies remained constant until after independence when these also increased in terms of numbers, membership and business volume. By 1964 there were 41 registered SACCOS that united to form the Savings and Credit Union League of Tanganyika (SCULT). However, the most active SACCOS were found in urban areas most of which were employee based SACCOS.

4.5 The Development in Rural Finance after Independence: 1961- 1966

4.5.1 Growth of Commercial Banking and Emergence of Nationalism

When Tanganyika became independent in 1961, private banks were the dominant financial institutions, of which the "Big Three" were leading. The three major banks dictated the terms of operations through the "Summary of Banking Arrangements"[41] signed in 1929. The Summary of Banking Arrangements provided mechanisms for self regulation within the industry, to which every new entrant was required to conform with. This arrangement was justifiable, especially in a situation where there is no central authority to supervise and regulate the sector.

The period between 1960 and 1966 saw new development in the banking industry. First, in 1962 seven co-operative societies in the cash crop growing areas established the Co-operative Bank of Tanganyika (CBT). According to interviews with the officials of the Tanzania Federation of Co-operatives (TFC), the decision to establish the CBT was reached by seven co-operative societies that subscribed shares. These were Bukoba Native Co-operative Union (Coffee); Kilimanjaro Native Co-operative Union (Coffee); Ngoni-Matengo Co-operative Union (tobacco); Rungwe African Coffee Co-operative Society (Coffee); Usambara Co-operative Society (coffee); Victoria Federation of Co-operative Union (cotton) and Matengo Co-operative Society (tobacco).

[41] The Summary of Banking Arrangements is criticised for imposing a discriminatory fee known as "finance fee" of 0.25% "on seasonal crop finance, over and above the normal interest rate" (Kimei, 1987:74). As some have argued, this might be justifiable in the light of high risk involved in financing agricultural sector and, therefore, high possibilities for default.

Second, four indigenous banks were established in 1964, where the Co-operative Bank of Tanganyika (CBT) was replaced by the National Co-operative Bank (NCB), and the Agricultural Credit Agency (ACA) formed in 1961 – as discussed under 4.4.2 - was transformed into a commercial bank - the National Bank of Commerce (NBC). During the following year, the government established the Tanzania Bank of Commerce (TBC)[42] to acquire assets and liabilities of the Ottoman Bank by the government (Binhammer, 1975:38-39). In Zanzibar, the People's Bank of Zanzibar (PBZ) was formed in 1966 to transact commercial banking operations for the government of Zanzibar and its institutions.

The period between 1960 and 1966 marked the beginning of growth of nationalism, where the independent government attempted to create its own political and economic identity. For this reason, establishment of indigenous banks were aimed at controlling the economy. Consequently, the TBC was charged with the responsibility of providing credit to the commercial sector and to act as banker to the government of Tanganyika, while PBZ played similar roles in Zanzibar. The NBC was designed to provide seasonal crop finance and financial business to the co-operative movement instead of foreign-owned banks.

Examining the sources and uses of commercial bank funds in Tanzania between 1960 and 1965, Table 4.2 shows that domestic deposits accounted for about 91% of the total liabilities in 1960 rising to 93% in 1963 but declined to 91% in 1964, as a result of rising foreign liabilities from 6.1% in 1961 to 9% in 1965. Nevertheless, the growth in domestic savings was sluggish due to bank's failure to mobilise domestic savings especially from the agricultural sector, cultural constraints including attitudes of natives towards banks, subsistence nature of the economy, and inadequate lengthening, widening and deepening of the financial institutions.

[42] The government established TBC in order to compete with foreign banks. The government acquired 60% shares and the remaining shares were sold to commercial banks.

Table 4.2: Sources and uses of Commercial Bank funds in Tanzania: 1960-65 (Annual %)

END OF YEAR	SHARE IN TOTAL SOURCES		SHARE IN TOTAL USES (ASSETS)		USES BY SECTORS		
	Domestic deposits	Other Liabilities	Domestic lending	Total domestic assets (including domestic loans)	Foreign	Private	Public
1965	91.0	9.0	87.6	93.3	6.7	73.2	26.8
1964	90.7	9.3	76.0	82.2	17.8	76.2	23.8
1963	93.3	6.7	63.5	68.3	31.7	83.2	16.8
1962	92.6	7.4	67.3	73.6	26.4	75.4	24.6
1961	93.6	6.1	66.5	70.6	29.4	70.2	29.8
1960	91.0	9.0	73.0	83.0	17.0	-	-

Source: Extract from Kimei (1987:75) table 4.3 (b)

The structure of assets held by the commercial banks shows that the proportion of domestic lending (in the form of loans, advances and bill discounting) increased from 66.5% in 1961 to 87.6% in 1965 with a slight fall in 1963. This is due to the introduction of crop finance facility by the EACB in 1960. Another plausible explanation for the increase is that advanced by Loxley (1979) cited in Kimei (1987:77-78) that the capital flight experienced in Tanganyika at independence led to an increased bank borrowing for working capital by domestic enterprises. Besides, government actions of introducing exchange controls in 1965 and the establishment of the Bank of Tanzania in 1966 reduced capital flight and made money available for domestic borrowings.

As correctly observed in most literature (Kimei, 1990; BoT, 1997; Binhamer, 1975; Kimei, 1987; Ndanshau, *et. al.,* 1999); these initial efforts by the government of "domesticating commercial banking" did not improve access to financial services in rural areas. This was as a result of the industry being constrained by the following: (i) too much concentration of domestic credit to the foreign trade, (ii) low degree of financing local/domestic sector, (iii) strict collateral requirement, (iv) low efforts in mobilization of local savings, (v) too much dependence on metropolitan head-offices for series of decisions, (vi) excessive utilisation of the savings resources by the private sector - mainly business and large scale farmers, and (vii) unchecked capital flight from Tanganyika for investment abroad.

4.5.2 Re-organisation of the Specialized Agricultural Credit Institutions

4.5.2.1 Agricultural Credit Agency (ACA)

In 1961 the government replaced the specialized agricultural credit institutions – the two Loan Funds, and the LBT – discussed under 4.3.2 - with Agricultural Credit Agency (ACA) in order to mobilize savings and support transformation of the agricultural sector (Kimei, 1987:87; Binhammer, 1975:62-63). The ACA started operations in 1962 and took over assets and liabilities of the two Loan Funds plus the bank it replaced. The initial capital was, thus, comprised of assets of LBT and LDLF & APLF; government subvention through the Ministry of Agriculture; subscriptions of shares by the co-operative movements, and to a lesser extent by "The Big Three" commercial banks (Kimei, 1987:87). The ACA was required to provide short-term; medium-term; and long term loans to individual farmers, co-operative movement, local authorities, and farming companies for the purpose of improving agricultural productivity and bringing rural development (Kimei, 1987:87-88).

According to Ndanshau (1996:79-80), unlike the Loan Funds it replaced, ACA loans' conditions and interest charged were more in favour of the target borrowers. For instance, short-term loans attracted interest rates of 8.5%, medium-term 7.25%, and 7.5% for long-term; whereas the applicable commercial bank rates over the same period were 10.5% and 8.5% for the short-term, and the medium term and long-term respectively. Besides, formal credit could be accessed by poor peasants without strict demands for security. However, some form of security and the terms on which it was operated were considered necessary. Thus, any chattel or chattels covered by a Chattels Transfer Instrument was accepted as collateral. Alternatively, the DLCs were allowed to accept security of two guarantors or, an advance cash deposit of not less than 10% of the total loan applied.

The ACA's loan system was criticized for not being able to address the credit needs of smallholder farmers. According to Ndanshau (1996:82) much of the credit went to few wealthy farmers who are less risky and easier to manage, hence giving leap attention to small producers. The agency was also criticized for its inadequate staffing who had insufficient skills required in appraising agricultural projects. Ironically, few co-operative societies received loans although they had better credit ratings as compared to smallholder farmers. Perhaps this is an indication that the agency had limited capital base. Thus, the performance of ACA was poor – in that it did not benefited the target group of smallholder farmers, and instead intensified social differentiation by creating classes of wealthy and poor farmers. Besides, it failed to address the credit needs for modernization of the agricultural sector as expected.

4.5.2.2 National Development Credit Agency (NDCA)

The failure of the ACA prompted the government to re-organize the institutional structure for rural finance so as to make credit available to smallholder farmers. As a result ACA was in 1964 replaced by yet another agency - the National Development Credit Agency (NDCA). On the other hand, the National Co-operative and Development Bank (NCDB) was established under the nominal control of the co-operative movement, which became the holding company for the National Co-operative Bank (NCB)[43] and the NDCA. In this respect, the NCDB was organized as an apex body designed to coordinate all activities of the NCB and NDCA in financing the rural sector (Kimei, 1987:88-90; Binhammer, 1975:63-72).

The NDCA was charged with the duty of providing credit for agricultural development, processing, storage and transportation of agricultural produce, and co-operative distribution services. In order to reduce administrative costs, and at the same time serve better the smallholder farmers it was decided that NDCA should channel all its loans through the co-operative movement (Binhammer, 1975:64-73; Kimei, 1987:88-90). This new structure of rural finance was based on the belief that a smooth flow of credit funds from credit institutions to farmers can best be managed by efficiently functioning co-operative system. The agricultural extension staff were given additional tasks of supervising farming and credit business at the district levels. According to Kimei (1987:88) the sources of NDCA's funds were specified as: (i) inherited funds from ACA plus loan funds, (ii)

[43] The National Co-operative Bank (NCB) was established to replace the Co-operative Bank of Tanganyika (CBT) in 1964, when the government decided to use the movement in managing agricultural credit.

deposits mostly from public institutions and to a limited scale from individuals, (iii) bank overdrafts from commercial banks guaranteed by the government, and (iv) loans from the Treasury.

It is worth noting *a priori* that the restructuring of the organization of the rural finance was necessitated by the needs of the First Five-Year Development (FFYP-1964-69), which underscored credit availability to smallholder farmers. In its attempt to improve smallholder farmers' agricultural production, the government adopted dual approach in agricultural development: the improvement approach and transformation approach that were both to be supported by the NDCA. According to Bee (1996:17-18) the improvement approach was envisaged to bring about a gradual improvement in the farming methods among smallholders without altering their social values and norms. This task was assigned to extension services and co-operative movements. On the other hand, the transformation approach aimed at rapid increase in agricultural production through extensive and intensive farming by selected progressive farmers. These *yeoman* farmers were brought together in established settlement schemes and provided with farm equipment and machinery. In each settlement mechanized farming methods as well as new crops were introduced under close supervision of the government extension staff (Dinham and Hines, 1983:115).

The formation of the NDCA and its approach to credit management in agriculture, like that of its predecessors was not successful. Nonetheless, it created certain degree of linking smallholders to commercial credit. The agricultural transformation approach was found to be very expensive as it relied excessively on the use of machinery and large scale farming techniques that were largely financed by the government with donor support[44]. On the other hand, the improvement approach succeeded in creating few capitalist farmers known as *kulaks* in some parts of Arusha, Iringa, Shinyanga and Tabora. Besides, the improvement of the smallholder farming through the co-operative movement and

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[44] The government abandoned the programme after two years of implementation in 1966 when 22 settlements had been established. For details see Amani, *et. al*. (1983); Dinham and Hines (1983); Hyden, (1980).

to a larger extent NDCA's financing did not work well either (Bee, 1996:18-19; Dinham and Hines, 1983:118).

The loan application and disbursement under NDCA had certain flaws. Borrowers were required to apply loans through their respective primary societies; which in turn submit aggregated applications to its co-operative union. In this case co-operative unions were the ones that negotiated loans from the NDCA. Besides, loans were tied to 25 percent of the individual farmer's average crop sales for the last three years. This procedure not only resulted into delays in inputs delivery to farmers, but also resulted into limited access to credit by smallholders and relatively by weaker societies. This practice according to Loxley (1975:278-285) again compounded absolute income differentiation in the rural areas as well as between regions. Thus, the transformation of ACA into NDCA was not a panacea to the problems of access to credit and technology by smallholder farmers.

4.5.3 The Bank of Tanzania and Rural Finance

4.5.3.1 Establishment of the Central Banking in Tanzania

Central Banks originated from the need to replace the role played by goldsmiths in providing repository services for gold and other treasure items as well as issuing "bank notes" (BoT, 1979a:5; Casseli, 1975; Newlyn, *et. al*, 1954; Keynes, 1936). Since issuing bank notes became a business that earns profits, many goldsmiths were tempted to over-expand their lending operations without corresponding efforts with the reserves of gold and treasure items they held in store. Thus, powers of issuing bank notes required some regulation, and hence the establishment of central banks. These were given monopoly powers over issuing of bank notes known as currency notes, while also acting as the repository of gold and foreign exchange reserves. According to the Bank of Tanzania (1979a:5-6) the Bank of Sweden was the first modern central bank to be established in the world in 1668 followed by the Bank of England in 1694. In East Africa, although the East African Currency Board (EACB) operated as a *de facto* central bank for the three countries of Kenya, Uganda and Tanzania between 1961 and 1966, in reality there was no central bank in the sense it is understood today. Thus, operations of commercial banks in Tanganyika were not supervised and regulated.

The first attempt to establish the central bank in Tanganyika was made in 1960, when Banking Ordinance was put in place[45]. This was followed by commissioning feasibility studies to establish central banks in the three countries to replace the EACB (Binhammer, 1975:1). However, while discussions on the future central banking system for the independent East African Countries were on, leaders of the three states declared their intent to establish a political union in 1963. Consequently, the quest for the establishment of the central banks was shelved for a while. As the political union was not forthcoming, primarily as a result of preoccupation with internal problems within the member states, Tanganyika decided to proceed on its own in determining the appropriate banking arrangement for the region by seeking expert advice from the IMF[46] (Abdi, 1977; Kimei, 1987:64-65; BoT, 1979a:32-33).

In 1964 Tanganyika united with Zanzibar to form the present United Republic of Tanzania[47]. The process of establishment of the Central Bank was facilitated with expert advice from the Central Bank of Germany and later the IMF (Bank of Tanzania, 1979a:32-33; Binhammer, 1975:2-3; Kimei.1987: 65-66). According to the discussions with the officials of the Bank of Tanzania (BoT), the three countries reached decisions to establish separate national Central Banks in 1965. These were, however, required to co-operate closely in monetary related issues and policies.

Following the decisions to establish separate banks for each country, the Union Parliament passed the Bank of Tanzania Act, 1965. The act provided for the "Establishment, Constitution and Functions of the Bank of Tanzania (BoT) as Central Bank, to provide for the currency of Tanzania, to provide that the Bank shall be Banker to the government and shall have certain powers in relation to other banks and financial institutions, to extend the banking ordinance to Zanzibar

[45] The other two East African countries established banking legislation much earlier than Tanganyika. Uganda introduced banking legislation in 1955 and Kenya during the following year.
[46] Discussions on the establishment of separate Central Banks for each of the member states dragged on for almost five years from 1960 to 1965.
[47] Tanganyika united with Zanzibar to form the United Republic of Tanzania on April 26th, 1964; and since then the United Republic of Tanzania or simply Tanzania replaced Tanganyika.

and to make certain amendments to the law relating to Banking and Exchange Control, and for connected purposes" (Bank of Tanzania, 1979a:33). The Bank of Tanzania was established on 14th June, 1966; being the first in East Africa, followed by the Bank of Uganda - 15th August, 1966 and the Central Bank of Kenya on 14th September, 1966 (Kimei, 1987:65-66; BoT, 1979a:33).

The establishment of separate central banks led to the collapse of the EACB and the East Africa Currency Union. Nonetheless, the three governments had to work on the modalities of how to strengthen the East African Common Market and Common Services Organisation (EACSO)[48] for continued co-operation in the failure of the envisaged political union. Consequently, this process culminated into the signing of the Treaty for the East African Co-operation in Kampala in 1968, which established the East African Community that collapsed in 1977[49] (Kimei, 1987:64-68).

In its operations the Bank is deemed to be an independent entity and was expected to advise the government on issues relating to monetary and relevant economic policies. According to the BoT (1979a:35) the main functions of the Bank of Tanzania were two-fold - traditional central banking and developmental functions. Besides, it was required to perform any other function conferred upon it by the government or an external agent under international agreement (BoT, 1982:170). The traditional functions can be categorised into (i) banking, (ii) domestic monetary management, and (iii) external monetary management.

(i) Banking functions

The banking functions of the BoT include fiduciary issue, banker to the government; bankers' bank, and the lender of last resort. The BoT is the sole issuer of legal tender currency in Tanzania. After its establishment in 1966, it issued the Legal Tender Currency of Tanzania denominated in Tanzanian

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[48] Under the British rule East African High Commission (EAHC) was formed in 1948 to provide on East African basis public utilities (air, railways and marine transport, posts and telecommunications, university education and environmental research). In 1961 EAHC was reconstituted into EACSO that was later transformed into EAC.

[49] The East African Community was revived on 30th November, 1999 when the Treaty for its re-establishment was signed and became operational on 7th July, 2000. It is an economic union, but envisages a political union by 2010.

Shillings (abbreviated as Tshs.) that is available in coins and bank notes[50] (BoT, 1982:170; Kimei, 1987:104; BoT, 1979a:39).

The BoT plays a role of official depository of the government by accepting deposits and effecting payments for the government; running a separate official account for and with direction from the government; and offer all types of services normally provided by a bank to its customers for the financial institutions. However, it is legally barred from direct participation in financial business as by so doing it will be competing with the financial institutions that it has to supervise and regulate.

According to Kimei (1987:118) the BoT also acts as a “lender of last resort” to commercial banks and financial institutions. Lender of last resort technically refers to a situation where competing banks cannot borrow from one another because all of them are in need of cash - due to a run on the entire banking system. This situation was not applicable to Tanzania especially after the nationalisation of banks, because there was in practise only one commercial bank - the National Bank of Commerce that was owned by the government.

(ii) Domestic monetary management

The BoT performs domestic monetary management through finance and credit plan formulated jointly with the Ministry of Finance. These involves the following: organizing financing of government budget deficits, managing government debts, advising the government on financial matters, extending short-term loans to financial institutions, and controls credit provision in the economy.

The BoT operated with discretion in regulating the terms at which to refinance the banking system, and charged different rates for bills it rediscounted depending on the purpose they were issued. Besides, the Bank also extended loans and advances on discretionary terms to financial institutions for various purposes.

[50] The BoT took over the share of Tanganyika in the assets and liabilities of the EACB that was finally liquidated by the member states in 1969. Besides, it assumed certain functions previously performed by the EACB.

However, agricultural and industrial financing were given special treatments in terms of repayment conditions (BoT, 1979b: 36-45).

(iii) External Monetary management

Foreign reserves play an important role in the stabilisation of the value of domestic currency and cushioning against temporary balance of payments deficits. In exercising its controls over foreign reserves, the BoT imposed controls on strict dealings in foreign exchange and determined exchange rate with hard currencies. Thus, the external monetary management involves the management of foreign reserves, formulation of policy regarding the administration of exchange, export promotion, and transactions with the International Monetary Fund.

4.5.3.2 Role of the Bank of Tanzania in Promoting Rural Finance

The establishment of the Bank of Tanzania was, by and large, government's desire to conduct its own monetary policy. The BoT's monetary policy prior to financial liberalization can be categorized into two periods, namely (i) BoT as a classical central bank period, and (ii) BoT and management of financial planning period.

(i) The classical central bank period: 1966-1971

According to Kimei (1987:98-99) between 1966 and 1970, the bank employed the traditional monetary policy tools, and as such did not interfere with the operations of the financial system despite the nationalisation of the financial institutions in 1967. Nonetheless, nationalisation of the financial institutions and other private investment was done without corresponding changes in the law establishing the Central Bank.

(ii) The Bank and management of financial planning: 1971-1995

During 1970/71 financial year, the government adopted Financial Planning as the basis for monetary policy partly due to the requirements of the Second Five-Year Plan (SFYP) implemented from 1970/71 to 1973/74[51]. According to Kimei (1987:99) annual financial planning was necessary in order to mobilise financial

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[51] Note Financial Year in Tanzania does not correspond to calendar year; instead it runs from July of the preceding year to June in the following year.

resources required for the public sector investments, balance of payments and internal monetary stabilities. The financial planning involved the following plans: (i) finance and credit (including - government recurrent budget, development budget, and money supply and credit allocation); (ii) foreign exchange; and (iii) annual development.

Despite the various initiatives by the government of providing rural credit through commercial banks and specialized agencies, the objectives of improving agricultural production was not realized. In 1976, the then Minister for Finance and Planning constituted a Committee on Rural Credit to advice the government on how the Central bank and commercial banks can increase the pace of rural development through credit (BoT, 1979b:104). According to the BoT (1979b:104 - 105) the Committee observed that the credit arrangements for agriculture did not provide adequate, effective and continuous co-ordination among the financial institutions and that the Central Bank was somewhat passive in the development of the mechanisms for domestic credit. Thus, the Committee recommended amendments to the Central Bank's Act with the view of giving it a more developmental role than that of regulating currency and credit. Consistent with this proposed role of the bank, the Committee recommended establishment of the Rural Finance Fund under the Bank[52].

Consequently, a major amendment to the BoT Act was made in 1978, which re-defined the functions of the Central Bank as: (i) undertaking traditional central banking functions as already discussed above, and (ii) performing developmental functions. The RFF was charged to perform functions, which are limited to rural development only:

(i) financing rural development,

[52] The RFF was operated under the Rural Finance Department of the Directorate of Economic Research and Policy of the Bank of Tanzania. Provisions were also made for establishment of similar funds for other sectors of the economy, which included Industrial Finance Fund, Export Credit and Guarantee Fund, and Capital and Interest Subsidy Fund.

(ii) converting short-term agricultural production loans into medium term loans for periods not exceeding five years on default resulting from natural calamities[53],

(iii) purchasing bonds, debentures or other negotiable securities offered by banks and financial institutions for financing rural development,

(iv) guaranteeing of loans and advances granted by banks and financial institutions for financing rural development, and

(v) subscribing to the share capital of a bank or financial institution and acquiring through the later of an interest in a Village registered under the Villages and *Ujamaa* Villages Act, 1975.

The BoT Act, 1978 defined the role of the Bank in the promotion of rural development by establishing the Rural Finance Fund (RFF), through which the Bank provided financial and non-financial services to public commercial banks namely the NBC and TRDB. Previously, only credit for refinancing seasonal operations was provided through the National Bank of Commerce. With the new role of the Bank, both short- and medium term loans were granted to NBC and TRDB, but strictly for rural development. Even long-term loans of up to 20 years could be granted directly or through purchase of bonds issued for the purpose of rural development. Apart from financial services, the Bank was obliged to train personnel to be employed by financial institutions and had to undertake supervision of the same (Bank of Tanzania, 1979a:101-113; Kimei, 1987:98; Ndanshau, 1996:89-90).

[53] The RFF was, therefore, used to stabilise agricultural credit and production in the country by providing conversion facility for short-term credits to medium loans in order to allow farmers to access fresh loans. In addition, it also provided grant to farmers who have sustained great losses resulting from natural calamities.

4.6 The State and the Financial Sector under the Arusha Declaration

4.6.1 The State and the Co-operative movement

After the failure of the transformation of the agricultural sector through progressive farmers' approach, the government adopted the socialist development strategy in 1967 through the Arusha Declaration. The Tanzania's socialism brand was based on the principles of the African family-hood of *ujamaa;* hence making it the central feature of the country's rural development strategy. In the agricultural sector, the policy aimed at socialization of production based on peasants' traditions of co-operation and reciprocities[54]. Mushi (1971:13-29) referred to this rural development strategy as "modernization by traditionalization" and in Hyden's (1980:98-99) view by so doing the government was attempting to universalize the rules of living within households to encompass larger and modern societies.

According to Bee (1996:23) the Arusha Declaration that gave birth to *Ujamaa policy* is very important in Tanzania's development history in many respects in that:

(i) it gave a distinctive political and ideological framework that aimed at reducing capitalist influences in the country,

(ii) it denounced all forms of exploitation through nationalization of the major means of production: land, industries, financial institutions; and provided for conditions for private investments,

(iii) to the political leaders it laid down specific rules guiding entry into political arena as well as political game itself, and

(iv) it gave emphasis on the transformation of the agricultural sector through the co-operative movement and *Ujamaa* Villages-replica of the Village Settlement Schemes promoted under the failed transformation approach.

In order to meet the needs of the Arusha Declaration, the government further re-organized the rural institutions: (i) NDCA credit focus was diverted from individual farmers towards co-operatives and *ujamaa* villages[55], (ii) co-operatives were re-

[54] In a way this approach was build on the improvement approach that was adopted in 1964.
[55] *Ujamaa* Villages and Co-operatives were considered as important vehicles for rural transformation. In this thesis, *Ujamaa* Villages are used synonymously to plan villages.

organized to meet the demands for rural development, and (iii) Agricultural Marketing Boards were replaced by Crop Authorities, and later in the 1980s back to Marketing Boards. The re-organization of the credit institutions in the agricultural sector placed major emphasis on co-operatives as detailed in section 4.3.2. Consequently, a Presidential Commission of Enquiry into Co-operatives was formed to look into the performance of co-operatives and marketing boards.

The Commission's report listed the following defects: uninformed membership; shortage of skilled manpower; lack of democracy at union level and lack of expert advice (Bee, 1996:19; Chachage, 1993; van Cranenburgh, 1990). Strengthening of co-operatives was found necessary as these were found having certain advantages over other forms of organizations in promotion of rural finance. These advantages are (i) co-operatives are people based organizations are capable of minimizing default rates through group pressure, (ii) minimum loan administration costs in terms of screening, lending, follow up and repayment, (iii) the enforcement problem is reduced vide their monopoly in crop marketing as they have an easy access to farmers' records and loan recovery from sales proceeds, (iv) co-operative committees are well informed about their members as opposed to specialized credit agencies.

In order to strengthen and control the co-operative movement, two legislations were enacted: (i) the Co-operative Societies Act of 1968 that repealed and replaced the Co-operative Societies' Ordinance 1932 to regulate co-operative activities; and (ii) the Unified Co-operative Services Act of 1968 that provided for the establishment of the Unified Co-operative Services Commission. The Co-operative Societies Act gave more powers to the Registrar of Co-operatives over control, supervision, audit, registration, and dissolution of co-operatives. Co-operatives were required to re-organize themselves along the government administrative boundaries for easy control by the state. Regional unions were required by law to join the national union of co-operatives - the Co-operative Union of Tanganyika (CUT). On the other hand, the UCSC was entrusted the tasks of hiring, discipline, providing terms of employment and dismissal of staff in the co-operative movement, hence making the respective Boards redundant (Wagao, 1982; Bee, 1996:20; Kimario, 1992).

By 1975 the government had made firm decisions of turning co-operatives into multi-purpose and production oriented entities. It was seen that free will of joining villages did not result into increased agricultural outputs through access to credit. According to Bernstein (1981:45) between 1967 and 1973 the pace of creation of *ujamaa* villages was very slow as it was initially based on individual voluntarism. For instance, by 1973 when living in planned villages was made a mandatory, the rural population that had already settled in *ujamaa* villages was only 15% of the total rural population.

Finally, the government disbanded co-operatives in 1976 so as to give way to a new alternative agricultural marketing that was put under the direct control of the government so that *ujamaa* could prevail over *Ushirika*. As a result co-operative unions were dissolved and liquidated, while primary societies were transformed into village co-operatives. Functions of the dissolved co-operative unions were transferred to Crop Authorities; District Development Corporations; and Regional Trading Corporations[56]. Disillusion of co-operatives were made on the pretext that they were corrupt, inefficient, undemocratic, and incurred huge losses. Whereas some of these allegations might be justified; there were equally other reasons that were mainly based on political grounds (Ellis, 1988; Hyden, 1980). According to ICA (2001:14-15) the government realized that the implementation of *ujamaa* through *ushirika* was readily accepted by the *wananchi*. Thus, the only available means of propagating *ujamaa* villages was to abolish co-operatives.

However, two developments were responsible for the demise of the co-operative movement. One, establishment of Crop Authorities[57] between 1973 and 1976, which replaced Marketing Boards that corroborated with Marketing co-operatives; and two, the establishment of *Ujamaa* Villages legalized by the *Ujamaa* and *Ujamaa* Villages Act, 1975, which replaced primary societies. According to Bee (1996:24) the villages were considered multi-purpose co-operatives that traded

[56] The government designed alternative marketing arrangements that are more responsive to the socialist development by establishing crop authorities, creating regional trading corporations and district development corporations.

[57] Coffee Authority of Tanzania; Tanzania Pyrethrum Authority; Cashewnut Authority of Tanzania; Tobacco Authority of Tanzania; and Tea Authority of Tanzania. National Milling Corporation; National Distributors Limited; and General Agricultural Produce Export Corporation were designed to handle food crops, oil seeds, and milling operations.

directly with Crop Authorities and received inputs from government designated credit institutions.

4.6.2 The State and Commercial Banks

The Arusha Declaration was followed by nationalization of main sectors of the economy that were privately owned. Consequently, commercial banks operating in the country with the exception of the NBC, NCB, and the Peoples Bank of Zanzibar; were nationalised[58] on February 6th, 1967 (Binhammer, 1975:39). According to the Bank of Tanzania (1979a:61), the list of nationalised commercial banks included: National and Grindlays Bank; Standard Bank Limited; Barclays Bank D.C.O.; *Algemene* Bank Nederland N. V.; Bank of India Limited; Bank of Baroda Limited; Commercial Bank of Africa Limited; National Bank of Pakistan Limited; and Tanzania Bank of Commerce Limited.

The control of the banking industry by the government was necessary in order to: (i) overcome the weaknesses enumerated under section 4.5.1, (ii) speed up expansion of the banking facilities throughout the country, (iii) undertake mobilisation of domestic savings more efficiently and manage utilisation of the same according to national priorities, and (iv) to improve remuneration for savings in order to attract domestic deposits, and create profits for the government through dividends and taxation. As a result, the country's financial system was shaped to suit the needs of the public sector economy that the government was attempting to create.

The financial system in Tanzania was highly differentiated as a result of nationalisation and consolidation measures taken after the post-Arusha Declaration era. Table 4.3 provides the country's financial picture after nationalisation. It describes the form of saving mobilisations, types of credit and sectors they targeted. According to the BoT (1979b:81) there were only nine financial institutions comprised of commercial banks, development banks, and near-banks.

[58] A small private Indian commercial bank operating in Zanzibar - Jetha Lila Bankers Limited - was not nationalized, however, ceased operations on its own in 1968. To legalize operations of the NBC, the Parliament had to provide for its establishment by enacting the NBC Act, 1967.

The banking sector was dominated by two commercial banks – NBC and PBZ. The important development banks include Tanzania Investment Bank (TIB); Tanzania Housing Bank (THB); Tanganyika Rural Development Bank; and Tanganyika Development Finance Company Limited. Besides, there are a number of near bank financial institutions such as the National Insurance Corporation (NIC), National Provident Fund (NPF), and the Post Office Savings Bank (POSB).

Table 4.3: Financial Institutions in Tanzania, 1967-1990

FINANCIAL INSTITUTION	FORM OF SAVINGS MOBILIZATION	TYPE OF CREDIT	SECTOR RECEIVING CREDIT
Bank of Tanzania	Currency issue	Short, medium and long-term	Government, Commercial Banks, and D.F.Is.
National Bank of Tanzania Peoples Bank of Zanzibar	Demand, Savings and Time deposits	Short, medium and long-term	Productive and Distributive Sectors of Government Economy
Tanzania Housing Bank	Savings and Time deposits	medium and long-term	Building Construction and closely allied industries
Post Office Savings Bank	Savings and Time deposits	medium and long-term	Government
Tanzania Rural Development Bank	None	Short, medium and long-term	Rural
Tanzania Investment Bank	None	Medium and long-term, credit and equity investment	Commercial Agriculture and all types of Industry
Tanganyika Development Finance Co. Limited	None	medium and long-term	Industry
Karadha Company	None	Hire purchase	Transport
National Insurance Corporation	Premium Income	Short, medium and long-term	Government
National Provident Fund	Provident Fund Contribution	Short, medium and long-term	Government

Source: Bank of Tanzania (1979a:83) Table VIII.I

The NCB experienced capital and staff shortages, a situation that forced the government to merge it with NBC in 1970, giving the latter a monopoly control over the commercial banking business. On the other hand, the NCDB that was established in 1964 as banker for most of the crop marketing co-operatives was transformed into the Tanzania Rural Development Bank (TRDB) in 1971. The establishment of the TRDB was as a result of: (i) the failure of NDCA to meet credit needs of smallholder farmers, (ii) excessive loan defaults by NDCA hence threatening its viability, and (iii) the need for bank that would mobilise domestic resources. Besides, the NDCA's over-dependence on external financing proved not sustainable and politically un-secure. Nonetheless, the re-organisation of the banking sector was also influenced by the government's need to meet the requirement of the SFYP and to make the control of the economy much easily done[59] (BoT, 1979a:86-90).

4.6.2.1 The National Bank of Commerce and Rural Finance

The National Bank of Commerce (Establishment and Vesting of Assets and Liabilities) Act 1967, defined the objective of the bank as “to provide adequate and proper banking services throughout the country” (Binhammer, 1975:42; Kimei, 1987:124). The growth of NBC may be categorised into two periods, namely: (i) transformation of the bank into commercially effective bank (1967-1970), and (ii) expansion of the banking business (1970 -1991). During the transformation period (1967 –1970), the NBC banking business was still dominated by the private sector, which accounted for over 50% of the total bank credit. The public sector was at infancy stage, but growing following the nationalisation of major sectors of the economy under the Arusha Declaration in 1967. However, the government was capable of funding the public sector as it had adequate foreign reserves that it inherited from the EACB. Nonetheless, capital flight was not easily controlled as the old currency was being converted into new currencies in all the three member countries of the then EAC (Kimei, 1987:125).

The period between 1970 and 1991 was characterised by the rapid expansion of the public sector that exerted more pressure on NBC funding. The government granted monopoly powers to NBC in commercial banking in Tanzania mainland after the National Co-operative Bank was merged with it in 1970. It was during this period, when the government adopted the Second Five Year Development Plan 1970/71-1973/74. As a result, the public sector (including financial demands of regional administration) crowded-out the private sector as major borrower from NBC (Kimei, 1987:126). In order to meet the public sector financing requirements the government followed financial planning as the basis for monetary policy (Kimei, 1987:99).

[59] The absorption of the NCB by the NBC in 1971 made Tanzania a “two-bank” system composed of the NBC operating on the mainland and the PBZ on the Isles.

In its efforts to increase deposits, NBC was restrained by the BoT to use interest rate as an incentive. Thus, NBC was instead required to open more branches throughout the country. This approach was also politically feasible as it fits very well with the development policy of the time of *Ujamaa na Kujitegemea* (i.e. socialism and self-reliance). The NBC embarked on rationalisation of branches of the nationalised commercial banks in all major towns. For instance, it was observed that in 1966 out of the total 64 bank offices, 70% branches were located in only 7 towns of Dar es Salaam (13), Tanga (7), Moshi (6), Mtwara, Mwanza, and Arusha (each 5), and Bukoba (4) (Kimei, 1987:127). Rationalisation in this case involved closure of some branches. In addition, the bank enhanced its penetration into rural areas by opening branches or establishing agencies at least in each district[60].

Informed studies revealed that the branch rationalisation policy followed by NBC between 1966 and 1980 enhanced significantly the bank density ratio in Tanzania (BoT, 1982; Kimei, 1987; Abdi, 1977; Binhammer, 1975; Casseli, 1975). This was made possible through the increases in bank branches, agencies and mobile units. As a result, when these are combined together, the commercial bank network appeared to have been considerably enlarged during the post-Arusha period. The average population served by a commercial banking unit decreased from about 171,000 in 1966 to 42,000 in 1980. As a result, there were significant improvements in access to banking services, as the average figures for most Sub-Sahara African countries, during the same period, were in the order of 100,000 to 420,000 inhabitants per bank branch (Kashuliza, *et. al*.; 1998:1).

Table 4.4 provides an overview of sources and uses of financial resources. It can be observed that deposits were the bank's main sources of financial resources, which accounted for an average of 80% of the bank's total financial resources. Of these, demand deposits constituted more than 50% of the total, while time deposits plus savings deposits contributed about 30%. The category of "Other

[60] Penetration of banking services refers to an extension of banking services to places where there are none that is different from increase in number of branches in areas already being served. A bank branch is a unit with working staff and a manager, whereas an agency is bank unit with working staff who perform limited banking services with the exception of giving loans.

Liabilities" that contains mainly capital and reserves amounted for an average of 15% over the period.

Perhaps, an interesting feature is that there was a significant rise in time deposits with a corresponding decrease in demand deposits especially between 1967 and 1973. Time deposits earn interest unlike demand deposits that offer an easy way of settling debts and access to overdrafts. Depositors, therefore, seem to have been attracted more by interest earning time deposits though it was fixed.

Table 4.4: Sources and Uses of financial resources of the NBC for selected years (%)

Liability/Asset Items	1967	1969	1971	1973	1975	1977	1979	1981
LIABILITIES								
DEPOSITS, Total of which:	79.6	81.5	79.8	84.9	69.8	77.0	81.4	79.3
- Demand Deposits	52.4	47.6	43.2	46.7	44.3	51.3	53.6	49.4
- Time Deposits	15.9	24.5	28.2	28.4	17.9	16.4	18.9	21.2
- Savings Deposits	11.3	9.4	8.4	9.8	7.6	8.9	8.7	-
Other Liabilities	20.4	18.5	20.2	15.1	30.2	23.0	18.6	20.7
TOTAL LIABILITIES	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
ASSETS								
Cash in hand	2.1	2.3	2.3	2.2	1.7	2.2	1.7	1.8
Deposits with other banks	10.9	15.1	20.9	19.5	11.8	9.0	8.3	6.6
Loans to non-govt. sectors	63.0	55.8	54.5	51.2	51.6	52.4	53.1	45.2
Loans to the Government	3.3	9.4	10.7	17.3	23.3	22.3	26.3	35.1
Other Assets	20.7	17.4	11.6	9.8	11.6	14.1	10.6	11.3
TOTAL ASSETS	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Kimei (1987:131) table 6.2 (b)

As for uses, much of the resources went to the non-government public sectors accounting for an average of 53% of the total loan consumption. However, loan to the government was on rise as well.

Table 4.5 analyses the NBC's lending structure by industrial sectors. Total domestic credit expanded rapidly, especially in financing public sector. However, NBC lending to the agricultural sector declined with the establishment of the TRDB in 1971, which took up seasonal credit requirements of smallholders.

Table 4.5: Analysis of NBC Lending by Economic Sectors for selected years (1967-80)

INDUSTRIAL SECTOR	1967	1970	1973	1976	1980
Commerce; of which:	58.1	57.5	63.3	59.3	73.5
- Marketing of Agricultural Produce	23.3	20.8	31.2	31.1	63.1
- Export Produce	18.1	10.3	3.8	10.9	1.4
- Trade in Capital Goods	1.8	3.9	1.2	2.7	0.3
- Wholesale, Retail and Other Trade	14.9	22.5	27.1	14.6	8.7
Agricultural production	12.5	12.7	4.9	4.2	6.0
Mining and Manufacturing	14.0	15.9	19.8	28.3	8.9
Building and Construction	3.0	2.6	2.0	0.8	1.9
Transportation	1.3	3.4	2.2	1.2	1.8
Tourism	-	1.8	0.6	1.0	0.5
Specified Financial Institutions	1.1	2.4	4.5	1.4	1.0
Public Administration	0.5	0.2	0.1	-	0.7
Other	9.5	3.4	2.6	3.8	5.7
TOTAL	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
TOTAL VALUE	**818.1**	**1,347.1**	**1,820.9**	**3,673.4**	**7,400.1**
TOTAL VALUE AS % OF GDP	**11.4**	**16.4**	**15.8**	**16.1**	**14.2**

Source: Kimei (1987:140) table 6.7

There was an increase in financing manufacturing, especially between 1973 and 1976 when government adopted Import Substitution industrialisation policy by promoting domestic manufacturing projects (BoT, 1982:111-123). The rise in agricultural marketing during 1967-1980 was mainly due to the financing of the National Milling Corporation (NMC) – the sole food crop-marketing corporation that was in deep financial crises and salvaged by the government through overdrafts from NBC. Thus, generally speaking NBC funding of the public sector consumed the largest proportion of the bank's financial resources. In 1973 alone, for instance, the public sector took about 75% of the total funds loaned out, whereas the central government on its part scooped an increasing share of 3% in 1967 rising to 35% in 1981.

4.6.2.2 Tanzania Rural Development Bank (TRDB) and Rural Finance

The Tanzania Rural Development (TRDB) was established in 1971[61] as a development bank to serve the rural sector. This was the period when the World Bank, which was the main financier of agricultural transformation in many developing countries, was trying to promote an "agricultural bank model" in many developing countries (Kashuliza, *et al*, 1998:1). The need for the agricultural co-operative bank came from two main assumptions. One, there was a belief that

[61] The TRDB replaced the National Development Credit Agency (NDCA). Similar other Development Finance Institutions formed during the period were Tanzania Investment Bank (1970), and Tanzania Housing Bank (1972).

without capital for investment - there is no growth or development. This investment capital must be generated from locally mobilised savings – a work that can be done by a bank and hence the justification for formation of a specialised agricultural bank. Two, smallholder farmers needed capital and must, therefore, be saved from exploitation by unscrupulous moneylenders.

4.6.2.2.1 Tanzania Rural Development Bank as Development Finance Bank: 1971-1984

The TRDB like its predecessor the NDCA, depended mostly on donor funding provided to the government for development purposes. The government realised that over-dependence on donor funding for development militates against the country's ideology of self-reliance and besides it has high uncertainty risk. Thus, the establishment of TRDB was meant to increase domestic savings mobilisation. Besides, TRDB was required to extend credit – both medium and long-term - to finance rural development by focusing on loaning agricultural input supply, and development of livestock, fisheries, and rural small-scale industries (URT, 1971: 58; Kimei, 1987:149; Binhammer, 1975:72-73). Moreover, TRDB was also to finance viable projects implemented by *Ujamaa* villages, co-operatives, and District Development Corporation (URT, 1971:54; Cliffe, 1973:195).

The government established an elaborate loan application procedure built around Villages and *Ujamaa* Villages[62]. Village Managers or Credit Officers were hired to supervise loan processing and recovery in every village. All applications were to be forwarded to regional offices and evaluated by the Regional Loan Committees (RLC)[63] established to scrutinise loan applications (URT, 1971:58; Binhammer, 1975:72-75; BoT, 1982:183-84).

TRDB extended the bulk of its loan initially through the co-operative movement up to 1976. Thereafter, when co-operatives were dissolved and replaced by villages in 1976, villages took over and the bank adopted the "village credit approach". As it can be discerned from Appendix 4.1, the share of credit distributed through the

[62] It was envisaged that the village credit approach would minimise rural credit related problems of information asymmetry, credit administration costs, and enforcement capacity to repay.
[63] The composition of RLC consisted of Regional Development Director, Regional Agricultural Development Officer, Regional Livestock Officer, Regional Cooperative Officer, Regional NBC Officer, Regional Manager of TRDB, Member of Parliament and Regional Planning Officer.

Ujamaa villages rose from 43% in 1976/77 to 66% in 1982/83 and dropped a bit to 57% in the following year. During 1980/81, when Tanzania experienced severe economic droughts, the demand for credit went down, except for villages where it went up to 90% from 56% the previous year. This was the time when Tanzania was just out of war with Idd Amini's government in Uganda, and as result villagers were required to produce more for consumption as well as export to meet partly the war expenses. Over the years, the credit demand from the growing *parastatal* sector was vivid, rising from 7% in 1971/72 to about 21% in 1979/80. As was the case with NBC, loans to private sector, especially individuals was constrained and accounted for a small proportion of between 5% and 7% of the total credit disbursement over the entire period.

Between 1972/73 and 1976/77 TRDB used the co-operative societies in distributing credit, but as villages were legally constituted through the Villages and *Ujamaa* Villages Act, 1975 and co-operatives disbanded in the following year, the village credit approach was adopted. This shift was not an easy task for the TRDB. Firstly, co-operatives though had their own weaknesses were better organized in management of rural credit, given their experience in coordination, distribution of agricultural credit and organizing marketing of agricultural products. Thus, villages were by no means better substitutes for co-operatives. Nonetheless, there were possibilities for increased efficiency in credit delivery, as they are closer to villagers. Secondly, although villages were legally constituted under the Villages and *Ujamaa* Villages (Registration, Designation and Administration) Act, 1975; the TRB could not meet the credit needs of all villages and villagers due to financial resources limitation. Thirdly, while villages operated on the ground, there were no replacements for co-operative unions at the middle. To fill in the vacuum left by co-operative unions, government established Crop Authorities between 1973 and 1976[64] that replaced Marketing Boards. These added credit pressures on TRDB as seasonal inputs were to be financed through crop authorities.

[64] Crop Authorities established include Coffee Authority of Tanzania (Coffee); Pyrethrum Authority of Tanzania (Pyrethrum); Cashewnut Authority of Tanzania (Cashewnut); Tobacco Authority of Tanzania (Tobacco); and Tea Authority of Tanzania (Tea).

Table 4.6 analyses the uses of TRDB loans as approved and disbursed between 1971/72 and 1984/85. As it can be discerned from the table, the TRDB loans mainly financed season inputs, which accounted for an average of 46% of annual loans disbursed. Of this, the amount of seasonal input loans to tobacco alone accounted for over 50%, leaving the other crops to share the remainder. Other traditional export crops that benefited from the TRDB seasonal input loans were coffee, tea and cotton.

Table 4.6: Uses of TRDB loans as approved by sector, 1971/72 – 1984/85 (in percentages)

		1971/72	1972/73	1973/74	1974/75	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84
Seasonal Inputs	To tobacco as a % of total	51.2	42.4	45.8	62.8	21.0	44.0	61.6	67.7	32.4	48.2	25.0	54.2	42.5
	Total	58.0	57.6	53.3	70.1	38.0	68.4	69.1	67.7	64.1	73.1	35.0	65.7	59.3
Rural Transportation		18.4	8.0	18.9	7.8	1.1	6.8	1.9	3.5	4.8	1.1	33.5	10.1	9.3
Farm machinery		2.8	1.9	0.8	2.0	1.0	0.4	0.4	3.9	0.7	12.8	4.2	9.8	10.3
Small Scale Industries		1.4	-	1.7	1.3	0.8	3.1	0.7	6.1	5.8	10.7	6.5	7.3	16.0
Livestock		1.4	7.2	16.0	18.5	57.7	19.0	23.5	7.8	8.0	1.2	17.7	3.0	3.7
Fisheries		-	0.8	0.8	0.5	*	0.7	4.2	7.3	0.6	0.6	1.4	0.8	1.1
Storage		14.8	1.8	0.3	*	1.4	0.8	*	1.2	1.3	0.4	1.5	2.9	0.2
Farm development		2.6	22.8	8.0	*	-	0.7	-	2.5	14.6	0.1	0.2	0.4	0.1
Others		-	-	-	-	-	-	-	0.3	-	-	-	-	-
Total		**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Ndanshau (1996:104) extract from table 4.7

In terms of geographical distribution, areas producing cash crops and more so tobacco benefited proportionately compared to the rest of the country. Consistent with the above crop targeting credit approach, Tabora, Iringa and Ruvuma - that are the main tobacco growing areas were the most favoured regions by the TRDB seasonal input credit. Because of this, TRDB was in some literature dubbed as "Tobacco Regions Development Bank – TRDB" (Msambichaka, *et. al.,* 1987:32). However, the distribution of credit based on crops was not the bank's own making, but rather influenced by the World Bank funding for tobacco and cotton projects in Tabora, Iringa and Kigoma regions (Nyirabu, 1981:65-66; Ndanshau, 1996:104-105).

Other uses of the TRDB loans were directed to the improvement of rural transportation, acquisition of farm machinery, development of small-scale industries, construction of storage facilities, livestock, fisheries and farm development. The proportions disbursed to these sectors varied from one sector to another and over years as well.

During mid -1970s, Tanzania experienced major agricultural crisis resulting from droughts, price disincentive, and inadequate investment and lack of extension services[65]. As a result, the country experienced a drastic fall in output of most export and food crops. In its response to address the agricultural crisis, the government adopted four measures. One, it pronounced *Siasa ni Kilimo* (literally meaning "Politics is Agriculture"). This reiterated the importance of agricultural sector in the country – without agricultural development there is no economic development. Two, access to credit was modified by introducing credit in kind - in form of fertilisers, and farm equipment. Besides, cash credit to farmers to meet life cycle needs was enhanced. Three, the government expanded the USAID sponsored National Food Credit Programme (NAFCREP) in 1976/77 by injecting additional resources from IDA and the Arab Bank of Economic Development in Africa (ABEDIA). Four, the government introduced four types of agricultural

[65] For more details refer Ellis (1982); Ellis (1992); Ndulu (1990); Lipumba, *et al* (1984); Bagachwa, *et. al.* (1995); Bryceson (1996); Gibbon, *et. al*., (1993); and Lipumba (1992).

production systems: individual family farms; *bega kwa bega* (block farms); collective farming; and state farms[66]. State farms were placed under *parastatals* such as the National Agriculture and Food Corporation (NAFCO) that produced maize, wheat and paddy; Sugar Development Corporation (SUDECO) – producing Sugar Cane and the Tanzania Breweries Limited (TBL) – producing barley and wheat (Bee, 1996:21-22; URT, 1982:24-25).

Like other credit programmes, the NAFCREP rural credit managed by TRDB had some limitations as well. First, the cash credit for the life cycle needs (basically for consumption purposes) created dependency and by all means faced high risk of default. Two, although under NAFCREP the government targeted both the smallholder farmers and large scale farmers, in reality only large scale farmers benefited mostly (Chachage, 1993:221; Ndanshau, 1996:106). Three, the project targeted smallholder farmers producing all types of food crops – sorghum, cassava, wheat and maize, but in reality the credit favoured largely maize producers and to some extent non-rationed tobacco farming. Fourth, in terms of its geographical coverage the credit was more concentrated in Iringa, Arusha, and Rukwa Regions, neglecting other maize growing regions of Mbeya, Kilimanjaro, Tanga, Dodoma, Ruvuma, and Morogoro (Ndanshau, 1996:105-106; Dinham and Hines, 1983: 113; TRDB, 1978:4; Msambichaka, *et. al,* 1987: 32).

The sources of the TRDB funds, like other development banks – TIB and THB at the time of their establishment, were defined as ordinary capital resources and special funds. According to Kimei (1987:146-47) ordinary capital resources comprised of authorised capital, funds raised by borrowing from mainly external sources, and income generated from the bank's operations. The special funds, on the other hand refer to funds placed in the disposal of the bank by the government or donor agencies for specific purposes. Consistent with this categorisation of

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[66] Each household were allocated land to grow crops of their choice, but block farming was carried out under the supervision of Village government where large scale farming were undertaken by individuals on private basis and proceeds shared between individuals and the village government. Collective farming followed the Chinese collective principles of working together, owning produce together and sharing of proceeds on the basis of "to each according to his contribution".

sources of funds, the financial operations of the bank was also classified as "ordinary operations" when financed through the ordinary capital resources and "special operations" for those funded through special funds.

Towards the end of 1970s, the TRDB started experiencing loan recovery problem as there were increasing rate of defaults, and besides, faced cumbersome bureaucratic procedures with the conversion of outstanding seasonal loans into term loans as provided for under the RFF. According to Mlambiti, *et. al.* (1988:5) in 1982 the TRDB applied for a conversion of short-term loan amounting to Tshs. 10.5 million to medium term loans for inputs advanced to 263 villages from Arusha, Kilimanjaro and Tanga regions, but could not be granted the facility by the BoT. In order to control the increasing rate of loans in these areas and lack of serious government intervention in loan recovery, TRDB adopted a classical measure of controlling the situation by introducing rationing of the delinquent borrowers. This measure reduced the amount of loans disbursed to clients for rural development during the period of 1979/80 to 1983/84 (Msambichaka, *et. al,* 1987: 32; Mlambiti, *et. al.* 1988:5).

4.6.2.2.2 Transformation of the TRDB into CRDB: 1984-1991

The Tanzanian economy experienced serious crises[67] towards the end of 1970s and during 1980s that called for interventions. In its search for the appropriate rural development strategy partly to address economic crisis, the government in 1980 constituted a Co-operative Review Commission. The Commission was charged with exploring on how best co-operatives can be revived in order to overcome the problems of rural finance since the formed villages and crop authorities had proven to be failures. Based on the report of the Commission, the government enacted Co-operative Societies Act, 1982 to provide for the re-establishment and registration of co-operative societies, which became effective in 1984. In addition, two Task Forces were formed to complement the findings by

[67] The discussions on Tanzania's economic crisis are beyond this study, but for details refer Lipumba, *et. al.* (1984); Bagachwa, *et. al.* (1992); Malymkono (1990); Bagachwa, *et. al.* (1995); Bryceson (1996); Gibbon, *et. al*., (1993); and Lipumba (1992).

main committee. One team examined the agricultural crisis and recommended the necessary institutional and structural adjustment. The recommendations of the Task Force one facilitated the formulation of the Agricultural Policy of 1982 that was, however, not implemented until after its revision in 1987 (Bee, 2004a:29-31). The second team considered the appropriate financing arrangement for the co-operative movement. The recommendations of this team led to the transformation of TRDB into the Co-operative and Rural Development Bank (CRDB) in 1984 (BoT, 1988:i; Banking Commission, 1990). The co-operative movement was granted 30% of the total shares of the CRDB at its inception and the remaining shares were subscribed by public and private investors. Besides, the BoT explicitly formalised CRDB (1984) as a commercial bank, which was hitherto considered as a development bank. Thus, the establishment of CRDB introduced some competition in the financial sector, as it was to compete with NBC – the sole commercial bank up to that moment. The CRDB also formally ceased to be an “agricultural bank” as it was conceived initially. On the other hand, agricultural subsidy provided through the TRDB was lifted[68].

Appendix 4.2 shows the CRDB lending operations between 1984/85 and 1990/91. With the re-introduction of co-operatives, CRDB continued to lend initially through villages as co-operatives were being re-organized. However, in terms of financing, the bulk of its loans continued to finance seasonal inputs. Nonetheless, there was a shift from tobacco financing that was experienced during 1970s to food crops production especially in the “big four” regions of Iringa, Ruvuma, Mbeya, and Rukwa that produce substantial food crop output in the country. Arusha region (that also covered the present Manyara Region-the focus of this study) got an increased amount of formal credit from CRDB as compared to the TRDB era. This is partly as a result of its inclusion in the National Maize Programme (NMP) that targeted 14 villages in Arumeru, Mbulu, and Babati districts in Arusha region (Ndanshau, 1996:113-114).

[68] This was the requirements for implementation of the Structural Adjustment Programme (SAP) where farmers were required to buy farm input at market prices.

As the CRDB became a commercial bank, domestic savings increased over time, but the bank continued to serve the government interest of transforming the rural sector and agriculture in particular. However, the bank continued to depend on government and donor funds for specified purposes as summarized on Table 4.7. The large chunk of its funds came from the government, followed by donors and general reserve funds.

Table 4.7: Sources of CRDB's Funds, 1984/85-1990/91 (in Tshs. million)

Year	Government Loans	Capital Reserve	Grant	General Reserve	Ujamaa Bonds	Other Liabilities	Total
1984/85	946.5	0.1	-	41.0	7.0	135.0	1,492.9
1985/86	1,464.0	425.0	-	47.3	7.0	38l.6	2,277.6
1986/87	446.5	441.0	582.6	93.0	7.0	-	1,570.9
1987/88	-	1,123.4	673.3	-493.1	4.0	-	1,307.6
1988/89	-	1,156.4	1,229.8	-371.7	4.0	-	2,018.6
1989/90	872.0	1,444.4	1,510.3	.-1,048.8	4.0	-	2,782.1
1990/91	3,152.3	1,493.4	1,501.3	464.6	4.0	-	6,615.7

Source: CRDB files (Annual Report and Accounts – various years)

4.6.3 Other Financial Institutions and Rural Finance

Other important non-bank financial institutions include development banks, and insurance and social security funds. The development banks include Tanzania Investment Bank (TIB); Tanzania Housing Bank (THB); and Tanganyika Development Finance Company Limited. In addition, there are a number of near bank financial institutions such as the National Insurance Corporation (NIC), National Provident Fund (NPF), and the Post Office Savings Bank (POSB).

The Insurance and Social Security Funds were of less relevance to rural finance due to the nature of their funding and their investment policies. These are financial institutions in the sense that they are capable of mobilising financial resources through premium income and provident fund contributions. The social security funds cover government and local government employees, employees in the state-owned *parastatals* and their investments are mostly in government treasury bills and stocks. The balance goes into properties, mortgage loans for construction of commercial premises and flats.

The Post Office Savings Bank (POSB) was a significant bank in Tanzania in terms of savings mobilisation, and nation-wide branch network. According to Kimei (1987:170) POSB was among the top country's banks in terms of savings mobilisation, it was second between 1950 and 1965, but third during 1966-80 after NBC and THB. Its branch network was almost comparable to that of NBC as it was operating branches and agencies throughout the country. Thus, it was ideal bank for addressing the needs of low-income segment of the population in both urban and rural areas. In this section, two Development Finance Institutions (DFIs) are briefly reviewed, namely the Tanzania Development Finance Limited (TDFL) and Tanzania Investment Bank (TIB)[69].

4.6.3.1 Tanganyika Development Finance Limited (TDFL)

The Tanganyika Development Finance Limited (TDFL) was established in 1962 to mobilise both local and international financial resources for providing term loan in an attempt to augment government's efforts in development financing. It was established as an international financial organisation operated on a commercial basis. Its shareholders are the Tanzania Investment Bank (TIB) 32.11%; Commonwealth Development Corporation (CDC-UK) 26.35%; FMO (The Netherlands) 4.52%; DEG (Germany) 26.35; and European Investment Bank (EIB - European Union) 10.67% (Rweyemamu, 1995:2).

The main sources of TDFL funds are lines of credit from multi-lateral and development aid agencies - including World Bank, Commonwealth Development Corporation, and European Investment Bank; capital contributions by shareholders; and retained earnings. The main TDFL funding areas fall in

[69] There are few other financial organisations – which are of less relevance to rural finance, but worth mentioning. These are the Diamond Jubilee Trust (DJTF), Tanganyika Finance Company (TAFCO), and Karadha Company. There is huge literature on these (see Kimei, 1987; Binhammer, 1975; Casseli, 1975; Abdi, 1977).

establishment and expansion of industrial, manufacturing, hospitality industry, real estate development, and agricultural processing. Thus, TDFL financing is more urban focused, though agricultural processing is involved (TDFL, 1988:5). TDFL funding takes three forms, namely (i) loans, (ii) shareholding, and/or (iii) a combination of both.

TDFL was one of the best performing development banks until early 1970s when it started experiencing resource decline and consequently there were decrease in the rate of financing development projects by about 23% in 1989 compared to a number of projects in 1983 (Kashuliza, 1994:97). Besides, this was the period when the economy was experiencing serious macro-economic imbalances forcing most industries to operate below capacity. Thus, most of those on TDFL funding were unable to pay back loans, a situation that increased TDFL's loans in arrears from Tshs. 25.6 million in 1985 to Tshs. 689.1 million in 1989 (Kashuliza, 1994:97). However, TDFL's environment was not very much different from that experienced by the wider financial system of the country at that point in time.

4.6.3.2 Tanzania Investment Bank (TIB)

Tanzania Investment Bank (TIB) is a development bank that was established by an Act of Parliament in 1970, with the objectives of:

(i) providing medium and long-term finance for the manufacturing, assembly, and processing industries; development of engineering, construction, transport, tourism, and mining; development of large scale corporate agriculture, ranching, forestry, and fishing;

(ii) provide technical assistance and advice for the purpose of promoting industrial development; and

(iii) administer special funds as may be directed by the BoT

The shareholders of the TIB are the government of Tanzania (60%), National Bank of Commerce (NBC - 30%) and National Insurance Corporation (NIC - 10%). The main sources of funds are capital from shareholders, retained earnings and loanable funds. Like the TDFL, the TIB's project financing takes the form of loans, shareholding or both.

According to Rweyemamu (1995:6), the bank managed investment in both equity and loan to over 295 projects between 1970 and 1995, with manufacturing taking the lion's share of 64% of the total. Since, it operates only term lending (medium and long-term loans) the bank business was limited in that term-lending is no longer a monopoly of DFIs; there are wide range operators who are competing in providing range of term lending products. In this respect the performance of the TIB was not different from that of its close ally – the TDFL.

Both TDF and TIB have been used by government as instruments of planned resource allocation, playing a role of financial intermediary for funds earmarked by the government and donors to provide an initial stimulus for development of specified sectors. However, DFIs have not been very successful in addressing their clients' needs due to (i) excessive reliance on donor funding, (ii) their inability to mobilize domestic resources, (iii) stiff competition in both resource mobilisation and lending. Official credit lines from donors and multi-lateral bodies, which have sustained the funding of TDFL and TIB in the past, cannot be guaranteed now. There is a need to re-define product lines such as inclusion of short-term loans, introduction of venture capital, participation in privatisation of public enterprises, asset leasing, and advisory services.

4.7 Financial Sector Crisis and the Need for Reforms

During the 1980s Tanzania experienced serious macro-economic imbalances that called for reforms. Internally, there were pressures emerging from the financial imbalances: budgetary deficits, balance of payments crisis and substantial financial losses by *parastatals* and marketing co-operatives. On the other hand price controls exercised proved ineffective; at most it resulted into parallel markets, leading to what Malyamkono and Bagachwa (1990) referred to as the "second economy"[70]. Controls on food crops failed too as they did not benefit the

[70] Elsewhere this is also referred to as underground, parallel or black economy.

targeted population, namely the salaried and food deficit households. The export sub-sector did not perform well, as overvaluation of the shilling did impose an *implicit tax* on exports (Bee, 1996; Bagachwa, *et. al.*, 1992; Malymkono, *et al* 1990; Lipumba, 1984; Lipumba, 1992).

According to available literature (Nyagetera, *et. al.*; 1995; Bagachwa, 1994; Nyagetera, 1992), the financial system in Tanzania experienced multiple weaknesses that include:

(i) loan in arrears, gross misallocation of credit to non-performing organisations and institutions, and banking system that was not responsive to profitability or loss;

(ii) financial system that was not dynamic and competitive;

(iii) inability of the financial system to mobilise domestic resources more efficiently;

(iv) poor governance within the financial system and by the government; and

(v) ineffective monetary policy that created adverse macro-economic conditions.

These problems were partly as a result of government intervention in financial markets that favoured lending to non-performing parastatals and co-operatives that resulted into bad debts, frauds, high overheads and gross inefficiencies. In most instances, the government subsidised loss-making parastatals and besides guaranteed loans at concessional interest rates to finance agricultural production and marketing. This practise was, to a large extent responsible for increasing money supply and therefore fuelling inflation. Furthermore, most loans became non-performing assets on the balance sheets of the lending commercial banks.

A Presidential Commission of Enquiry into the Monetary and Banking System was appointed in 1988 with the task of advising the government on the required reforms in the financial system (ERB and Planning Commission, 1990:41). The Banking Commission’s report was submitted in July 1990, and based on its recommendations and other supporting studies that were commissioned as well;

the government prepared the Banking and Financial Institutions Act (BAFIA) of 1991. This legislation paved way for implementation of comprehensive reforms that led to the establishment of a competitive financial system in the country.

4.8 Summary and Conclusions

This chapter documented the development of the financial sector in Tanzania, which is categorized into five periods, namely: (i) the introduction of commercial banks in the country, (ii) expansion of the financial sector, (iii) growth of the financial sector and emergence of nationalism under independent government, (iv) financial sector under central planning, and (v) liberalization of the financial sector. The chapter reviewed and documented the four first periods, while the fifth era is covered under chapter six.

The German colonial government was the first to introduce modern commercial banks and financial institutions in the country, which were expanded by the British who adopted indirect rule after being granted the mandate to rule Tanganyika by the United Nations. In addition, the British colonial administration facilitated the introduction of specialized financial institutions, co-operatives and establishment of Agricultural Marketing Boards that focused on financing of agricultural development. Despite the growth of financial institutions in the country, access to credit by smallholders remained very limited, even though the latter were forced to grow export crops for the colonial markets.

The independent government attempted to create its own political and economic identity by establishing local commercial banks and financial institutitions. However, foreign banks remained the dominant commercial banks in the economy, hence could not address the needs of the newly independent state. Consequently, the government established its own Central Bank – the Bank of Tanzania – in 1966 followed by the Arusha Declaration that nationalized all commercial banks and financial institutions along with other major foreign investments and put these under the public sector – the *parastatals.*

Thus, during the period after the Arusha Declaration up to 1991, the country's financial system was characterized by state owned financial institutions, with pervasive government interference. Credit was determined and directed on the basis of government priorities with little regard to credit-worthiness analysis, while domestic savings mobilization was neglected. Two commercial banks, NBC and CRDB dominated the supply of rural financial services. Whereas, NBC provided working capital and other short-term finance to agriculture, CRDB supplied rural development finance. These banks had their own statutes and there was minimal supervision and regulation by the BoT.

The Central Bank – BoT - was directly involved in the rural financial market through its arm of the Rural Finance Fund, which was implemented through the two state owned banks – NBC and CRDB. Thus, the Central Bank and the two commercial banks – NBC and TRDB dominated the rural finance system in Tanzania mainland before the financial sector reforms. Initially, when the NBC was the only bank allowed to finance rural seasonal operations, it was hard to distinguish between the BoT and itself. In this respect, NBC in its operations acted like an arm of BoT and performed such functions like banker to the government.

The financial planning exercised by the government between 1970 and 1980 failed to establish a well functioning financial market, which contributed immensely to the financial crisis experienced during the 1980s through 1990s. This failure resulted from (i) lack of adherence to financial plan targets, (ii) lack of mobilisation of domestic savings especially from the private sector, and (iii) over reliance on donor funding that was risky and highly volatile. In this respect, the growth of the private sector was stifled by the government monetary policies[71]. As the government exercised excessive controls on interest rates, it was in reality forcing

[71] The monetary policy instruments employed included determination of interest rate ceilings on loans and deposits, control of the total volume of credit given by banks and financial institutions, allocation of credit amongst different sectors, and the terms and conditions under which credit is supplied.

the BoT to subsidise other financial institutions through access to cheap credit provided under its rediscounting facilities and the specialised credit programmes.

In an evaluative approach followed in this chapter, there are obvious mismatch between the desired outcomes and the actual performance of rural financial strategies adopted by the independent government. Logically, and as it has been revealed here there are “unfulfilled ambitions” that were accompanied by “unintended outcomes” such as credit resulting into social differentiation and hence causing more poverty. Indeed, these situations happened under the designed discriminating credit supply system under the state-managed economy.

Thus, the analysis carried in this chapter draws three conclusions: First, the government rural development policy focused on agricultural credit. Of course this was understandable at that point in history when agriculture was equated to rural development, and hence agricultural credit synonymous to rural finance, a distinction already brought up in chapter two. Second, agricultural credit system devised by the government was inadequate in coverage and scope, which led to poor access to credit among smallholder farmers. This is explained by mismatch between supply and demand for credit. On the supply side, the credit system relied heavily on donor money, which was coupled with the inefficiencies in credit delivery resulting from structural and institutional weaknesses, dominance of single product – the seasonal inputs, biases to few crops and limited in geographical coverage denying producers the freedom to make own production decisions.

Third, there were also weaknesses on the demand side, which included inadequate credit supply, inability to appraise properly the borrowers’ proposals – if any as understood in the modern business world, lack of business plans and records and capacity to repay. In other words conditions for credit worthiness were not followed as credit was sometimes allocated on political pressure to meet demands of specific political campaigns. As a result, the agricultural credit system that was adopted over the years did not result into achieving the desired objectives of enhancing agricultural productivity and growth, and adoption of improved technologies, leading to economic growth. Besides, agricultural credit programmes were highly associated with over-politicisation of the credit programmes leading to poor loan recoveries, and heavy losses that increased non-performing portfolios within the commercial banks and financial institutions. This situation demanded for the financial sector reforms and liberalization.

CHAPTER FIVE

REGULATION AND SUPERVISION OF THE FINANCIAL SECTOR: IMPLICATIONS FOR THE DEVELOPMENT OF RURAL FINANCIAL MARKETS

5.1 Preamble

This chapter presents a review of Regulation and Supervision of the banking and financial institutions in Tanzania and how they facilitated or constrained access to financial services in the rural areas. The chapter situates the financial sector reforms within the context of the larger macroeconomic policies and strategies. It traces the financial sector liberalization to the enactment of the Banking and Financial Institution Act (BAFIA), 1991. The government translated the BAFIA 1991 into specific legislations, guidelines and regulations that formed the basis for prudential regulation and supervision of the banking and financial institutions in the country.

5.2 Macroeconomic Policies and the Financial Sector Reforms

Tanzania followed centrally planned economic policies from 1967 until the mid-1980s, when new market - driven economic policies were ushered in (Bagachwa, 1995; Malymkono, *et. al*.; 1990; Bee, 1996; Bryceson, 1993). Since then the government has formulated a number of macro-economic and sectoral policies associated with various reform measures as detailed in chapter six. These policies, strategies and reforms are aimed primarily at attaining the Tanzania's Development Vision[72] (TDV) 2025 of achieving a "sustainable socio-economic development by the year 2025" (URT, 1995:1-3; URT, 2002a:14). The government prepared the National Poverty Eradication Strategy (NPES) in 1998 to provide a framework to guide poverty eradication initiatives in the country. According to URT (2002a:15) the implementation of NPES is envisaged to reduce poverty by 50% by the year 2010, and eradicate it absolutely by 2025. The NPES was translated into a medium-term strategy for poverty reduction known as the

[72] The government established TDV 2025 in 1995 that formulated long-term development goals and perspectives against which the NPES was developed in 1998. TDV 2025 and NPES are long-term national strategies that address the poverty reduction issues in the framework of the UN-Millennium Development Goals.

Poverty Reduction Strategy Paper (PRSP) in 2000. The PRSP was prepared in the context of the Highly Indebted Poor Country initiatives (HIPC) process. The PRSP focused on reducing income poverty, improving human capabilities, survival and social well-being, and containing extreme vulnerability among the poor (URT, 2002a:15).

The review of the PRSP in 2004 culminated into the establishment of the National Strategy for Growth and Reduction of Poverty (NSGRP or in Kiswahili *Mpango wa Kukuza Uchumi na Kupunguza Umaskini Tanzania* abbreviated as *MKUKUTA*). MKUKUTA is the second national organizing framework for poverty reduction and promotion of social inclusion. It places growth and poverty reduction at the centre of the country's development agenda. It represents a more comprehensive approach to poverty reduction than the PRSP. Thus, MKUKUTA builds on the PRSP and integrates components of the country's existing overall and sectoral strategies and policies by giving poverty more of a focus. Unlike its predecessor, MKUKUTA places emphasis on priority outcomes and results rather than focusing on priority sectors as was the case with the PRSP. In addition, it recognizes the contribution of every sector, includes cross-cutting issues such as governance and communications (URT, 2005a:13-15).

The TDV 2025 outlined the goals of sustainable livelihoods and sustained economic growth. Consequently, the development of the country's rural financial market is defined in various policies and strategies that include: the National Micro finance Policy, 2000; Co-operative Development Policy, 2002; Small and Medium Enterprises Development Policy, 2003; and Rural Development Strategy[73]. It is out of these policies that the legal and regulatory framework for the financial sector was developed.

[73] There are equally other important sectoral policies and strategies, which to certain extent touch on the question of access to financial services. These include: Agricultural Development Strategy; Community Development Policy; National Employment Policy; and National Environmental Policy.

5.2.1 National Microfinance Policy, 2000

The National Microfinance Policy defines financial instruments and institutions for rural finance. The policy provides for the development of a sustainable microfinance industry as an integral part of the wider financial sector, within the framework of the country's Financial Sector Reform Policy Statement of 1991[74]. The National Microfinance policy that was prepared by the government had the following overall objective (URT, 2000c:4):

> to establish a basis for the evolution of an efficient and effective micro financial system in the country that serves the low-income segment of the society, and thereby contributes to economic growth and reduction of poverty.

Thus, out of this overall objective the following specific objectives were identified:

(i) to provide a framework within which micro-finance operations will develop;

(ii) to establish principles that will guide operations of the system;

(iii) to co-coordinate intervention by respective actors in the system; and

(iv) to provide the roles of implementing agencies and tools to be applied to facilitate development of microfinance institutions.

The policy covers all aspects of microfinance institutions (MFIs), including mobilization, registration, governance, supervision and guidance to ensure sustainable community-based rural development. Moreover, it spells out the provision of financial services to smallholder farmers, and small and medium-scale enterprises in both rural and urban areas. It is envisaged that a wide range of institutions will be involved in the provision of services, including specialized and non-specialized financial institutions. Although, there is no specific strategy for the promotion and development of MFIs in the country, the Bank of Tanzania is charged with the preparation of such framework in addition to that for Supervision and Regulation (URT, 2000c; Nyagetera, *et. al*.; 1995:141; IMF, 2003:21-22).

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[74] There was no policy document covering the financial sector *per se*. Some researchers (Nyagetera, 1995:135) have criticised the reform for lack of policy document upon which legal framework is based.

5.2.2 Co-operative Development Policy, 2002

Co-operative Development Policy (CDP), 2002[75] provides for the overall objectives and strategies necessary to ensure that the poor people and those disadvantaged in the society have a reliable vehicle for attaining economic and social development through collective efforts. The policy was the first to address a list of comprehensive issues; the most important being the promotion of autonomous member based co-operatives that observe internationally recognized co-operative values and principles (URT, 2002b: 12-16). The policy came at the right time when there were changes in macroeconomic environment taking place both nationally and internationally. In addition, the co-operative movement was caught in a deep crisis that called for immediate revival, strengthening and facilitative intervention based on a new enabling policy and regulatory framework (URT, 2005e:5-8).

The Co-operative Development Policy, 2002 recognizes the role of co-operatives in poverty reduction, and thus defines the roles of various actors. It addresses co-operative development issues in the context of macro-economic changes brought about by globalization and liberalization forces. Moreover, CDP considers cross-cutting issues such as gender, environmental issues, as well as the position of marginalized groups such as youth, women and the disabled. The policy emphasizes the following: commitment of the government in promoting member-driven co-operatives based on internationally accepted principles, recognizing economic groups as a step towards genuine co-operatives, focusing on commercially oriented and business minded leadership, and appreciating the structural and historical factors that hinder co-operative development in liberalized market environments (URT, 2000b).

The government has established the Co-operative Reform and Modernization Programme (CRMP), which is envisioned to translate the CDP into more practical

[75] The first Co-operative Development Policy was established in 1997 to provide the overall guidance for interested members to come together for a common goal, but this was never implemented as it lacked strategy.

terms to achieve its vision, mission and goals (URT, 2005e:5-6). Thus, the aim of the CRMP is to:

> initiate a comprehensive transformation process of co-operatives to become organizations which are member owned and controlled, competitive, viable, sustainable and with capability of fulfilling members' economic and social needs" (URT, 2005e:7).

Both the co-operative development policy and Co-operative Reform Programmes recognize the role of co-operatives in rural finance, where emphasis is placed on co-operative financial services. Consequently, specific rules to supervise and regulate co-operative financial services have been put in place (URT, 2005f).

5.2.3 Rural Development Strategy (RDS)

The overall goal of the Rural Development Strategy (RDS) is to provide a strategic framework for the co-ordination of strategies related to the development of rural communities. It is geared towards creating opportunities for rural communities to attain sustainable livelihoods (URT, 2001b:3). In this context, the RDS identifies short and medium term priorities in order to contribute to the long-term goal of sustained economic growth as outlined in the country's Vision 2025. The RDS involves four categories of strategic interventions. These categories are (i) promoting pro-poor growth, (ii) increasing opportunities and access to services and assets, (iii) reducing risks and vulnerability, and (iv) adherence to good governance (URT, 2001b:27-68).

The RDS realizes that the improvement in the standard of living of the rural people depends on several initiatives. These include commercialization of smallholder agriculture, improving infrastructure and services, improving access to economic and social services, financial services and markets, and ensuring sustainable management of the natural resource base[76]. In this context RDS provides strong

[76] In this respect the RDS appreciates the need for harmonization and rationalization of sectoral policies into an integrated strategy that encompasses the issues of globalization, liberalization and decentralization if it has to become an effective strategy for poverty eradication. Besides, RDS views poverty reduction initiatives as demanding integrated and holistic interventions.

linkages with major country policy initiatives that are complementary to one another (URT, 2001b: 27-40).

The policy recognizes access to financial services as a crucial component in the improvement in rural productivity and investments. Indeed, efficient and cost-effective financial services are a stimulant to the private investment needed to induce growth and reduce poverty. The absence of well-functioning rural financial markets continues to constrain rural development. The RDS identifies three main constraints to the development of rural financial markets that need to be addressed, namely: (i) adverse macro-economic environments and unfavourable agricultural and financial sector policies; (ii) weak institutional capacity of rural and micro-finance institutions to expand their services due to poor governance and operating systems, low skills, and inadequate physical infrastructure; and (iii) weak legal and regulatory frameworks that contribute to unclear property rights and inhibit secured transactions (URT, 2001b:29). In addressing these weaknesses the RDS stated the need for development of a favourable policy that would provide for an enabling environment for the growth of rural financial markets and sustainable MFIs.

5.2.4 Small and Medium Enterprise Development Policy, 2003

Small and Medium Enterprises (SMEs)[77] are considered an important foundation for the growth of the private sector in Tanzania. The majority of the SMEs fall within the category of the informal sector, yet they are very important in terms of job creation, income generation, and stimulation of growth in both urban and rural areas. A strong and productive industrial structure can be developed where SMEs and large enterprises coexist. Thus, the SME Development Policy addresses the need for developing linkages between different sectors in the economy (URT, 2003e:1-14).

[77] SMEs stand for Micro-, Small- and Medium enterprises that cover non-farm activities. There is no universally accepted definition of what SMEs are. However, certain characteristics based on number of employees; investment; and sales turnover are used to explain them.

The vision of the SMEs Development Policy is to have a vibrant and dynamic SME sector that ensures effective utilization of available resources to attain accelerated and sustainable growth. The mission of the policy is to stimulate development and growth of SMEs activities through improved infrastructure, enhanced service provision and creation of an appropriate legal and institutional framework so as to achieve competitiveness. In this context, the overall objective of the policy is to foster job creation and income generation through promotion of SMEs and improving competitiveness of existing ones in order to increase their participation and contribution in the economy (URT, 2003e:16-17).

The policy appreciates SMEs' limited access to financial services due to: (i) the perception that it is a high risk sector to lend to, (ii) inability of SMEs operators to fulfil collateral requirements, (iii) most banks are not operating micro-credit facilities, (iv) some banks have limited geographical operating areas, (v) lack of guarantee facilities to support banks financing SMEs, and (vi) high cost of loan administration. The policy envisions improving this situation by enhancing financial sector reforms through further liberalization and the creation of financial intermediaries that carter for the needs of SMEs (URT, 2003e:24-26).

5.3 Regulation and Supervision of Financial Institutions

According to Chami, Khan and Sharma (2003:10) Regulation and Supervision are built on three-pillars[78], namely (i) setting of rules to be used by a regulator (regulation); (ii) establishing a system for monitoring and enforcement of regulations (supervision); and (iii) creating a system for enforcement of good behaviour by financial markets and institutions (market discipline). The Banking and Financial Institutions (BAFIA) Act of 1991 empowered the Bank of Tanzania with prudential regulatory and supervision framework. The Bank of Tanzania (BoT), is therefore, charged with the task of strengthening the overall legal and regulatory framework with the view of increasing financial discipline and improving the credit repayment culture.

[78] The BAFIA 1991; Bank of Tanzania regulations and Circulars all address the three pillars: Regulations, Supervision and Market Discipline.

In order for the Bank to be able to properly perform the regulation and supervision of financial institutions, the BAFIA of 1991 was required to be translated into specific legislations, and guidelines. Consequently, the government designed a Regulatory and Supervisory Framework to guide the BoT by developing three specific legislations, namely:

(i) The Bank of Tanzania Act of 1995, which empowers the Central Bank to regulate and supervise banks and financial institutions,

(ii) the Foreign Exchange Act, 1992 provides for efficient administration and management of dealings and other acts in relation to gold, foreign currency, securities, payments, debts, import, export, transfer or settlement of property, and

(iii) the Co-operative Societies Act, 2003 and its accompanying Co-operative Societies' Rules, 2004 to provide for the regulation and supervision of co-operative and co-operative-like financial institutions, which are delegated to the Co-operative Division under the Ministry of Agriculture, Food Security and Co-operatives.

In exercising its regulatory and supervisory powers, the Central Bank focused on three critical issues. First, the implementation of prudential controls concerning capital adequacy, liquidity, concentration of credit and risks diversifications, assets classification and provisioning, and indulgence in prohibited activities. Second, licensing of banks and financial institutions, and third, facilitating and monitoring of a deposit Insurance Fund to protect, mainly small depositors. Thus, various regulatory frameworks in the form of Rules, and Regulations were developed. In addition, the BoT is also empowered to issue circulars from time to time to guide and direct operations of financial institutions (www.bot-tz.org/Banking Supervision/methodol.htm visited on April 24th, 2006).

According to the BoT (www.bot-tz.org/Banking Supervision/methodol.htm visited on April 24th, 2006) the following regulations and guidelines are in place:

(i) Banking and Financial Institutions Regulations, 1997,

(ii) Management of Risk Assets Regulations, 2001,

(iii) Capital Adequacy Regulations, 2001,
(iv) Liquid Assets Ratio Regulations, 2000,
(v) Publication of Financial Statements Regulations, 2000,
(vi) Independent Auditors Regulations, 2000, and
(vii) Credit Concentration and other Exposure Limits Regulations, 2001.

The Banking and Financial Institutions Regulations, 1997 stipulates conditions for entry and exit into the banking industry as well as licensing requirement. It describes broad criteria for licensing that includes financial soundness, character and experience of shareholders, business strategies, plans and policies, capital adequacy, and contribution to economic development. The regulation also sets minimum capital requirements, and demands for plans as to whether there would be branches, representative office, agencies, or subsidiaries to be operated by the bank or financial institution seeking licensing. The minimum capital requirement to open a commercial bank account was Tshs 1 million, but has been increased to 5 billion and for a non-bank financial institution is between Tshs. 200 and 500 million. These details are summarized in Table 5.1 below. The shareholders are required to double the minimum core capital within five years since licensing of the bank.

Table 5.1: Minimum capital requirements, 2005

No.	Category of Financial institution	Minimum capital (Tshs.)	Minimum capital Adequacy/gearing ratios (%)
1.	Nation-wide commercial banks	5 billion	8
2.	Regional Banks	200 – 500 million	10
3.	Financial Company	800 million	-

Source: Extract from microfinancegateway.org/resource_centres/reg_sup/mic_reg/compare/?PHPSESSI… visited on April 24th, 2006.

The Management of Risk Assets Regulations, 2001 provides for prudential guidelines on management of risk assets, classification of loans, and other risk assets and provisioning for losses and accrual of interest. The Capital Adequacy Regulations, 2001 provides for measurements of capital adequacy to protect depositors and banks so as to avert incidence of bank failure. The Liquid Assets Ratio Regulations, 2000 guide measuring and monitoring of liquidity of banks and financial institutions and maximum ratio of loans to deposits, whereas the Publication of Financial Statements Regulations, 2000; requires banks and financial institutions to publish their financial statements for public accountability purposes.

Other regulations are the Independent Auditors Regulations, 2000, which requires commercial banks and financial institutions to be audited by independent, but approved practising auditors. The BoT provides the list of such firms from time to time, for banks and financial institutions to choose from. The Credit Concentration and other Exposure Limits Regulations, 2001 aims at diversification of risks, providing for business relationships between bank/financial institutions and its members of governing boards, staff, and shareholders. It also regulates provision of credit facilities to broader group of borrowers, and to guide for amount of investment in fixed assets.

Regulation and supervision of banks and financial institutions is necessary in order to bring about the stability of the financial system. Crisis in financial systems and weak regulations are regressive, in that they tend to bring decline in economic growth and lead to profound effects on macro-economic stabilities. Experiences elsewhere have shown that stable financial systems are important for economic development. According to Kirkpatrick and Green (2002:207) the crises of the financial systems in East Asian countries experienced during the early 2000s demonstrates this reality. Moreover, regulation and supervision increases public confidence in the financial institutions, reduces risks and brings market discipline in the industry (Chami, *et. al*.; 2003:9-12).

The Directorate of Banking Supervision within the Bank of Tanzania is responsible for Regulation and Supervision of banks and financial institutions in the country. The BoT carries both on-site and off-site surveillance of banks and financial institutions. It carries on-site inspection of books and other financial records of financial institutions to satisfy itself of the soundness of the banks and financial institutions. According to BoT (www.bot-tz.org/Banking Supervision/methodol.htm visited on April 24th, 2006) on-site inspection involves a full scope examination of Capital Adequacy, Asset Quality, Management Quality, Earnings Capability and Liquidity (in short CAMEL). Furthermore, the Bank verifies banks' and financial institutions' compliance with laws and regulation and examines the effectiveness of their internal control system. On-site examination answers many queries easily as it provides an opportunity to obtain on the spot clarification without resorting to time consuming correspondences. The BoT carries out on-site examination of each bank once every year.

In addition, the BoT also undertakes off-site surveillance through review of the regulatory reports from banks and financial institutions to monitor and supervise their operations. It is concerned with on-going analysis of prescribed prudential returns submitted by the bank and previous examination information. These returns include weekly liquidity reports, report on statutory minimum reserve, report on foreign exchange net open position, monthly balance sheet, income statements and related schedules, quarterly publications and annual audited financial statements (BoT, 2004b:27). From the off-site assessment, the BoT produces an Early Warning Report in case of any alarming situation that may require attention.

The BoT is not the sole regulator of the financial sector, although it is the primary regulator. In the capital markets, there are number of regulatory and supervision instruments put in place and implemented by the Capital Markets and Securities Authority (CMSA). The CMSA Enforcement Guidelines, 2003 was developed to set out the practice and procedures to be followed when conducting investigations in the event of a breach of the law and regulations. Moreover, it provides disciplinary actions to be taken and measures to rectify the defaults observed in the capital market (CMSA, 2005: 15). Likewise, the Gaming Board of Tanzania (GBT) and the Insurance Supervisory Department of the Ministry of Finance regulate and supervise gaming (gambling and lotteries – national lottery, private lotteries, and varied promotional lotteries), and the insurance industry respectively. Gaming was formally licensed in the country in 2003, and a national regulatory body – the GBT was established.

5.4 Harmonization of Standards and Compliance with Basel Core Principles

The current regulation and supervision environment in Tanzania is based on the implementation of Basel I Accord[79], compliance with the Core Principles for Effective Banking Supervision, and implementation of the second Generation of Financial Sector Reforms (BoT, 2004c: 26). This is in line with Basel II Accord, which focuses on international convergence of capital measurements and capital standards. It places strong emphasis on the understanding and assessment of adequacy of bank's risk in appropriate and timely manner in addition to full implementation of Basel I Accord. Consistent with this, BoT has put in place Risk Management Guidelines for banks and financial institutions to keep abreast with the requirements of the Basel II Accord.

The Basel Committee of the Bank for International Settlements (BIS) formulated the first Basel Accord – Basel Accord I – in 1988, which emphasized the importance of capital adequacy in supervision and regulation (Chami, Khan, and Sharma, 2003:9). This was necessitated by the need for defining the best practises for the banking standards internationally. This response was necessary as a result of the changes that unfolded during the 1970s through 1980. Firstly, during this period, the interest rates and exchange rates were deregulated as a result of the changing macroeconomic environment. Secondly, there were the advances in the information communication technology industry that brought profound changes in the banking industry. Thirdly, the competition that ensured in the financial sector called for a global response to the need for standards in regulatory framework.

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[79] Basel Accord is an agreement made by the Basel Committee that provides an international forum for regular co-operation on banking supervisory matter formed by Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, The Netherlands, Spain, Sweden, Switzerland, United Kingdom, and USA (www.bis.org/bcbs/index.htm visited on November 30th, 2006).

However, by 1999 it was obvious that Basel I could not provide adequately for the regulation framework of banks, as there were a number of deficiencies. For instance the risk categories used under Basel I focused in the calculation of risk – weighted assets that were crude and easily dodged by banks. In addition, Basel I did not consider other risks apart from credit risks. As a result, the Basel Committee prepared Basel II that came up with three pillar approach to regulating banks. These, according to Chami, *et al* (2003:10), are: (i) regulation in the form of rules/guidelines defined by the government or its agency, (ii) supervision – the monitoring and enforcement of regulations, and (iii) market discipline which is embodied in the enforcement of good behaviour by financial markets and institutions.

The BoT has expanded co-operation both nationally and internationally in its efforts to harmonize standards and increase co-operation in banking regulation and supervision. It has continued working very closely with the IMF and World Bank as well as other regulators locally and regionally. It has, for instance, carried on-site examination activities with other Central Banks of the East African countries of Kenya and Uganda in the spirit of fostering harmonization of the banking supervision approaches, practises, and sharing of skills and knowledge among the three regulators in the region (BoT 2003:29). The BoT has participated in the Committee of central bank Governors forum in Southern African Development Community (SADC). Moreover, locally the bank has initiated a national forum for financial sector regulators – the Capital Markets and Securities Authorities (CMCA); Gaming Board of Tanzania (GBT); Insurance Supervisory Department of the Ministry of Finance[80]; and BoT itself.

The liberalization of the financial sector has opened up doors to investors. There are exploiters who take advantage of investments by legitimizing unlawfully

[80] The Ministry through its Insurance Supervisory Department regulates and supervises the Social Security and Insurance Schemes. The insurance industry is supervised based on the Insurance Act, no 18 of 1996, which empowers the government through the Ministry of Finance to supervise the insurance industry in the country.

earned money. The worldwide integration of financial systems and freedom to move capital across international boundaries has made it possible for money to be laundered on a global basis. There are variety of methods of laundering money, ranging from purchase and resale of properties, assets, etc. Tanzania is not left out of the global war against money laundering and the financing of terrorism. The BoT has participated in the drafting of Anti-money laundering legislations, training and capacity building measures, raising awareness on money laundering and combating financing of terrorism (BoT, 2004b:32). A Financial Intelligent Unit (FIU) is expected to be established to collect and disseminate information to law enforcement agency with respect to Anti-Money Laundering.

Money laundering not only accelerates crimes but also has an economic effect. It increases money supply that fuels inflation and food prices, resulting into what is commonly referred to as the “Dutch disease” in an economy. Money laundering poses a real threat to genuine development in the world. There are various global efforts geared towards curbing money laundering. According to BoT officials the G-7 during their Summit in Paris in 1989 established the Financial Action Task Force (FATF) with the aim of promoting the development and establishment of policies that would contain money laundering. FATF has affiliates such as the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG). The members of ESAAMLG include Tanzania, South Africa, Kenya, Malawi, Mauritius, Mozambique, Namibia, Seychelles, Uganda and Swaziland.

5.5 Regulation and Supervision of Microfinance Institutions

According to Microfinance Gateway (2004: Regulation Home Page: Basics visited on 24 April, 2006) regulation is defined as:

> …the set of government rules (including laws, regulations, and their implementation) that applies to microfinance. It aims at overseeing the financial soundness of licensed intermediaries’ businesses in order to prevent financial system instability and losses to depositors.

Supervision on the other hand, is the process of ensuring compliance with set of rules established for regulations.

There are two types of regulation – prudential and non-prudential. Prudential regulation aims at protecting the financial system as a whole and the safety of small deposits in individual institutions. Thus, prudential regulation focuses at protecting the financial soundness of a financial institution, while non-prudential regulation concentrates on MFI's business operations. Non-prudential regulation intends to prevent frauds and crimes; examine interest rate policies; and assesses credit information, management, sources of capital, tax and accounting and consumer protection. When compared, the prudential regulations are relatively complex, difficult and above all very expensive as it involves understanding and protecting the MFI's operations in the financial system as opposed to non-prudential regulation.

It is important to make a clear distinction on what is regulated – Microfinance's or Microfinance activities[81]. There are two cases, where regulation of Microfinance is either done by establishing new, specialized institutions that would legitimize microfinance operations or microfinance activities that are conducted across the entire financial system. New and specialized microfinance institutions are required by law to be established by regulation and need to focus on microfinance. However, according to Microfinance Gateway (2004: Regulation Home Page: Basics visited on 24 April, 2006) where microfinance activities are carried over the entire system, one needs to regulate the microfinance activity, where emphasis will be placed on the following:

(i) lending activity – e.g. loan size, limit of borrowers to micro entrepreneurs, credit decisions not necessarily to be based on collateral but rather on borrowers character and cash flow,

(ii) regulations to focus on microfinance portfolio addressing such issues as capital adequacy ratios, minimum capital requirements, limits on unsecured lending, provisioning a high percentage on unsecured lending, full registration of collateral costs, requirements for branches,

[81] This practise is appropriate especially where Micro-lending is regarded as illegal under existing law or where an existing financial license does not allow for Microfinance activities.

standard loan documentation requirements; and interest rate caps to cover administrative counts through charging higher interest rates.

In Tanzania, the National Microfinance Policy provides the basis for Regulation and Supervision of Microfinance Institutions[82]. The policy appreciates the need of integrating the Microfinance sector into a broader national financial system for the development of the country's financial market. Moreover, the policy underlines the fact that microfinance, as a line of business, can be undertaken by a variety of institutions promoting diverse financial and non-financial products employing various methodologies (Rubambey, 2005:2-3). The policy recognizes four types of institutions:

(i) commercial banks, community banks, cooperative banks, non-bank financial institutions,
(ii) those MFI's specializing in the provision of microfinance,
(iii) member – based MFI's, and
(iv) Micro-lending organizations - NGO's, and Microfinance Companies.

The Directorate of Banking Supervision together with the Directorate of Micro-finance and other stakeholders have developed appropriate regulatory framework for microfinance institutions. These have been translated into various regulation guidelines as follows:

(i) SACCOS Regulations, 2005
(ii) Financial Co-operative Societies (FICOS) Regulations, 2005.
(iii) Microfinance Companies and Micro-credit Activities Regulations, 2005
(iv) Independent Auditors Regulations, 2000; and
(v) Internal control and Internal Audit Regulations 2005

[82] The policy outlines three tools for its implementation: regulation and supervision of MFI's; development and application of standards; and capacity building.

(i) SACCOS Regulations, 2005

Savings and Credit Co-operative Societies (SACCOS), like other forms of co-operatives, are regulated by the Registrar of Co-operatives, save for those that qualify for supervision by the BoT under the Financial Co-operative Societies (FICOS) as discussed below. All financial co-operative societies are to be registered under the Co-operative Societies Act, 2003 and are subjected to the Co-operative Societies Rules, 2004.

(ii) Financial Co-operative Societies (FICOS) Regulations, 2005.

Financial Cooperative Societies (FICOS) Regulations, 2005 provides registration and licensing requirements; supervisory framework; and describes the minimum capital conditions. FICOS regulations 2005 establishes minimum cut off point for SACCOS to be placed under the supervision of the BoT. This amount is the same as those provided for Microfinance Companies which is Tshs. 800 million. The regulation of SACCOS of this type by the BoT is justified on the ground that as SACCOS grow, the willingness and capacity of the members to control their society declines, hence there is loss of accountability and transparency. The involvement of the BoT is aimed at addressing this weakness in addition to protecting depositors' money. In addition, for an economy like Tanzania, this is a substantial amount that can cause instabilities in the financial sector if unchecked.

(iii) Microfinance Companies and Micro-credit Activities Regulations, 2005

The Microfinance Companies (MFCs) regulation stipulates the minimum core capital and other licensing conditions; along with specifying lending limits, capital adequacy, asset quality, and reporting requirements.

The minimum core capital for MFCs is set at Tshs 800 million in the case of a nation-wide branch network and Tshs. 200 million in the case of a unit MFCs – without a branch network. The prescription for minimum capital requirement is necessary for the MFC to be able to acquire the required infrastructure, technology and above all be able to attract qualified staff.

The Microfinance Companies (MFCs) are legally required to be registered with the view that these may attract foreign investors. NGOs with a good track record, in collaboration with a strategic partner may acquire shares in a MFC of up to 66% as opposed to 20% limit applicable to commercial banks and other financial institutions (Rubambey, 2005:5). Table 5.2 provides summary of regulatory frameworks operating in the country as derived from different regulations.

Table 5.2: Summary of Regulatory framework for MFIs, 2005

Categories of MFIs	Licensing Authority	Minimum Capital (Tshs.)	Regulatory Authority	Other Requirements
Microfinance Companies	BoT	200 – 800 million	BoT	Shareholding up to 66%
Financial Co-operatives	BoT/Registrar of Co-operatives	200 - 800 million	BoT/Registrar of Co-operatives	Shareholding limited to 20%
SACCOS	Registrar of Co-operatives	None	Registrar of Co-operatives	Shareholding limited to 20%
Commercial Banks	BoT	200 million – 5 billion	BoT	Shareholding limited to 20%

Source: Extracts from various Regulations.

According to Rubambey (2005:2) prudential regulations related to micro-credit activities are applicable to all banks and financial institutions engaged in microfinance business. All MFIs are required to report their micro-credit portfolios and follow credit methodology and the reporting format recommended by the BoT.

(iv) Amendments to the Independent Auditors Regulations, 2000

This amendment was made in order to clearly specify the duties of independent auditors when carrying the audit function of an MFI. The amendment specified the scope of the audit and special reports to be prepared to cover: (i) assessment of the accuracy, security and effectiveness of the information system, (ii) examine implementation of the internal control systems, (iii) assess credit classification and provisioning, and (iv) evaluate compliance with the relevant regulatory framework for money laundering.

Although, previously it was mandatory for co-operative financial institutions to be audited by the public Co-operative Audit and Supervision Corporation (COASCO), now the Board of Directors are allowed to choose any reputable and qualified firm to undertake audit task.

(v) Internal control and Internal Audit Regulations 2005

This regulation is for banks, financial institutions and Financial Companies (FICOS). The objectives of this regulation are: (i) put in place effective internal control system followed by the management; and (ii) promote quality of internal control and internal audit functions without hindering development of new financial products and services.

The supervisory framework for the MFIs in Tanzania is summarized in Table 5.3, where supervisory authority is clearly indicated for the different MFIs and the instruments and strategies identified.

Table 5.3: Supervision Authorities and Instruments for MFIs in Tanzania, 2005

No.	Supervisory Authority	Institutions to be supervised	Supervisory Instruments and strategies relevant to microfinance
1.	Bank of Tanzania (Central Bank)	▪ Commercial Banks ▪ Financial Institutions (including MFCs) ▪ FICOS	▪ License MFCs ▪ License FICOS ▪ Review microfinance operations of commercial banks and other financial institutions (whose core business is not microfinance) through segmented financial reporting. ▪ Conduct on-site and off-site examinations ▪ Review external audit reports and conduct random attestation of audit firms.
2.	Registrar of Cooperatives	SACCOS	▪ Register SACCOS ▪ Conduct on-site and off-site examinations of SACCOS ▪ Review external audit reports and conduct random attestation of audit firms
3.	Ministry of Finance (Technical Credit Unit)	NGOs	▪ Review external audit reports prior to authorizing disbursement of funds provided by Government or donors. ▪ Grant accreditation to NGOs as “Micro-credit Institutions – MCIs” ▪ In coordination with NBAA, review external audit reports and conduct random attestation of audit firms auditing the respective NGOs.

Source: Rubambey (2005:12)

Table 5.3 depicts the supervisory authorities of MFIs falling under three main institutions – the Bank of Tanzania, Registrar of Co-operatives, and Ministry of

Finance. The Ministry of Finance, and the Ministry of Agriculture, Food Security, and Co-operatives are instrumental in the development of MFIs. Apart, from other units supervising MFIs under the Ministry of Finance, the BoT also falls under the same Ministry of Finance. On the other hand, the Registrar of Co-operatives not only supervises SACCOS, but also the co-operative-like financial institutions such as SACAs.

5.6 Limitation of the Regulation and Supervision framework

The supervision and regulation of the increasingly growing microfinance industry brings a complication to BoT. This complications arise out of the *nature of MFIs* (i.e. rely on grants, donor funds, members' deposits, or leverage public funds); *operations* (credit only, savings and credit, or accept deposits); *ownership; size; and target clientele*. In regulating and supervising MFIs, the BoT is mandated to apply the same basic principles that apply to the banking industry. However, regulations and supervision of MFIs requires some modifications in the approach and methodology. It must be noted that the regulatory and supervisory framework should seek to foster rather than inhibit the development and growth of the MFIs sector. It is important supervision and regulation framework for MFIs to take into account lessons for successful operations of the informal financial system, for instance, in terms of loan repayment enforcement mechanisms, flexibility, and above all how to integrate practices in the informal financial system into formal structures.

The capacity of the designated institutions in regulating and supervising MFIs is questionable. Although the BoT has re-defined its organizational structure to meet the new functions of the Bank as stipulated under the BoT Act of 1995, it has limited capacity to regulate and supervise MFIs in the traditional sense. According to Randhawa and Gallardo (2003:17) the number of staff in the Directorate of Microfinance has increased from four when it was established to fifteen in 2003.

This increase in number of staff did not commensurate with the rationalization of MFIs[83] operating in the country. A "rush at regulation" might constrain the growth of MFIs rather than supporting its natural development and products diversifications.

The regulation and supervision of Savings and Credit Co-operative Societies (SACCOS) is currently undertaken by the Registrar and/or BoT for those in the group of FICOS. The Co-operative Audit and Supervision Corporation (COASCO) performs external audit of SACCOS. However, COASCO and the Co-operative Development Department have no adequate technical staff to audit, supervise and regulate co-operative financial institutions. On the other hand, SACCOS have themselves internal weaknesses in leadership and management capacities hence not effectively undertaking self-regulation.

There are also concerns such as those raised by Randhawa and Gallardo (2003:22-32) that the judicial system of Tanzania has borrowed heavily from the British legal system. As a result this provides an underdeveloped nation with a sophisticated regulatory framework that is in line with the international standards, but which is of little use to the ordinary citizen as well as to the underdeveloped economy such as that of Tanzania. This might be useful in the long-run; it is of little assistance in the immediate future.

Much of the economic activities in Tanzania are operated informally. Formalization of businesses and properties is highly desirable. This calls for an appropriate incentive schemes for the growth of formal local companies operating formally with available business information and records. However, the growth of the private sector is constrained by inadequate enforcement capacity and lack of will

[83] MFIs are principally of diverse in nature, they include banks, financial co-operatives, and financial NGOs, and hence they are registered under different statutes. Within each category, registration is also different e.g. Financial NGOs are registered under different statutes: Registrar of Societies Ordinance Cap. 37; Trustees Incorporation Ordinance, Cap. 375; and Companies Ordinance, Cap. 212. As a result it is difficult to have uniform standard for supervision and regulation for all of them, unless some kind of harmonization and rationalization is done.

for formalization of businesses and properties, bureaucratic practices, corruption, and lingering culture of non-payments of debts.

Liberalization of the financial sector, has brought with it the advancement in technologies, and financial innovations in the banking and financial institutions. These developments have led to increased diversification in products and services, leading to improved productivity, efficiency, security, and decision-making supported by automated systems. On the other hand, raised security concerns have come about due to increased information and data. For instance easy access of proprietary information and data by unauthorized persons by downloading onto USB flash disks or MP 3 players, and/or uploading potentially harmful software or viruses.

5.7 Non-prudential Issues: Capacity Building and Regulatory Instruments

5.7.1 Conducive Policy Environment

The government is responsible for creating a conducive environment for growth and the development of MFIs through appropriate policy, guidelines and regulatory framework. Since the policy and regulatory frameworks are in place, there is now a need for capacity building of all institutions involved. There are various actors in the microfinance industry conducting trial operations in microfinance in search of the standards for the “MFIs BEST PRACTICES”. As a result there are varied programmes supported by donor agencies, government, and research and training institutions that are piloting specific interventions through implementation of projects and programmes. Appendix 5.1 provides a list of actors in the microfinance industry in Tanzania, their legal basis and other relevant characteristics. Some of these cover the whole country and some have specific interventions due to limited geographical coverage.

The Bank of Tanzania, using the powers vested on it under the BoT Act, 1995, prepared an Operational Guideline for Government and Donors supporting the Microfinance Sector in Tanzania. In addition, the BoT has established the

Tanzania Microfinance Institutions Directory, which provides information about the main actors and operators in the Microfinance industry. The purpose of this Directory is to provide information concerning MFIs' legal status, market outreach, the target group, and contacts for interested parties including the general public. The operational guidelines aim at promoting the growth of strong, self-sustaining MFIs participating in intermediating micro-finance services to clients and other service providers in the industry. It also provides for the role that the government and donors have in supporting the development of MFIs in the country.

The National microfinance policy provides tools for policy implementation, which includes regulation and supervision, development and application of standards, and capacity building. Regulation and supervision of micro-finance institutions is important for the development and expansion of market-based microfinance services. This is important, because it serves the low income segment of the population. It also requires institutions to have access to financial resources and funding far beyond what donors and the government can provide. In addition, MFIs cannot easily and safely access money from commercial banks and financial institutions without appropriate regulatory and supervisory frameworks in place. There is also a desire to integrate the microfinance activities within the larger national financial system for efficient and effective economic operations.

Another tool for policy implementation is the development and application of standards. This is important because it facilitates the development of a strong micro-finance industry in the country. Finally, the need for capacity building of all actors is called for in order to meet the set standards of operations in the industry. There is a need to address the challenges that the industry is facing at the moment. These needs include how to meet the financial needs of the rural population who are scattered in rural areas, and where communication and transport infrastructures are poor, markets are segmented, and the degree of illiteracy and innumeracy are high.

It is prudent to mention some institutional aspects that have been put in place by the government and other stakeholders to facilitate the development of the financial market. These are (i) the establishment of the Credit Reference Bureau (CRF), (ii) establishment of the Tanzania Bankers Association (TBA), a forum for stakeholders' in the banking industry, (iii) formation of Commercial Courts, and (iv) introduction of a programme on Formalization of Property Rights in the country.

5.7.2 Credit Reference Bureau (CRD)

The biggest problem commercial banks are facing is the non-repayment of loans. To overcome this problem, an institution is required to monitor the behaviour of borrowers. Thus, the idea of establishing Credit Reference Bureau (CRDB) was conceived in order to enable banks to determine credit worthiness of their borrowers – individuals, groups and enterprises; and therefore reduce the loan default risk. Services of Credit Reference Bureaus (CRD) were first introduced in London and have now spread to other countries worldwide. It is now operating in Kenya, Tanzania, Uganda, Zambia, Ghana, Botswana, Malawi, Cameroon and Egypt (The Citizen Thursday 27th July, 2006 "Easing Loan Provision" p.13).

The CRB was formally established in Tanzania in 2003 when the government enacted a legislation to operationalize its operation in the country. However, a regulatory framework to guide its implementation is lacking. The CRB, when operational, will be licensed by BoT to access the information database on the way banks offer loans and their repayment characteristics. In this respect the CRB will help in: (i) sharing information on default among banks; (ii) eliminating corrupt borrowers – those with the aim of borrowing from different financial institutions with the aim of defaulting; (iii) providing commercial professional credit reference to say prospective foreign investors; and (iv) identifying honest/credible borrowers based on known history and character.

5.7.3 Establishment of the Tanzania Bankers Associations (TBA)

In 1995 commercial banks and other financial institutions formed the Tanzania Bankers Associations (TBA). The TBA provides a forum for dialogue with the government in addressing issues of relevance to the industry. These include issues such as legal and regulatory frameworks, policies as well as sharing experiences in financial businesses (The Guardian, Wednesday April 12th, 2006). The forum has so far 28 memberships from commercial banks operating in the country (The Guardian, Wednesday April 12th, 2006). Moreover, such a forum is important as it increases public – private partnership in the development of the financial market in the country.

5.7.4 Formation of Commercial Courts

The government has established commercial courts in order to improve the performance of the Judiciary machinery. The establishment of the Commercial Courts is a great step forward in law enforcement against defaulters. This also includes the attachment of defaulters' assets and where necessary, auctioning off their assets to recover the loans.

5.7.5 Formalization of Businesses and Property Rights: MKURABITA

The government has established a programme on Formalization of Property Rights (also known in Kiswahili as *"Mpango wa Kurasimisha Rasilimali na Biashara za Wanyonge* – and in short as MKURABITA") to enable the rural population to tap into formal banks, by having their businesses and properties formalized. MKURABITA focuses on empowering Tanzanians for self-development by improving the collateral system. The programme is supported by the Institute of Liberty and Democracy (ILD) under Prof. Hernando de Soto of Peru and the Norway Registers Development (NRD). MKURABITA is a poverty reduction initiative and hence a vehicle for MKUKUTA that addresses the issues of income poverty through economic growth at grassroots level. It aims at building a national legal framework on property ownership rights and business that merges an improved version of the present traditional practices in the extra legal sector and improved laws governing property and business.

MKURABITA targets owners of properties and businesses in the informal sector or more appropriately the extra legal sector seeking to transform their businesses and property ownership into legally held and operated entities. It is envisaged that properties and businesses will equip the owners with the following mechanisms for creating wealth:

(i) property rights that promote economic potential of assets, integration of dispersed information, fungibility of assets, accountability networking of actors (people), and protection of transactions,

(ii) business organization forms which ensure appropriate division of labour, business's separate legal entity, perpetual succession, asset partitioning, limited liability, legitimacy of associations, professional management, contracting to third parties, management accountability, availability and access to information on business transactions, and

(iii) access to expanded markets emanating from standardized and enforceable rights obligations, protection of trade names and marks, accountability at national, and international levels, promotional activities, registration of contracts, oversight on compliance with regulations improved accounting and investments (The Citizen Wednesday April 19th, 2006 No. 498).

5.8 Summary and Conclusions

This chapter reviewed the role of Supervision and Regulation in the development of the financial sector as exercised by the government. The chapter starts by providing the policy context under which regulation and supervision were prepared. Financial sector liberalization and reforms were initiated through the BAFIA 1991. Consequently, the government formulated various legislations, which were translated into supervision and regulatory frameworks. These included the BoT Act, 1995 empowering the Central Bank to perform Regulation and Supervision of the banks and financial institutions; Foreign Exchange Act, 1992 to provide for efficient management of dealings in foreign exchange, gold, trade and the like. The Co-operative Societies Act, 2003 to provide for the regulation and supervision of co-operatives in a market economy.

Consistent with the BoT Act, 1995 the regulatory and supervisory frameworks for banks and financial institutions were established through series of Regulations, Circulars and guidelines. These provided such conditions for entry and exit as well as the need for registration and licensing, minimum capital requirement, and criteria for financial soundness. Others provided for management of risk assets, and provisioning for losses and accrual of interest.

The Directorate of Banking Supervision is responsible for the regulation and supervision of banks and financial institutions. The BoT carries both on-site and off-site surveillance of banks and financial institutions. It carries on-site inspection of books and other financial records in order to satisfy itself on the financial soundness of the respective banks and financial institutions. Besides, it examines their compliance with laws and regulations in addition to assessing the effectiveness of the internal control systems. The Bank carries off-site surveillance through review of reports from banks and financial institutions.

The current regulation and supervision framework focuses on implementation of Basel II, compliance with Core Principles for Effective Banking Supervision, implementation of the second generation of the financial sector reforms as recommended by the IMF. These emphasise a three-pillar approach to the regulation of banking and financial institutions, which include regulation defined by a set of rules and guidelines, monitoring and enforcement of regulation, and market discipline. In implementing these, the BoT collaborates with various regulators locally, regionally and internationally. The Bank has initiated a local forum with other financial sector regulators including the Gaming Board of Tanzania, the Capital Market and Securities Authority, and the Insurance Supervisory Department. Within the East African region, the BoT has closely worked with its counterparts in Uganda and Kenya, as well as those from the SADC region on various regulatory issues such as anti-money laundering, financing terrorism, and capacity building through training and experience sharing.

The chapter concludes that the government has put into place an appropriate regulatory and supervisory framework that supports the growth of the financial market. However, still there are several constraints that need to be addressed, some of which are structural and others that are institutional weaknesses. Moreover, there is a need for technological advancement, awareness creation, change in mind-set, and upholding good governance among the various factors.

Finally, any prudential regulatory and supervisory framework that supports the growth of the financial sector needs to be flexible, transparent, predictable and capable of addressing potential risks perceived in a timely manner. In a competitive environment, the roles of various actors need to be transparent and easy to fulfil. Prudential regulation and supervision are part of the financial infrastructure that must contribute towards a healthy growth of the financial sector. Thus, it is necessary to see that regulatory and supervision framework adopted at any time does not undermine the efficiency of the financial market.

CHAPTER SIX
THE FINANCIAL STRUCTURE UNDER THE MARKET ECONOMY AND ITS IMPACT ON RURAL LIVELIHOODS

6.1 Preamble

This chapter discusses the development of financial structure in Tanzania after its liberalization, analyzes constraints to access to financial services in rural areas. It also examines the impact of the financial sector reforms on rural households' livelihoods. The intended market based reforms were envisaged to increase access to financial services, improve domestic savings mobilization and enhance efficiency in the financial sector and hence improve national financial structure. Financial structure is comprised of the financial instruments in use (such as bank notes, treasury bills, overdrafts, etc) and financial institutions in a country (Goldsmith, 1969:4-5).

6.2 Financial Markets in Tanzania during the Post-Reform era

Financial markets are comprised of money markets and capital markets[84]. Money markets are concerned with borrowing and lending of short-term nature where treasury bills, commercial papers, and overdrafts form the main financial instruments; while capital markets concentrate on long-term borrowing and lending with corporate and government bonds as main financial instruments (Kashuliza, 1994:31). Financial markets are formed by a financial system and financial intermediaries, where all transactions in financial instruments such as currency, bank deposits, and related services take place (Kashuliza, 1994:31). According to Kashuliza (1994:30) financial systems refer to institutions, instruments and markets in an economy, whereas financial intermediation is a process of buying and selling credit or debt instruments such as securities, bonds, insurance policies, and mortgages. A financial intermediary, therefore, is an agency that serves as a conduit for funds as they move from net savers to ultimate borrowers that consist of commercial banks, savings banks, co-operative

[84] The distinction of financial markets into money and capital markets is necessary because it measures the degree of liquidity of the financial instruments.

financial institutions, contractual savings institutions, development banks, hire purchase, lotteries and informal finance.

Financial markets typically perform three basic functions namely: (i) transfer of funds from surplus units to deficit units; (ii) ration funds among users; and (iii) provide for a return on funds from borrowers to lenders. These functions are performed by financial intermediaries such as commercial banks, credit associations, and co-operative financial institutions. Financial intermediaries do this by providing a system for transferring the time, place, form, and other characteristics of money mobilized from savers to make it available to borrowers in the form of different financial instruments, such as loans, overdraft, etc.

The financial structure in Tanzania is summarized in Table 6.1, which is comprised of three financial sectors, namely: (i) formal finance, (ii) informal finance, and (iii) semi-formal finance.

Table 6.1: Tanzania's Financial Sector Landscape, 2004

Informal Sector	**Semi-Informal Sector**	**Formal Sector**
Saving at home	Saving and Credit Co-operative Societies (SACCOS)	Central Bank
Reciprocal lending among friends and relatives	Micro Finance Institutions	Commercial Banks
Rotating Savings and Credit Associations (ROSCAs)		Development Banks
Savings and Credit Association (SACAs)		Insurance Companies
Self-help groups		Registered Finance Companies and some SACCOS
Money Lenders		National Social Security Fund
Money Guards		
Deposit Collectors		
Village Community Bank		

Source: Modified from Mutesasira, (1999:4).

6.2.1 Financial Sector Reforms and the Bank of Tanzania

Following the Banking and Financial institutions Act, 1991[85], the government introduced a series of reform measures that were aimed at improving efficiency in the financial markets. According to Nyagetera and Kilindo (1995:121) the financial sector reform involved the following:

(i) restructuring of the public financial institutions through write-offs of non-performing assets, appropriate provision for remaining loans and re-capitalization,

(ii) liberalization of interest rates, elimination of credit allocation,

(iii) strengthening the Bank of Tanzania in regulation and supervision of financial institutions, and

(iv) privatization of banks and financial institutions by encouraging private sector participation.

In order to be able to regulate and supervise the banking and financial institutions, the government amended and enacted various laws to provide for an appropriate regulatory and supervisory framework as discussed in chapter five. One of these legislations is that of the Bank of Tanzania Act, 1995; which provided for the regulation and supervision framework for the banks and financial institutions. The BoT Act, 1995 legalized the licensing of both public[86] and privately operated financial institutions. According to the Banking Commission report (1990:12) prior to the BAFIA, 1991 there were no laws that adequately specified and vested the licensing and supervision powers of banks and financial institutions to the Bank of Tanzania. In addition, there was no provision for ensuring the soundness and management of banks and financial institutions, which was accordingly provided for under the BoT Act, 1995.

The Central Bank is also charged with the formulation and implementation of appropriate monetary policy for price stability by regulating quantity of money in

[85] Prior to the BAFIA 1991, the banks and financial institutions were governed by the Banking Ordinance 1960 (Cap.430) as discussed in chapter four.

[86] It was within this framework that Tanzania Postal Bank Act, 1991; National Bank of Commerce (1997); National Microfinance Bank (1997); and CRDB Bank (1996) were re-established and registered.

circulation and instituting controls in credit expansion over time (www.bot-tz.org/AboutBOT_Function.htm visited on January 4th, 2006). In addition, the BoT is also charged with the task of promoting financial development in the country. In this regard, the central bank is expected to create a supportive environment for the development of appropriate market conditions. These conditions provide an ideal circumstance for the growth of a broad range of actors to interact in the rural financial market. Thus, BoT is envisaged to focus on the creation of efficient financial intermediation, facilitate financial innovation, reduce transaction costs and market risks.

6.2.2 Commercial Banks and Rural Finance

Prior to reforms, the financial sector regime in Tanzania was characterized by monopoly of state-owned banks and financial institutions (Nyagetera and Kilindo, 1997:121) that created serious financial distortions. After the BAFIA, 1991, the government initiated restructuring and reorganization of four major public banks: National Bank of Commerce (NBC), Co-operative and Rural Development Bank (CRDB), Tanzania Investment Bank (TIB) and Tanzania Housing Bank (THB). This processes resulted into: (i) closure of 22 loss making branches of NBC in 1993; (ii) closure of THB due to its huge losses, non-performing loans and poor book keeping; (iii) splitting of NBC into National Bank of Commerce (NBC 1997) Limited and the National Microfinance Bank (NMB 1997) Limited respectively, and (iv) privatization of the restructured public commercial banks – NBC, and CRDB (Ndanshau, 1995:7).

Before the financial liberalization, the NBC was the largest commercial bank with 203 branch networks and 337 agencies spread over the regions of Tanzania Mainland. According to the discussions with BoT officials the closure of unprofitable NBC branches and its agencies reduced significantly access to financial services, especially in rural areas. The split of NBC into NMB and NBC respectively was based on the need for separate finance strategy for low income people to be attended through the NMB and corporate and major business through NBC. The NMB Act, No. 22 of 1997 defined the role of this bank as: (i) to mobilize local savings and promote savings habits among low income earners, micro enterprises, small scale farmers, and households; (ii) to set up machinery for provision of loans designed to help low income people; (iii) to provide adequate and efficient financial intermediation services.

The NBC was privatized in 2000 whereby the Amalgamated Bank of South Africa (ABSA) acquired 70% of its shares. On the other hand, the government contracted a USA based contract firm – the Development Alternative Inc. (DAI), to manage the NMB bank in order to improve its business performance (www.psrctz.com/Utilities%20&%Major%20Transanctions/nmb.htm visited on April 23rd, 2006). However, privatization of NMB dragged for some years, but was finally privatized in March, 2006 with the government, through NBC Holding Corporation Limited, holding 51%, Rabobank of Holland 34.9%, NICO 6.5%, Exim Bank 5.8%, and Investment Company Limited 1.7% (discussion with BoT officials, April 2006). The Rabobank will in addition, provide management and technical assistance for the further development of the bank. However, for it to become a modern bank, it calls for massive investment in banking information technology (www.ippmedia.com/ipp/financial/2005/08/31/financialtimes.html. Downloaded 2006-04-25).

The second largest bank was CRDB Bank, which was privatized on 1st July, 1996. The bank adopted a diversified shareholding financial strategy. With an authorized share capital of Tshs. 20.0 billion, its total paid up share capital is so far Tshs.12.3 billion owned by over 11,000 shareholders as of December, 2005. The bank's shareholders are comprised of private individuals (37.0%); co-operatives (14%); Companies (10.2%); DANIDA Investment Fund (30.0%); and National Insurance Corporation and *Parastatal* Pension Fund (8.8%) (www.crdb.com/news2.asp visited on April 20th, 2006).

Since its privatization, the CRDB Bank has improved its services significantly[87]. Its branch network increased from 19 in 1996 to 36 in 2005 located in major towns and 4 at district level. Moreover, it introduced a linkage banking services with 170 Savings and Credit Co-operative Societies through its Microfinance Company (CRDB - MFC Limited) established in 2005. The CRDB MFC Limited undertakes micro-financing activities using two basic models – retailing and wholesaling. First, the retail approach focuses on individual customers where salaried customers can access loans directly from the bank if guaranteed by their employers, and loan amounts are determined by one's salary. The second approach, which is highly preferred by the bank, is whole-selling of financial services through microfinance institutions, mainly SACCOS[88].

Following the privatization of the financial sector, the number of commercial banks and financial institutions combined increased from 12 in 1991[89] to 22 commercial banks, 3 financial institutions, 5 regional unit banks, and 2 regional unit financial institutions by 2005. Table 6.2 shows the list of registered commercial banks in the country as of December, 2005. As it can be discerned from the table, only three banks - NMB, CRDB and NBC have a wide branch network of 104, 36 and 34 respectively.

These banks covered every regional headquarters of Tanzania mainland, except Manyara that is served by NMB only. The NMB has the largest outreach that reaches most districts in the country. With the exception of Stanbic (T) Limited that has 5 branches, and the Federal Bank of the Middle East Ltd and the Peoples

[87] Since its privatization CRDB Bank has undergone extensive bank face lifting with the aim of improving its customer services. It has introduced electronic banking services, refurbished branches – making them more spacious, airy and comfortable (www.crdb.com/news2.asp visited on April 20th, 2006).

[88] The CRDB Bank – SACCOS' linkage has created business connections with about 100 Savings and Credit Co-operative Societies (SACCOS) throughout the country.

[89] The pre-reform era was characterized by few (about twelve) mostly state owned intermediaries designed to facilitate the management of a centrally planned economy in which the public sector was the dominant. According to the BoT (website www.BoT-tz.org/BankingSupervision/registered_banks.htm visited January 4th, 2006) a commercial bank is a financial institution authorized to receive money on current account subject to withdrawal by cheque.

Bank of Zanzibar each with 3 branches; the rest have branch networks of between 1 and 2. Of the emerging private commercial bank, Exim Bank Limited is increasingly involved in financing of the agricultural sector, despite its limited outreach[90].

Table 6.2: Registered Commercial Banks, as of December, 2005

No.	Name of Bank	Branch Network
1	Standard Chartered Bank (T) Ltd	7
2	Stanbic Bank (T) Ltd	5
3	Citibank (T) Ltd	2
4	Federal Bank of the Middle East Ltd	3
5	Eurafrican Bank (T) Ltd	1
6	Diamond Trust Bank (T) Ltd	1
7	Exim Bank (T) Ltd	3
8	NBC Limited	34
9	National Microfinance Bank Ltd	104
10	CRDB Bank Ltd	36
11	The Peoples' Bank of Zanzibar Ltd	3
12	Savings and Finance Commercial Bank Ltd	1
13	Akiba Commercial Bank Ltd	3
14	Kenya Commercial Bank Ltd	2
15	International Bank of Malaysia (T) Ltd	2
16	Habib African Bank Ltd	1
17	Barclays Bank (T) Ltd	2
18	African Banking Corporation	1
19	United Bank of Africa	1
20	CF Union Bank Ltd	1
21	Azania Bancorp Ltd	1
22	Bank of Baroda	1

Source: BoT website www.BoT-tz.org/BankingSupervision/registered_banks.htm visited January 4th, 2006

6.2.3 Grassroots-based unit Banks: Community Banks

Since most commercial banks are reluctant to serve the rural sector, the government started the promotion of grassroots based unit banks in the form of community banks in order to facilitate the integration of grassroots financial intermediation process into the emerging financial markets. According to the Bank of Tanzania (www.BoT-tz.org/BankingSupervision/registered_banks.htm visited January 4th, 2006) regional unit banks and financial institutions are those licensed financial intermediaries, which operate as a regional unit bank or a financial

[90] Exim Bank is managing STABEX funds for crop price stabilization provided by the EU to the government of Tanzania under ACP-EU Contonou agreement; operating Warehouse Receipt Scheme introduced under the Agricultural Marketing Systems Development Programme financed by the IFAD; and the Agricultural Input Trust Fund funded by the government.

institution. The government envisions that the market serving the rural sector has to evolve from within the rural settings. This will help to reduce the existing macroeconomic imperfections in the financial system that constrains the development of the financial markets. Moreover, grassroots financial institutions are expected to increase local community participation in financial markets. Enhanced local participation, equity mobilization and local management are bound to improve access to rural financial services – bringing benefits to diverse rural economic agents such as households, enterprises, and institutions.

According to the BoT (www.BoT-tz.org/BankingSupervision/registered_banks.htm visited January 4th, 2006) the registered and operating regional unit Community Banks[91] include the Dar es Salaam Community Bank (Dar es Salaam), Mbinga Community Bank (Mbinga district in Ruvuma region), and Uchumi Commercial Bank (in Moshi town - Kilimanjaro region).

6.2.4 Non-bank financial institutions

Non-bank financial institutions are licensed financial institutions, authorized to engage in banking business that does not involve receipt of money on current account subject to withdrawal by cheque (www.BoT-tz.org/BankingSupervision/registered_banks.htm visited January 4th, 2006). Such financial organizations include development banks (also called Development Financial Institutions), hire purchase, social security (provident or pension) and insurance funds. The category of development banks involves specific financial institutions that serve the development credit needs of specified sectors. This group includes Tanzania Investment Bank[92] that provide services mainly to industries and large scale farming, Tanganyika Development Finance Limited

[91] Community banks are private banks operating in specific localities and capitalized wholly by individuals and economic agents such as NGOs, Village Governments, and SMEs; while co-operative banks are, like Community Banks, private entities but wholly member-owned as its shareholders and operated on co-operative basis.

[92] The TIB was transformed into a merchant bank in 1993 to undertake merchant banking activities, and engage in banking business in addition to its core business of term lending. In 2005 the government transformed the TIB into Tanzania Development Bank (TDB) to carter for the development needs of Tanzanians, with majority of the shares still under the government control.

(TDFL) that carters for credit needs for all sectors, and the Diamond Jubilee Investment Trust (DJIT) that serves the business community in Dar es Salaam - mainly people of Indian origin.

Other registered non-bank financial institutions, with their branch networks in parentheses include: Tanzania Postal Bank (TPB - 4), and Twiga Bancorp Ltd (4). Furthermore, there are two non-bank regional unit financial institutions that are established by the communities namely, Mufindi Community Bank (Mufindi district in Iringa region) and Mwanga Community Bank (Mwanga district in Kilimanjaro region) (www.BoT-tz.org/BankingSupervision/registered_banks.htm visited 4th January, 2006). These are known as unit banks or non-bank financial institutions because they are operated within the specified local communities, drawing clients from their localities, but facilitating financial system integration with the larger sector.

There are also Hire Purchase companies, which organize credit for consumer durables. According to the discussions with BoT officials (April, 2006) a good case in point is *Karadha* Company Limited that provided hire purchases of motor vehicles, buses, tractors, farming equipments and consumer durables organized through the NBC branch network. Currently, there are other emerging corporate firms that provide credit purchase services such as *Tunakopesha* Limited, which finances households' equipment and furniture on a credit basis. In addition a few other specialized companies organize commercial credit from financial institutions to fund purchases of things like computers, motor vehicles, and machineries. This practise, though limited in scale, increase access to credit and in their small way introduces competition to the traditional banking industry.

Other non-bank financial institutions are provident or pension funds, which are contractual savings institutions in that they mobilize savings by entering into short-term contracts with individuals, groups of individuals or institutions. By December 2005, there were five social security funds in the country, namely the *Parastatal* Pension Fund (PPF), Public Service Pension Fund (PSPF), Government

Employees Provident Fund (GEPF), Local Authorities Provident Fund (LAPF), and National Social Security Fund (NSSF).

The PPF, which was established in 1978 by an Act of Parliament and amended in 2001, is managing pension schemes mainly for the employees of parastatal organizations in the country. However, with privatization of the parastatals that was followed by retrenchment of employees, the PPF has lost substantial membership. The PSPF, on the other hand was established in 1999 to cover employees of the Central Government and those employed by its Executive Agencies on permanent and pensionable terms. The GEPF was established during the colonial times in 1942 to provide social benefits to government employees in the category of operational staff, those on contract; and those employed by the police force, prisons, and fire brigade (those below the designation of an inspector). The LAPF, which was established in 1994 and formally converted into a corporate body through an Act of Parliament No. 6 of 2000, is organizing a pension scheme for local government employees and its associated organizations. The NSSF was established by an Act of Parliament No. 28 of 1997 to replace the National Provident Fund established in 1964. It carters for all employees not covered by other social funds – private organizations/companies, NGOs, informal sector, self employed, and those not part of other social schemes (Ministry of Finance, Pension Funds, 2006).

The general insurance sector, on the other hand, is operated by about twelve companies, with the National Insurance Corporation (NIC) dominating the industry. The insurance industry was liberalized through the Insurance Act No. 18 of 1996 (IMF, 2003:11). The Act requires at least one-third of the controlling interest of any insurer to be held by Tanzanian citizens, except for brokers or agents. Furthermore, the Act provides for the establishment of the national reinsurance corporation, in which all local insurance companies would be required to participate. Consequently, the Tanzania National Reinsurance Corporation Limited (TAN-RE) was formally incorporated as a national re-insurance company registered under the Companies Act, 2002, but it is yet to be operational.

Currently, all reinsurance services are placed outside the country (Ministry of Finance, Pension Funds, 2006).

6.2.5 Microfinance Institutions

A Microfinance Institution (MFIs) may be defined as an organization that provides financial services to the poor through financial intermediation (Khandker, 1998; CGAP, 1998; FAO & GTZ, 1998). Moreover, MFIs also provide non-financial services, which include social intermediation[93], enterprise development services, and provision of social services (Bennet, 1997:12; Narayan, 1997:50-55). In this respect social intermediation include training in financial literacy, group formation, leadership training and co-operative learning. This broad definition of Microfinance Institutions involves a wide range of providers that vary in their legal structure, mission, methodology, and sustainability. However, they all share a common characteristic of providing financial services to a focused group of clientele - the poor people.

Low-income earners need a diverse range of financial services to run their businesses, build assets, stabilise consumption, and shield themselves against risks. Thus, financial services needed by the poor range from savings, working capital loans, consumer credit, pensions, insurance, and money transfer. Poor people can hardly access these services through formal financial sector due to perceived risks, misconceptions of lack of official collateral, lack of business records, and perceived credit administration costs. They address their needs for financial services through a variety of financial relationships, mostly informal such as moneylenders, savings clubs, rotating savings and credit associations, and mutual insurance societies. As already pointed out in chapter five, the National Microfinance Policy 2000, recognizes four categories of microfinance providers in Tanzania, namely (i) commercial banks, community banks, cooperative banks, non-bank financial institutions; (ii) those MFI's specializing in the provision of

[93] According to Bennett (1997:12) social intermediation is the "process of creating social capital as a support to sustainable financial intermediation with poor and disadvantaged groups or individuals".

microfinance; (iii) member – based MFI's; and (iv) Micro-credit - NGO's, and Microfinance Companies.

6.2.5.1 Co-operative Rural Financial Services

In Tanzania, co-operative financial services, which are also known as member-based financial services, are distinguished into (i) Co-operative Banks, (ii) Savings and Credit Co-operative Societies (SACCOS), (iii) pre-co-operative groups such as Savings and Credit Associations (SACAs), and Village Community Banks (ViCoBa). Currently, there are two co-operative Banks, which are registered as Regional Unit Banks. These are the Kilimanjaro Co-operative Bank (KCB in Kilimanjaro), and Kagera Farmers Co-operative Bank (Bukoba and Muleba districts - Kagera Region) (www.BoT-tz.org/BankingSupervision/registered_banks.htm visited January 4th, 2006). Unlike co-operative banks, SACCOS are regarded as quasi-formal financial institutions as they are legally constituted but not regulated by the BoT.

Savings and Credit Co-operative Societies (SACCOS) are the most important microfinance institutions in Tanzania, which are legally recognized as independent form of co-operatives by the Co-operative Societies Act (CSA), 1991[94] and now the CSA 2003. Between 1982 and 1991 SACCOS operated as appendage to the Agricultural Marketing Societies and were known as Savings and Credit Schemes. In Kenya during a similar time period, these were referred to as the Banking Section of the Marketing Societies (ICA, 2001:15). The CSA 1991 was replaced yet by another Act of 2003, which recognizes pre-co-operative groups such as Savings and Credit Associations (SACAs); and Village Community Banks (ViCoBa) as co-operative like financial institutions (URT, 2004; Bee, 2001:9).

A study by the International Co-operative Alliance (2001:18) shows that SACCOS are unevenly distributed across the regions, with about half of the SACCOS found in five regions of Dar es Salaam (19%); Kilimanjaro (9%); Mbeya (8%), Kagera

[94] Co-operative legislation in independent Tanzania has undergone series of amendments and repeals as follows 1962, 1968, 1975, 1982, 1991, 1997, and 2003.

(8%); and Iringa (6%). Appendix 6.3 provides the co-operative map in Tanzania as of April, 2004. According to these statistics SACCOS make about 25% of the total co-operative organizations in the country, preceded by marketing co-operatives that constitute 50% of the total co-operative system.

According to the Executive Secretary of SCCULT Mr. Mshaweji (discussions held on May 21st, 2005) SACCOS re-established[95] their apex body in 1992 known as the Savings and Credit Co-operative Union League of Tanzania (SCCULT), charged with the following functions:

(i) to represent SACCOS locally and internationally, and act as lobby and advocacy body for the sector,
(ii) to promote and provide financial services through managing of inter-SACCOS lending programme, risk managing programme, and arrangement for wholesaling linkage with other financial institutions,
(iii) capacity building through training; and supply of equipments, and standardized stationery, and Management Information system, and
(iv) to undertake business development, research and consultancy services.

SCCULT's membership increased from 214 founding members at its inception in 1992 to 450 by 2005. However, the increase in membership do not compare favourably with an increase in the number of SACCOS in the country. Whereas there were 1,875 registered SACCOS, SCCULT's membership constituted only 24% of the total SACCOS in the country. This indicates that some SACCOS stay out of joining the national apex body due to lack of clear added benefits, ignorance, or inadequate mobilization drive by SCCULT.

[95] In 1964 about 42 SACCOS formed the first Savings and Credit Union League of Tanganyika (SCULT), which was abolished by the government in 1976 (www.ushirika/sccult.htm visited on September 26, 2006).

SCCULT is organized into nine zones covering twenty one regions of the Tanzania mainland[96]. This arrangement, however, creates a high potential for networking among the co-operative financial institutions in the country. Ironically, most of the SACCOS are small in terms of membership, geographical coverage, and capital base (www.ushirika/sccult.htm, visited on September 26, 2006).

SCCULT offers limited financial and non-financial products to its members. The financial products are three fold – Central Finance Facility (CFP), wholesale credit schemes, and Risk Management Services. The non-financial services products include education and training, research and development, and distribution of stationery and equipment particularly safes.

The CFP is a SACCOS inter-lending programme established in 1998 by members through purchase of shares and savings. According to the interview with the Executive Secretary of SCCULT (May 21st, 2005), the Central Finance Program (CFP) provides short-term liquidity support to help members grow and develop. In this respect, CFP functions like a "co-operative central bank" for SACCOS or "SACCOS of SACCOS". As a central bank it collects surplus funds from SACCOS through buying more shares or deposits and invests this money centrally at higher interest rates than individual SACCOS can realize. From this pool, CFP also advances loans to SACCOS in need of additional funds or bail out those in financial crises. By December, 2004, members' savings amounted to a total of Tshs. 1,490,079,211 with outstanding loans of 3,612,820,214 as summarized in table 6.3.

[96] The zones are: Southern Highlands (Mbeya and Rukwa); Lake Nyasa Zone (Iringa and Ruvuma); Southern Region (Mtwara and Lindi); Eastern Region (Morogoro and Tanga); and Western Zone (Shinyanga and Tabora). Other zones are Lake Victoria (Mwanza, Mara, Kagera and Kigoma); Central Zone (Dodoma and Singida); Mzizima Zone (Dar es Salaam and Coast) and (Northern Region (Kilimanjaro, Arusha and Manyara).

Table 6.3: The status of the Central Finance Programme, 31.12.2004

ZONE	REGIONS	SAVINGS	LOANS	MEMBERS
Southern Highlands	Mbeya Rukwa	196,286,879 33,547,867	348,391,697 62,534,752	109 Total
Lake Nyasa	Iringa Ruvuma	241,183,971 260,667,800	701,604,947	65 in total
Southern	Lindi/Mtwara	182,331,429	800,133,503	83 in total
Eastern	Morogoro/Tanga	196,251,062	264,395,095	51
Western	Shinyanga/Tabora	17,000,000	44,109,125	21
Lake Victoria	Mwanza/Mara Kagera/Kigoma	33,243,383 306,138	68,098,831 -	53
Central	Dodoma/Singida	88,395,124	242,232,389	77
Mzizima	Dar es Salaam / Coast	149,174,269	365,901,628	113
Northern	Kilimanjaro/Arusha/Manyara	91,691,289	137,910,822	99
TOTAL		1,490,079,211	3,612,820,214	671

Source: SCCULT Reports, 2004.

The demand for loan through CFP is high and the union is unable to meet it due to its undercapitalization. As a result, members are now seeking loans from commercial banks operating micro-credit windows such as CRDB, NMB, Stanbic Bank, and/or Akiba Commercial Bank. These alternative sources pose a threat to SCCULT and hence reduce motives for SACCOS joining SCCULT.

Risk management is another financial product, which is relatively new but important. It is designed to cater for the Union League members to mitigate risks that SACCOS face. The Co-operative Societies' Rules 2004, require SACCOS to insure bonds to protect members' deposits. This is also a requirement under the regulations governing Microfinance Institutions. Upon joining the programme, SACCOS pay a reasonable rate of premium and are expected to receive prompt settlement of claims and payments of rebate. This is not applicable in other insurance firms/brokers.

SCCULT is operating a loan insurance scheme for its members to mitigate financial losses resulting from the following occurrences: death of a member, outstanding loans becoming bad debt, loss of employment. Although, no statistics were available, the loan insurance scheme has not been very effective due to varied reasons. One plausible explanation is the weaknesses in SACCOS' structure and operations.

Wholesaling services to its members is a recent innovation by SCCULT, which is implemented as a linkage service with commercial banks (CRDB Bank, Exim Bank, Akiba Commercial Bank, and Community and Co-operative banks). Besides, other commercial banks are eyeing the linkage enthuastically as it provides a safe way of undertaking rural financial transactions less costly. There are also some specialized programmes that work with SCCULT in credit wholesale business. According to Mshaweji (interview May 21st, 2005) these include the Small Enterprise Loan Fund (SELF), and the Agricultural Input Trust Fund (AGIFT).

In terms of non-financial products, SCCULT is responsible for the facilitation of SACCOS' governance, social intermediation through networking and alliance building, representation of SACCOS locally and internationally, lobby and advocacy, organized accounting services and stationery, conduct research on new innovations, and facilitate training in financial literacy and management. The observation in this respect is that SCCULT has inadequate capacity, given its present situation, to provide adequately these non-financial needs to its members due to inadequate staff with weak capacity.

Most studies (Bee, 2001; ICA, 2001) reveal that SACCOS in the country operate limited financial products. In many instances these are savings, credit, and deposits. The discussions with various stakeholders (in rural areas, and officials from the Co-operative Development Department) show that the demand for co-operative financial services is significant, which includes households' life cycle needs - smoothening consumption, emergencies, and meeting investment opportunities. Clearly, there are other financial needs such as insurance services, payments services, leasing, safe deposits, and money transfer that are all needed by rural folks but not provided by SACCOS. As it is now, SACCOS' operations are welfare oriented as opposed to commercial financial business. This is partly reflected by the lack of financial innovation. However, currently, there are some efforts by few actors – NGOs, government, and research institutions to assist microfinance institutions in developing appropriate products based on market needs.

6.2.5.2 Financial Non-Governmental Organizations (FiNGOs)

Financial Non-governmental Organizations (FiNGOs) are increasingly becoming popular in the microfinance industry. Most of these were established after the liberalization of the financial sector to address the financial gap experienced by rural population. Most of the FiNGOS are externally financed and are following the credit only approach, although there are few that mobilize savings in the guise of "loan insurance funds". The main reason being that credit only financial organizations are not legally allowed to accept deposits unless formally transformed into finance companies.

Most literatures (Ndanshau, 1996:8-10; Ndanshau, *et al* 1999:18; BoT, 1997: 46-52) indicate that FiNGOs operate mostly in urban and peri-urban areas, in other words in areas that are easily accessible by road and other types of communication. Most of these follow the group lending methodologies with strict loan screening methods. According to the interviews with BoT officials (February, 2006) some of these require collateral and in some other cases this take the form of compulsory savings – the so called "loan insurance fund" that has to be in place before the loan is approved and disbursed. The interest rate charged is higher than that charged by commercial banks, in many cases it ranges between 18% and 40% per annum (BoT, 1997:101). Some FiNGOs provide complementary services such as short-term training, and preparation of business plans.

Although the FiNGOs are on the increase, the industry is still dominated by a few – mainly five namely the Promotion of Rural Initiatives and Development Enterprise (PRIDE – Tanzania), Small Enterprises Development Agency (SEDA), Mennonite Economic Development Associates (MEDA), FINCA International Inc., and Poverty Africa[97]. Some of these FiNGOs are discussed below.

[97] Note there other FiNGOs that are localized and operate in various parts of the country. These are beyond the coverage of this study. For details see Makombe, Temba and Kihombo (1999).

(i) PRIDE Tanzania

PRIDE Tanzania is the largest FiNGO in the country. It was founded in 1994 with the aim of promoting micro-credit activities based on the Grameen Bank micro lending model. It has been supporting micro-entrepreneurs by providing loans and technical skills. According to the PRIDE's General Manager Mr. Obama (March 20, 2005) PRIDE started with a capital injection from the Norwegian Agency for Development (NORAD) with the aim of promoting micro-credit activities in the country, but now it depends on borrowing from commercial banks and mobilization of savings from its customers.

PRIDE Tanzania lends to small and medium ongoing businesses using graduation model, under which one starts with a small amounts of loan initially but qualifies to a higher loan level after repaying the previous one. There are eight loan cycles with loan amounts of between Tshs. 50,000 and 5 million. Members form groups in order to access loans. Loan products offered are solidarity group guarantee loan given to Market enterprise group, and *Fahari* Loans to a solidarity group of 3 – 5 self selecting members (Obama, March 20, 2005). PRIDE's products' features are summarized on Table 6.4.

Table 6.4: PRIDE's Tanzania Product Features

No.	CRITERIA	DESCRIPTION OF PRODUCT FEATURES
1	Eligibility	Above 18 years, must own business, must be in a group of five. Ten groups of fives are organized into a *Market Enterprise Group* (MEG).
2	Procedures	Loan application followed by 8 weeks training after which 2 group members get 1st loans, followed by 2 members after 4 weeks, followed by the chairperson after another 4 weeks. Clients must take weekly contributions to LIF during the waiting period. Currently, the procedures for loan release have been changed to 6:2:2 from 8:4:4.
3	Security	▪ 1st guarantee is the group, ▪ 2nd guarantee is the MEG, ▪ 3rd guarantee is the Loan Insurance Fund (LIF)
4	Grace Period	Nil grace period
5	Repayment	30% interest flat. Weekly payments include contributions to LIF. Prepayments are accepted.
6	Repeat Loans	Must follow the prescribed sequence of loan sizes. An interval of 2 weeks between loans.

Source: Discussions with PRIDE Management, Arusha

According to Obama (March 20, 2005) PRIDE has a loan portfolio of US $ 10 million, with a total borrowers of 63,804 and a portfolio at risk (less than 30 days) of 0.004%; a situation indicating that loan repayment is good. This result from a strict loan appraisal process, enforcement through peer pressure, strict monitoring system, and the compulsory savings put in place.

Loan issued by PRIDE target mostly non-poor population in urban and peri-urban areas that are more accessible for monitoring purposes by the FiNGO. Some observers criticize the delivery methodology as too rigid and that PRIDE has been implementing a single product, until recently when an additional product was conceived. Furthermore, the MFI has experienced inadequate collaboration from financial institutions in implementing micro-credit activities. Moreover, some borrowers were observed viewing credit as a handout from the government, hence making repayments a problem.

(ii) SEDA Tanzania

According to Pinder (2001:1) Small Enterprise Development Agency (SEDA) was initiated by the World Vision Tanzania as a microfinance institution in 1995 with an initial capital of US $ 50,000 from World Vision International and subsequent injections from Ford Foundation and the United States Development Agency (USAID). It was registered as a FiNGOs in 1996 with branches in Arusha, Moshi, Mwanza and a field office in Shinyanga. The objective of SEDA was to improve the socio-economic and health status of households in poor communities through the development of micro-enterprises owned primarily by urban poor women.

According to its Executive Director Mr. Mwangi (June 10th, 2005) SEDA does not mobilize savings, but provides loans to ongoing businesses with a minimum amount of Tshs. 50,000. Most loans are given to women and follow the graduation approach as that of PRIDE Tanzania. SEDA requires its borrowers to form a Rotating Savings and Credit Group of between 15-18 members, who are required to contribute at least 20% of the total amount of loan as collateral before the group receives loan. The loan term is six months, with an interest rate of 30% and a 3% one time commission.

(iii) FINCA International Inc.

Discussions with the BoT officials (October 20, 2005) revealed that FINCA International Inc. (Foundation for International Community Assistance) is a not for profit international organization that started micro-credit operations in Mwanza in 1998 with a capital injection of US $ 1 million from the United States Development Agency (USAID). In 2001 FINCA relocated its head office to Dar es Salaam in order to be able to serve better the rest of the country. Its operations are conducted through three regional branch networks of two in Dar es Salaam, and one in Mwanza and six district offices in Bukoba, Bunda, Shinyanga, Morogoro, Mahenge and Iringa.

FINCA focuses on rural poor women, based on village banking principles, where borrowers are given responsibilities and autonomy in running their banks and put emphasis on community, as well as individual development. Borrowers obtain loans at market based interest rates, and loans are viewed as renewable resource that has an impact on the entire community through asset building effect. FINCA loans range between Tshs. 100,000 and Tshs. 300,000 for various ongoing businesses that include food vending, tailoring, handcrafts, animal husbandry, and petty trade. In addition, FINCA also provides non-financial products mainly in the form of training and advisory services to its clients' groups. It relies solely on its capital injection, but requires groups to save and open a bank account with any commercial bank. Loans are made to individuals in a group of not more than 30 people, and borrowers are screened before receiving loans.

Thus, FINCA's village banking programme's products are loans, voluntary savings, and insurance. FINCA finances its activities through grants, and loans from commercial banks. The MFI receives its funding from donors though the Foundation for International Community Assistance - the Hivos-Triodos Fund, Triodos-Doen Foundation, and the Microfinance Rating and Assessment Fund.

(iv) MEDA Tanzania

Mennonite Economic Development Associates (MEDA) is an association of compassionate business persons who through training, loans and mentorship can earn a livelihood. MEDA started operations in Tanzania with a start up capital of US $ 300,000 from Canada and licensed as a FiNGO in 1993. It operates two branch networks – one in Dar es Salaam and another one in Mbeya. MEDA provides loans to both individuals and those organized in groups without any requirement for savings. Loans are given to individuals with ongoing businesses. MEDA provides credit through screening of its applicants based on character and trust. In addition, clients are required to contribute 20% of the value of loan as collateral or loan insurance.

The value of loans ranges between Tshs. 50,000 and Tshs. 150,000 with an interest rate of 48% in addition to charges for technical services offered at 12% falling to 6% and 0 in first, second and third rounds of borrowing.

(v) Poverty Africa

Poverty Africa (Tanzania) is a registered MFI headquartered in Dar es Salaam. It was established in 1993 and started operations as an MFI in 1994. It was started with a capital acquired on goodwill of some local and foreign benefactors. Initially it targeted those ongoing businesses, but later on accommodated those in the process of starting new businesses.

Poverty Africa micro-financial services are modelled along that of the PRIDE Tanzania. Borrowers are required to form groups, and each member in the group must save so as to be able to access loan. Poverty Africa gives loans when group savings equals 30% of the desired loan amount. This amount not only inculcates savings habits among group members, but also serves as an insurance against lending risks. Strictly, Poverty Africa lends through groups and to those who contribute to the insurance fund. However, within groups lending operations largely depends on borrower’s savings and, therefore, determine the degree of sustainability of its lending operations.

6.2.5.3 Government and Donor sponsored Trust Funds/Programmes

The government alone or in partnership with other stakeholders is implementing various financial sector development programmes. These programmes focus on income improvement, poverty reduction, financial systems development, and/or food security. Some of these interventions are implemented through commercial banks, which contribute towards the integration of the rural financial markets into the larger national financial system. Some of these programmes are reviewed hereunder.

(i) Agricultural Input Trust Fund (AGITF)

The agricultural Input Trust Fund (AGITF) was established by the government in 1994 for the objective of making loans available to finance importation and distribution of agricultural inputs for the benefits of smallholder farmers. After the liberalization of the agricultural markets, smallholder farmers' access to farm inputs was reduced. According to the AGITF Coordinator (2005) the "objective of the fund was to make available loans on such conditions and terms depending on the availability of finances for the importation and distribution of agricultural inputs and to finance consultancy services or any other technical assistance in relation to acquisition, distribution, and use of agricultural inputs". The AGITF aimed at encouraging the use of agricultural inputs, machinery and equipment in order to increase agricultural production and productivity.

According to official report (URT, www.tanzania.g.tz/economicsurvey1/2004/part4/agriculture.htm visited on July 26th, 2006) the Fund has administered input credit through different commercial banks since 1994. During 2004 alone it offered about 80 input loans worth Tshs. 2,150,395,000, financed direct purchase of 24 tractors worth Tshs. 860,031,178 and offered Tshs. 351,522,000 for tractor maintenance.

The Fund has established business linkage with Exim Bank, and the Savings and Credit Union League of Tanzania (SCCULT) and SACCOS in implementing its activities. According to the Fund's Coordinator, SCCULT borrows from the Fund and lends farmers through participating SACCOS. According to SCCULT reports (interview with Peter Mashingia April, 2006) by May 2006, agricultural loan amounting to Tshs. 2.9 billion had been disbursed through SACCOS and repayment was good at the rate of 80%. The input loan is either paid directly to farmers or to input suppliers. These linkages have some advantages in that: (i) it reduces transaction costs, (ii) it substitutes for collateral, (iii) strengthen local SACCOS and improves marketing of farm inputs.

(ii) Small Industries Development Organization (SIDO)

Small Industries Development Organization (SIDO) is a *parastatal* body established by the government in 1973[98] with equity of 72% by the government, foreign donors 23%, NGOs 4% and others 1% (Director General Mike Laizer, May 20, 2005). It has branch networks in every region of the Tanzania mainland aimed at the decentralization of industrial extension services (www.fao.org/DOCREP/S8380e0f.htm visited on April 20, 2006). The mission of SIDO is poverty reduction through stimulation of economic growth and employment creation by SMEs. Consequently, SIDO is mandated by the government to implement the National SME Development Policy of 2003, which emphasises the promotion of small scale industries (www.tanzania.go.tz/government/sido.htm visited May 20, 2006). As a *parastatal* organization, SIDO is charged with the following functions:

(i) to promote development of small industries and coordinate their activities,

(ii) to provide technical assistance, management and consultancy services to the sector, and

(iii) to provide and promote training for the betterment of the sector.

Thus, SIDO offers a wide range of services to mostly SMEs operated by individuals or groups. These services include credit and hire purchase, business skills development, and advisory services. Since most SMEs do not qualify for

[98] Support to small scale industries started way back in 1966 when the government under the National Development Corporation (NDC) provided a framework for the development of the small scale industries.

commercial bank loans, SIDO designed credit methodology based on three foundations: group lending, promotion of self-help groups, and solidarity groups that were designed to implement different programmes financed by various organizations.

One of its outstanding programmes is the National Entrepreneurship Development Fund (NEDF) established by the government in 1995[99]. According to SIDO's Director General Mr. Laizer (May 20, 2005), the NEDP offered, among others, micro-credit and hire purchase services, business skills development training and advisory services. The NEDP micro-financial services were provided through two schemes: (i) Micro-hire purchase scheme for individuals and groups, where the maximum loan amount to an individual is Tshs. 500,000 and for a group Tshs. 1.5 million, each attracting an interest of 30% per annum, and (ii) the entrepreneurship development fund sponsored by the Tanzania Chamber of Commerce, Industries, and Agriculture (TCCIA) and financed jointly by the National Income Generation Programme (NIGP) and the government. The beneficiaries of entrepreneurship development fund, as is the case with micro-hire purchase, are individuals and groups.

Credit delivery mechanism under SIDO follows group methodology and individuals approach. Group lending methodology depends on group solidarity that helps in overcoming the need for collateral, which most SMEs do not posses. Group solidarity methodology is based on loan graduation through five stages as operated under the Grameen Bank model. Groups graduate from one stage to the other determined by their business needs, character of borrowers, and predetermined loan ceilings. Through group pressures, borrowers are forced to repay their loans in time, and those defaulting re-payments are penalized accordingly. However, the group pressure is ineffective in case where individual enterprises are scattered over a wide geographical location.

[99] SIDO has been managing range of credit programmes such as Informal Sector Programme with funding from ILO; SIDO-NIGP/UCP Programme; SIDO-SELF Programme; SIDO-TGT programme; TUTAWEZA Programme; and SIDO-GDS programme. These are, however, beyond the scope of these discussions.

Nonetheless, lending to individuals as a solution can not work as follow up becomes costly and, therefore, uneconomical. Whereas, the solidarity group encourages enterprise growth, it has certain limitations, such as (i) the loan amount is not determined per project, but by the amount available and ceiling set, (ii) ceilings are set per stage that limits the enterprise growth. In addressing these weaknesses, SIDO encourages self help financing arrangements where it complements such efforts by providing technical and business advisory support.

The credit package managed by SIDO had its own limitations. Firstly, demand for credit was too high for this *parastatal* alone to manage. Secondly, most applications were turned down due to some inadequacies, ranging from poor project write-up, lack of collateral, and failure to meet the required down payment of 20% of the proposed project cost. Moreover, the high interest rate set at 30% per annum discouraged the potential customers.

(iii) IFAD Supported Programmes of: RFSP and AMSDP

The government, with financial support from the International Fund for Agricultural Development, is implementing Agricultural Marketing Systems Development Programme (AMSDP) and Rural Financial Systems Development Programme (RFSP) that address the question of rural finance. The RFSP, which is a nine-year programme that was conceived in November 2001 aims at achieving a sustainable increase in incomes, assets and food security among the poor rural households by enhancing the capacity of the rural poor to mobilize savings and to invest in income generating activities through the development of viable rural finance services systems (URT, 2005b:2). The specific programme objectives are to: (i) support the design, development and implementation of sustainable rural financial services at the village or ward levels in the form of registered MFIs, (ii) improve the managerial capacity of solidarity groups and other micro-finance Institutions, (iii) develop a sustainable rural financial network infrastructure, and (iv) empower the poor rural households to benefit from rural financial services.

The programme is promoting linkages of MFIs with banking and financial institutions in order to enhance commercialization of the rural economy. So far, RFSP has managed to link 23 MFIs with three financial institutions - CRDB, Mufindi Community Bank (MUCoBA), and the Kilimanjaro Co-operative Bank (KCB) (RFSP, 2004.5). These banks are, on their own providing additional capacity building services thus in a way supplements the efforts of the programme. Moreover, the promotion of SACCOS, SACAS and other types of MFIs encourages MFIs to use bank services, which in its limited scale opens up the under-monetized rural areas to commercial banking practices. In this respect MFIs become more exposed to the competitive financial market environment, and hence gain experiences and build confidence in the financial market.

The second IFAD supported programme is the AMSDP, which is a seven year programme implemented in 38 districts in eight regions of Tanzania mainland[100]. According to the programme management (URT, 2005c:2-4) the long-term goal of the AMSDP is to increase incomes and food security of the rural people in Tanzania. The intermediate goal is to improve the structure, conduct and performance of the agricultural marketing systems. The programme covers four components, namely: (i) The Agricultural Marketing Policy and Development, (ii) Producer Empowerment and Market Linkages, (iii) Financial Market Support Services, and (iv) Rural Marketing Infrastructure.

The Financial Market Support Services (FMSS) component of the programme is built on the premise that smallholder farmers and medium-scale traders and processors face many constraints, of which access to financial services is one. It has been observed that these groups of entrepreneurs can not economically use their produce as collateral for commercial loans from formal financial institutions. As a result, the degree of exploitation of the rural poor people by merchants,

[100] AMSDP is being implemented in the following regions with districts in brackets: Arusha (Arumeru); Manyara (Babati and Hanang); Tanga (Muheza, and Lushoto) and Kilimanjaro (Hai). Others are Iringa (Ludewa and Mufindi), Mbeya (Mbeya rural, Mbarali, and Rungwe), Rukwa (Sumbawanga and Nkasi), and Ruvuma (Namtumbo, Mbinga and Songea rural) (URT, 2005e:7-20; IFAD, 2002c; IFAD, 2001).

money-lenders and large-scale processors is high, especially in the food growing areas. Thus, the objective of FMSS component is to address the liquidity constraint facing smallholder producers and small and medium scale rural traders and processors by enhancing their access to financial services through the use of warehouse crop receipts as collateral. In its design this component was to be achieved through the implementation of two sub-components: a rural inventory credit scheme and a loan guarantee scheme[101].

(iv) Small Enterprise Loan Facility (SELF)

Small Enterprise Loan Facility (SELF) is a loan facility operated by the government with a Loan from the African Development Fund. The aim of the SELF project is to enhance access to microfinance services in the rural areas through eligible microfinance intermediaries. The vision of SELF is to reduce poverty in Tanzania through the facilitation of sustainable microfinance services, which enhance economic opportunity of enterprising rural and urban poor. The project covers the following regions: Coast, Morogoro, Dodoma, Singida, Mtwara, and Lindi from Tanzania mainland and Unguja and Pemba Islands from the Tanzania Islands.

SELF project activities are operated through three windows, namely (i) by disbursing credit funds; (ii) by providing support and building institutional capacity of existing partner institutions in line with MFI best practices; and (iii) through the sensitization and promotion of grassroots based financial institutions. In addition, the project is also concerned with monitoring of poverty reduction initiatives as a result of increased access to financial services among poor households.

The disbursement of loans has been very slow due to strict application procedures and conditions. Furthermore, the abilities of collaborating MFIs are low in terms of

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[101] Smallholder farmers access a pre-negotiated line of credit from a participating commercial bank using warehouse agricultural produce deposits' receipts as collateral. The scheme is expected to reduce credit transaction costs and improve access to training, and extension services. On the other, rural inventory scheme targets smallholder groups and small- and medium-scale traders/processors; while the loan guarantee scheme is for medium-scale traders/processors and micro-finance institutions (see chapter seven for details).

managerial capacities, capacity to manage and follow-up loans, and rural household's attitude of non-paying credits.

6.3 Capital Markets

Financial sector reforms apart from promoting money markets also facilitated the establishment of capital markets – i.e. financial intermediaries that deal with stocks, shares and bonds. The government established the Capital Markets and Securities Authority (CMSA) under the Capital Markets and Securities Act, of 1994 in order to manage the development of securities market as well as undertake its regulation and supervision (IMF, 2003:23; Nyagetera, *et. al.* 1995:140). Consequently, the Dar es Salaam Stock Exchange[102] (DSE) was incorporated in 1996 as a company limited by guarantee without a share capital; which became operational in 1998. So far, securities traded are ordinary shares of seven companies and two corporate bonds. The five companies, which are listed at DSE and their shares traded are the Tanzania Oxygen Limited, Tanga Cement Company Limited, Tanzania Tea Packers Limited, Tanzania Cigarette Company Limited, Tanzania Breweries Limited, Dar Airport Handling Company (now SWISSPORT Company) and one foreign company – the Kenya Airways. In terms of bonds, the DSE has listed government bonds together with corporate bonds of the Eastern and Southern Africa Trade and Development Bank (PTA Bank)[103] and the BIDCO Oil Soap Limited (DSE, 2002 – Roles, Functions and Procedures: Public Information Brochure No 1 DSE, DSM; CMSA, 2005: 12-13).

Another interesting development in the capital market is the establishment of the Tanzania Venture Capital Fund (TVCF), which is managed by Equity Investment Management Limited (EIM), established in 1993 to facilitate mobilization of equity funds for development of the formal private sector (Machunde, 1995:1). The concept of venture capital is relatively new to Tanzania, but it entails: (i) the provision of equity financing for the development of small and medium-sized

[102] A Stock Exchange is a market where large and small investors can buy and sell securities such as shares, boards, treasury bills, etc.
[103] Commercial banks are required to mobilize capital through trading shares at DSE by the Central Bank through increase in minimum capital of commercial banks from Tshs. 1 billion to Tshs. 5 billion in 2004.

enterprises with high growth potential in terms of its products, (ii) supplemented by provision of active management support, and (iii) projects whose main objective is significant long-term capital gain. As it stands, venture capital is not a loan, but equity finance for limited projects. Since venture capital is a risky capital without security and little legal recourse its focus is limited in terms of projects, scope and geographical coverage (Machunde, 1995:2-5).

The development in the capital market has increased competition, though on a limited scale, as now investors are free to chose where to invest their financial resources - in buying shares/bonds or place funds with banks/non-bank financial institutions. Unfortunately, this information is not easily accessible to all people, especially those in the rural areas. Capital markets in Tanzania, like in most other developing countries, are still underdeveloped, and their emergence is a recent development (Jafferis, 1995:346). Despite the existence of capital needs by domestic enterprises in the country, it seems most corporations have been reluctant to use the capital market to raise the needed capital.

The development of the capital markets is constrained by a number of factors. As argued by Nyagetera, *et. al.* (1995:140) “the institutional developments of the capital market are still at their infancy”. Most privately owned enterprises are unwilling to register with the capital market due to either not being willing to disclose their businesses for fear of competition, avoiding taxes or ignorance/little experience of issuing securities. In the case of financial institutions, since most of them are privately owned, transfer of shares is in most cases highly restricted. On the other hand, as correctly argued by Jefferies (1995:346-347) the smallness of economies of developing countries, such as Tanzania, make it difficult for the growth of a broad-based capital market. Besides, most of these economies experience institutional and infrastructural weaknesses that further complicate the growth of the capital market.

Access to modern technology is another barrier to capital market operations. The DSE for instance, is criticized for still relying on the old open outcry system of securities trading. The DSE must modernize its trading infrastructure by introducing the electronic trading system to replace the old system. This is crucial especially with the current efforts for regionalization and consequent globalization of the stock market in the world.

6.4 Access to Rural Financial Services: An Assessment

Liberalization of the financial sector is expected to increase access to financial services through enhanced competition, increased and diversified financial products and providers, and improved integration of the financial system (Nyagetera and Kilindo, 1997:123; Shaw, 1973; McKinnon, 1973). Assessment of the impact of the financial sector reforms reveals mixed results. Although there are positive results in terms of increased private sector participation, enhanced financial discipline, improved supervision and regulation of the financial sector, and price stability; access to financial services has remained limited among the rural populations in the country.

6.4.1 Development of the financial Institutions and outreach

Assessment of the impact of the financial sector reforms relies on four variables – domestic savings, credit structure, interest rate spread, and price stability. Implementation of reforms in the financial sector has increased participation of the private sector in the financial market. Licensing of private commercial banks, privatization of the state owned banks coupled with the development in information technology have enhanced degree of competition in the financial sector. There are emerging innovations, though limited and slow, based on improved technology such as personalized services, introduction of electronic banking, and limited other financial products. However, the banking industry is controlled by about six commercial banks – CRDB, NBC, NMB, Standard Chartered Bank, Stanbic Bank, and Citibank, thus posing a threat to the expected competition. There are possibilities for these banks to operate in an oligopolistic manner creating a cartel as it was the case during the 1940s through 60s. As pointed out in chapter four, three major banks - National and Grindlays Bank, Standard Chartered Bank, and the Barclays Bank – dominated the economy and therefore determined credit policies.

Table 6.5 contains some commonly used indicators in measuring financial deepening[104]. The yearly ratios of the broadly defined money supply (M2) over GDP as a proxy to financial deepening indicate an increase from 23% in 2000 to 26% by 2004. This indicates that over the period of 2000 to 2004, more people used bank services. On the other hand, the ratio of private credit to total credit, traditionally used as a proxy to access to credit, indicates a favourable growth over years. It increased from about 46% in 2000 to over 100% in 2004 and slightly down to 85% in 2005. However, in practice commercial banks favour corporate customers than small scale operators who are the majority. In addition, small scale enterprises lack capital, collateral, and skills to prepare bankable proposals; hence they are more marginalized in terms of access to credit.

Table 6.5: Selected financial indicators, 2005

Indicators	2000	2001	2002	2003	2004	2005
Savings to GNDI Ratio (%)	11.6	11.1	12.7	11.8	12.3	12.5
GDP per capita-current prices (US $)	262.7	264.4	267.9	276.2	303.0	317.8
Inflation (%)	5.9	5.2	4.5	3.5	4.1	4.4
Total Credit to GDP Ratio (%)	9.8	7.6	8.8	8.7	8.5	9.4
Ratio of Private credit to Total Credit (%)	46.6	63.7	69.2	98.0	104.7	84.6
GDP –factor cost-current prices	4,777,249	5,414,643	6,194,318	6,972,496	8,015,816	-
M2	1,093,610.9	1,233,667.0	1,507,386.5	1,721,109.9	2,050,886.0	2,808,247.6
M2/GDP (%)	23	23	24	25	26	-

Sources: BoT (2006a, various tables 21-51) and own calculations

Key:
- GDP calculated at market price
- GNDI – Gross National Disposable Income
- M2 – Broad money that is comprised of money in circulation outside banks and demand deposits (M1) plus time deposits and savings deposits

In terms of domestic savings mobilizations there were a slight improvement as savings to GNDI registered a slight increase from 11% to 13% over the period, indicating that households were undertaking minimum financial savings. However,

[104] The financial depth in an economy is measured by calculating bank deposits and M2 as a ratio of GDP.

since inflation was stable during this period and GDP per capita was on the rise, the rate of savings ought to have been higher than that registered. Price stability as indicated by the rate of inflation had stabilized at a unit digit as it was reduced from 5.9% in 2000 to 3.5% in 2003. In 2005, inflation went up slightly from 3.5% in 2003 to 4.4%.

The decline in inflation is a result of implementation of tight fiscal and monetary policies that focused on controlling government expenditure and containing an increase in money supply. This means that there has been less borrowing by the government hence making more resources available to private sector. Furthermore, privatization of *parastatals* that have been relying on government funding also eased the situation. Other measures that helped to improve price stability include the establishment of an independent tax collection authority – the Tanzania Revenue Authority (TRA) - that helped to increase tax collection.

The financial system is increasingly diversified comprising of commercial banks, non-bank financial institutions, pension funds, insurance companies, *bureau de change*, micro-finance institutions, and stock exchange. However, the commercial banks are mainly comprised of foreign owned banks that dominate the sector by 80%. Thus, the contribution of non-banking financial institutions is still limited. Despite the banks dominance of the financial system, their deposits are still small in relation to the national income. In 2003, this was estimated at 14% of the GDP and bank credit to private sector at about 6% of GDP, which is among the lowest in Sub-Saharan Africa (IMF, 2003:7). According to IMF report (2003:7) participation of foreign financial institutions now accounts for about two-thirds of the banking system capitalization, and over 50% of total banking assets ownership (IMF, 2003:7). This situation increases possibilities for capital flight and less access to loans by the considered “risky rural people”.

On the other hand, financial services are not evenly spread across the country - making access to financial services limited mostly to the favoured geographical areas and cities/towns. The financial sector largely remains fragmented with competition mostly felt in major cities of Dar es Salaam, Arusha, Mwanza and Moshi where major commercial banks have branch networks. Most of these banks operate branches in regional towns and to a limited extent in district towns. Before the split of the state run giant commercial bank – NBC in 1997, this sole commercial bank had branch networks reaching most of the district headquarters. With its privatization, about 22 branches were closed and mobile banking services that were introduced in some parts of the rural areas were abandoned.

Although the government has put in place a policy and regulatory framework for the development of the financial system, it has not adequately addressed the need to develop the institutional structures that deepens the financial sector. Most commercial banks continue to rely on the conventional lending methodologies that emphasize on collateral security, capacity to repay, character of the borrower, capital outlay, and business track record – conditions mostly referred to as “the five-Cs of credit” ratings. There is a growing emphasis on the promotion of Microfinance Institutions to fill the gap left by the commercial banks in addressing the financial needs of the rural households, SMEs, and low income people in particular. Whereas the MFIs have shown the capacity to serve this segment of the population better, they are not well integrated into the national financial systems and their outreach is limited.

6.4.2 Development of appropriate financial products and services

The financial sector reforms have enhanced promotion and innovation of financial retail capacity by financial institutions. Due to increasing competition in the financial sector, most financial institutions have improved management and governance practises, quality of financial business and technology. However, almost all commercial banks are offering one or a combination of traditional financial products in the form of savings, loan, transfer payments, and insurance. Others are trade finance, changing money, and to a limited extent share trading, bank guarantee, mortgage and lease funds. Table 6.6 summarizes the types of financial services offered by surveyed commercial banks.

Table 6.6: Typology of Financial Services offered by surveyed commercial banks, 2005

Savings	Loans/Credit	Insurance	Transfer payments	Others
Savings Current Fixed WADU Provident Funds Special Accounts – children, etc	Overdrafts Short-term Long-term Agricultural loan Micro-credit, etc	Domestic package Personal accident Motor vehicle	Money orders Money fax Bank transfer Electronic transfer Travellers' cheques Cheques Western money union	Payments Trade finance Securities and share trading Bank guarantee Foreign exchange services

Source: Information gathered from surveys

(i) Mobilization of Savings

The survey results, as summarized on Table 6.6, reveal that all commercial banks operate different treasury products and services through the mobilization of savings and deposits. All the surveyed commercial banks operate deposits accounts in the form of savings accounts, current and fixed accounts. However, there are few innovations by some banks such as that by the CRDB bank, which operates minor accounts for children under 18 years, the Tanzania Postal Bank (TPB) operating a popular saving scheme known as *Weka Akiba Daima Upatapo* (WADU), and a provident fund scheme.

Table 6.7 summarizes the trend of commercial bank deposits over the period of 1996 to 2003. Total Bank deposits increased from Tshs. 573,307.5 million in 1996/97 to Tshs. 1,368,506 million in 2002/2003 equivalent to 139%. Higher increases were recorded in foreign savings and deposits followed by demand deposits. Foreign direct investments (FDI) were one of the reasons for an increase in foreign currency deposits.

Table 6.7: Trends in Commercial Banks Deposits, 1996-2002

Type	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
Demand Deposits	176,208.6	234,135.1	208,975.3	229,122.1	261,302.7	316,210.0	386,192.4
Time Deposits	109,872.5	130,918.8	132,734.7	152,902.1	152,290.9	171,598.0	218,602.1
Savings Deposits	145,199.9	130,915.0	155,803.0	168,805.3	203,021.0	236,184.0	299,345.8
Foreign Deposits	142,026.5	152,447.8	177,214.1	204,192.9	302,471.0	373,867.9	464,365.7
Total	**573,307.5**	**648,416.7**	**674,727.1**	**755,022.4**	**919,085.6**	**1,097,859.9**	**1,368,506.0**

Source: URT (2003d:86) table No. 31

Most rural households and their enterprises save in one way or another, but savings in commercial banks is limited. This is explained partly by the low income most households earn to warrant sizeable savings. Furthermore, the distance between rural areas and the location of financial institutions prohibits financial savings. According to the IMF Report (2003:8-9) only 6.4% (or about 450,000 household) of all households had a savings or current account in 2003 – down from 18% a decade earlier, with a corresponding figure of 3.8% in rural areas. The decline in bank savings is, partly accounted by closure of bank branches in remote areas considered to be commercially unprofitable during the restructuring of the banks and financial institutions. However, the restructuring process never considered the development dynamics of social capital and long-term effects of maintaining bank branches in the rural areas.

Financial savings is an investment in bank deposits if returns are attractive. The interest rate spreads are high and therefore, de-motivating as discussed in the subsequent sections. However, savings is not only financial savings but there are other forms of savings for varied reasons. Generally speaking, there are four main motives for savings, namely (i) life-cycle motives, (ii) precautionary motives, (iii) investment motives, and (iv) bequest motives (Horioka and Watambe, 1997; Mwega, 1997; Schmidt – Hebbel, Serven, and Solimano, 1996). The life cycle motives arise from the temporary imbalances between current income and expenditures at various stages in one's life cycle, which are determined by the differences in timing between income and expenditure streams. The precautionary motives come from the need to hedge against uncertainties concerning future income and/or expenditures. The investment motives are determined by the rate of return on investment and availability of investment opportunities, whereas the bequests motive originates from the need to leave assets behind for heirs in the form of transfers.

Explanations for the low levels in domestic savings mobilizations arise out of low deposits rates. Table 6.8 shows the trends of lending and deposits rates between 1997/98 and 2003/2004[105]. The gap between interest rate paid on deposits and that charged on loans is substantial reflecting the degree of risks involved. The discount rate charged to commercial banks and the government when they borrow from the Central Bank, declined from about 20% to 9% over the period, whereas the weighted average savings deposits rates offered by commercial banks declined from 12.8% to 3.1% over the same period.

Table 6.8: Trend in Average Nominal Interest Rates, 1997/98-2003/04

Type	1997/98	1998/99	1999/00	2000/01	2001/2002	2002/2003
Discount Rate (BoT)	20.5	20.7	16.6	13.1	9.8	9.2
Deposit Rates:						
- Savings	12.8	12.0	7.4	7.1	4.2	3.1
- Fixed (3-6 months)	29.0	13.1	8.3	9.1	5.2	3.5
Lending Rates:						
- Short-term	24.5	28.0	21.4	19.1	20.9	15.9
- Medium & Long-term	21.5	26.0	21.3	21.0	19.2	15.7
Treasury Bills:						
- 91 days	15.0	15.6	9.7	7.3	4.2	4.4
- 182 days	15.5	16.4	12.0	7.8	4.8	4.7
- 364 days	17.3	18.0	13.7	10.3	5.1	4.7

Source: URT (2003d:86) Table No. 32

Likewise, the average fixed deposits rates for 3 to 6 months declined from 29.0% in 1997/98 to 3.5% in 2002/2003. On the other hand, the weighted average

105 The reporting format of the Bank of Tanzania follows the government fiscal year that begins in July of the preceding year and ends on June of the following calendar-year.

interest rate on short-term lending by commercial banks declined from 24.5% in 1997/98 to 15.9% in 2003/2004. Interest rates on medium and long-term loans followed suit in declining from an average of 21.5% to 15.7%. As it can be discerned from table 6.8, the trend in interest rates charged by commercial banks shows that the spread between lending and deposits continues to be wide hence creating a disincentive to savers.

(ii) Credit and Overdraft facility

Commercial banks are engaged in provision of credit and overdraft facilities as this is one of the banks' main sources of income. Most commercial banks prefer short-term to long-term credit financing mainly as a result of the nature of their liabilities, which are of short-term comprised of mainly "call deposits" as opposed to long-term deposits[106]. On the other hand, overdrafts (ODs) have great advantages to enterprises, in that they could save part of their investment costs in interest charges since interest is paid only on amount and duration of overdrawing on a customer's account as opposed to a loan. It suffices to note that while OD facility is a good investment booster, it is accessed to by a few large scale enterprises, which operate current accounts. Since the bulk of our people live in rural areas, their access to OD is an imaginable at least in the short-run. This is due to that most rural people do not operate current accounts, either due to distance, restrictive bank conditions such as minimum deposit requirements, literacy, and lack of adequate information about their business.

Most commercial banks are generally risk averse as they tend to concentrate their investments in government papers - the treasury bonds and bills. For instance, by the end of 2005 there were about 24 commercial banks operating in the country with a combined customer deposits of Tshs. 3 trillion, where about two thirds of this amount was held by three top Commercial Banks – CRDB Bank 653.63 billion in customer deposits, NBC 620.15 billion, and NMB 530.75 billion. Most of this money was invested in government securities. Statistics show that during the

[106] Commercial banks run a liquidity risk when they finance long-term credit from short-term deposits. To motivate, long-term savers banks must introduce higher interest rates on long-term deposits.

fourth quarter of 2005, CRDB, NMB and NBC alone invested a total of 708.34 billion in Treasury bills and Bonds (Daily News, Thursday February 16th, 2006).

In addition, access to loans also differs by sectors. For instance, it is universally accepted that there is always limited access to loan capital for certain types of businesses and development opportunities such as cattle keeping, starting new farms, and rural housing. There might not necessarily be a general lack of all types of capital in rural areas, but rather by types of investment and location. In some cases some financial institutions possess limited project evaluation skills, and others are reluctant to make small loans to new businesses located in remote areas as a result of high administrative costs involved. This inadequacy of capital in rural settings has far-reaching effects of creating lack of employment and income opportunities hence leading to massive rural-urban migration.

(iii) Means of payments and money transfers

Means of payments and transfer payments are becoming critical issues in access to financial services for security reasons and efficiency purposes. All commercial banks perform payments and make money transfers through various instruments. Remittances constitute an important source for financial support in consumption smoothing, investment, and meeting emergencies. Rural households, therefore, demand for efficient mechanisms for money transfers. The most common means of transfers and payments are cheques, which takes time as they must be cleared before payments are effected. The fastest methods are the bank transfers, electronic transfer, money fax and travellers' cheques.

Technological advancement has brought revolution in money transfers, as it is increasingly replacing the cheque payment arrangement, hence making holding of current accounts redundant. The introduction of Automated Teller Machines (ATMs) has not only increased convenience but have also reduced costs of cash management and hence making opening of bank branches a redundant undertaking. Most commercial banks have improved payments systems through introduction of automation of banking services – where loading and Cash back services are now possible through the use of a local electronic card known as Tembo Card, Visa Cards, and other local electronic cards. CRDB bank has, in collaboration with SACCOS introduced limited ATMs services at some rural SACCOS by establishing merchants' outlets. However, the widespread of such services is constrained by the underdeveloped communication and transport infrastructure and lack of electricity.

(iv) Insurance and social securities

Rural households and enterprises are faced by a number of risks that calls for some sort of mitigation. For instance farm households and small businesses need insurance to protect them against unexpected output losses and damage to equipment and buildings. Thus, property and liability insurance is critical in reducing risks in financial intermediation. Due to fluctuations in production and prices, insurance is increasingly becoming an important financial product demanded by the rural households to protect their agricultural businesses. Although, hedging instruments based on weather or price indices are increasingly becoming available crop insurance, life insurance, and loan insurance are still important.

The insurance and social security sectors are at nascent stages of growth. The services provided by institutions dealing with insurance and social security are mostly biased towards the urban population. On the other hand, commercial banks are yet to seriously engage themselves in the provision of these services. As already pointed out in *et passim*, the TPB is organizing pension schemes, but it is still limited. The CRDB bank is providing insurance services only for properties – motor vehicles, buildings and life insurance.

(v) Lease

Leasing is an important financial product for most enterprises, especially for the Small and Medium Enterprises (SMEs) that have no access to financial capital in a developing country environment. However, it is one of the underdeveloped financial products as there are few companies involved in it. According to the discussions with the Manager of a local Micro-leasing company known as SERO Lease and Finance Company (SELFINA) operating in Dar es Salaam and Coast Regions leasing is defined as “a contractual arrangement between two parties, which allows one party (the lessee) to use an asset owned by the other party (the lessor) in exchange for specified periodic payments that are known as rental charges”. Leasing, mostly takes place in use of equipments and land, which is more appropriate as one only pays rent/lease for the use of the property while legal ownership rests with the institution. In this respect, it replaces the demand for collateral.

Micro leasing[107] products play an important role in creating wealth and alleviating poverty by increasing access to productive investments among SMEs. Leasing is most ideal for Small Medium Enterprises (SMEs) who can not purchase equipment such as sewing machines to start up tailoring business, or a tractor for farming. Leasing helps Small Medium Enterprises (SMEs) to move to a new level of business. However, there are only a handful of companies that offer such service in Tanzania. SELFINA (T) is one of the leasing companies emerging in Dar es Salaam, which provide leasing services to women only. It started in 2002 and has so far opened business to more than 3,000 women entrepreneurs. According to the SELFINA’s Manager, the company’s lowest leasing equipment ranges from a simple sewing machine (about Tshs.75, 000) to trucks, photocopiers, and maize milling machines (that do not exceed Tshs.15 million). The applicants must attend training, make deposits of not less than 20%, have two guarantors, and must have sound business plans. If they fail in making monthly payment, owners will loose the 20% deposits plus the equipment.

(vi) Other financial products

With liberalization, commercial banks are increasingly becoming innovative in designing new products tailored to customers needs. Increasingly, banks are forging ahead with other products such as trade finance, securities and share

[107] However, the appropriateness of this product depends on the legal and tax incentives of the country.

trading, and bank guarantee, and foreign exchange services. In addition, commercial banks are increasingly engaged in provision of non-financial services such as advisory services, environmental protection and related social and community obligations.

6.5 Rural Finance and Households' Livelihoods

Access to finance is expected to reduce both poverty and social and economic differences in the rural settings through assets portfolio building[108]. However, if access to loans is based on large assets that are possessed by few households, then finance will decrease rural equity. Examining the impact of financial sector reform on rural poverty in Tanzania, one observes that there are no clear correlations. Table 6.9 describes the decomposition of changes in poverty between 1991 and 2001. Income poverty[109] fell by about 3% over the period, depicting a slight improvement. Some 36% of the country's population are still below the basic needs poverty line and 19% below the food poverty line, compared with 39% of the population below the basic needs poverty line and 22% in 1991/92 as depicted in table 6.9.

Table 6.9: Decomposition of changes in poverty, 1991-2001 (%)

Indicators	Country level	Dar es Salaam	Other urban	Rural
Poverty 1991	38.6	28.1	28.7	40.8
Poverty 2001	35.7	17.6	25.8	38.7
Change 1991/2001	-2.9	-10.5	-2.9	-2.1
Growth impact	-8.4	-18.4	-6.6	-5.3
Inequality impact	5.5	12.4	4.0	2.7
Residual	-0.2	-4.5	-0.2	0.6

Source: URT (2005c:6) Table 6

[108] Poverty is usually described in terms of income, food intake and powerlessness. According to Rutasitara (2002:9) it is "…a situation of lack of sufficient means or income for a minimum level of living: food, shelter, clothing, a job, piece of land to till, vulnerability to changing economic and natural conditions…it also means lack of a wider array of human non-material needs such as rights of/or access to community – or state provided goods, freedom and respect".

[109] Food poverty is defined as "the minimum spending per person needed to provide 2,200 calories a day for one month based on foods consumed by the poorest 50% of the population. A higher basic needs' poverty line allows for other essentials such as clothes". The food poverty line for Tanzania was Tshs. 5,295 in 2001/2002 as opposed to Tshs. 2,083 in 1991/92.

The comparison of poverty by geographical location shows that Dar es Salaam had a significant improvement in poverty reduction than other regions, with 28% in 1991/92 dropping to 18% in 2001/02 as opposed to other urban centres that had 28.7% in 1991/92 falling to 26%.

Poverty is still a major challenge to rural population as the change of 2% is statistically insignificant with majority of population still languishing in poverty. However, the inequality measure – Gini coefficient[110] indicates that there is an increase in inequality especially in urban areas. According to the Household Budget Survey (URT, 2002b:18-19), 20% of the households accounted for 44% of household expenditure, as opposed to 43% in 1991/92; whereas the poorest 20% account for 7% of the household spending in both periods in the rural areas.

Theoretically access to financial services facilitates improvement in households' productive base, which as detailed in chapter two is comprised of five capitals – physical, natural, human, social and financial capital itself. Access to financial capital in this context is viewed as enhancing increase and diversification in incomes that mitigate risks through an increased food security, nutritional status, health, housing conditions, sanitation and water.

The United Nations Millennium Declaration on human development in the developing countries adopted in the year 2000, to which Tanzania is a party too, addressed these issues[111]. Consequently, the government designed the National Strategy for Growth and Reduction of Poverty (NSGRP) – also known in Kiswahili as *Mpango wa Kukuza Uchumi na Kuondoa Umaskini* Tanzania in short MKUKUTA in line with the UN-Millennium Development Goals (MDGs) (URT,

[110] Gini coefficient measures inequality in distribution of income and its value ranges from zero to one – with zero showing perfect equality and one perfect inequality.

[111] The Millennium Development Goals (MDGs) aimed on improving the livelihoods of poor people of whom about 70% are in Africa and Asia by addressing the following objectives: (i) Eradicate extreme poverty and hunger, (ii) Achieve universal primary education, (iii) Promote gender equality and empower women, (iv) Reduce child mortality, (v) Improve maternal health, (vi) Combat human immunodeficiency virus/acquired immune deficiency syndrome (HIV/AIDS), malaria, and other diseases, (vii) Ensure environmental sustainability, and (viii) Develop a global partnership for development.

2005c:xix). The implementation of MKUKUTA was, however, preceded by the Poverty Reduction Strategy Paper (PRSP). Whereas the PRSP provided a vehicle for increasing public allocations to priority sectors – health and education featuring well, MKUKUTA on the contrary emphasizes on poverty reducing growth[112].

Since the majority of the Tanzanians – about 80% live in rural areas and depend on agriculture for their livelihood, it is evident that immediate gains in poor households' welfare can be achieved through the transformation of the agricultural sector. Agriculture remains to be the key source for increased employment and incomes, from which the poor people can meet their needs sustainably. Moreover, agriculture produces food for reduction of hunger and malnutrition. With increased incomes, access to education and better health is enhanced. In this regard, agriculture is the most critical sector in the realization of development goals as defined under MKUKUTA.

Assessment of Tanzania's macroeconomic indicators reveals that economic growth rate has improved from 2.5% during 1990-94 to 5.8% in 2000 – 2004 as summarized on table 6.10 and detailed in Appendix 6.1.

Table 6.10: Average annual growth for selected GDP sectors, 1990 – 2004 (%)

Economic Activity	Average Annual Growth rate			Average Contribution to growth		
	1990 – 94	1995 – 99	2000 – 04	1990 - 94	1995 - 99	2000 – 04
Agriculture	3.1	3.6	4.8	1.5	1.8	2.3
Industry	2.0	5.4	8.7	0.3	0.9	1.5
Manufacturing	0.4	4.6	7.0	0.0	0.4	0.6
Services	1.9	3.8	5.9	0.7	1.3	2.0
Financial & Business Services	2.9	3.6	4.3	0.3	0.4	0.4
TOTAL GDP (factor cost)	**2.5**	**4.0**	**5.8**	**2.5**	**4.0**	**5.8**

Source: Extract from URT (2005c: 4, 99) table 2 & A.1

[112] Poverty Reduction Strategy Paper (PRSP) is a medium term development framework designed to achieve Tanzania's Development Vision 2025. The PRSP was successfully implemented, culminating into another medium term development framework of MKUKUTA in 2005.

Its contribution to economic growth, as summarized in table 6.10, averaged 1.5% (1990-94); 1.8% (1995-99); and 2.3% (2000-04). On the other hand, its average annual growth rates over the same period were 3.1% (1990-94); 3.6% (1995-99); and 4.8% (2000 – 2004). Although the growth rates realized are positive, they are below the projected rate of 5.0% due to various shocks – drought, world commodity price crisis, and a high population growth rate of 2.8% (URT, 2000b:27). Appendix 6.2 shows the contribution of each sector to the country's GDP, where the contribution of the agricultural sector is found to be significant at 46.0% in 1990 decreasing to 44.1% in 2002 (URT, 2005d:10).

Thus, agriculture being the key sector must be perceived as a critical sector to economic growth. However, informed studies show that the agricultural sector is highly under financed (Moshi, 2003; Bee, 1997; Kashuliza, 1994; Nyagetera and Kilindo, 1995). According to Moshi (2003:12) after the liberalization of the financial sector, commercial bank lending to agriculture declined from 12% of the total domestic lending volume in 1996 to 6% in 1999. On the other hand, the share of commercial bank loans for agricultural marketing fell from 19.7% of the total in 1995 to 0.8% in 1999. Due to the inadequate access to formal financial services, agricultural traders, processors and producers have been relying on informal financial arrangements.

Agricultural producers and agri-business in general (encompassing all forms of agricultural activities)[113] demand variety of financial products such as savings, short-term finance, term-finance, leasing, money transfer, and insurance (Hollinger, 2003; Schmidt and Kropp, 1987; Adams, 1995). Unfortunately, financing agriculture has been a problematic area as it is conceived by most financial institutions as a risky undertaking.

[113] Agricultural activities are taken to include production, processing, distribution, and marketing. Agricultural finance can be distinguished into *short-term* finance and *term-finance*. Short-term finance focuses on working capital - for inputs supply, crop-finance, processing, and labour charges. Term finance encompasses financial needs for over a period of one year for mainly acquisition of farm machinery, irrigation equipment, land improvements, livestock, and purchase of processing equipment.

There are indications that rural households are diversifying their economic activities and taking up more of non-farming employment in the emerging private sector and self-employment. According to the Household Budget Survey of 2001/2002 (URT, 2002b:14-16) the number of households depending solely on agriculture and fishing has gone down from 75% in 1991/92 to 63% in 2001/2002. The assessment of sources of households' incomes indicates that 51% of households' income is from agricultural activities, and 21% from self-employment in non-farm activities. The remaining balance is comprised of employment 12%, transfers 8%, and other receipts making 8% (URT, 2002b:18-19). This scenario confirms the findings by Mwamfupe (1998:i) that the dominance of peasant farmers in Sub-Saharan Africa, is diminishing in relative size and significance creating a new labour pattern that is expanding rural-urban relationships.

6.6 Summary and Conclusions

This chapter analyzed the structure of the financial sector under the liberalized market environment. The financial sector reform and liberalization implemented in Tanzania aimed at fostering savings mobilization and productive investments, improving efficiency, and reducing risks. The traditional view for liberalization of the financial market was to increase depth and width, and that market access is viewed as a by product of an improved outreach of financial sector. As financial sector stabilizes, access to financial market by the poor and private sector – especially by the SMEs in a country like Tanzania will be enhanced.

Performance assessment of the financial sector after liberalization presents mixed results, a situation that supports similar observations in other developing countries in Asia and Latin America (Sowa, 1994; Nyagetera, *et. al.*; 1995:124). As for positive results, liberalization of the financial sector has resulted into expansion and diversification of the financial intermediaries – commercial banks, non-bank financial institutions, insurance and social security funds, as well as facilitated establishment of capital markets. The role of the Central Bank has been redefined by focusing more on the attainment of price stability, which is critical for the development of a sound and efficient financial service in the country.

Although there is an increased diversification of the financial institutions, the financial sector is still dominated by the banking system, which is concentrated mainly in urban areas, highly liquid and well capitalized. Thus, banks perform a limited role in economic growth in rural areas despite the extensive policy and institutional reforms. Furthermore, there are limited product development and innovation appropriate for the rural sector. Consequently, credit to the emerging private sector is still limited and mostly available in the form of short-term loans and or overdraft. This situation is partly explained by the weak institutional environment that makes financial institutions still rely on the use of conventional lending methodologies that emphasize on collateral, availability of business records, and credit worthiness, which restrict rural households' access to bank credit. Consequently, financial institutions prefer to invest in government papers and offshore hard currency savings especially in US dollars. Interest spread between deposits and lending are still high, though declining. This creates a major disincentive in terms of savings mobilization.

Rural areas are characterized by high poverty, low population density, isolated markets, seasonality, and high covariant risks such as widespread crop failures that often result in high transaction costs, lack of traditional collateral, variable incomes, and limited opportunities for diversifying risks. These features differentiate rural financial markets from urban ones and often scare off commercial financial intermediaries. These features, however, do not represent market failures, although increases transaction costs that calls for government intervention.

On the other hand, financial intermediaries need a system that provides for claims against property and enforcement of financial contracts. The more uncertain and expensive this process, the less willing lenders become. Thus, inadequate laws, regulations, and institutions prevent the formal sector from delivering credit to farmers, rural business people or even non-bank creditors. Access to credit demands in part property rights that can be offered as collateral. In the rural areas this calls for registering land or land use, existence of secured transactions, availability of other acceptable forms of collaterals, and availability of legal registries; which are incidentally all lacking.

The weaknesses limiting market access as observed above, calls for appropriate government intervention. However, the case for intervention should be guided by the government development objective – whether the objective is increase in rural incomes or poverty reduction. Direct interventions through say subsidies, credit programmes, or institutions – need to be carefully analysed as efforts should be made to avoid further failures through state interventions as observed in many countries during the 1970s through 1980s. Alternatively, policies and regulatory measures focused on enhancing rural growth and improving households' livelihoods may be appropriate if well designed.

Thus, sustainability of access to financial services rests on an improved demand for financial services, reduced banking services provision conditions, reduced transaction costs, improved infrastructure, and other structural bottlenecks. In addition, change in attitudes of the rural population on credit and savings is needed to enhance savings mobilization for increased lending and instil timely loan repayment culture. In the short-run government intervention through credit guarantee schemes may help to build banks' confidence in the rural areas. This may be associated with other market-based incentive schemes such as tax incentive, product development, integration of MFIs with commercial banks through linkage banking, capacity building and awareness creation, and improving legal and regulatory framework to enhance financial discipline and credit repayment culture.

CHAPTER SEVEN

AN ANALYSIS OF THE RURAL FINANCIAL MARKETS IN BABATI DISTRICT

7.1 Preamble

This chapter presents an analysis of demand, supply and utilization of financial services within the framework of the liberalized financial sector in Babati district. Liberalization of the financial markets was expected to enhance rural households' access to financial services through an improved participation of the private sector and market efficiency resulting from competition. In this context the chapter analyzed households' sources of incomes, their demand for financial services, supply of financial services, and constraints to access to financial services among rural households and enterprises.

7.2 The Demand for Credit in Babati District

The demand for rural financial services is diverse and varied among the rural population, which ranges from access to safe and convenient savings facilities, loans, insurance and provident fund, lease, means of payments, and transfer payments. Since in rural areas it is difficult to separate the demand of these financial services from households' and enterprises' needs, the study assumed access in terms of households needs.

7.2.1 Description of the Data

The demand for credit is taken as a proxy to access to financial services for obvious reasons. One, majority of people demand credit to meet various needs - consumption smoothening, investment opportunities, and emergencies. Two, access to credit in many instances is associated with opening of a bank account as an individual or groups. Three, through capacity building programmes and awareness creation, other financial products such as insurance, leasing, transfer payments, etc. will be learnt slowly and adopted. It is assumed that the demand for credit, which is used as a proxy to access to financial services, is influenced by age of the head of the household, main occupation of the household, education level of the head of the household, household size, and proximity of the household to a financial institution. Based on this assumption, the loan demand equation was formulated, which was described in chapter three as follows:

$$L_i = \beta_0 + \beta_i A_i + \beta_i O_i + \beta_i E_i + \beta_i D_i + \beta_i H_i + e_i \text{ --- } (2)$$

where: L_i = Amount of loan accessed by households i
A_i = Age of head of household i
O_i = Occupation of head of household i
E_i = Education of head of household i
H_i = Household size of household i
D_i = Distance of household i from the nearest financial institution
β_0 = constant
β_i = coefficients for the respective explanatory variables
e_i = random error residual

The age of respondents (**A_i**) in years was recorded during the interviews that were used in the analysis without alterations. However, for concrete analytical reasons, rural households were categorized into youth for those falling within the age limits of 18 - 35 years, adults for those between 35 and 60 years, and elderly for those in the age range of 60 years[114] and above. *A priori* expected sign for the variable **A_i** was positive, indicating the demand for credit increases with an increase in the age of the borrower to meet the life cycle needs.

Occupation of the household (**O_i**) was expected to have positive influence on the demand for credit, other factors remaining constant. Since majority of the rural population are engaged in farming activities, farming was taken as proxy to occupation. Those household engaged in farming were assigned number 1 and those doing other forms of employment were assigned number 2. In this context other employment involves those in both formal and informal sectors, which include mining, fishing, rural workers, and tourism.

The level of formal education of the head of the household (**E_i**) was expected to have positive influence on the demand for credit as households with relatively

[114] This categorization fits into the national definitions for youth and adults. Besides, it also captures the definition for productive labour as used in the national statistics.

higher education are more exposed to the understanding of the role of credit, appreciate its benefits, and are expected to have better knowledge on the procedures of accessing loans and its repayment conditions. The classification of households' education levels were determined by the minimum cut-off point of primary education against no formal education as widely used in similar studies in the Sub-Saharan Africa (Mduma and Wobst, 2005:36; Mduma, 2003: 6; Readon, 1997). For this purpose, those without formal education were assigned number 1, those with primary education number 2 and 3 for those with education above primary level.

The proximity of a financial institution to households, defined by distance (**D_i**), was expected to have inverse relationship with the demand for credit. Conversely, distance of a financial institution from a household is a critical factor, as the further it is from a financial institution, the less the demand for financial services, hence a negative sign for distance variable was expected. Distance can be measured in two ways - average travel distance in kilometres (distance – km), and average travel time (distance – hours). Since, the travel time is more appropriate as it captures the distance, time lost, physical exhaustion and risk involved than the kilometres one travels, the former was used in this analysis.

The household size measured in terms of number of household members (**H_i**) was expected to have a positive sign as the higher the number of household members, the higher the demand for money for various reasons – consumption smoothening, precautionary needs, investment requirements, and for bequest reasons.

7.2.2 Empirical Results and Discussions

A multiple regression analysis was employed to determine the maximum likelihood of the explanatory variables identified that influence the households' access to credit. The demand for credit was assumed to be determined by Age of borrower, Occupation, Distance, Education level, and household size. Thus, the loan demand equation was specified as a linear combination of independent variables (A_i, O_i, E_i, D_i, and H_i) plus an error e_i which is normally distributed with mean zero.

Data analysis was at first conducted using Statistical Package for Social Sciences (SPSS) programme using the Ordinary Least Square (OLS) technique but gave poor results. Consequently, this was replaced with Tobit analysis as explained in chapter three, and the Stata programme for data management in social sciences was used instead, which produced better results as summarized in Table 7.1.

Table 7.1: Data output from Estimation of Tobit Regression Model.

Tobit estimates	Number of obs	=	284.00
	LR chi2 (8)	=	22.99
	Prob > chi2	=	0.0034
Log likelihood = -732.52505	Pseudo R^2	=	0.0155

Lloan	Coef.	Std. Err.	T	P>t	[95% Conf.	Interval]
edu_p	-.0197372	.5004575	-0.04	0.969	-1.00492	.9654459
edu_a	.0420197	.6095635	0.07	0.945	-1.157946	1.241985
Lage	20.06	8.029949	2.50	0.013	4.252525	35.86748
lage2	-2.714615	1.069082	-2.54	0.012	-4.819172	-.6100584
Lhhs	.97301	.3824922	2.54	0.012	.2200493	1.725971
distance	-1.866537	.8684675	-2.15	0.032	-3.576171	-.156902
ldist2	3.117164	1.37911	2.26	0.025	.402296	5.832032
occupation	.8187645	.4982167	1.64	0.101	-.1620075	1.799536
_cons	-27.59	14.77569	-1.87	0.063	-56.67692	1.496911
/sigma	3.400299	.1519006			3.101273	3.699325

The rho parameter is 3.400391 and standard error is 1519073, which does not have direct interpretation. The model is statistically proven correct in the sense that the likelihood ratio test ($R^{2)}$ is passed, however, relatively low but comparable to similar studies. After all in Maximum Likelihood Estimation Pseudo R^2 does not have direct interpretation as in Ordinary Least Square, but OLS results were found poor.

The expected signs, as hypothesized are defined as:

(i) positive to mean the increase in the variable results to an increase in the loan (dependent variable),

(ii) negative is the contrary (increase in the variable results in the decrease in loan accessed)

However, of all the variables, age portrayed unique features of possessing both characteristics of increasing and decreasing at different points. Whereas initially it increased, but after reaching the age of 51 years, demand for loans started to decline. This result, which is explained in the following section, is demonstrated as follows:

```
. wherext lage lage2, boot kdensity

range of lage       = [2.8900001, 4.4899998]
lage+lage2 has maximum in argext =   3.6914
Std Error of argext (delta method)    = .1100936
95% confidence interval for argext   = (3.47562, 3.907179)

Parametric bootstrap statistics (assuming bivariate normality)
Variable    Reps   Observed      Bias            Std. Err.   [95% Conf. Interval]

argext   10000     3.6914  -.03502361.7046    .3500409  7.032758  (N)
           3.25834   3.983055 (P)
           3.256035  3.982001 (BC)
N = normal,          P = percentile, BC = bias-corrected
```

It shows that the turning point is
. disp exp(3.6914)
40.100949

with the following 95% confidence interval
lower
. disp exp(3.47562)
32.317859

Upper
. disp exp(3.907179)
49.758385

Compare with the sample distribution
sum age

	Variable	Obs	Mean	Std. Dev.	Min	Max
	Age	285	51.03158	21.08991	18	89

(i) Proximity to a financial intermediary

The results of the regression analysis confirmed the inverse relationships between distance and access to loan. Due to their proximity to NMB bank branch located in Babati town, residents of Singe, Gallapo, and Mamire Wards have higher number of population operating bank accounts. Magugu being along the highway to Arusha city has relatively easy communication and, therefore, well connected to urban based financial services. Bonga, Singe, Mwada, and Magugu Wards, which are connected by the Northern Great Road connecting Cape Town and Cairo passing through Arusha – Babati – Dodoma - Iringa to Zambia, are also relatively better off than others due to easy transport. These Wards have relatively high degree of commercial activities than others, and therefore experience high cash turn-overs that enable them to operate bank accounts. These results were also confirmed during the focus group discussions held in the villages surveyed.

Examining access to financial services by using time variable it is revealed that those staying in town have higher chances of accessing bank services within shorter time as opposed to those travelling from upcountry. For example, someone coming from Bashanet would need two days for visiting the bank. He or she might be forced to stay a night in Babati town because by the time he/she is through with the bank business, there is no reliable transport back to Bashanet, hence he/she is forced to travel back home on the second day instead. The risk involved of carrying cash for two days is, for example, also high. Consequently, those staying far away from Babati town incur high transactions costs as the majority have no own transport, and public transport is not reliable due to poor roads, the cost of fare paid, and the risks involved. According to the NMB Babati branch manager there are incidences of robberies in the areas, though not highly pronounced as in other towns like Dar es Salaam, Arusha, and Mwanza.

Efficient and reliable communication and transport infrastructures are critical in facilitating the development of rural financial markets. Babati district unfortunately is one of the disadvantaged rural districts in Tanzania in terms of communication and road networks. Road network is not in good conditions as they are gravel and earth roads that are not passable especially during the rainy season. On the other hand, communication facilities are not good either. Telephone services – land based services cover Babati town and few other townships through wireless connections introduced through a pilot project by the state run – Telecommunication Company Limited (TTCL). In addition, cellular phones are available, though in limited areas provided by two private companies – the

Vodacom and Celtel. However, the handsets are expensive and their maintenance can hardly be afforded by rural people especially where there are no facilities for recharging and buying air time. Nonetheless, its introduction has provided an innovative money transfer product – through airtime.

Whereas commercial banks are concentrated in town, SACCOS and informal finance practices[115] dominate the rural areas. However, most SACCOS are yet to open up their common bonds, making their services a closed one to the rest of the non-members. Informal finance is the best option, as these are easily available, convenient, and with less bureaucratic procedures. Nonetheless, the problem of informal finance is availability of money when needed as friends and relatives do not have money all the time. Besides, the rural areas are in most cases cash constrained as their main source of cash is through sale of produce that happens not all the year round.

(ii) Occupation – farming

Regression results negated the expected results of credit having an impact on occupation. Out of the 285 households interviewed, about 78% had farming as their main occupation and 22% as non-farming group mainly in the form of paid employment. Out of the total interviewed households, only 5% had access to formal credit, 67% to informal credit and 20% from both formal and informal sources. In terms of occupation, about 77% are farmers and 22% are non-farmers as summarized in table 7.2.

Table 7.2: Sources of loan for different occupations in Babati, 2004

	SOURCE	OCCUPATION				TOTAL	
		Farmers		Others			
		No.	%	No.	%	No.	%
Sources of loan	Formal	9	3.2	5	1.8	14	5.0
	Informal	160	56.1	32	11.2	192	67.3
	Both	35	12.3	22	7.7	57	20.0
	None	18	6.3	4	1.4	22	7.7
Total		**222**	**77.9**	**63**	**22.1**	**285**	**100.0**

Source: Compiled from field data, 2004

[115] Financial NGOs (FiNGOs), as alternative source of credit, are few in Babati as discussed under 7.4.4.

The regression result shows that farming – as the main occupation – has no significant relationship with the dependent variable – credit. The reasons for these results are that most rural households undertake variety of economic activities as their survival strategy as well as risks aversions technique. In addition, it also reflects weaknesses in extension services especially in advising farmers on optimal production techniques that lead to efficient use of resources including credit. In this context, the demand for credit is not influenced by the households' main economic occupation, but rather by other variables.

(iii) Household Size

Regression results do not support any significant relationships between demand for credit and household size. This means that there is no evidence that household size tend to influence the demand for credit. Most rural households have large families hence experiencing high dependency ratios, and also practice extended family relations. Larger families have higher demands for money for school fees, medical care, food, and transport. The study revealed that to the contrary most households are observed relying mostly on self-financing arrangements rather than depending on credit.

According to the 2002 population census, average rural household size for Babati was 5.1 persons, which is higher than that of urban households with 4.2 persons (URT, 2003b viii). In this, context it is concluded that a large households' size is an indicator for difficulties household meet in saving as higher proportion of incomes goes to consumption budget. Consequently, households tend to rely more on own resources especially through utilization of past savings and labour rather than relying on external credit.

(iv) Educational characteristics of respondents

Regression results do not show any significant relationships between demand for credit and education of the head of the household. The three categories of education level – none, primary and above primary levels exhibited no causal relationships with demand for credit. The assumption that the more educated individuals have higher development aspirations and hence tend to seek credit for development purposes is negated.

According to the URT (2005f: vii) literacy rate for Babati was 63% among populations aged 5 years and above, with 55% literacy in Kiswahili and only 8% in English. Unfortunately, literacy was the highest among the category of those supposed to be attending primary and secondary education aged between 10 and 19 years creating a net enrolment rate of 69% for rural population as compared to 83% in urban areas.

Table 7.3 depicts that most borrowers in the group of those with primary education accessed credit informally. Out of a total of 67% of informal borrowers, about 40.3% had primary education, 12.3% with education of above primary while 14.7% had none. Those with education above primary are the ones who borrowed mostly from formal financial institutions (2.1%) out of 5%.

Table 7.3: Sources of loan for different Education levels, 2004

SOURCES OF LOANS	**EDUCATION LEVEL**						**TOTAL**	
	None		**Primary**		**Above primary**			
					No	%	**No.**	**%**
formal	4	1.4	4	1.4	6	2.1	**14**	**5**
informal	42	14.7	115	40.3	35	12.3	**192**	**67**
both	15	5.3	29	10.2	13	4.6	**57**	**20**
none	6	2.1	10	3.5	6	2.1	**22**	**8**
TOTAL	**67**	**23.5**	**158**	**55.4**	**60**	**21.1**	**285**	**100**

Source: Compiled from field data, 2004

Although the study observed that education is not a good determinant of access to credit it is, however, a necessary condition for those beneficiaries who have to come to terms with the complex borrowing procedures under commercial banks. Rural households with education above primary education level constitute a category of enlightened group who can forge their way ahead in credit negotiations with commercial banks. Nonetheless, education can also act as a barrier, when compared with the borrowing transaction costs and the expected stream of benefits from credit.

(v) Age characteristics

Regression results show some causal relationship between the age of the borrower and demand for credit, with different age groups benefiting differently from loans. The study concludes that those falling within the age group of 35 and 60 benefited more as opposed to those in the youth and elderly groups respectively. Access to loan tends to increase with age, but reaches a turning point at which access to loan starts to decline. This turning point compares with the mean age for the sample calculated at 51. 03. Besides, this turning point is very close to the life expectancy for Tanzanians that is 52 years. However, these findings also tally with the population characteristics of Babati. The district portrays a youthful population, as the proportion of the population under 15 years was 46%; while that of adults (between 15 and 64 years) was 50% and those falling in the age of 64 years and above are only 4% (URT, 2005f:6).

The age of respondents were categorized into youth (for those falling within 18 -35 years of age), adults (between 35 and 60 years), and elderly for those in 60 and above. The aim was to determine which age group has a higher demand for financial services, given the rural environment and economic activities. The youth age group is mostly of individuals who are young and earn little or no wage income. This age bracket is non-productive and hence depend mostly on family past savings.

The second stage is the middle age (between 35 and 60 years), which is considered as a productive age. During this stage, the behaviour of an individual changes over time as family and societal commitment increases. The third stage is the retirement stage or ageing. This is the period when an individual depends much on accumulated savings to finance consumption expenditures. Thus, age of a person can influence positively or negatively the demand for credit, depending on the stage one is in the life cycle.

7.2.3 Utilization of Credit in Rural Areas

In analysing sources and uses of credit, respondents were asked to list four sources of their credit by importance. In addition, they were required to indicate how these loans were used. The results, which are summarized in Table 7.4 shows that there are diverse sources and uses of credit. Uses of credit may be summed up into three broad categories of expenditures – consumption, investments and social capital expenditures. Consumption expenditures cover households' consumption needs, health services, and festivals such as weddings, clans' gatherings, and other rituals. Investment expenditures include investment in agriculture, business, construction, acquiring land, purchase of livestock and households' durables. Social capital expenditures cover expenses related to education, community development, and local government contributions.

The table 7.4 shows that, credit from friends/relatives accounted for 16% of the total credit used for households' consumption. Other important credit sources for consumption were SACCOS (10%), traders (9.4%) and money lenders (8.8%). The amount of credit committed to support consumption alone was 62% of the total loan sourced from various providers.

Investment that took up about 21% of the total credit was financed by traders by 5%, relatives and friends 4.7%, and ROSCAS 3.8%. Other sources of financing investments included money lenders (3.2%), SACCOS (2%), and commercial banks by 1.3%. Social expenditures – education, community projects and local government contributions – took about 17% of the total credit accessed by households. ROSCAS were found to be the main financiers of social expenditures by 4%, followed by relatives and friends (2.2%), money lenders, FiNGOs, and SACCOS at 2% each respectively.

Relatives and friends constituted the major sources of credit for households, which accounted for about 23% of the total loan, followed by traders at 16%, and money lenders and SACCOS at 14% each. Other sources of rural households' credit are ROSCAS that accounted for 12%; while remittances, gifts, food aid, support through faith-based organizations, and the like, constituted about 2%.

Table 7.4: Sources and Uses of Loans, 2004

Sources/Uses	Consumption					Investments					Social expenses				Total	
	Cons.	**Health**	**Others**	**Total**	**%**	**Agr.**	**Busin.**	**Others**	**Total**	**%**	**Edn**	**Com.Dev**	**Total**	**%**	**Total**	**%**
Relatives/Friends	860	450	240	1,550	16.0	256	67	130	453	4.7	185	27	212	2.2	2,215	**23.0**
Traders	310	321	274	905	9.4	162	-	320	482	5.0	93	90	183	1.6	1,570	**16.0**
Money Lenders	219	320	309	848	8.8	108	-	200	308	3.2	153	40	193	2.0	1,349	**14.0**
ROSCAS	188	110	107	405	4.2	233	71	62	366	3.8	325	60	385	4.0	1,156	**12.0**
Programmes	201	40	-	241	2.5	-	-	-	-	-	60	84	144	1.5	385	**4.0**
FiNGOs	96	-	-	96	1.0	-	-	-	-	-	73	120	193	2.0	289	**3.0**
SACCOS	341	345	277	963	10.0	150	40	3	193	2.0	165	28	193	2.0	1,349	**14.0**
Banks/FIs	140	-	53	193	2.0	5	35	85	125	1.3	67	-	67	0.7	385	**4.0**
Others	181	-	12	193	2.0	-	-	-	-	-	-	-	-	-	193	**2.0**
None	304	254	20	578	6.0	46	-	50	96	1.0	20	76	96	1.0	770	**8.0**
TOTAL	**2,840**	**1,840**	**1,292**	**5,972**	**62.0**	**960**	**213**	**850**	**2,023**	**21.0**	**1,141**	**525**	**1,666**	**17.0**	**9,661**	**100**

Source: Compiled from data collected.

Note: Each expenditure item – defined by columns - has its totals that are expressed in percentages of all responses recorded, which is 9,661. The last row contains totals for all expenditures, while the rest of the rows indicate sources of credit.

7.3 Demands for other Rural Financial Services

Rural people demand a diverse array of financial services apart from credit. These according to the interview results include saving facilities, money transfers and means of payments, insurance and leasing. The utilization of these financial products and services supports assets building processes among rural households and enterprises by increasing production and creating employment that contribute to economic growth.

7.3.1 Savings facilities

Savings is a critical factor in economic growth through promotion of investment. Rural households save part of their incomes in various forms. In this study, income and expenditure variables were not dealt at length due to paucity and reliability of data as most rural households are unable to classify and quantify their expenditures and incomes as well. However, in attempting to make annual estimates for households' incomes, three categories of rural income levels were identified, namely: (i) low income group - Tshs. 0 -100,000, (ii) medium income category - Tshs.100,000 - 500,000, and (iii) high income group Tshs. 500,000 and above. Estimates for households' savings and the financial gap – the demand for credit, were made.

When asked in what form households' save, responses summarized in 7.5 were obtained. The patterns of savings include: tangible things – grains, animals, real estate (land and buildings), cash, and with business operators. Other forms are in SACCOS, bank and with church. About 29% of the respondents were found saving their incomes in tangible assets such as grains, buildings, land, trees, equipment such as oxen ploughs, and oxen carts. Another 23% of the respondents indicated that they save in buying animals – mostly traditional species that are not very productive. Few respondents from Dareda, Singe, and Gallapo indicated saving in exotic dairy cattle and goats.

Table 7.5: Savings facilities identified by respondents, 2004

	Identified forms/types of savings	Frequencies	(%)
1.	Tangible assets and crops (buildings, land, trees, etc)	79	28.0
2.	Animals (especially cattle)	60	21.0
3.	Business persons	55	19.0
4.	Cash (at home, with a friend)	31	11.0
5.	SACCOS	40	14.0
6.	Bank	14	5.0
7.	Others (e.g. church, etc)	6	2.0
	TOTAL	**285**	**100**

Source: Compiled from the field data, 2004

Most farmers reported that they save in grains or livestock, while entrepreneurs especially grain speculators save in grains while waiting for higher prizes. Land is becoming a scarce commodity in most rural areas of Babati, thus forcing families to invest in real estate by buying land, or building houses in nearby town centres for income generation. Since most rural land lack title deeds, prices for land are not very attractive.

Other respondents reported that they safe-keep their money with business operators (21%) who are free to use such “free loans” to improve their business. About 11% reported that they safe keep their money with friends, relatives or at home. The members of rural SACCOS, who are mostly employees of local government, save their money with these quasi-financial institutions (11%). There were very few respondents who indicated that they are operating bank accounts (3%), while few others reported having their money safe kept with local church.

Ideally, financial liberalization should provide incentives and avenues for wealth holders to shift the composition of their wealth portfolios from non-financial savings to financial assets if deposits rates are motivating enough. However, savings behaviour seems to be proving this thesis a fallacy as most wealth holders have shown preference of saving in inventory goods, real estates, and animals as observed above. The explanations for this behaviour are the underdeveloped financial markets, low depository rate, and in some cases lack of information. Furthermore, in most developing countries much of savings take the form of bequest informal savings in lieu of provident fund/pension funds since these services are not available in rural areas.

Savings in physical assets have disadvantages of not providing the needed safety and liquidity as the tangible assets cannot easily be transformed into cash when needed. Moreover, the various forms of savings identified are more prone to risks such as drought, pests, diseases, theft, misuse, etc. This situation is also as a result of inadequate institutional savings facilities in the rural areas to provide for security, convenience, liquidity, and competitive returns.

7.3.2 Means of payments and Transfer payments

Means of payments and transfer payments are becoming critical issues in access to financial services for security reasons and efficiency purposes. Respondents were asked to list means of payments they use and choose one method that they often use in order to avoid repetitions. Table 7.6 summarizes various methods of payments in use in Babati based on their importance. Babati is a rural district, with characteristics of underdeveloped economy and, therefore, payments are mostly done in cash (75%), exchange of goods/produce/livestock (11%), and exchange of money or goods with labour (9%). Payments through banks are minimal found at only 4%. There are very few reports of payments done through SACCOS, crops in farm, and heifers (1%).

Table 7.6: Means of Payments in Babati, 2004

No.	Means of Payments	Frequencies	%
1.	Cash	214	75.0
2.	Exchange of goods, produce, and livestock	31	11.0
3.	Exchange of labour	26	9.0
4.	Bank	11	4.0
5.	Others	3	1.0
	TOTAL	285	100.0

Source: Compiled from interviews

The danger of the pre-dominantly cash economy arises from safety concerns and that of money laundering. In a cash economy one needs to carry cash in order to make payments, while injection of “dirty money” – the ill-gotten money into the economy is very easy. Incidences of robberies, cheating during payments and misuse of income on drinks and gambling have been reported as a result of carrying cash.

The cash economy facilitates the conversion of ill-gotten money – through corruption, drug trafficking, tax evasion, smuggling of gemstones - into the economy through purchase of properties, and investment in real estates without being asked. Money laundering involves the manipulation of money or property to hide its criminal origin by injecting it in legal activities, which can taint country's image internationally, weaken the value of local currency, and increases money supply and hence fuel inflation. Payments through commercial banks and use of credit cards in financial transactions may help to overcome problems associated with the cash economy.

On transfer payments and remittances, most respondents reported that they receive money from friends and relatives from distant areas like Dar es Salaam, Arusha, Dodoma, and Mwanza through various methods. Respondents were asked to list down means of money transfers in use in the district, and were then asked to pick one that they most often used. The results were summarized as in table 7.7. Most respondents reported that they mostly use friends and relatives travelling home or to towns to carry payments or remittances back to their kins, children or friends (70%). Business operators, bus companies and truck drivers were also reported as other service providers. While bus operators charge fee for this services, business people and trucker drivers do it at no cost.

Table 7.7: Money transfers and Remittances Methods, 2004

No.	Means of Transfers/Remittances	Frequencies	%
1.	Friends/relatives travelling back to the village	200	70.0
2.	Business people	31	11.0
3.	Bus companies/truck drivers	14	5.0
4.	Postal office	11	4.0
5.	Bank transfers (NMB/TPB)	3	1.0
6.	Sending money in the form of airtime	14	5.0
6.	Others: Courier, in kind, etc	9	3.0
7.	None	3	1.0
	TOTAL	285	100

Source: Compiled from the field interviews, 2004

Formal financial institutions – NMB, TPB, and Postal Office were reported playing minimal role in money transfers. The main reason given was that these institutions are located away from rural areas and have cumbersome procedures. There is an emerging electronic money transfer through air-time, which was reported by some respondents (5%). Transfer of airtime through cell phones facilitates payments of remittances to friends, relatives and children staying away.

According to interviews the most secure means of formal transfers are money orders and postal orders[116], and payments through Post Giro that are effected through postal branch[117] networks. According to the TPC Babati branch Manager, postal offices also provides money transfer services through Express Money Order and EMS Money Fax to pay for bills, fees, tuition or simply transfer funds to relatives and friends at a fee.

Post Giro facilitates TPC's business customers to payout items like salaries, insurance benefits, pension benefits, dividends to shareholders. Using the same system, payments from customers to businesses are also effected through the Giro system. Post Giro system has the advantages of countrywide network, convenience, safety and reliability. However, these instruments are not available in rural areas, partly due to underdeveloped institutional infrastructure, lack of electricity, weak communication and transport infrastructure. Although, the fastest methods are the bank transfers, electronic transfer, and money fax; these are not available in rural areas due to underdeveloped infrastructures.

According to interviews, money received by households is mostly in the form of financial assistance, grants, medical and education expenses, food aid and construction expenses.

[116] Postal Orders can be used as travellers' cheques that are acceptable for settling bills and meeting other expenses without necessarily carrying cash.
[117] The NMB is another pan-territorial bank that serves mainly low income serving bank. Currently, it provides infrastructure for payments and offers limited savings products.

Transfers from rural to urban areas are minimal, but provide financial support to children schooling in urban areas or those seeking employment, elderly and/or those attending treatment.

7.3.3 Demands for other Financial Services

Other forms of financial products identified during the interviews are insurance, pension schemes, and to a very limited extent leasing. Table 7.8 summarizes demands for other financial products as gathered from the focus group discussions. Respondents were asked to list in priority their other financial demands and then required to select only one out of the list.

Table 7.8: Demands for other financial services in Babati, 2004

No.	Financial products demanded	Frequencies	%
1.	Insurance	195	68.4
2.	Pension/provident funds	49	17.2
3.	Leasing	24	8.4
4.	Other products and services	11	3.9
5.	None	6	2.1
	TOTAL	285	100.0

Source: Compiled from the field interviews

About 68% of the respondents indicated that they need insurance services to mitigate themselves against variety of risks. Rural households are described as vulnerable to variety of risks. Vulnerability is described to mean households' and individuals' abilities to deal with risks such as loss of property, business related risks (theft, robbery, price fluctuations, bad debts, etc), health related risks (death, malnutrition, sickness, disability), and loan risk as detailed in Appendix 7.4.

The interviews revealed that while rural households are prone to various risks, as explained above, the formal insurance system is undeveloped and dominated by state-controlled National Insurance Corporation (NIC). The NIC is the main actor in the property related insurance. Although, the financial sector is liberalized, yet there are few insurance providers in the country that are mainly concentrated in large cities and towns. For instance, Babati district has no insurance firm; even the NIC has no branch. All insurance clients have to travel to Arusha to obtain insurance services or through part time brokers.

On the other hand, insurance services from formal financial institutions as a financial product are not well known among majority of the households, except for those owning motor vehicles. Life insurance, farm insurance, and business insurance are the least known. Most respondents view investment in insurance as a wastage of money. On the other hand, most financial institutions shy away from serving the rural sector as insurance products are not well tailored to the needs of the rural households to cover their family enterprises, properties, and themselves. Besides, rural households have low average incomes and therefore viewed as unprofitable customers. Perhaps, this group of clients can best be served through the emerging micro-insurance services, which is yet to reach Babati presently.

Social security in the form of pension or provident fund is not available in Babati. Respondents indicated this as another important product (17%). The types of formal social security funds available are limited and organized by few parastals as delineated under chapter six[118], which include old age and disability insurance, workman's compensation, and health insurance. There are no formal unemployment benefits in the country. Most of those benefiting from services of these social security funds are mostly employees in the formal sectors. However, the proportion of these employees represents a small fraction of the total country's workforce estimated at 5% for the entire country (Van Ginneken, 1999). Those in the informal sector, who are self employed have no access to formal social security. For Babati, this is not a financial product worth discussing as most employees do not know much about their social security schemes, although they contribute through salary deductions.

[118] The social security providers include the National Social Security, Local Authorities Provident Fund, Public Service Pension Fund, and Government Employees Provident Fund.

Another financial product in demand is leasing. This was reported by few respondents (8%) but very appropriate to SMEs and large scale farmers. This financial product is not available and it is one of the least known in the district. When mentioned, it seems to have attracted the interest of most family enterprises, however, it cannot be accessed as there are no suppliers. There are a few others (4%) who indicated the need for non-financial products such as project write-ups, advisory services and capacity building in business skills and management.

7.4 Supply of Rural Financial Services

The financial landscape of Babati is comprised of five main providers, namely (i) formal financial institutions, (ii) semi-formal financial institutions, (iii) Non-government organizations, (iv) government credit programmes, and (v) informal rural finance. The formal financial institutions are registered and licensed by the Bank of Tanzania to undertake banking business. According to the Microfinance policy, the commercial banks are also allowed to operate microfinance activities alongside other commercial banking functions. Two commercial banks will be reviewed in this section, as they are operating in the district, namely the NMB bank, which has a bank branch in Babati Town, and the Tanzania Postal Bank (TPB) that operates through an agency – the Postal Corporation branch. In addition, it is worth mentioning that Exim bank is operating linkage banking through a warehouse receipt scheme with two SACCOS, although it has no branch in Babati. Furthermore, CRDB bank has carried out a survey with an intention of collaborating with SACCOS through wholesaling credit arrangement.

7.4.1 Commercial Banks: NMB and TPB

7.4.1.1 National Microfinance Bank (NMB)

The split of the former giant state-owned NBC was envisaged to ease access to financial services among the poor rural households, as NMB was to concentrate in the provision of microfinance services. The mission of the bank was to provide access to financial services to people who would otherwise have not. However, due to its undercapitalization it operates under provisional banking license (www.psrctz.com/Utilities%20&%Major%20Transanctions/nmb.htm visited on April 23rd, 2006). The NMB inherited some of the former NBC branches, especially those in the districts, including Babati.

According to the NMB Babati branch Manager (2005), before the NBC was split and nationalized, it operated a mobile banking service in Bashanet, Dareda, Magugu, Gallapo, and Minjingu. In addition, such mobile services were also available on auction days at selected cattle auctions. After its split and subsequent privatization, this service was closed down and abandoned altogether. Now rural population and enterprises have to travel to Babati to get banking services.

The closure of the rural branches and mobile banking services reduced substantially access to financial services in the rural areas. As rightly observed by Schreiner (1997) closure of the once public financial institutions has complicated the problems of financial needs of the rural people, in that it has made commercial banks incur substantial losses in terms of loss of vocation to agriculture, loss of knowledge of financing rural sector, loss of network of branches, and loss of rural focus.

Assessing the degree of access to financial services in Babati district in terms of availability of financial intermediaries, it was observed that the whole district is served by only one branch of the NMB and to a limited extent by Tanzania Postal Bank (TPB) that operates through its Post Office agency. In other words, the bank population ratio for Babati is 1:303,013, which is typical of the Sub-Saharan Africa bank ratio of between 100,000 and 420,000 inhabitants per bank branch (Kashuliza, *et. al*., 1998:1). This is so because the Post Office offers limited financial services. In this respect it does not perform commercial banking functions in Babati as it does not provide much of the banking services as understood.

According to the NMB Babati branch Manager Ms Mjauzi (2005), the NMB is providing limited financial products and services that include deposits accounts (savings, business, fixed, and current accounts), micro-credit, transfer payments and payment services especially of salaries of the central government and local government employees. The bank's microfinance activities are on trial basis and, therefore, not fully blown up. For instance, during the survey in 2005, the bank had just introduced a short-term micro-credit product for small businesses. Likewise, electronic transfer payment services were also just introduced as the branch was connected to the national network during the same year. The bank money transfer services are implemented through electronic transfer, telephone, or money register.

The NMB was privatized in April, 2006 as pointed out in chapter six, with major shares bought up by some sections of the "corporate public", hence giving the bank a truly local ownership. However, for it to engage itself in a profitable business it requires re-capitalization and a massive investment in information technology in order to keep abreast with the modern banking business so as to compete with other financial service providers in the market. In order to serve the grassroots population and enterprises, NMB must link itself with microfinance institutions. Because of this, the bank is making deliberate efforts to determine ways of penetrating the rural financial sector so as to access financial services to the rural population directly or through rural based financial intermediaries such as SACCOS, or credit based MFIs.

7.4.1.2 The Tanzania Postal Bank (TPB)

The Tanzania Postal Bank (TPB) was established by an Act of Parliament, No. 2 of 1991 and became operational in the following year. The establishment of the TPB was facilitated by the split of the Tanzania Postal Telecommunications Corporation (TPTC) into three corporate entities – The Tanzania Posts Corporation (TPC), Tanzania Telecommunications Company (TTCL), and the Tanzania Postal Bank itself with the aim of restructuring the telecommunications company (www.winne.com/tanzania/cr05.html visited 12 December, 2005). The TPB has few branches, and several agencies operated under the auspices of the TPC. It has eighteen Regional Operating Units in all regional centres of Tanzania mainland, with the exception of Manyara region (www.postalbank.co.tz/services_tpb.htm visited on 12 December, 2005).

The TPB offers a variety of financial products and services, which includes (i) deposits accounts – savings accounts, and Save as You Earn Account (SAYE or WADU in Kiswahili); (ii) investment accounts – fixed deposits, call accounts, and Staff Provident Fund Schemes; (iii) Credit facilities; (iv) International trade and finance; and (v) money transfers.

Of all its products, TPB has three innovative products that are on high demand. These according to most interviews are: savings, provident fund schemes, and money transfer. Ordinary Savings Account, which accounts for 63% of bank's business, is one of the oldest Postal products that help most low income earners to save small amounts as conditions are more flexible. The minimum balances for savings deposits are Tshs. 5,000 while that of fixed deposits is Tshs. 10,000; this is in sharp contrast with other commercial banks that demand Tshs 50,000 for minimum balances (TPB, 1998; www.postalbank.co.tz/services_tpb.htm visited on 12 December, 2005). However, in order to promote savings among low-income people, the minimum interest-bearing balance has been fixed at Tshs. 50,000, which is the minimum balance accepted by most other commercial banks. This aims to simplify account management and to encourage customers to achieve the minimum threshold. This requirement by the bank is aimed at realizing its social and public objective of encouraging thrift among the poorest sections of the population.

Save as You Earn (SAYE) or popularly known in Kiswahili as *Weka Akiba Daima Unavyopata* (WADU), which accounts for 32% of the bank's business, is a popular contractual savings scheme where clients are encouraged to save a fixed sum of money monthly for a year, after which they may start withdrawals on a three monthly basis (www.postalbank.co.tz/services_tpb.htm visited on 12 December, 2005). Owing to its expansive network, the TPB is becoming a popular bank in handling provident fund schemes.

The TPB has successfully managed to forge business links with the Western Union Money Transfer and American Citibank. Since Western Union Money Union has over 70,000 locations worldwide, it makes money transfer through TPB using the Western Union Money Transfer one of its attractive product as it is most reliable, convenient, fast and international. Other TPB innovative financial products are electronic banking services provided through electronic cards known as *Uhuru card* that can be used to withdraw, deposit and transfer money at specified TPB branches with ATM facilities – in Dar es Salaam, Arusha, Dodoma, Mwanza, Zanzibar and Mbeya ("TPB installs more ATMs countrywide" at www.ippmedia.com/ipp/financial/2005/10/19/52157.html visited on 20 January, 2006).

Apart from speed cash through ATMs, the bank has also established partnerships with some service providers such as restaurants, hotels, supermarkets, where purchases can be made using *uhuru card*. In addition, the bank has also established points of sale through an innovative product of *Pesa Chap Chap*, where clients can cash money from bank's established "cash shops". The instant cash shops, which are concentrated in Dar es Salaam, are established by the bank through partnerships with other business operators such as petrol station, supermarkets, and restaurants; where clients can withdraw money from these centres in amounts not exceeding Tshs. 50,000 at a fee of Tshs. 550 per transaction without necessarily travelling to a TPB branch. This service is dubbed "the bank without going to the bank" ("TPB creates instant "cash shops" at www.ippmedia.com/ipp/financial/2005/11/30/55029.html visited on 20 January, 2006).

The TPB commands certain advantages over other commercial banks, namely:

(i) being a public financial institution it enjoys certain government incentives - fiscal incentive and a guaranteed liability,

(ii) it commands public confidence and integrity as it is still owned by the government,

(iii) it manages certain public payment services such as payment of annuities, pensions, dividends, taxes and insurance charges,

(iv) its partnerships and networks with the Postal Corporation and Telecommunication Company gives it advantages associated with logistics in providing financial services at lower costs, and

(v) it is a more ideal bank for transfer payments especially through Western Union Money Transfer, and EMS money transfer.

In Babati, TPB operates through the TPC agency where limited savings financial services are provided – individual savings, joint account, trust accounts, Infant Accounts, and SAYE/WADU. Since the TPB has no branch in Babati, much of the benefits accruing to low income earners described above are not readily available to rural communities and enterprises in the district. The presence of TPC branch office has facilitated accessibility to TPB's services and products in a limited way. The link between TPB and postal networks provides a high potential for providing microfinance services to rural populations. Ironically, the link is utilized for few financial products mainly transfer payments but limited savings mobilizations (www.tanpost.com/finsve.htm visited on 23rd April, 2006).

Apart from offering TPB products, the TPC has its own financial services that include money transfers (express money order or money fax), postal orders, and payments mechanisms. Money transfers are implemented through express money order or money fax for paying bills, fees, tuition fees, and transfer to a family member or a friend (TBC Babati branch Manager, 2005). Postal orders can be used reliably as travellers' cheques to settle expenditures and foot bills. These are available at fee from any post office and may be cashed when needed. Money fax is done at any Expedited Mail Service (EMS) desk at the Post Office where money is transferred through fax message to your preferred destination for meeting own needs when on transit or paying bills or a transfer. The Giro System is also facilitating payments from business to customers and vice versa in terms of payments of salaries, insurance benefits, pension benefits, and payments from customers to business. Under Giro system, the post office acts as an agent for making or receiving payments or both. Consequently, most clients of TPB do not know much about the bank, but the TPC that gives them service, of course it has been there even before the split as one company (www.tanpost.com/finsve.htm visited on 23rd April, 2006).

7.4.2 Co-operative Rural Financial Services

7.4.2.1 Savings and Credit Co-operative Societies (SACCOS)

The most dominant co-operative rural financial services are the Savings and Credit Co-operative Societies (SACCOS). As pointed out in chapter six, SACCOS can be categorized as rural or urban depending on where they operate, although in some cases such categorization is meaningless as members move freely between urban and rural. Members of rural SACCOS have a common bond of residence or association. In this respect self regulation through savings mobilization and credit monitoring is easily done as members reside in the same geographical location and almost entirely rely on same commodity markets – a primary marketing society or a private crop buyer or same cattle auction popularly known as *minada*.

According to Babati District Co-operative Officer Mr. Chisumo (April, 2005) SACCOS are legally required to operate bank accounts with the nearest commercial bank of their choice. In Babati there are twenty SACCOS that operate savings accounts with the only bank in the district – the National Microfinance Bank (NMB). There are, however, two SACCOS upgraded from economic groups to SACCOS status during 2005 – MAQBEMI SACCOS and Mshikamano SACCOS. These were established in order to implement the warehouse receipt scheme initiated under the IFAD funded Agricultural Marketing Systems Development Programme (AMSDP). In implementing the warehouse receipt scheme, MAQBEMI and Mshikamano SACCOS have established business linkage with Exim Bank, which has a branch in Arusha city - about 260 kilometres away from Babati town.

Table 7.9 provides the general picture of SACCOS in Babati district. The district has a total of 40 registered co-operatives of which about 50% are SACCOS that constitute about 60% of the total co-operative membership. Others are Agricultural Marketing Co-operatives that constitute about 38% of the total co-operative societies with 31% of total co-operative membership.

Table 7.9: The status of Co-operative Societies in Babati district, 2004

Type of Co-operatives	Membership		Membership size		
	Number	% of total	Number	% of population	Outreach (coops/district population)
SACCOS	20	50.0	974	60.3	-
Agricultural Marketing	15	37.5	504	31.2	-
Consumer Cooperatives	1	2.5	48	3.0	-
Others	4	10.0	90	5.6	-
TOTAL	40	100.0	1616	100.0	0.005

Source: Field survey, Babati District Council, 2004

SACCOS and to a limited extent marketing societies, organize financial services for their members. However, the outreach of co-operatives is limited in that the percentage of the district population accessing financial services through co-operatives is just 0.5%. If households are considered as denominator, the co-operative financial depth improves to 3 percent[119] from 0.5 percent.

Appendix 7.2 shows status of the surveyed SACCOS in the district. The statistics shows that most SACCOS are very small in terms of memberships (between 28 and 180 members), business volumes (in terms of capital base, loan size, surplus generation), and limited geographical coverage as most are formed to cover single Wards - a political and administrative unit at grassroots level under the local government structure.

[119] According to the National Census of 2002, Babati district had a population of 303,013 found in 59,970 households. Taking co-operative membership as a ratio of total district population and that of household sizes we obtain the figures for the co-operative financial depth.

Most of these SACCOS are employee-based, mainly teachers' SACCOS. There are two significant farmer based SACCOS – MAQBEMI in Qash Ward and Mshikamano SACCOS in Magugu Ward.

Appendix 7.3 delineated financial products offered by SACCOS. These are limited to two main products - saving products (savings and deposits) and credit products (emergency, and short term/medium term).There are few SACCOS that organize - consumer and furniture loans, housing loan and trading of shares in public *parastatals* undergoing privatization. For instance Babati Teachers SACCOS has shares in Tanzania Breweries Limited (TBL), CRDB Bank, and Akiba Commercial Bank (ACB). The majority of the Babati SACCOS have shares in the Central Finance Programme that is managed by the SCCULT.

The main sources of SACCOS' capital are members' shares, deposits, and savings. Generally there is limited loan screening seemingly because of peer pressure that is associated with co-operatives. The loan sizes depend on member's savings as savings are linked to credit. In most cases, one can borrow at twice or three times the amount saved, depending on the respective society's by-laws – procedures governing individual SACCOS that are approved by the members and the Registrar of Co-operatives during the registration and licensing of the SACCOS. In this respect, individual members' savings and shares are used as collateral in addition to two guarantors who must be active fellow members.

Financial co-operatives are constrained by a number of factors, which include inadequate skills in accounting, bookkeeping, how to make and assess loan applications and preparation of small business proposals or loan portfolio management. On the other hand, they can not afford to hire professional managers and accountants due to the smallness of their operations. Thus, most SACCOS use part time workers who are not professional managers, who have no time to attend to SACCOS businesses more seriously. The members of the Board of Directors are also ill-equipped in managing co-operatives as they lack the required knowledge, and skills in co-operative business management. Moreover, there are also cases where members are unaware of their legal rights and obligations.

Although SACCOS are in every Ward in Babati, they do not provide financial services to immediate communities. Most or almost all stick to their common bond as defined by employment. Most of them have no proper business premises - they conduct their business in employers' premises. Whereas conducting business in employers' premises might be safe, it has its own limitations in terms of business growth, opening up membership bonds, and employment of professional managers.

7.4.2.2 SACCOS - Commercial Banks Linkage

There is an emerging innovative commercial banks linkage with SACCOS. Exim Bank is working closely with two SACCOS in implementing Warehouse Receipt Scheme in Magugu and Qash Wards. CRDB bank has carried out sensitization of SACCOS to hook the latter into its Microfinance Company operations. Although in other parts of the country, CRDB has established linkages with SACCOS in wholesaling micro-credit activities, it is yet to start in Babati. Other banks – NMB, TPB, are among those eyeing such partnerships. Already there are indications in most commercial banks future business plans of working with SACCOS.

(i) Exim Bank – SACCOS Linkage under Warehouse Receipt Scheme

In order to address the liquidity constraints facing smallholder farmers, traders, and processors, the government through the Agricultural Marketing Systems Development Programme (AMSDP) is implementing Financial Market Support Services that has two components, namely (i) a rural inventory credit scheme, and (ii) a loan guarantee scheme. The rural inventory credit scheme addresses the financial needs of smallholder groups, and small and medium scale traders and processors, whereas the loan guarantees scheme targets medium scale traders and processors and MFIs.

According to Babati District Executive Director Mr Mbunda (January 28, 2005) the loan guarantee scheme component is yet to be implemented as the programme management wanted to see results of the first component of the rural inventory scheme implemented in 2005. The rural inventory scheme focuses on increasing the level of commercialization of rural areas by enhancing access to credit by smallholders, small and medium scale traders, and processors. According to the AMSDP Monitoring and Evaluation Officer Mr Swai (February 13, 2006) access to credit is envisaged to facilitate smallholders' ability to store their crops after harvest, when prices are practically low, and sell later during the season when prices are higher. This arrangement is expected to correct the artificial lack of competition that is experienced in many rural areas especially during harvesting periods.

In Babati, the scheme is implemented through the Exim Bank, where two SACCOS are involved - MAQBEMI SACCOS in Qash Ward and Mshikamano SACCOS in Magugu Ward. The Warehouse Receipt scheme involves a commercial bank, a borrower, and a warehouse operator. The borrower can be a trader, a farmer, or a group of farmers who seek loans using produce stored as collateral. Produce are stored with licensed professional warehouse operators/collateral managers[120], whose businesses are insured.

The AMSDP is implementing grains storage for maize at MAQBEMI and paddy at Magugu. During harvest time, prices of these food staples is normally low, thus farmers are encouraged to deposit grains at a designated warehouse as security for a bank loan. The loan can be used to meet farmers/traders immediate cash needs or to purchase more produce, which can itself be pledged as security for

[120] Inventory credit is useful for financing of procurement and storage of agricultural produce destined for exports, imported produce held in secured warehouse, and/or domestic food crops subjected to seasonal gluts.

another loan. When market prices rise, borrowers may sell their produce and repay loans with interest. The depositors are also required to pay the warehouse operators for the service before withdrawing produce. However, inventory credit is not supposed to subsidize anybody in the process. Ideally, this exercise should be profitable to both the lender and the borrower alike.

Table 7.10 summarizes implementation of the warehouse receipt scheme at Magugu and Qash Wards. At Magugu the SACCOS has secured three warehouses with a total capacity of 1,200 tonnes, while at Qash the SACCOS has one warehouse of 400 tonnes capacity. A total of 114 farmers benefited from loans from Exim bank during 2005 using their stored grains as collateral.

Table7.10: Farmers' Pledges against actual, June-December, 2005

WAREHOUSE	PLEDGES (Metric Tones)	STOCK DEPOSITED (Metric Tones)	WAREHOUSE CAPACITY (Metric Tones)	TOTAL LOAN (Tshs)	FARMERS BENEFITED	SACCOS' MEMBERSHIP
Magugu (3)	100	97	1,200	22,956,150	24	85
Qash (1)	100	125	400	10,178,638	33	183
TOTAL (7)	**17,474**	**831**	**14,650**	**120,253,978**	**114**	**968**

Source: AMSDP files, Arusha, 2005

Since this is a pilot project, it was not operated on a commercial basis as the programme (AMSDP) paid for warehouse management, training, supervision and monitoring. Moreover, it also facilitated bank negotiations on behalf of the farmers. In order to motivate banks, the programme had to deposit cash - Tshs. 35 million with Exim bank and Tshs. 40 million with CRDB bank - as guarantee facility, which was supposed not to be paid as the whole idea behind the programme is to use crops as collateral valued at 75% of the market price in order to accommodate potential price fluctuations.

According to interviewed farmers, interest charged by the commercial banks in both cases was higher at 19% plus a fee of 2% by the SACCOS. The SACCOS – commercial banks networking in the delivery of rural financial services provides the following lessons: (i) lack of collateral is overcome by developing alternative ways based on available resources such as crops, (ii) linkage of banks to SACCOS as intermediate financing organization that is closer to farmers reduces transaction costs, (iii) networking with commercial banks builds up on “best practices” among MFIs.

7.4.3 Government Specialized Credit Programmes

7.4.3.1 Youth and Women Development Funds (YDF and WDF)

The government in collaboration with District Councils are implementing micro-credit funds – the Youth Development Fund (YDF) and Women Development Fund (WDF). The two funds are coordinated by the Ministry of Labour and Youth Development and Ministry of Community Development, Women Affairs, and Children respectively and administered by the District Community Development Office under the District Executive Director in each district of Tanzania. These Funds were both established during the 1993/94 financial year with capital injection from the government of Tshs. 300 million for the YDF and Tshs. 1.5 billion for the WDF. The YDF was established primarily to address the issue of lack of employment among the youth whereas WDF focuses on women economic empowerment. In each case the target beneficiaries are required to form groups of their choice with not more than 30 members. They are required to undergo training before they qualify for a loan (NBS and RC-Manyara Region, 2005:175-177). The loan from the two funds attracts an interest rate of 24% per annum.

Over years the Funds have enjoyed generous support from the government, donor agencies such as Oxfam, Swedish International Development Agency (SIDA), and United Nations Development Programme (UNDP). Local district councils are required to contribute 10% of their revenue collections towards the YDF and WDF in their respective districts. Table 7:11 presents the status of groups under the Youth and Women Development Funds respectively. By the end of 2004 there were 43 Youth Groups with a total of 260 members – equivalent to an average of six persons per group. Of these, only eight groups benefited from YDF by accessing a total loan of Tshs. 8, 950, 000.

Table 7.11: Economic Groups, Membership, and Financial Assistance, 2004

Types of Economic groups	Number of Groups	Total Membership	Loan	
			No. of Groups benefited	Loan amount (Tshs)
WEGs	360	10,800	9	3,830,000
YEGs	43	260	8	8,950,000
TOTAL		**11,060**	**17**	**12,780,000**

Source: DC Community Development Department, Babati, 2004.

According to the Babati District Executive Director (March, 2005), Women Development Fund (WDF) focuses on providing women with access to credit. The Fund is registered as an NGO with the following objectives: (i) raise the economic status of women, (ii) mobilize funds and logistical support for the fund, (iii) plan and invest in income generating activities, (iv) create employment and income generating activities, and (v) coordinate and evaluate activities of various organizations that assist women income generating activities. By December, 2004 the district had 360 WEGs with a total membership of 10,800, of which only 9 groups got loans from the Fund amounting to Tshs. 3,830,000.

According to the discussions with some group members, the WEGs and YEGs are voluntary groups formed by women and youth respectively, but with guidelines on how they should operate – usually defined as Group Constitution. Each member has mutual trust of one another. As a pre-condition to loans, groups are required to be registered with the district Community Development Department and members must have participated in capacity building programmes organized by the Community Development Office focussing on leadership, project management, entrepreneurship and record keeping.

The YDF and WDF provide good opportunities for the practice of microfinance activities at grassroots level through groups. Besides, the capacity building programmes, and links with commercial banks through savings are necessary pre-conditions for the success of rural microfinance practise. However, the size of funds is relatively small given the district's population of youth and women.

Consequently, the average loan size has been small for one to make any meaningful investment out of it. Discussions with beneficiaries revealed that:

(i) the Funds are to a large extent urban biased and over politicized,

(ii) borrowers have inadequate business skills thus, undermining their investment decisions,

(iii) there are delays in loan disbursements as it faces bureaucratic procedures,

(iv) lack of monitoring and evaluation officers employed on a full time basis, and

(v) lack of commitment on the part of district officials and borrowers to ensure proper loan utilization and timely repayments.

7.4.3.2 Small and Medium Enterprises Credit Guarantee Scheme

The government is implementing Small and Medium Enterprises – Credit Guarantee Scheme (SME-CGS), through participating Financial Institutions since 2005 under the coordination of the Bank of Tanzania. According to the Director of Microfinance at the BoT a number of commercial banks have signed the Guarantee Framework Agreement with the Central Bank to provide loans to SMEs, of which Exim Bank, CRDB Bank, NMB Bank, and the TPB are among the players. Under this framework, the government guarantees 50% of the principal loan to eligible SMEs thereby sharing the risk with commercial banks. Although NMB operates in Babati it has not yet started providing micro-credit to SMEs through the SME-CGS framework.

The government allocated Tshs 2 billion in 2005, but so far only 18 SMEs have benefited from it (The Citizen Thursday 15 June, 2006:20). According to some observers (BoT, commercial bank officials, District Executive Director) the scheme has not been fully utilized due to lack of information about the facility among entrepreneurs, high interest rate charged, and some banks willingness to engage themselves in such risky undertakings. Furthermore, most SMEs have no business records as banks wants to have their past performances before granting them loans.

Participating banks charge an interest rate of between 18% and 24% per annum, which is the highest in East Africa. In Uganda interest rate for similar loans is between 16% and 18% and in Kenya it stands at 15%. Targeted borrowers are, therefore, deterred by high interest rates charged by banks. It is argued that the high rates reflect risks involved in lending to SMEs. On the other hand interest rates for deposits are very low standing at 5%, making a big difference.

Other weaknesses cited are: (i) bureaucratic procedures under financial institutions, (ii) demand for collateral where government guarantees 50% and the remaining 50% by the borrowing SMEs, (iii) need for a viable business plan that demands professional consultants – who cannot be afforded by SMEs, and (iv) commercial banks' risk-aversion attitudes.

7.4.4 Non-Governmental Organizations.

There are number of Non-governmental programmes (NGOs) that support promotion of micro enterprises and micro-credit in Babati. According to the Babati District Executive Director Mr. Mbunda (2005) the district receives some support from about seven NGOs with international funding in facilitating implementation of various development projects and programmes in partnership with the local communities and the Council. Some of these are directly engaged in financial intermediation on a small scale, while others are providing an effective link between the grassroot organizations and formal financial institutions, thus providing an impetus for effective development of the rural financial markets. The list of these NGOs is contained in Table 7.12.

Due to inadequate access to business capital, resulting from lack of appropriate products and inability of financial institutions to serve the rural enterprises, community's coping strategies for survival has, in majority of the areas, affected the country's environment negatively. Rural households engage in variety of economic activities as coping strategies, which have far-reaching effects on environmental conservation. These include felling of natural trees for charcoal making, firewood, or logging and timber. In addition, intensive farming and livestock keeping are leading to serious environmental degradation in the district. As a result, the Swedish International Aid Agency (SIDA) has initiated environmental conservation in Babati implemented through Land and Agricultural Management Programme (LAMP).

Table 7.12: NGOs operating in Babati District, 2004

Name of NGO	Project Supported
Arusha Community Initiative Support Trust	Modernization and capacity building of SACCOS
Food and Agricultural Research Management (FARM) Africa	Agro forestry, soil and water conservation, water supply, livestock production, capacity building
Friends in Development Trust Fund (FIDE)	Agro forestry, soil and water conservation, water supply, livestock production, capacity building, grain storage, wood energy conservation technologies
Local Initiative Support Organization (LISO)	Advisory Services, credit facilities
Diocese of Mbulu Development Department	Water Supply
Swedish International Aid Agency (SIDA)	Support various projects implemented by the communities and the Council that aim at improving productivity by harnessing natural resources
Integrated Agricultural Training Centre (IATC)	Training on Agro-forest, and fishing practices

Source: Babati District Council, Babati

In order to address these environmental problems, the SIDA through LAMP has initiated a programme to improve rural households' access to financial services by promoting Village Community Banks (ViCoBa). The objective of ViCoBa is to facilitate diversification of community occupations so as to conserve environment. As of March, 2006 the position of ViCoBa in the district is as summarized in table 7.13.

ViCoBa were first implemented in Mwada Ward where four groups were established in 2003 followed by others in 2005. By the end of 2005 a total of eleven groups were formed in seven wards with a total membership of 424 with an accumulated savings of Tshs. 19,053,791.

Table 7.13: Village Community Banks in Babati district, March 2006.

No.	ViCoBa/WARD	YEAR ESTABLISHED	MEMBERSHIP	TOTAL DEPOSITS (Tshs)
1.	Mwada			
	- Ngoley Muungano	2003	33	2,595,410.00
	- Mwangaza	2003	30	1,333,010.00
	- Kweure	2003	38	1,871,867.00
	- Muhale	2003	48	2,300,095.00
2.	Nkaiti			
	- Mazingira	2005	35	3,400,000.00
	- Mkombozi	2005	62	4,488,750.00
3.	Mamire	2005	30	612,550.00
4.	Gallapo	2005	37	725,660.00
5.	Dareda	2005	40	812,162.00
6.	Ufana	2005	35	561,120.00
7.	Magugu	2005	36	353,167.00
	TOTAL		424	**19,053,791**

Source: District Co-operative Office, Babati

7.4.5 Informal Rural Finance

Informal finance may simply be defined as financial intermediaries that operate outside the structure of the regulatory and supervisory mechanisms (Shreiner, 2000:2). Unlike formal institutions, informal finance performs financial transactions that rarely use legal documentation or legal system to enforce the contract. Financial transactions are essentially based on informal arrangements. Informal finance providers may be categorized into commercial and non-commercial providers[121]. Commercial informal finance providers do it commercially by providing saving facilities for own business gains – such as money lenders (who are not many), and business operators. The non-commercial operators base their financial transactions on personal or business relationships. The latter category includes individuals, neighbours, and money safe keepers: church leaders, spiritual leaders, businessmen, custodians of assets, and friends.

Appendix 7.5 summarizes distinct characteristics of Informal finance as opposed to formal finance. These differences are classified into organization, scope of services, transactions, and cost structure. It is important to note that informal

[121] The difference between the two forms of informal finance is the price factor, whereas the commercial informal finance is essentially an informal business, the non-commercial is basically based on reciprocity ideals with less or no commercial attachment.

finance has been in practice for decades, however, it is increasing in scope, expanding organizationally and structure-wise especially with liberalization of the financial sector. It is based on socio-cultural values of communities, and ethnic groups. Some of the informal finance systems are based on traditional reciprocity systems and others were developed to fill the unmet financial needs of the rural people.

Empirical evidences from the surveyed households in Babati shows that rural households engage in informal financial savings. Table 7.14 identifies forms of informal savings and institutions. Most households – about 26% of the total respondents - save in form of agricultural produce (produced or purchased waiting for better prices), cash at home (16%), and save in livestock (13%). There are some who save with relatives and friends (12%), business operators – especially shop operators (11%), and trustees (6%). Other forms of informal savings are purchase of land – for farming and grazing, and construction.

Savings in produce was more pronounced at Magugu (40%) where paddy is the main commercial crop, Bermi (35%) where maize, and seed beans constitute main crops, Mamire and Singe (30% each) for maize, peas, and seed beans. Livestock is an important form of informal saving at Mwada (35%), Gichameda and Mamire (20%), and Qameyu and Magugu (15%). Saving with friends was most practised at Qameyu (21%), Qash (20%), Bashanet (19%), Babati town and Bermi (14%). Those saving with business operators are common at Magugu and Bashanet (18%), and Seloto (15.8%), while ROSCAS seem to be a common feature for all villages, although Babati led by 12%. Keeping money with trustees was common at Qash (12.5%) and Seloto (10%).

Table 7.14: Forms and Institutions of Informal Savings in Babati, 2004

VILLAGE/ FORMS	CASH		LIVESTOCK		PRODUCE		FRIENDS /RELATIVES		ROSCAS		BUSINESS		TRUSTEE		OTHERS		TOTAL	
	No.	%	No	%	No.	%	No	%	No.	%	No.	%	No	%	No	%	No.	%
Babati Town	5	21.0	2	8.5	4	20.0	3	14.3	3	12.1	3	13.3	1	4.2	2	6.6	**23**	**100**
Gallapo	4	18.0	2	9.0	8	36.0	2	11.5	2	10.2	2	12.0	2	8.7	2	8.2	**23**	**100**
Mamire	6	25.0	5	20.0	7	30.0	2	10.0	2	8.0	1	5.2	0	1.0	0	1.2	**23**	**100**
Singe	5	25.0	1	5.2	6	30.8	2	11.4	1	5.4	2	9.2	1	2.8	2	10.2	**20**	**100**
Bonga	5	23.0	2	8.2	6	26.0	2	8.0	2	6.9	2	9.0	1	3.2	2	7.0	**22**	**100**
Qash	2	12.0	3	13.0	3	17.0	4	20.0	2	8.0	2	12.0	2	12.5	2	8.0	**20**	**100**
Bashanet	3	15.0	2	8.0	4	18.0	4	19.0	2	7.0	4	18.0	2	10.0	1	3.0	**22**	**100**
Seloto	3	14.0	1	6.5	7	30.0	3	13.0	2	7.0	3	15.8	1	5.0	2	7.2	**22**	**100**
Bermi	5	24.0	1	5.0	8	35.0	3	14.0	1	5.2	2	10.2	2	7.0	0	1.3	**22**	**100**
Qameyu	3	13.2	3	15.0	3	10.0	5	21.0	2	9.5	3	13.6	2	8.2	2	7.5	**22**	**100**
Magugu	2	8.9	3	15.0	9	40.0	1	3.0	1	6.4	4	18.0	1	6.2	1	2.5	**22**	**100**
Gichameda	2	9.6	4	20.0	9	41.0	1	3.5	1	6.5	2	11.3	1	5.1	0	0.5	**22**	**100**
Mwada	2	10.4	8	35.0	4	17.0	2	10.1	2	10.2	2	10.7	1	4.2	1	2.4	**22**	**100**
TOTAL	**47**	**16.0**	**37**	**13.0**	**77**	**26.0**	**34**	**12.0**	**23**	**8.0**	**32**	**11.0**	**17**	**6.0**	**17**	**6.0**	**285**	**100**

Source: Field survey data, 2004.

Note: The percentages for each village were obtained by dividing the number of respondents for every form of informal saving by its total respondents. However, the total respondents for each form of informal saving divided by the total sample of 285 gave us the percentage of that informal saving (see the last bolded row).

Saving in cash at home was practised at Mamire and Singe (25%), Bermi (24), Bonga (23%) and Babati town (21%). Some of these areas although were found to have easy access to financial institutions, they seem to be saving at home for business speculation reasons.

The operations of ROSCAS were found in three forms – cash, labour, and crops. There are cases where households contribute cash in own groups and help one another in a rotational way. Such groups were common feature in almost all villages. In Bashanet, Dareda, Ufana, Madunga, Seloto and Bonga labour sharing – referred to as labour clubs – is common. Here households contribute labour by working on each other's plot on a rotational basis. Ndanshau (1996:17) referred to this practise as "Rotating Labour Associations" which are distinct from the famous mutual help/groups popularly known as "working party groups" locally known as *slaqwe* among the Iraqw communities that are the dominant tribe in the study area. Finally, there are cases where households provide one another with supplies especially food and seeds, during shortage or planting season, with expectations for reciprocation in future.

Apart from informal savings, there are evidences for informal credit. Table 7.4 under section 7.2.3 describes sources and uses of credit in Babati. Making a cross reference to this table, the main sources of credit are relatives and friends, traders, ROSCAS, and to a limited extent commercial informal money lenders. Table 7.15 summarizes the sources of rural credit in Babati. Out of the 285 households interviewed, 78% (223 households) received credit through informal arrangements, 4% (11 households received from formal financial institutions NMB, TPB, and SACCOS); while 16% (45 households enjoyed credit from both sources).

Table 7.15: Savings against sources of loan, 2004

		Source of loan								Total	
		formal		informal		both		none			
Depositor	Forms	No	%	No	%	No	%	No	%	No	%
	Formal	2	0.7	5	1.8	2	0.7	2	0.7	11	3.9
	informal	7	2.5	166	58.2	34	11.9	16	5.6	223	78.2
	Both	5	1.8	18	6.3	21	7.4	1	0.4	45	15.8
	None	0	0.0	3	1.1	0	0.0	3	1.0	6	2.1
Total		14	5.0	192	67.4	57	20.0	22	7.7	285	100.0

Source: Compiled from survey data, 2004

The study observed an emerging form of informal finance in the form of contract farming, which challenges the microfinance regulatory framework. Contract farming is an emerging alternative method of financing agri-business, especially after the collapse of co-operative inputs delivery system. The study observed contract farming being practised in Mamire, Galapo, Qash, Magugu, and Ufana where high value crops such as sunflower, seed beans, and barley are produced on large scale farming. Under this new arrangement, smallholder farmers are linked with agricultural companies that provide farm credit and market for the outputs. Most respondents, however, showed some degree of reluctance in joining contract farming arrangement on the fear of risks involved in terms of crop failure, price risks and engagement in new crop farming. Nonetheless, these fears seem to be a short term constraint that can be addressed through training, education, awareness creation, and use of market based incentives mechanism.

Another informal financial product is the informal risks mitigation strategies. Analysis of rural households' livelihood strategies show that most rural population have developed own" indigenous" coping mechanisms with regard to risks. These strategies are based on cultural values, environment and available natural resources. For instance, there are informal risk-sharing arrangements that are in place with regard to funerals, health related risks, business and property risks and family risks including divorce, separation and break ups. These risks are mitigated through community works, livestock and produce sharing, remittances, exchange of seeds and food, and grants.

7.5 Gender and Rural Financial Markets in Babati

This section discusses the issues of gender and access to rural financial services in Babati within the context of Tanzania's Financial Sector Reform. The underlying assumption is that both men and women have equal access to financial services. Thus, the concerns here are to identify the relevance of financial sector reforms for gender accessibility to financial services and how the liberalized financial environment facilitates access to financial services by women, men, and youth.

According to the Tanzania Census report (URT, 2003b:171) Babati district had a total population of 303,013 of which, 117,734 are men and 120,535 women. This contradicts with the general picture in most regions, where the sex ratio ranges between 94 and 99 males per 100 females[122]. Manyara, where Babati district is, depicts the highest sex ratio of 106 males per 100 females in Tanzania (URT, 2003b:10). According to discussions with leaders and visited households, this is as a result of urban migration where girls have higher tendencies of working in urban areas as house attendants, bar waiters, restaurants and hotel workers especially those with low education or none than the boys.

The rural environment in Babati is characterized by inadequate infrastructural facilities that prohibit rural households' access to financial services, including women. Besides, there are institutional constraints such as demands for collateral, which most women do not have as the property ownership is vested in men. Even the inheritance system, requires a son to inherit wealth. The main economic activities are agriculture, to which land ownership is traditionally vested in men. On the other hand, financing of agriculture by commercial banks has been reduced significantly, so even man-owned agriculture is affected substantially with inadequate access to productive funding.

However, there are national credit programmes that focus on women economic empowerment. These include Women Development Fund, Credit Scheme for Productive Activities of Women in Tanzania, Presidential Trust Fund – support to Women Income Generating Activities, and Youth Development Fund (Makombe,

[122] Sex ratio is defined as the number of males per 100 females.

Temba and Kikombo, 199:2). With the exception of the WDF that is the most active scheme throughout Tanzania, access to other credit programmes is limited in terms of coverage and scope. In Babati the only functioning schemes are two – the WDF and YDF.

The survey involved 66 women and 219 men, where only 2 (about 0.8% women) managed to get loan from formal financial institutions, 10 (4%) were able to source credit from both informal and formal as summarized in Table 7.16. Those who obtained loans from informal sources were 44 (about 15.4%).

Table 7.16: Source of loan for Men and Women in Babati, 2004

	SOURCE	**GENDER**				**Total**	
		MALE		**FEMALE**			
		No.	%	No.	%	No.	%
Source of loan	Formal	12	4.2	2	0.8	14	4.9
	Informal	148	51.9	44	15.4	192	67.4
	Both	45	15.8	12	4.2	57	20.0
	None	14	4.9	8	2.8	22	7.7
TOTAL		**219**	**76.8**	**66**	**23.2**	**285**	**100.0**

Source: Compiled from survey data, 2004

According to focus group discussions (FGD) with women, the following constraints to women access to loans were revealed:

(i) demand for collateral by most financial institutions,

(i) skewed ownership of resources determined traditionally,

(ii) risk aversion by women,

(iii) fear of men in misuse of loans,

(iv) perceived borrowing costs (interest, time, travel, and bureaucracies involved), and

(v) lack/inadequate education/awareness.

This section concludes that inequality between men and women in accessing financial services is as a result of unequal social relations and unequal financial opportunities that create gender-specific barriers in the financial sector. Lack of access to financial services is as a result of cultural norms, beliefs, and practises that affect social and economic lives of the people. Women as property-less people, have limited access to credit facility, as they do not own assets to mortgage and therefore, not appearing to be credit worthy. In rural areas, women are mostly relegating to domestic chores and raising children.

7.6 Constraints in Access to Rural Finance

Based on the preceding analysis, rural households' access to financial services is constrained by various factors that may be categorized into three broad issues:

(i) the cost of borrowing,

(ii) policy, legal, and regulatory framework, and

(iii) institutional and infrastructural weaknesses.

7.6.1 The Cost of Borrowing: Interest rate and transactions costs

The cost of borrowing, which includes transaction costs and interest rates disparities, is becoming an impediment in access to loans. As argued in chapter six, the differences between lending and savings rates are too wide. Whereas the lending rates range between 19% and 21% across the board, deposits/savings are below 5% interest per annum. Such a disparity scares both the potential borrowers as well as depositors. What is startling is that this does not correspond to inflation rate which is 4.4% in 2005. Most banks attribute this disparity to credit risks involved and costs associated with credit administration. Table 7.17 summarizes interest rates charged by different lenders, commercial banks, informal finance providers, and co-operative financial institutions.

Table 7.17: Interest rate by Lenders, 2005

Source	0%	0% - 10%	11% - 30%	Over 30%	Total
Relatives/Friends	60	-	5	35	100
Traders	5	30	10	55	100
ROSCAS	-	-	-	-	-
Money Lenders	-	-	-	100	100
SACCOS	-	-	100	-	100
Employer	-	-	-	-	-
Govt. Prog.	-	-	-	-	-
NGO	-	-	100	-	100
Bank	-	-	100	-	100
Others	-	-	-	-	-

Source: Field data, 2005

Majority of those who borrowed from friends/relatives received interest-free loans that were essentially grants. This is because, most rural communities have reciprocity system of helping one another during shortages, and get repayment at later date. It is viewed as a “social savings” or a mitigation strategy rather than a pure loan. However, there are few commercial undertakings where an interest rate of over 30% is charged as reported by some respondents. Most commercial banks, however, charge between 11% - 30% per annum. For traders, the interest rate is spread from 0 (very few) to over 30%. Most traders charge above bank commercial rates purely for profit motives. Money Lenders, as this is their main line of business, charge exorbitant rates higher than that by commercial banks - over 30%.

Interest rates by SACCOS fall in between 11% and 30% and are in most cases found to be uniform across all SACCOS surveyed. The rates charged by government programmes and NGOs, fall also within these limits. In most cases, all loans accessed by borrowers are of short-term in nature not exceeding two years, with majority falling within six to twelve months. This shows that, there is a limited supply of long-term development loans.

On the other hand, the costs involved in undertaking transaction are high as well. The transaction costs are incurred in the process of seeking and issuing loans by both the borrowers and suppliers as well. According to focus group discussions, these costs items are summarized in Table 7.18. Borrowers incur certain costs beyond the interest rate they are charged. These costs include application process, service fee/ledger fees, photographs, and time spent on processing of loans.

Table 7.18: NMB and TPB Loan Transactions costs, 2004

No.	Types	Forms of costs	Who meets
1.	Conditions	- Collateral - Minimum deposit requirement Tshs 50,000 - Business proposal - Business registration - Business records, - Audited Accounts - Minimum non-withdrawable balance Tshs 5,000	Borrower's costs
2.	Search costs	- searching information - screening expenses - borrower's character	Lender's costs
3.	Transaction costs	- service fees - travel time - cost of photographs - time spent on processing loans - search for a referee	Borrower's costs

Source: compiled from field interviews, 2004

In addition, there are other costs associated with the enterprise, business proposal development, collateral and minimum bank balance requirement or company's/enterprise's contribution to capital as part of the loan application conditions. The lender or banks incur costs as well, for instance costs of gathering borrowers' information, loan administration and enforcement.

Opening a bank account with commercial banks is also associated with some conditions that can act as a disincentive to potential savers. These include minimum balances of Tshs 10,000 for TPB and Tshs. 50,000 in the case of NMB and CRDB that touch base with Babati district residents[123] as summarized in Table 7.19. Furthermore, opening of new bank accounts requires clients to undergo an identification process where one has to bring acceptable passport size photographs (2 to 4), introduction letter from employer, village or local government leader, referees, and fill a signature specimen card.

[123] For other commercial banks such as NBC, Barclays, Stanbic bank, and Standard Chartered bank that are not currently providing services in Babati, the minimum balance requirements are double this amount.

Table 7.19: Requirements for opening Bank Account with selected Commercial Banks

Bank	Savings Minimum Balance	Identification
NMB	Tshs. 50,000	- 2 photographs - Photocopy of passport/ID/driving license - Referee - Letter of intro employer/village govt./local authority
CRDB	Tshs. 50,000	- two passport size photographs, - referees, - an introduction letter, or /passport/ work-permit for foreigners
TPB	Tshs. 10,000	- two passport size photographs, - referees, - an introduction letter or /passport/ work-permit for foreigners

Source: Survey data, 2004

According to the discussions and interviews, most respondents indicated what type of a commercial bank they prefer, a situation that reflects weaknesses in the current service provision. The following attributes of a good bank were listed:

(i) a bank that is close to its customers,

(ii) a bank that has simple procedures with minimum bureaucratic procedures,

(iii) a bank with speedy services,

(iv) disciplined employees with a sense of humour and charming,

(v) lift up restrictions on minimum balances,

(vi) ability to offer wide range of products and services, and

(vii) attractive interest rates, and respond to customers needs timely and in a flexible manner.

7.6.2 Policy, Legal and Regulatory framework

Promotion and expansion of rural financial services is facilitated by appropriate macroeconomic policy environment, legal and regulatory framework in place. While reforms have established broader participation of actors in the financial markets, there are institutional constraints such as property rights and registries, functioning credit bureaux to provide information on borrowers and advice lenders accordingly, and delayed litigation as a result of weaknesses in the judiciary system. On the other hand, there is a need for improved efficiencies through research and design that requires public investment. One case in point is the acquisition of management information system based on technological advancement, which will minimize risks and improve flow of information.

The Judiciary system has a big role to play in supporting the financial sector reforms in the country. As it is now, there are some snags that hinder the smooth provision of some banking services in the country. For instance, banks have been complaining about judgements made by courts of law on issues pertaining to court injunctions granted to the banks' defaulting clients. Such a practise increases banks' fears of non-repayment that is associated with costs resulting from court injunctions against forfeiture of defaulter's properties. There are incidences where injunctions also favour defaulters, since they continue to enjoy the bank services that they have defaulted. Protracted legal wrangles is said to be one of the biggest obstacle forcing many banks to be reluctant to extend loans, making them opt for risk-free government securities especially Treasury bills and Bonds. This practise not only undermines the growth of the financial sector, but also increases interest rates on lending.

The country's regulatory authority needs to put in place regulatory framework for the protection of financial institutions. However, commercial banks on their part need to improve their banking services by employing honest personnel, well paid, install sufficient and effective security system and ensure that those maintaining bank strong rooms are carefully selected. Moreover, strong rooms also need to be re-designed to make robbers difficult to succeed.

7.6.3 Infrastructural weaknesses

The degree of access to financial services among rural households in Babati district is very low, partly as a result of the underdeveloped institutional and infrastructural frameworks. Babati district has underdeveloped infrastructural facilities in terms of transport and communication facilities. Efficient and reliable communication facilities are critical in facilitating the growth/development of rural financial markets. The road density is relatively low put at 10.8 kilometres per 100 square kilometres, putting the region in the eighth position nationally. On the other hand the road conditions are generally poor. With the exception of the few kilometres of tarmac road that stretches from Arusha into the district, the rest of the roads are gravel and earth roads that are in most instances not passable during the rainy season.

In terms of communication facilities, there a few land based services that covers the Babati town and few other townships through wireless connections introduced through a pilot project by the state run – Telecommunication Company Limited (TTCL). In addition, although cellular phones are available through two private companies – the *Vodacom and Celtel,* their use is limited. The handsets are expensive and their maintenance can hardly be afforded by rural people especially where there is no electricity for recharging and buying air time. However, the introduction and use of mobile phones have brought about an innovative money transfer service – through airtime.

7.7 Summary and Conclusions

This chapter analyzed access to financial services in Babati district, by examining demand, supply and utilization of financial products. The chapter presupposes that liberalization and financial sector reforms widened actors in the financial sector thus increasing efficiency, through enhanced competition. The demand for credit was found to be influenced by the age of the borrower, household size, and distance. Education and occupation were observed as having no direct impact on access to credit. On utilization of credit, the study found that households' expenditures are categorized into consumption, investments and social capital. Consumption expenses include consumption, healthcare, and festivals, whereas investment covers investments in agriculture, business, real estate, and livestock; while social expenditure covers education, contribution to community development, and local government development initiatives.

Apart from credit, rural households also demand other financial services and products - savings facilities, means of payments and transfer payments, insurance and leasing. At household level, separation of demands for financial services for purely household needs and the development of enterprises are often difficult, as economic activities are intertwined with households needs. It was revealed that there is a supply gap in the availability of these financial products and services. The main reasons for this situation are institutional weaknesses and structural weaknesses reflected by the underdeveloped communication and transport infrastructure, inadequate policy and regulatory framework, weak innovative product design, and inadequate product delivery mechanisms.

Babati district experiences limited financial service providers – there is one commercial bank branch, and postal bank agency. In addition, there are few microfinance providers comprised of mainly employee-based SACCOS. Consequently, rural households to a large extent depend on informal finance providers. The informal finance operators are classified into two categories of commercial and non-commercial operators. While commercial informal finance operators benefit financially, non-commercial providers do it for personal or business relations to promote social capital rather than commercial capital. The decline in access to formal financial services is found to be strengthening the self – financing practices through informal financing among rural population. In addition, this scenario is a candid indication for the demands for services of financial institutions, which negates the assumption that rural people are poor savers.

The existing financial institutions in the district provide limited financial products and services, which are mainly savings and credit products. The NMB is the only commercial bank branch that has started micro-credit product to small scale business operators. TPB that operates through the TPC as an agency does not give credit but instead provides savings mobilization and transfer payments to limited geographical coverage. MFIs – mainly SACCOS – also provide few financial products mostly in the form of savings and credit. In addition, these in collaboration with other non-governmental organizations organize to a limited extent capacity building programmes, mobilization of memberships, and development of rural enterprises. These efforts contribute to the growth of the financial markets that will help to safeguard the poor households against extreme vulnerability.

The chapter concludes that liberalization of the financial sector is not a sufficient condition in itself. It calls for a facilitative environment through development of appropriate policies, legal and regulatory framework. In addition, there must be purposive investment strategy that supports development of the public infrastructure, institutional and infrastructural development, judiciary machinery, credit bureaus, and property and business registries. Furthermore, there must be an accompanying acceleration of the rate of innovation in developing financial products and services, improvement in organization of the rural financial institution, establishment of the institutional framework and improvement of rural infrastructure for smooth operations. Moreover, cultural constraints that prohibit women, youth and disadvantaged persons from accessing financial services need to be addressed as well.

CHAPTER EIGHT
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

8.1 Preamble

This chapter provides summary, conclusions and recommendations of the study based on research findings and analysis done. It also recaps briefly the background information of the study, study objectives, research questions, and organization of the thesis. This chapter, therefore, contains introduction, provides summary and conclusions, recommendations and also identifies areas for further studies.

8.2 Summary and Conclusions

Tanzania is among the poor countries with most of its population living in rural areas. The government has been implementing a series of economic reform measures since mid-1980s. One of these reforms is the financial liberalization that was initiated through the Banking and Financial Institutions Act, 1991. Liberalization of the financial sector facilitated participation of private financial institutions, restructuring and privatization of public financial institutions, liberalization of interest rates, elimination of credit allocation and targeting, and strengthening the role of supervision and regulation of financial institutions in the country.

Following privatization of the financial sector, the number of financial service providers increased and diversified, which include commercial banks, development banks, insurance and social security funds, and establishment of capital markets. The role of the central bank has been re-defined and strengthened in terms of price stability, supervision and regulation. Although there is an increase in financial sector service providers and products, rural households' access to financial services is very low. The degree of access to formal financial services is diminishing significantly, hence making poverty reduction initiatives difficult.

The purpose of this study was to analyze the inherent weaknesses in the development of the rural financial markets, assess the impact of the financial sector reforms on growth of RFMs and improvement of rural households' livelihoods, assess the constraints to supply and demand for financial services, and recommend appropriate financial sector development strategies.

The data for the study were collected from various sources – both primary and secondary. Primary data were collected from selected thirteen villages in Babati and government offices in the district through interviews, focus group discussions, questionnaire, and observation. Secondary information were gathered from documentary sources in the form of reports, records and review of literature from various sources in Babati, Arusha, Moshi, Dar es Salaam, and Morogoro. A combination of analytical techniques was employed – qualitative and quantitative that suits this kind of study.

8.2.1 The Development of the Rural Financial Markets

The history of rural finance in Tanzania is associated with the colonialization of Tanganyika. Germans were the first to introduce the commercial banking in the country, followed by the British who did much of its expansion. The British colonial administration established the East African Currency Board (EACB) that played the role of a Central Bank up to the time when the Bank of Tanzania was established in 1966. Thus, the Banking history in Tanzania evolved over years, which is categorized into: (i) the German period (1884-1918), (ii) the initial British period (1919-1950), (iii) the second phase of the banking expansion (1950-1960) characterized by opening of branches countrywide in response to rapid shift from subsistence to a money economy, (iv) the third phase is the independence period from 1961, and (v) the period after reforms and liberalization.

The study concludes that during the colonial era, rural finance was limited to agricultural finance and favoured mostly settler farmers. On the other hand, the intervention by the independent government, during 1960s through 1970s aimed at stimulating growth and reduction of poverty, where specialized credit programmes and co-operative system were the dominant forms of agricultural credit institutions. Consequently, implementation of the agricultural credit was facilitated by different rural development policies, and direct intervention through specialized credit institutions, and commercial banks. These interventions, however, failed to bring about the desired results, leading to macroeconomic instabilities, financial repression and distortions. It was because of these results that the financial sector reforms were instituted.

The financial structure after independence up to the 1990s was characterized by state owned financial institutions, with pervasive interference. Credit was directed on the basis of the government priorities with little regard to credit worthiness analysis. The NBC and CRDB were the dominant banks that implemented the government monetary policy. The savings mobilization was forgotten and instead emphasis was put on aid programmes managed through the commercial banks, development banks and/or specialized credit programmes. This practice was based on the notion that "poor people can not save" and, therefore, they need credit to transform their agriculture. The demand for various financial products proved this wrong as in reality rural people do participate in informal finance through varied forms and types of financial arrangements.

Liberalization of the financial sector was introduced through the BAFIA, 1991 to address the weaknesses experienced in the financial sector. It was envisaged to improve access to financial services through enhanced competition, increased and diversified financial products and providers, and improved integration of the financial system. In this context, access to financial services in the rural areas was expected to be improved. However, assessment of the impact of financial liberalization has mixed results. Although, there is an increased efficiency in provision of financial services, participation of financial institutions and products, enhanced financial discipline, improved supervision and regulation, and price stability; rural households' access to finance was found to be diminishing. Increasingly there is a high concentration of banks and financial institutions in big cities and towns, and most of these rely on traditional banking approaches - of insistence on collateral, preference for less risky category of clients and preference for large loans and bureaucratic and lengthy procedures of providing loans. There are limited initiatives in product innovation, design of appropriate delivery mechanisms, and high interest rates spreads.

As a result of poor access to financial services, most households have strengthened self-financing mechanisms through the informal arrangements. Although, semi-formal financial institutions and FiNGOs are attempting to correct the financial imbalances, their outreach, products and services are still limited. The study observes that there are still other constraints that need to be addressed, some of which are structural and others institutional. Thus, it is concluded that ongoing financial sector reforms are necessary conditions for improving access to rural financial services, but not a sufficient condition.

The government has put in place appropriate regulatory and supervisory framework that supports to a larger extent the growth of the financial market. Regulation and supervision framework of the MFIs is in place implemented by various regulatory bodies – the BoT, Ministry of Finance, Co-operative Development Department, Capital Markets and Securities Authority, and the Gaming Board of Tanzania. However, the challenges are on the complications arising out of the nature of the microfinance institution (relying on grants, donor funds, members' money, etc), operations (credit only, savings and credit, or accept deposits), and the ownership, size, and target group. As the BoT apply same principles in regulating these institutions, it needs to put extra care not to limit the growth of the MFIs. The capacity of the regulatory authorities in supervision and regulation is another limitation as the BoT and the Co-operative Development Department are not adequately staffed and in addition lack necessary facilities.

There are positive initiatives in developing non-prudential instruments such as capacity building and networking, development of facilitative policy environment, improvement in judiciary systems through formation of commercial courts, establishment of credit reference bureau, formalization of business and property rights, and formation of the Bankers Association. The study concludes that these efforts are just beginning and are not popularized. In addition, the prudential regulatory and supervisory framework need to be flexible, transparent, predictable and capable of addressing potential risks perceived in a timely manner in order for it to support the growth of the financial sector. In other words, as part of the financial infrastructure, prudential regulation and supervision must contribute towards the development of the financial sector, and should not undermine the efficiency of the financial market.

8.2.2 Impact of the Financial Sector Reforms on RFMs and Households' livelihoods

The financial sector reform and liberalization implemented in Tanzania aimed at increasing financial depth and width, improving outreach and quality services through the growth of financial markets. In this context, as financial sector stabilizes, access to financial markets by the poor and private sector – especially the SMEs and rural households is enhanced. The performance of financial sector reforms in Tanzania, however, presented mixed results – of improvement and failures. As for positive results, liberalization of the financial sector has resulted into expansion and diversification of the financial intermediaries – commercial banks, non-bank financial institutions, insurance and social security funds, as well as facilitated establishment of capital markets. The role of the Bank of Tanzania was redefined to focus more on the attainment of price stability, which is critical for the development of sound and efficient financial markets.

Although there are increased diversifications of the financial institutions, the financial sector is still dominated by the banking system, which is concentrated mainly in urban areas, highly liquid and well capitalized. Furthermore, there are limited product development and innovation appropriate for the rural sector. Consequently, credit to the emerging private sector is still limited and mostly available in the form of short-term loans and or overdraft. This situation is partly explained by the weak institutional environment that makes financial institutions still rely on the use of conventional lending methodologies that emphasize on collateral, availability of business records, and credit worthiness analysis. These conditions restrict rural households' access to bank credit. As a result, most financial institutions are found investing in government papers and offshore hard currency savings especially in US dollars, which are less risky.

Despite the increase in financial institutions that improves competition and hence efficiency, bank interest spread between deposits and lending are still high, though declining. This creates a major disincentive in terms of savings mobilization.

Access to financial services facilitates economic development, private sector development and poverty reduction initiatives. The financial sector represents the interface between the demand for financial services by individuals, households and enterprises, and the financial intermediaries - both formal and informal institutions. These actors include rural population, microfinance institutions, commercial banks, non-financial institutions, informal finance providers, and the central bank that is involved in regulation and supervision.

Rural households need a variety of financial products – savings, loans, insurance, means of transfer payments, etc. However, their financial needs vary according to household's level of poverty, household size, level of education and skills, life cycle needs, and local market opportunities. In addition, access to financial services helps rural households to benefit from economic opportunities, which build up incomes and assets to lift them out of poverty. Financial liberalization was anticipated to reduce poverty, social and economic differentiations through access to financial services. The financial liberalization, to the contrary, is associated with an increase in inequalities, and poverty. In addition, there is a reduced funding to agriculture, which forms the key sector of the economy. As a result the performance of the agricultural sector, though still significant, has been on decline.

The declining importance of agriculture has forced rural households to design coping strategies of taking up more non-farm activities. Incomes from these supplements that from the agricultural sector. However, even then shortage of capital is still a limiting factor to these new types of households' activities. This situation constrains economic growth in rural areas. The efforts of poverty reduction are, therefore, constrained by inadequate access to financial services. The study has demonstrated that access to financial services enables poor people to increase their incomes, build assets and reduce vulnerability, but since access is limited most rural households are increasingly becoming vulnerable to external shocks such as drought, floods, diseases and pests. Thus, rural households' livelihoods are at stake despite the noted improvements in the RFMs.

8.2.3 Constraints to Supply and Demand for Financial Services

Assessing the supply and demand for rural financial services, it is concluded that rural areas are hardly secured by banks hence limiting access to financial services. Prior to liberalization, government owned financial institutions provided financial services to rural people that were organized through co-operatives and specialized credit agencies. CRDB was responsible for organization of farm inputs, while NBC provided crop finance. In addition, CRDB also facilitated rural development programmes through donor funds. Moreover, there were development banks – TIB, TDFL, and THB, which financed limited long-term development projects in rural and urban areas. With the liberalization of the financial sector – commercial banks have withdrawn from rural areas, development banks are no longer active, and the co-operative state-sponsored credit system has collapsed, thus creating a “supply gap” that is increasingly being replaced by informal finance.

Although, at household level separation of financial needs for purely household needs and enterprise development is often difficult as economic activities are intertwined with households needs, it is possible to identify factors influencing the demand for credit. Analysis from Babati revealed that the demand for credit was influenced by age of the borrower, household size, and distance from a financial institution. Other factors were found to be the costs of borrowing that includes loan transaction costs plus interest rate charged, bank procedures and conditions, policy and regulatory framework and institutional and infrastructural weaknesses.

Apart from credit, rural households also demand other financial services and products - savings facilities, means of payments and transfer payments, insurance and leasing. It was revealed that there is a supply gap in these products as there is institutional underdevelopment, underdeveloped communication and transport infrastructure, inadequate policy, legal and regulatory framework and weak innovative product design as well as product development and delivery mechanisms.

Babati is experiencing limited financial service providers – one bank branch, an agency, and handful microfinance operators as formal financial intermediaries.

Consequently, rural households increasingly depend on informal finance providers. The informal finance operators are categorized into commercial operators and non-commercial operators, with the later group mostly operating on reciprocity mechanisms. Increase in demand for the informal financial services is an indication for the potential for demands for services of financial institutions, which negates the assumption that rural people can not save.

There are few Microfinance actors – SACCOS, specialized credit programmes, FiNGOs, and informal finance. These offer limited financial products and services, which provide for high potential for growth of the financial markets that help to safeguard the poor households against extreme vulnerability. Few of these MFIs are networking among themselves to attain economies of scale in services and products they can not provide singly. Networking among MFIs allows for sharing of information and hence reduces cost of delivery of microfinance services. Linkages with commercial banks, for instance facilitate the development of the financial system and besides improving savings – investment process.

The development of the rural financial market helps in poverty reduction through improved investment, creating employment opportunities, improved food security, and reduced vulnerability. Thus, emphasis should be on rural financial sector deepening as part of the strategy to stimulate rural private sector development. However, the inability of rural households and enterprises in Babati to access financial services on competitive terms to undertake profitable investments, or take advantage of market conditions, means that incomes and growth are constrained. The absence of competitive savings instruments and other financial services in rural areas leads to less productive forms of savings that cut further into households' scarce liquidity and dampen local growth prospects. On the other hand, without market instruments to hedge against risks, rural households and enterprises may even retreat from profitable projects for which they have adequate liquidity.

For financial sector reforms to have an impact on poverty reduction, households' access to financial services on a sustainable basis is critical. However, access to financial services rests on an improved demand for financial services, reduced banking services provision conditions, reduced transaction costs, improved infrastructure, and other structural bottlenecks. In addition, change in attitudes of the rural population on credit need to be enhanced through training, and awareness creation. Furthermore, savings mobilization drive has to be promoted. In the short-run government intervention through credit guarantee schemes may help to build banks' confidence in the rural areas. This may be associated with other market-based incentive schemes such as tax incentive, product development, integration of MFIs with commercial banks through linkage banking, capacity building and awareness creation, and improving legal and regulatory framework to enhance financial discipline and credit repayment culture.

8.3 Recommendations and Policy Implications

As discussed in the various chapters of this thesis, access to financial services is important for an improved wellbeing of rural households, especially in developing countries such as Tanzania. However, such access has to be based on development of broader and deeper rural financial markets. In this context, elimination of obstacles to the growth of RFMs is a must. Thus, the following recommendations are made:

8.3.1 Appropriate and supportive Macro-economic policies

Financial liberalization need to be accompanied by additional facilitative policies – macroeconomic and financial policies. On the other hand sectoral policies – such as financial policies, fiscal and monetary policies, and rural development strategies call for harmonization in order to provide for a conducive environment for the growth of RFMs in the country.

Furthermore, these need to be accompanied by a regulatory and supervisory framework for the financial sector that is flexible, transparent, predictable and capable of addressing potential risks perceived in a timely manner. The government has taken some decisions towards this direction, but still there are areas that require further actions as identified in the thesis.

8.3.2 Interventions by Government and development Partners

The development of the RFMs in a developing country like Tanzania calls for a facilitative intervention. However, the case for intervention should be guided by the government development objective – of poverty reduction through economic growth. Direct interventions through say subsidies, credit programmes, or institutions – need to be carefully analysed as efforts should be made to avoid further failures through state interventions as those of 1970s through 1980s.

In this context, the desired government actions are those focused on improvement in demand for financial services, reduced cumbersome banking conditions, reduced transaction costs, improved infrastructure, and other structural bottlenecks limiting access to financial services. In addition, change in attitudes of the rural population on savings and credit is required in order to improve domestic savings mobilization and loan repayment culture.

In the short-run government intervention through credit guarantee schemes may help to build banks' confidence in the rural areas. This may be associated with other market-based incentive schemes such as tax incentive, product development, integration of MFIs with commercial banks through linkage banking, capacity building and awareness creation.

8.3.3 Development of Appropriate Financial Institutions and products

The heterogeneity of the socio-economic status of rural people and diverse nature and scale of their economic activities imply that the demand for financial services by rural enterprises and households cannot be met by a single financial institution or through a uniform approach. Thus, this calls for institutional mix, product innovations, and appropriate methodology. Owing to high costs and associated risks with the early stages of the development of RFMs, market forces alone can not bring about the required financial sector development. Hence some kind of government and donor facilitation is called for.

It is, however, critical to note that such facilitation should be based on a coherent RFMs development Strategy that involves various actors in the market so as to make them own the development process. Such an envisaged RFMs should be an integrated one so that the various players in the financial system operate as one guided by the same regulation and supervision framework.

Financial viability of the “infant financial intermediaries” is critical. The government has to ensure that such institutions are nurtured through appropriate incentive mechanisms, appropriate financial infrastructure – legal, regulatory and information system that minimizes transactions costs and market risks. In addition a well designed financial innovation reduces transaction costs and brings about widenening, deepening and integration of RFMs. In turn this process stimulates economic growth through enhanced savings, investment and production.

8.3.4 Investment in infrastructure and Institutional development

Investment in institutions and infrastructure development is required so as to facilitate markets to function efficiently. There must be purposive investment strategy that supports development of the public infrastructure – such as transport and communication, electricity, security system, and research and development.

On institutional development, there is a need to improve and strengthen the judiciary machinery, operationalize credit bureaus, improve security, and formalization of properties and businesses. Popularize formalization of business and properties through holistic rural development initiatives that is based on market systems and ownership rights. Besides, improve access to information by rural population, for instance the availability of the SME – Credit Guarantee facility that is least known.

Building up of an appropriate Management Information System (MIS) is another critical aspect in institution building. In addition, internal control system, identification of auditors, or research and development, and training or capacity building calls for government support. Such investment cannot be borne singly by financial institutions.

Cultural constraints that prohibit women, youth and disadvantaged persons from accessing financial services need to be addressed through various development policies.

8.3.5 A "New Role" for Financial Institutions

Financial institutions and commercial banks need to revisit their financial terms and conditions in favour of the development of RFMs, especially in terms of bank conditions, interest rate spreads, demand for collateral, and requirements for addressing the needs of the poor and rural people.

There is a need for financial institutions to become more innovative in developing new products and services, improvement in organization of the rural financial institution, improved delivery mechanisms, and establishment of the institutional framework for integration of MFIs into financial system. Product development and pricing need to be based on clients' needs and flexibility.

8.4 Areas for Further Research

This study was based on primary and secondary data obtained from different sources during the time when there were a number of policy reform processes going on. In the financial sector, the government was moving to the second stage of the financial reform, where a Bill was submitted to the Parliament during 2006 seeking amendments to the BAFIA, 1991 that introduced the ongoing reforms. It is, therefore, recommended that similar studies be conducted to involve more rural population so as to be able to make a conclusive policy propositions, especially after the introduction of the second stage financial sector reforms. However, this has provided groundwork for such a further study.

There are also specific issues that call for further studies. These include:

(i) development of realistic rural development strategy that covers, among others, the development of the financial markets,

(ii) rural property ownership rights in order to determine how these can be used productively, through say mortgage, collateral, and/or sale for cash income, and

(iii) Strategies for loan enforcement mechanisms in rural areas – especially on how the informal finance experiences can be utilized.

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APPENDICES

APPENDIX 3.1: RESEARCH QUESTIONNAIRE FOR INDIVIDUAL HOUSEHOLDS

Date------------------------------------ Household Code/No. ----------------------------------

Location: Village/Ward--

A: HOUSEHOLD BASIC DATA

1. Interviewee: Age----- Sex------Male/Female
2. Size of the family---------------- Male-----------Female-------------Children--------
3. Active and productive family members----------------- No. of dependants----
4. Level of formal Education of Head of the household -----------------------------
5. Linkages with urban areas? (e.g. operate business in urban areas; or has a relative working in towns, or retired from employment)
6. Membership to any socio-economic organisation in the locality----------------

B: ECONOMIC ACTIVITIES

1 (I) The main household economic activities---

(ii) Subsidiary/minor activities---

2 (i) If you are a farmer, how many acres? ---

(ii) What types of crops do you grow? ---

(iii) What are the objectives of growing these crops: commercial, subsistence, habit, do not know, others (specify)

(iv) What method of production used? (large scale and machinery, labour, gender consideration)

(v) Do you keep animal? Yes/no. If yes what type and how many? Traditional----Improved breed----------

(vi) How are these animals used?

(vii) Ownership of animals by gender: men/women

3 Marketing of both crops and livestock: where, how, who decides and how prices are determined?

4 What type of business are you engaged in?

5 Changes in major occupations over the last five years (i.e. size of livestock kept, farm size, business, use of labour, etc.)

6 Assess and discuss existing potential economic activities that are untapped?

C: HOUSEHOLD INCOME AND EXPENDITURE

1. Sources of Household income: Obtain data (make estimations) on households' incomes from various economic activities in the last five seasons.
2. Any income remittances from any source for the last five years? (specify where possible)
3. Other types of incomes or savings in expenditure (specify).
4. Who controls household income? Why?
5. How households' do spend their incomes during the last five years?
   - ♦ Subsistence: food, clothing, shelter
   - ♦ School fees, Medicare, transport,
   - ♦ Investment (specify: farming, livestock, business, etc)
   - ♦ Entertainment/festivals
   - ♦ Others (specify)
6. Does the household income meet family needs? Assess over a period of five years.
7. Who decides on how to spend and how much?
8. Assess households' savings over five years.

D: SAVINGS AND CREDIT

1. Do households save? How much and in what forms? Specify savings in formal financial institutions and that made informally as well.
2. Has the household ever applied for credit (both formal as well as informal) over the last five years?
3. If yes, state where and how much?
4. What was the loan used for?
5. What constraints (if any) households experienced in accessing loans?
6. What considerations, in households' views, are attached to accessing loans? (gender, security, education, rich, collateral)

7. Is the household aware of the existence of any credit giving institution in the area? How are they related? (A member, obtained support, given credit, received training)
8. Household's future plan(s)---
9. Any crucial remarks---

APPENDIX 3.2: CHECKLIST OF ISSUES FOR DISCUSSIONS WITH LEADERS/EXTENSION STAFF AND POLITICIANS

1. Village/Ward/Organisation---
2. Designation of the interviewee--
3. Households access to financial services. How and why?
4. Types/forms of Rural Financial Services available in the area.
5. How were they established? (capital, support, membership, relationship with rural households)
6. Types of products/services such organisations provide.
7. Major economic activities
8. Uses of Natural Resources (land, forest, water others: specify)
9. Access to and ownership of Resources by gender
10. Data on production, livestock, business, and financial services.
11. Cultural constraints to development
12. Information on marketing: quantities, decision to market, where to market, distance and means of transport
13. Average area household income and Expenditure: low, medium, and high
14. Savings: where, how, what form
15. Problems related to the development of the rural financial services
16. Community problems (in their own view)
17. Unexplored opportunities
18. General opinions

APPENDIX 3.3: QUESTIONNAIRE FOR THE FORMAL FINANCIAL INSTITUTIONS

1. Name, organisation and Location

Name of the Financial Institution---

Location town/village---

Type Public/private---

How organised---

Aims and objectives of the institution

2. **Product / Services**

(i) Types of services/ products

(ii) Savings. What types of savings?

(iii) Interest on savings.

(iv) If credit, what types: short term, medium, long terms. In terms of purposes what uses?

(v) The target beneficiaries rural/urban?

3. Loan Procedure and Policy

(i) Is there any loan policy?

(ii) What types of loans and loan portfolio?

(iii) Interest on loans?

(iv) Method of interest determination: flat rate or declining balance method

(v) How long does it take for one to get a loan?

(vi) How many times can one get a loan?

(vii) What security is offered for loans: collateral, shares, deposits, salaries, employer guarantee, immovable assets, others (specify)

(viii) Experiences in terms of lack of loanable funds. If yes how overcooked?

(ix) Loan repayment rate over the last five years

(x) Loan delinquencies, how frequent? Data on the last five years.

(xi) Data on loans issued over the last five years?

4. Savings Regulations and Procedures

(i) What products are available? How these products evolved? Based on clients'/members' needs?

(ii) How is interest on savings determined?

(iii) Types of clients and savings

(iv) How are savings/withdrawals being done?

(v) Are savings being charged as collateral? If yes, how is it done?

(vi) In the event of lack of borrowers what does the institution do with excess money? Invest (where?)

1. Loan processing and monitoring

(i) Loan application: what are the necessary conditions?

(ii) Loan Appraisal: How does one qualify for a loan?

(iii) Loan Review and Approval/deferment/rejection

(iv) Loan agreement

(v) Loan disbursement and repayment process (data?)

(vi) Loan follow-up and monitoring

(vii) Rescheduling and refinancing (possible to get data?)

(viii) Loan writes off: does it happen? How frequent and under what circumstances? (Possibility on obtaining data for the last five years)

2. Business Plans

(i) Sources of Capital: own funds, loan from elsewhere (specify), donation (specify), others (specify)

(ii) The Governance of an Institution

(iii) Business performance Analysis done? How often?

(iv) Number of clients by gender

(v) Linkage with other financial institutions

Appendix 4.1: Distribution of the TRDB loans by borrowers, 1972 – 1984 (in %)

Borrower	1972/73	1973/74	1974/75	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84
Villages	-	-	-	-	43.1	41.6	59.6	55.6	90.3	30.9	65.6	57.0
Individuals	*	0.1	-	-	-	0.5	3.1	5.1	6.9	6.3	8.1	14.5
Companies / Parastatals	6.7	14.0	20.3	42.0	25.2	28.5	17.4	20.7	2.3	42.4	9.4	7.7
Associations	12.9	11.7	10.3	7.3	9.5	29.1	17.1	16.4	-	14.4	15.4	20.3
Cooperative Societies	28.1	25.5	18.6	21.2	16.9	-	0.4	0.7	0.2	4.1	0.7	0.1
District Dev. Corps.	4.2	16.0	6.3	8.6	5.3	0.2	1.8	0.4	0.1	-	0.1	-
Ujamaa Co-op Societies	19.0	20.0	39.3	19.9	-	-	-	-	-	-	-	-
Cooperative Unions	30.0	15.9	5.2	1.0	-	-	-	-	-	-	-	
Others	-	-	-	-	-	-	-	-	-	-	0.1	-
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Ndanshau (1996: 101) table 4.5
Note: * Amount very small

Appendix 4.2: CRDB approved loans by regions, 1985-1991 (in percentages).

Region	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Arusha	5.1	3.6	4.8	5.1	10.8	7.9	7.0
Coast	3.1	0.1	3.3	1.0	0.9	2.7	2.4
Dar es Salaam	11.6	2.1	3.4	5.9	3.1	13.1	22.4
Dodoma	1.1	1.0	2.0	0.9	1.2	1.5	3.0
Lringa	9.2	15.2	16.0	16.8	13.4	11.7	7.6
Kagera	3.7	1.9	1.5	0.4	4.6	1.4	1.0
Kigoma	2.7	2.8	2.8	3.5	2.5	1.1	0.2
Kilimanjaro	5.4	10.1	9.2	5.2	5.7	4.5	19.3
Lindi	1.5	1.0	I.8	0.6	0.7	2.3	3.9
Mara	0.6	5.1	2.9	2.0	2.2	0.8	0.7
Mbeya	6.9	9.3	14.8	14.8	13.8	9.5	10.6
Morogoro	4.6	2.6	3.3	2.9	1.7	1.9	1.7
Mtwara	2.5	0.4	1.2	0.9	1.3	I.8	1.5
Mwanza	2.8	7.4	4.7	6.4	10.8	3.4	2.9
Rukwa	9.9	6.4	1.6	2.9	1.3	0.7	0.2
Ruvuma	7.4	7.1	3.0	7.9	1.9	0.5	0.8
Shinyanga	S.4	5.7	7.7	6.4	11.2	5.7	6.5
Singida	1.1	1.0	2.5	2.1	0.1	2.5	0.7
Tabora	12.8	13.5	11.1	12.9	11.9	7.7	0.2
Tanga	2.4	2.2	2.5	1.2	0.8	19.2	6.6
Zanzibar/Pemba	-	-	0.8	*	*	0.1	0.7
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Ndanshau (1996) extract table 4.12 p. 116

APPENDIX 5.1: DONOR FUNDED MICROFINANCE PROGRAMMES IN TANZANIA, 2005

DONOR	LOCAL COUNTERPART	PROGRAM AMOUNT	REGION	PROGRAM DESCRIPTION
African Development Bank (AfDB)	Local NGOs and Community Based Organizations (CBOs)	$ 10.8 million	Coast Region, Mtwara, Lindi, Morogoro, Singida	Small Entrepreneurs Loan Facility (SELF)
AfDB African Development Fund – Microfinance Initiative for Africa (AMINA)	SIDO, Poverty Africa, SCCULT, CREW, PTF	$ 20 million, among 10 countries	Counterpart MFIs have differing coverage of the entire country.	Capacity building for MFIs, Policy dialogue with Government agencies, Coordination with other donors.
Belgian Co-operation	Local MF NGOs working with Mennonite Economic Development Association	$ 0.8 million	Nationwide	National Income Generation Programme Umbrella Credit Project – capacity building, training, technology transfer, financing.
	Local MF NGOs	$ 0.5 million	Kagera, & Dodoma Regions	Belgian Micro Intervention Programme: group-based micro credits to support household-based income generating activities.
Canadian International Development Agency (CIDA)	Huduma ya Maendeleo (HYM)	$ 2.8 million	Dar es Salaam, & Mbeya (Urban areas)	Mennonite Economic Development Association Micro enterprise Business Development Program – capacity building, training, financing.
	To be identified	$ 0.35 million	Dodoma, Iringa, Mwanza, Dar es Salaam, Shinyanga, Morogoro	CARE Canada Imara – capacity building, marketing, financing.
	Gov't of Tanzania – Ministry of Agriculture	$ 50,000	Tabora (Nzega)	World Vision Soft Loan for Food Security – capacity building, marketing, training, financing.
	SACCOS Needs Assessment for BOT Donor Microfinance Update Survey for use by BOT	$ 70,000		Microfinance Related Studies – capacity building, technology transfer, training, financing, studies.
	Moshi University College of Co-operative and Business Studies	CAD 35,000	Headquarter in Moshi and Regional Centres	Rural Microfinance Capacity building programme-training, curriculum development, and practicum local and international
Danish International Development Assistance (DANIDA)	CRDB Bank	$ 15 million total for BSSP	Dodoma, Iringa, Mbeya, Morogoro	Business Sector Support Programme – Microfinance Component targeted at households, smallholder farmers and small and micro enterprises through CRDB Bank.
	High Court of Tanzania		Nation wide	Business Sector Support Programme – Commercial Court
Department for International Development (DfID)	Microfinance Capacity Building Programme in Africa (AFCAP)	$ 6.6 million total for multi-country program		Microfinance Capacity Building Programme in Africa (AFCAP), a joint initiative with CGAP for capacity building of MFIs in East, Central and Southern Africa.
	Micro Save Africa	$ 0.660 million		Micro Save is a joint initiative with UNDP, to provide TA to organizations to strengthen their development of savings services.
	SCCULT, Ministry of Co-operatives & Marketing, BOT	$ 40,000		Study of Rural Savings and Credit Cooperatives (SACCOS) in Tanzania.

Netherlands Embassy	Akiba Commercial Bank	$ 0.425 million	Dar es Salaam, Lake Zone, Arusha, Mbeya, Kilimanjaro	Akiba Commercial Bank (I and II) Expansion Project: capacity building and technology transfer program to improve outreach to micro, small and medium entrepreneurs.
	Netherlands Development Cooperation (SNV), CRDB	$ 0.895 million	Arusha	Finance & Advice Development Assistance – Small Enterprise Promotion (FAIDA-SEP), to provide credit guarantee scheme for small and micro entrepreneurs
Norwegian Embassy (NORAD)	Pride Tanzania	$ 6.3 million	Arusha, Tanga, DSM., Morogoro, Dodoma, Iringa, Mwanza, Shinyanga, Mbeya, Songea, Musoma, Singida, Tabora, Kigoma, Zanzibar	Pride Tanzania: capacity building, training and credit funds to micro entrepreneurs who can be assisted to develop their enterprises into financial viability and sustainability.
	Pride Tanzania and Pride Africa	$ 0.490 million	Arusha	REDI Arusha: microfinance capacity building and training for NGOs, specifically Pride Tanzania and Pride Africa.
Swedish International Development Agency (SIDA)	Government of Tanzania			GOT/Multi-Donor Mission: Review of Rural and Micro Finance in Tanzania.
	Pride Africa	$ 0.53 million	Tanzania and Uganda	Research and development to improve the Pride microfinance model in 2 countries.
	Bank of Tanzania	$ 120,000		Supervision and regulation of microfinance, Financial Sector Assessment – in World Bank's comprehensive Rural and Micro Financial Services Project.
	Presidential Trust Fund (PTF)	SEK 11 million		TA for capacity building and institutional support to develop self reliance for PTF

	Tanzania Association of Microfinance Institutions	SEK 4 million		TA for capacity building and institutional support to develop self reliance for TAMFI
	SACCOS	$ 1.0 million	Lake Victoria Region	TA for capacity building and institutional support to SACCOS through Swedish Co-operative Centre with FISEDA and BUMACO
United Nations Development Programme (UNDP)	Government of Tanzania	Not indicated	Coast Region, Dodoma, Kigoma, Lindi	Community-Based Initiatives (CBI) for Poverty Eradication: funds for on lending
	Government of Tanzania	Not indicated	Dar es Salaam, Arusha, Mwanza, Zanzibar	National Program of Action for Sustainable Income Generation: support for income generation projects in agriculture, micro-enterprise, and infrastructure sectors.
United Nations International Development Organisation (UNIDO)	Confederation of Tanzania Industrialists (CTI), Tanzanian Chambers of Commerce Industries and Agriculture (TCCIA), Small Industrial Development Organization (SIDO), The Planning Commission	Not indicated		Non-financial business support services to microfinance administrators for informal sector development, in computers, information and communications technology, opportunity studies, marketing.
DID Canada (Quebec)				

Source: Randhawa, Bikki and Joselito Gallardo (2003:34) Extract from Appendix B

Appendix 5.2: Chronology of Cooperative History in Tanzania

2005 Bill of the Cooperative Audit and Supervision Corporation (COASCO) Act 2005, passed by Parliament on 20th April, 2005

2003 Declaration Order is signed by the President transforming The Cooperative College Moshi into Moshi University College of Cooperative and Business Studies (MUCCoBS) of Sokoine University of Agriculture (to operate as campus of that University until it attains full university status in future).

2003 New Cooperative Societies Act, 2003 passed (gazetted 6th February 2004 and came into effect August 1st 2004)

2002 The Ministry of Cooperatives and Marketing issues a new Cooperative Development Policy in line with the 1995 ICA Statement of Cooperative Identity and Principles.

2001 In the Tanzania mainland the Department of Cooperatives within the Agricultural Ministry is upgraded to the status of a separate Ministry – Ministry of Cooperatives and Marketing.

2001 Presidential Committee submits its report in which 10 key problems for the cooperative movement are identified and 10 strategies for addressing them are proposed. The findings of the Commission are accepted by the Government.

2000 A Presidential Committee on the Revival, Strengthening and Development of Cooperatives in Tanzania was formed.

1998 Amendments to the Cooperative Act No. 4 of 1986 were passed enhancing the accountability of cooperatives in Zanzibar – Cooperatives Societies Act, No. 3 of 1998.

1997 First Cooperative Development Policy formulated.

1997 Amendments to the Cooperative Act No. 15 of 1991 were passed enhancing the accountability of cooperatives on Tanzania mainland.

1995 The Zanzibar Union of Cooperative Ltd (CUZA) was formed as a cooperative apex body for cooperatives in Unguja and Pemba.

1994 The Tanzania Federation of Cooperatives Ltd (TFC) was formed as the cooperative apex body for the Tanzanian mainland.

1992 The Tanzania Cooperative Alliance (TCA) and interim cooperative enterprise was formed to enhance the formation of the Tanzania Federation of Cooperatives (TFC).

1991 The Cooperative Societies Act No. 15 was passed for the Tanzanian Mainland establishing a four-tier structure for cooperative societies.

1986 The Cooperative Societies Act, No. 4 reinstating Cooperative Unions and Rural Primary Societies in Zanzibar.

1983 The Ruling Party (CCM) Executive Committee appoints the Secretary General of WASHIRIKA – Cooperative mass organization affiliated to the Party.

1982 Cooperative Societies Act No. 14 reinstating Cooperative Unions and Rural Primary Societies passed for the Tanzania mainland.

1980 Government Commission on cooperatives recommends the reinstatement of the disbanded Cooperative Unions for both the mainland and Zanzibar.

1979 Act passed recognizing the Union of Cooperative Societies (UCS) and its incorporation as a mass organization of the Ruling Party (CCM). The law applies to both the Tanzania mainland and Zanzibar.

1978 Union of Cooperative Societies (UCS) formed.

1977 Merger of the Zanzibar and Tanganyika political parties to form Chama cha Mapinduzi (CCM) as the sole political party in Tanzania. Cooperative Policy, regulation, promotion and development remains a devolved matter of the United Republic government with regard to the Tanzanian mainland and the Zanzibar government with regard to Unguja and Pemba.

1976 All Cooperative Unions dissolved and multipurpose Cooperative Societies introduced.

1974 Villages and Ujamaa Villages Registration, Designation and Administration Act passed.

1973 Presidential Decree on Villagisation and Crop Boards.

1969 Second 5-year National Development Plan emphasizes the formation of multi-purpose cooperative societies (1969 – 74)

1968 Enactment of new Cooperative legislation.

1962 Formation of the Cooperative Supply Association of Tanganyika (COSATA) as a wholesaler and supplier of consumer cooperative societies.

1962 National Cooperative & Development Bank established.

1953 Registration of Shinyanga Cotton Cooperative Union.

1950 Registration of Bukoba Native Coffee Cooperative Union.

1949 Registration of Rungwe Coffee Cooperative Union.

1935 Registration of Bugufi Coffee Cooperative Union (Ngara District)

1934 Registration of Ngoni Matengo Cooperative Union (Tobacco)

1933 Registration of Matengo Native Cooperative Union (Coffee)

1932 Registration of Kilimanjaro Native Cooperative Union (KNCU) (Coffee).

1932 First Cooperatives law enacted.

1925 Kilimanjaro Native Planters Association founded.

Appendix 6.1: Sources of GDP Growth, 1990-94 to 2000-04 (%)

	Average annual growth rate			Average contribution to growth		
Sector	**1990-94**	**1995-99**	**2000-04**	**1990-94**	**1995-99**	**2000-04**
Agriculture	3.1	3.6	4.8	1.5	1.8	2.3
• Crops	3.2	3.9	4.8	1.1	1.4	1.7
• Livestock	2.5	2.7	4.1	0.2	0.2	0.3
• Forestry and Hunting	2.8	2.4	3.9	0.1	0.1	0.1
• Fishing	3.4	3.7	6.6	0.1	0.1	0.2
Industry	2.0	5.4	8.7	0.3	0.9	1.5
Mining and Quarrying	11.8	14.8	15.2	0.1	0.2	0.4
Manufacturing	0.4	4.6	7.0	0.0	0.4	0.6
Electricity and Water	4.0	5.7	4.3	0.1	0.1	0.1
• Electricity	4.5	6.3	4.4	0.1	0.1	0.1
• Water	0.8	1.9	3.6	0.0	0.0	0.0
Construction	2.2	3.5	10.0	0.1	0.2	0.5
Services	1.9	3.8	5.9	0.7	1.3	2.0
Trade, Hotels and Restaurants	2.0	4.5	6.9	0.3	0.7	1.1
Transport and Communication	3.6	4.8	6.0	0.2	0.2	0.3
Financial and Business Services	2.9	3.6	4.3	0.3	0.4	0.4
• Finance and Insurance	2.6	3.5	3.6	0.1	0.1	0.1
• Real Estate	3.0	3.7	4.8	0.2	0.2	0.3
• Business Services	3.6	4.5	5.5	0.0	0.0	0.0
Public Admin. and Other Services	1.9	1.6	3.9	0.2	0.1	0.3
• Public Administration	0.6	-0.2	2.4	0.0	0.0	0.1
• Education	4.9	4.2	6.7	0.1	0.0	0.1
• Health	3.9	3.6	5.9	0.0	0.0	0.0
• Other Services	4.7	6.0	5.4	0.1	0.1	0.1
Less Fin. Services (ind. Measured)	5.7	3.4	3.6	-0.3	-0.2	-0.2
Total GDP (factor cost)	2.5	4.0	5.8	2.5	4.0	5.8

Source: URT, Economic Survey 2004

Appendix 6.2: SECTORAL CONTRIBUTION TO OVERALL GDP (%) AT (AT CONSTANT 1992 PRICES)

ECONOMIC ACTIVITY	1994	1995	1996	1997	1998	1999	200	2001	2002	2003	2004
Agriculture	49.6	50.7	50.6	50.1	49.1	48.9	48.1	48.0	47.5	46.7	46.4
Crops	36.5	37.7	37.6	37.3	36.5	36.4	35.7	35.8	35.5	34.8	34.6
Livestock	6.9	6.8	6.7	6.7	6.6	6.5	6.4	6.3	6.1	6.1	6.0
Forestry and Hunting	3.3	3.3	3.3	3.2	3.1	3.1	3.1	3.0	2.9	2.9	2.8
Fishing	2.9	2.9	2.9	3.0	2.9	2.9	2.9	3.0	3.0	3.0	3.0
Mining and Quarrying	1.3	1.4	1.5	1.7	2.0	2.1	2.3	2.5	2.7	3.0	3.2
Manufacturing	8.1	7.9	8.0	8.1	8.4	8.3	8.3	8.3	8.4	8.6	8.8
Electricity and Water	1.6	1.6	1.7	1.7	1.7	1.7	1.7	1.7	1.6	1.6	1.6
Electricity	1.4	1.4	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.4	1.4
Water	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Construction	4.6	3.8	3.9	4.1	4.3	4.5	4.6	4.8	5.0	5.2	5.5
Trade, Hotels and Restaurants	15.7	15.7	15.6	15.8	15.9	16.1	16.4	16.5	16.6	16.8	17.0
Transport and Communication	5.1	5.3	5.1	5.2	5.3	5.4	5.4	5.4	5.5	5.4	5.4
Financial and Business Services	10.6	10.3	9.9	10.3	10.5	10.4	10.4	10.2	10.0	9.9	9.7
Finance and Insurance	4.0	3.7	3.4	3.8	4.0	4.0	3.9	3.8	3.7	3.6	3.5
Real Estate	6.2	6.3	6.2	6.2	6.2	6.2	6.2	6.1	6.0	6.0	5.9
Business Services	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Public Administration and Other Services	8.7	8.2	8.0	7.9	7.8	7.7	7.7	7.5	7.3	7.2	7.1
Public Administration	5.7	5.2	4.9	4.9	4.8	4.6	4.5	4.4	4.2	4.1	3.9
Education	1.1	1.1	1.1	1.1	1.2	1.1	1.2	1.2	1.2	1.2	1.2
Health	0.6	0.6	0.6	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Other Services	1.2	1.2	1.2	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Less Financial Services indirectly measured	-5.3	-4.8	-4.2	-5.0	-5.2	-5.1	-5.0	-4.8	-4.7	-4.6	-4.6
TOTAL GDP (factor cost)	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: National Bureau of Statistics

Appendix 6.3: The Co-operative Map in Tanzania, as at 30th April, 2004.

NO	REGION	AGRI-CULTURAL (AMCOS)	SACCOS	LIVE-STOCK	FISHING	HOUS-ING	MINING	INDUST-RIAL	TRANS-PORT	UNION	APEX & TFC	OTHERS	TOTAL
1	ARUSHA	47	67	0	0	0	0	7	0	1	0	13	135
2	COAST	119	32	0	11	2	2	111	0	1	0	74	352
3	DODOMA	0	47	0	0	0	1	0	1	0	0	5	54
4	DSM	25	237	0	4	20	0	35	4	2	1	313	641
5	IRINGA	119	77	0	4	0	0	16	0	2	0	12	230
6	KAGERA	222	95	27	8	0	0	3	0	3	0	54	412
7	KIGOMA	45	7	0	4	2	2	1	0	0	0	11	72
8	K'NJARO	100	115	5	0	0	0	9	0	3	0	28	260
9	LINDI	76	23	0	0	0	0	4	0	1	0	8	112
10	MANYARA	40	60	0	0	0	2	5	0	1	0	21	139
11	MARA	149	37	1	0	1	0	1	0	4	0	1	194
12	MBEYA	91	108	22	23	0	0	10	2	5	0	12	273
13	MORO	51	43	1	1	2	0	2	0	3	1	22	126
14	MTWARA	126	38	1	2	0	0	0	1	2	1	20	191
15	MWANZA	344	29	2	20	0	2	8	2	1	1	36	445
16	RUKWA	7	16	0	5	0	0	0	0	1	0	5	34
17	RUVUMA	113	28	0	1	0	0	0	0	3	0	4	149
18	SHINYANGA	495	61	15	0	3	1	5	0	2	0	10	592
19	SINGIDA	32	15	1	1	0	0	2	0	1	0	6	59
20	TABORA	173	56	0	2	0	0	3	0	2	0	21	257
21	TANGA	42	45	9	0	0	0	10	0	2	0	50	158
	TOTAL	**2416**	**1236**	**84**	**86**	**30**	**10**	**232**	**10**	**40**	**4**	**726**	**4875**

Source:* *Ministry of Cooperatives and Marketing

Appendix 7.1: Some basic Indicators of economic and financial infrastructure, 2004

Division	Population (2002)	Average farm sizes (ha.)	Average herds size	Bank branch	SACCOS	Others
Bashanet	90,826	3	10	-	5	3
Babati	102,849	3	15	NMB, Postal Bank Agency	7	4
Gorowa	52,930	5	10	-	4	2
Mbugwe	56,408	2	20	-	6	-
TOTAL	**303,013**			2	22	9

Source: compiled from the field data

Appendix 7.2: Status of SACCOS in Babati District, 2005

NAME OF SACCOS	MEMBERSHIP				POPULATION		AREAS OF OPERATIONS (WARDS)
	M	F	I	T	Ward Pop	SACCOS' pop. as %	
Babati Teachers	37	53	0	90	31,077	0.29	Babati Town (Babati Ward)
Lake Teachers	18	37	0	55	8,243	0.67	Singe Ward
Gallapo Teachers	28	37	0	65	16,791	0.39	Gallapo Ward
BOGI Teachers	37	22	0	59	21,036	0.28	Bonga and Gidas Wards
Mamire Teachers	18	10	0	28	18,281	0.15	Mamire Ward
ADADA Teachers	35	32	0	67	42,792	0.16	Arri, Dareda, & Dabil Wards
MASABEDA Teachers	19	11	0	30	17,298	0.17	Bashanet Ward
Ufana Teachers	24	8	0	32	14,520	0.22	Ufana Ward
Madunga Teachers	39	13	0	52	16,216	0.32	Madunga Ward
Magugu Teachers Mshikamano SACCOS	40 42	27 43	0	67 88	23,682	0.65	Magugu Ward
MWANKAMA Teachers	18	11	0	29	32,726	0.9	Maghara, Mwada, & Nkaiti
MAQBEMI SACCOS	111	60	9	180	14,892	1.21	Qash Ward

Source: Compiled from the survey

Appendix 7.3: SACCOS' Financial Products, 2004

NAME OF SACCOS	INVESTMENT PRODUCTS		LOAN PRODUCTS		
	Savings	Others	Short-term	Medium term	Interest rate (%)
Babati Teachers	Savings, deposits	Shares CRDB, ACB, CFP	2-6 months	6-12 years	10-30
Lake Teachers	Savings, deposits	Shares TBL	2-6 months	6-12 years	10-15
Gallapo Teachers	Savings, deposits	Shares TBL, CFP	2-6 months	6-12 years	10-20
BOGI Teachers	Savings	Shares TBL, CFP	2-6 months	6-12 years	5-15
Mamire Teachers	Savings		2-6 months	6-12 years	12-17
ADADA Teachers	Savings, deposits	Shares CFP	2-6 months	6-12 years	10-15
MASABEDA Teachers	Savings	Shares CFP	2-6 months	6-12 years	10-15
Ufana Teachers	Savings	-	2-6 months	6-12 years	10-15
Madunga Teachers	Savings, deposits	-	2-6 months	6-12 years	15
Magugu Teachers Mshikamano SACCOS	Savings	Shares CFP -	2-6 months	6-12 years	10-15 15-25
MWANKAMA Teachers	Savings	Shares CFP	2-6 months	6-12 years	10-15
MAQBEMI SACCOS	Savings		2-6 months	6-12 years	15-25

Source: Respective SACCOS' files, Babati**.**

Appendix 7.4: List of Risks identified during the interview

No.	Types of Risks	Risks involved
1	Property Loss	- Fire, - Destruction of premises/buildings - Droughts and floods - Theft/robbery
2.	Business risks	- death of the entrepreneur, - sickness, - crop/livestock diseases and loss - Price fluctuations, - Theft and robbery - Defaults, - Bad debts, - breakdowns
3.	Health problems	- death of a family member or a relative - malnutrition - sickness - disability - HIV/AIDS
4.	Loan risk	- misappropriation of loans - theft/robbery
5.	Others	- Divorce - Separation - Macro and meso economic policies

Source: Views from the field, 2005

Appendix 7.5: Characteristics of informal financial institutions

	Formal financial institutions (FFIs)	Informal financial institutions (IFIs)
A. Organization:		
1.	Complex	Simple organizations
2.	Well defined	Poorly defined
3.	Controlled by legal system	Uncontrolled by legal system
4.	Highly structured	Relatively flexible
5.	High in static efficiency	High in dynamic efficiency
B. Scope of services:		
6.	Broad spatial resource base	Narrow spatial resource base
7.	Private property rights emphasized	Commercial property rights emphasis
8.	Profit motivated in general	Security motivated
9.	Use of bank accounts and currency	Use of currency and physical goods
10.	Economic focus	High social content
11.	Universalistic	Particularistic
12.	High degree of security	Low degree of security
C. Transactions:		
13.	Large loan transaction	Small loan transactions
14.	Impersonal relations	Personal relations
D. Cost structure:		
15.	High fixed and low variable costs	Little or no risk costs
16.	High risk costs	No fixed but high variable costs
17.	Low nominal interest rate	High nominal interest rate

Source: USAID, (July 1989: 9)