Tanzania and the IMF

Press Release:
IMF Executive Board Completes Fourth Review Under Tanzania's PRGF Arrangement and Approves US$4.1 Million Disbursement
July 29, 2005

Country’s Policy Intentions Documents

E-Mail Notification
Subscribe or Modify your subscription

Tanzania: Letter of Intent and Memorandum of Economic and Financial Policies

July 14, 2005

July 14, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Rato:

**LETTER OF INTENT
AND MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES**

1. On behalf of the Government of the United Republic of Tanzania I hereby transmit the attached Memorandum of Economic and Financial Policies (MEFP) which reviews recent economic developments and progress in the implementation of the 2004/05 programme supported by the PRGF arrangement, and policies that Government intends to pursue for 2005/06 and the medium term.

2. Satisfactory progress was achieved and the programme has remained on track; all quantitative performance criteria were observed. The structural performance criteria and benchmarks are also on track, except for the performance criteria regarding submission to Parliament of the amendments to the Bank of Tanzania Act and the Banking and Financial Institutions Act.[1] This could not be completed by the scheduled date due to longer than expected consultations with Zanzibar and a tight legislative agenda, and will now be completed in July 2005. In this regard, we are seeking waivers of the non-observance of the structural performance criteria, and conclusion of the fourth review under the PRGF arrangement, and the consequent disbursement of the fifth tranche in an amount equivalent to SDR 2.8 million.

3. Implementation of the newly promulgated National Strategy for Growth and Reduction of Poverty (NSGRP, or MKUKUTA in Kiswahili), which sets economic growth, social well being of the population, and good governance and accountability as the pillars of the country's development agenda, will commence in 2005/06. In this regard, the Government remains committed to maintaining macroeconomic stability, including monetary and fiscal policies, as well as structural reforms particularly in the areas of domestic resource mobilization, strengthening of the financial sector, and improving governance. By implementing the measures set forth in the attached MEFP, the Government can achieve these objectives in coherence with the programme. The Government will continue to provide the Fund with the required information to assess progress in implementing the programme

[1] The finalized Financial Sector Reform Implementation Action Plan was submitted to Government in June rather than end-May as envisaged in the benchmark.

and will also consult with the Fund on the adoption of any measures that may be appropriate at the initiative of either Tanzania or the Fund.

4. The Government of Tanzania intends to make the contents of this letter and those of the attached MEFP available to the public and authorizes its publication on the IMF website, together with Fund staff report on the fourth review under the PRGF, once the Executive Board completes the review.

Yours sincerely,

/s/
Basil P. Mramba (MP)
Minister for Finance

Attachment: Memorandum of Economic and Financial Policies.

Memorandum of Economic and Financial Policies for 2005/06 and the Medium Term

I. Recent Economic Developments and Progress Under the Programme:

1. Substantial progress has been achieved in Tanzania's macroeconomic performance under the PRGF programme. During the calendar year 2004 6.7 percent growth in real GDP was attained compared to 6.3 percent previously projected, and an outturn of 5.7 percent in 2003. The higher than expected GDP growth stemmed almost entirely from the agriculture sector following favourable weather conditions and the recovery of some commodity prices. The annual rate of inflation (based on the newly revised CPI index) dropped from 4.3 percent at end-June 2004 to 4.0 at end-April 2005, mainly because of the weather related recovery in food production.

2. The fiscal performance for 2004/05 has remained broadly in line with the programme with overall budgetary performance being broadly in line with the budget estimates. Revenue collections for the year are estimated to have been slightly above the budget estimate, and more than 20 percent higher than in 2003/04, primarily on account of higher collections from VAT and income taxes as well as sharply higher non-tax revenue.

3. With regard to expenditure, there has been an improvement in overall execution by the spending units in 2004/05. Total recurrent expenditure is estimated at Tsh 2,608 billion in line with the budget estimates, while estimated development expenditure was Tsh 898 billion, slightly above budget because of higher foreign financing. Estimated net domestic financing of the budget is Tsh 79 billion, or about half of the programme target of Tsh 157 billion.

4. The Government has completed a review of various tax laws with a view to updating them in the coming year, including rationalisation of the administration provisions of different tax laws as part of the ring-fencing agenda. The main laws reviewed include The Tanzania Revenue Authority Act, 1995; The Value Added Tax Act, 1997; The Stamp Duty Act, 1972; The Road Toll Act, 1985; The Airport Service Charge Act, 1962. In addition, the TRA has continued with implementation of the reform initiatives stipulated in its Corporate Plan for 2003/04-2007/08 with support from various stakeholders including East AFRITAC of the IMF. A complete quality assurance review of the Customs and Excise Department reforms under the TRA's second corporate plan was completed in June 2005 as envisaged. This includes updating the action plan that focuses on post-clearance auditing and compliance. Following a transfer of 100 additional taxpayers to the Large Taxpayers Department last year, a further expansion of the Department has brought the number to 278 at end-June 2005. This will be accompanied by consolidation of the department's capacity through recruitment of staff with the requisite skills.

5. As a way to strengthen Treasury functionality and improve its expenditure management, the Government has introduced measures to curb the accumulation of expenditure commitments at year end, which had led to huge expenditure floats in the past

and impaired fiscal flexibility for executing first quarter budgets. Closer monitoring of the expenditure float will involve building capacity for improved cash management and the projections of monthly expenditure requirements by MDAs.

6. Public debt continues to be an area of focus on the basis of the National Debt Strategy (NDS). Recent developments in this area include the adoption by the National Debt Management Committee (NDMC) of a capacity building plan for the various institutions to fulfill the obligations specified in the NDS in collaboration with the Macroeconomic and Financial Management Institute (MEFMI) and as part of the Public Financial Management Reform Programme (PFMRP). The Government Loans, Guarantees and Grants Act of 1974 incorporating the changes introduced in 2003 has been distributed to all MDAs with a circular describing its effect in clear language. Enforcement of the legislation will be ensured through regular meetings of the relevant committees to advise the Minister for Finance on developments, including applications for new loans and public guarantees.

7. Progress was also made in the implementation of the PFMRP and includes the identification of core activities for each component as well as the processes, outcome and output indicators, and a structure for monitoring, reporting and controlling performance. The PFMRP has been mainstreamed into the budget to ensure consistency between strategic plans and budgets.

8. Substantial progress has been made in the procurement area by enacting a new law, The Public Procurement Act 2004, which has decentralised all tendering functions and established a Public Procurement Regulatory Authority.

9. A steady inflow of official foreign funds to the budget during 2004/05, coupled with HIPC debt relief, and an increase in exports of both goods and services, resulted in a considerable build-up of liquidity in the economy and subsequent pressure in liquidity management. The Bank of Tanzania continued to exercise vigilance in its monetary policy actions so as to keep the reserve money programme on track. The Bank of Tanzania continued to manage liquidity using domestic instruments (i.e. Government securities, and repurchase agreements) while complementing with sale of foreign exchange when appropriate. On the fiscal front, strong revenue collections that exceeded targets in most of the months in the period under review helped to contain reserve money within targets. The above measures enabled the Bank to observe the targets for reserve money throughout the year.

10. Consistent with the increase in demand for financing of the expansion in economic activities in the country, credit to the private sector increased by about 30 percent during the year ending June 2005, in line with the programme projection for 2004/05. The strong growth of private sector credit was sustained in part by the increased number of credit-worthy clients taking advantage of relatively favourable negotiated cost of borrowing in the domestic market. Also, the ongoing efforts by the Government to improve the business environment have influenced expectations of positive investment returns and therefore stimulated demand for private sector credit.

11. The tightened monetary policy stance of the Bank of Tanzania in response to high liquidity led to an upward pressure on interest rates. The overall weighted average yield for Treasury bills went up from 7.8 percent in June 2004 to 8.4 percent in March 2005. In line with the Treasury bill rate, the lending rate moved upwards from 14.2 percent in June 2004 to 15.6 percent in March 2005. Whilst, the weighted average time deposit rate stood at 4.3 percent in June 2004, it moved only slightly up to 4.5 percent in March 2005, and savings rate remained at around 2.5 percent throughout the year.

12. During the period under review, balance of payments developments were characterized by substantial growth in both imports and exports. The external accounts improved as a result of large inflows of external assistance and growth in the mining exports, a recovery in traditional exports and tourism receipts. On an annual basis, the current account deficit is estimated at $630 million, marginally below the programme target and virtually unchanged from the previous fiscal year. Exports are estimated to have increased to $1,456 million from $1,174 million in the previous year, whereas estimated imports rose to $2,574 million, up from about $2,155 million the previous year.

13. A steady inflow of foreign assistance, coupled with HIPC debt relief, resulted in the increase in official gross reserves to $2,137 million from about $1,878 million at end-June 2004, which is equivalent to about 7 months of 2004/05 estimated imports of goods and non-factor services. The nominal exchange rate of the shilling to the U.S. dollar depreciated slightly from Tsh 1,107 at end-June 2004 to Tsh 1,124 at end-May 2005.

14. During the year, the Government continued negotiations with both Paris and non-Paris Club bilateral creditors for debt relief on terms comparable to those under the Enhanced HIPC framework. As at end-June 2005, total debt relief received from Paris Club VII arrangement stood at an estimated $2.5 billion. The countries that offered debt relief are Austria, Belgium, Canada, France, Germany, Italy, Norway, the Netherlands, United Kingdom, USA, Russia and Japan. The U.K. offered additional relief this year of 10 percent of debt service obligations to IDA and ADB. Efforts are under way to have the remaining bilateral agreements signed with Brazil and other Japanese agencies namely EID/MITI and the Japanese Food Agency. With regard to Non-Paris Club members, only Bulgaria, India and Kuwait had offered debt relief in line with the HIPC framework. Bulgaria extended debt relief by canceling debt amounting to $15.1 million, and India offered debt relief by canceling all of its intergovernmental loans amounting to $19.7 million. Kuwait rescheduled its debt amounting to $31.8 million under terms that provided debt relief equivalent to 90 percent cancellation in NPV terms. Meanwhile, China offered debt relief by canceling debts worth $37.7 million. Meanwhile, dialogue is continuing with Abu Dhabi Fund, Hungary, Libya and Iran.

15. The Government has made substantial progress in the areas related to Private Sector Development (PSD). A major study on a new PSD strategy is under way and is scheduled to be completed by November 2005. This work will benefit from inputs from a Diagnostic Trade Integration Study (DTIS) currently being carried out by the World Bank. The reform

work in this area will increase the long-term growth potential of the economy and support poverty reduction through increased incomes. A coherent Monitoring and Evaluation (M&E) system for BEST, SME policy and PSD strategy is being developed and is expected to be institutionalized by November 2005. The Government has continued to mobilise resources and it is envisaged that the implementation of SME policy priority projects will start by November 2005. Reforms in the business licensing system have continued and the Draft Business Activities Registration Bill has been prepared which will eventually lead to the repeal of the Business Licensing Act of 1972.

16. The Government continues with its efforts to promote good governance in line with the NSGRP and the National Anti-Corruption Strategy and Action Plan (NACSAP). Quarterly reports are being prepared depicting progress made in the implementation of the MDAs' anti-corruption plans. Following broad consultations with stakeholders, proposals to amend the Anti-Corruption Law are in process. In addition, the Government is taking broad measures to strengthen the Good Governance Coordination Unit (GGCU) in the President's Office through, among others, increasing the number of staff and enhancing training.

17. The Government remains committed to implement the Public Service Reform Programme (PSRP) aiming at improving public service delivery so as to contribute to economic growth and poverty reduction. The reform strategy has continued to focus on attracting and retaining better qualified staff and strengthening human resource capacity in order to sustain the overall Government reform programmes. This will be achieved through the Government's long-term plan of capacity building as well as pay reform which is performance-oriented. A study is underway to establish a detailed analysis of the nature of and trends in employment allowances, and employment growth in order to make specific recommendations that would be consistent with improved rationality and an accelerated pace of salary enhancement within an affordable wage bill.

II. Economic Policy for 2005/06 and the Medium Term Strategy

A. The MKUKUTA and Overview of Medium-Term Economic Objectives

18. The recently adopted MKUKUTA charts in broad strokes, for the next five years, Tanzania's policy direction towards rates of broad-based economic growth of 8-10 percent per annum, and the attainment of the Millennium Development Goals. The MKUKUTA improves on the approach of the recent years' PRS in so far as it is organized around three clusters of outcomes: Growth and Reduction of Income Poverty; Improved Quality of Life and Social Well-Being; and Good Governance and Accountability. Thus, policy design and all government activities are being determined with respect to their contribution to achieving specific targets within these clusters. At the same time, the framework takes into account inter-sectoral linkages and synergies and pays more attention to cross-cutting issues, namely HIV/AIDS, gender, environment, employment, governance, children, youth, elderly, disabled and human settlement. By comparison with the PRS, it also gives more emphasis to economic growth in poverty reduction.

19. The emphasis on equitable economic growth translates into particular attention to stimulating private investment, developing infrastructure, building human capacity and a competitive economy. The MKUKUTA provides entry points for stakeholder participation in its implementation, starting out with a process where all levels and sectors of the government administration (i.e. including each MDA and the Local Government Authorities) are required to indicate how their policy interventions will contribute to achieving goals in the respective three clusters. In order to support rising household income and reduce income disparities, policy interventions in the following areas are also geared to boost district and regional economic growth: agriculture, roads, lands, energy, trade, tourism, mining, private sector environment—with emphasis on SMEs, establishing special economic zones, and formalizing property and business ownership. Improvement in the quality of life and social well being is to be realized through more equity and quality in the delivery of social services, including education, health, nutrition, water, sanitation, and shelter. Policy reforms concerning the third cluster, governance and accountability, focus on creating well functioning and fair justice and anti-corruption systems, and facilitating public access to information on laws, policies, and policy implementation (including public finances).

B. Real Sector

20. Strong growth is expected to continue across all sectors of the economy leading to overall economic growth of 6.9 percent in real terms in 2005 and, supported by the continued structural reforms and infrastructure investment, accelerating further to 7.5 percent over the medium term. Assuming normal rainfall, growth in agriculture is expected to remain strong, at around 6 percent a year in 2005-06 and over the medium-term, supported by the provision of extension services, facilitated access to agricultural inputs, and the continued reform efforts aimed at improving rural infrastructure and the availability of credit. Tanzania's mining sector received a boost in 2004 following Tanzania's ranking in the top ten list of global locations for mining investments by the mining industry's authoritative Annual World Risk Survey and growth should remain robust. Strong expansion is expected in 2005-06 in the manufacturing sector, agro-processing, trade, and construction. In the area of infrastructure development, Tanzania will undertake rural and peri-urban electrification projects involving different components of the power sector; improve the rail network and rehabilitate the ports through providing specialized equipment for handling containers and their removal into new customs inspection areas. Growth in tourism-related activities is expected to remain buoyant over the forecast period although further rapid expansion of the sector will be constrained by the limited park and accommodation capacity.

21. Inflation is expected to remain at an average of about 4 percent in 2005-06 and over the medium term. Although there are indications of potential food shortages in a few regions of the country that did not receive adequate rainfall during the short rains season, measures are being taken to distribute foodstuffs from the strategic grain reserve and from surplus to deficit areas thus dampening the pressure on food prices.

C. Fiscal Policy and Public Resource Management

22. In its preparations for the 2005/06 budget, the Government has been guided by two objectives, maintaining macroeconomic stability and translating the policies stipulated in the MKUKUTA into the budget. The newly developed Strategic Budget Allocation System (SBAS) has ensured this strategic linkage, with the central government budget allocating about 48 percent of total funds for the implementation of the MKUKUTA to the cluster of Growth and Poverty Reduction, about 44 percent to Quality of Life and Social Well-Being, and about 8 percent to Governance and Accountability. MKUKUTA-related funding accounts for about 54 percent of central government budget allocations. Over time, as work on the full costing of the MKUKUTA progresses, the Government's Medium-Term Expenditure Framework is expected to translate comprehensively policy objectives into programmes, targets and activities. Nevertheless, already today, the expenditure programmes are driven by policy priorities and disciplined by budget realities, such as institutional capacity and resource constraints. In order to mitigate these constraints, the Government will press ahead with its ongoing programmes of strengthening public administration systems and domestic resource mobilization.

23. The Government's budget for 2005/06 envisages an increase in domestic revenue, and higher domestic financing with a concomitant increase in expenditures. Domestic revenue collection for 2005/06 is expected to reach at least 14.3 percent of GDP. The envisaged 0.7 percent of GDP increase in comparison to FY 2004/05 reflects: (i) the full-year effect of the introduction of the new Income Tax Act (ITA); (ii) the impact of tax administration reforms on VAT and income tax revenues (in particular related to the Large Taxpayer Department(LTD)); (iii) the graduation of a number of tax-exempted companies into the tax bracket, and (iv) increased non-tax revenue associated with coming into stream of gas-related projects. It will also be bolstered by the ongoing comprehensive tax reform programme as described below.

24. The overall expenditure level is budgeted to increase by 3.3 percentage points of GDP in 2005/06. Wages and salaries are projected to increase to 4.7 percent of GDP, consistent with our Public Service Reform Programme (PSRP) aiming at improving public service delivery so as to contribute to economic growth and poverty reduction. The Government's reform strategy, developed in consultation with major development partners, has continued to focus on attracting and retaining better qualified staff and strengthening human resource capacity in order to sustain the overall government reform programmes. The budget for goods and services shows a sharp increase, from 12.8 percent to 14.4 percent of GDP. However, as noted below, it is expected that actual outlays under this item will be lower. Development expenditure is budgeted to increase by 1.2 percent of GDP to 8 percent of GDP, especially reflecting higher infrastructure investment. Despite the significant levels of external support for investment, it is still not sufficient to meet the substantial demand for public investment in our country. Externally financed assistance therefore needs to be supplemented by domestic financing in order to enhance the productive capacity of the

economy. Our ongoing efforts to improve expenditure management and efficiency, and for greater involvement of local governments, are discussed below.

25. The revenue and expenditure estimates noted above would lead to an overall budget deficit equivalent to 14 percent of GDP, or 6.5 percent of GDP after grants, with domestic financing equivalent to 2.6 percent of GDP. However, we believe the outturn will be markedly lower. As always, the budget is prepared on a cautious basis and Tanzania has almost always over-performed against the programme's domestic financing targets through both higher revenue and tight control of expenditure. Moreover, noting the importance of expanding spending on infrastructure, we have requested additional support from our development partners. In any event, we will continue to strike a balance in the demand for domestic resources from the public sector to ensure that it does not crowd out productive private sector activities. To this end we are firmly committed to limit domestic financing to no more than Tsh 164 billion, or 1.1 percent of GDP. If necessary, the expenditure constraint would be mainly in the area of scaling back the significant increase in goods and services included in the budget.

26. In cognizance of the need to strengthen development and eventually to reduce external dependency, the Government will continue to enhance domestic resource mobilization. Further strengthening of tax administration will be in line with the TRA Corporate Plan, in particular: (i) reorganizing of the TRA along functional lines, and strengthening the LTD, with emphasis on making self-assessment fully functional, enhancing audit capacity, and further expanding its coverage of the LTD; and (ii) improving services to taxpayers. To enable additional taxpayers to obtain all tax services they need under one roof, it is expected that new centers in 15 additional districts will be established. We are also developing an Action Plan, to be completed by June 2006, to establish a single department with responsibility for all domestic taxes.

27. Efforts to streamline customs are continuing, including: (i) continued application of risk management tools in the customs administration; (ii) enhancing the post-clearance audit and verification unit; (iii) transmitting master manifests from arriving vessels directly to customs; and (iv) creating an intelligence unit at customs. Moreover, with technical support from the World Customs Organization, we are conducting a Time Release study to determine how the clearance process can be further improved. Moreover, the Government is working with other EAC members to harmonize the implementation of customs administration practices and procedures in line with the Customs Union Protocol. To increase the efficiency of post-clearance audit, we plan to increase the number of staff in this section from the current 14 to 32 by end-March 2006 (structural benchmark). Also, by end-January 2006, we plan to integrate the destination inspection programme with custom procedures to rationalize processes and tasks at the Dar es Salaam custom offices (structural benchmark).

28. The Government's focus remains on improving expenditure management and greater involvement of local government agencies (LGAs) in expenditure execution as instruments for reducing poverty. To this end, the Government will continue to implement expenditure management reforms along several tracks. First, concerning the linkages between the

MKUKUTA and the budget, the following steps will be taken: (i) more comprehensive costing of the MKUKUTA interventions; (ii) developing a budget-linked monitoring and reporting system for the MKUKUTA targets; and (iii) strengthening the Integrated Financial Management System (IFMS) by linking the new budget allocation system (SBAS) with the accounting and control system (EPICOR). Second, the increasing devolution of spending to lower levels of government will need to be accompanied by the following efforts in capacity building: (i) at the stage of working with budget guidelines, the LGAs will need to be fully integrated into the budget preparation process, through both direct allocations from the central government budget and reconciliation of their own budget plans with the MKUKUTA and the MTEF; (ii) at the stage of monitoring of spending execution, through the technical support programs of the Accountant General's office, help set up integrated reporting systems that facilitate spending control; and (iii) recognizing the need for closer supervision of the budget process of LGAs, efforts will be strengthened to obtain detailed monthly expenditure reports before releasing further funds to LGAs. The Government will give high priority to these improvements, given that 19 percent of the recurrent expenditures and 4 percent of the development expenditures of the central government budget are to be transferred to local authorities via grants.

29. The Government will also continue to address other issues of expenditure management. In order to avoid problems arising from a large carry-over of payment obligations into the start of a new budget year, the Government will monitor closely adherence to new guidelines that limit the commitment period for MDAs towards the end of the fiscal year. It will also tackle shortcomings in projecting monthly expenditure requirements, which have complicated liquidity management. In this context, it will examine whether a quarterly or monthly budget allocation would be better for expenditure and liquidity management (currently priority sectors operate under a quarterly system while other sectors receive monthly allocations). As far as recording of donor-funded project spending is concerned, there has been significant progress, as more development partners have agreed to lodge funds in the exchequer system instead of in decentralized project accounts. Nonetheless, in-kind project support still poses recording problems. Lastly, the Government has requested assistance from EAST AFRITAC for reviewing the Public Finance Act 2001 and related regulations. The objectives are to realign the Act with other legislation that has been updated in recent years, and to review the organizational structure of the Ministry of Finance.

30. As discussed among government, development partners, and stakeholders in the recent Public Expenditure Review, there is a clear need to strengthen internal and external audit of public expenditure. Parliament was called upon to play a stronger role in scrutiny of reallocations and enforcement of expenditure controls. To this end, the Government will strengthen the capacity of the National Audit Office, including facilitating more expeditious access to records, so that the reports on the audited budgets reach Parliament within the deadline stipulated by the law.

D. External Sector

31. The external sector is expected to continue benefiting from increased exports due to solid growth in the mining and manufacturing sectors, and a strong performance of traditional exports. The opening of a new gold mine this year will support continued strength in non-traditional export growth in the coming fiscal year. Expanded road infrastructure, the abolition of many local taxes and facilitated access to inputs for production are expected to continue to contribute to high growth in traditional exports volume. A benign environment for commodity prices should also contribute to the sector's recovery. On the import side, high oil prices and fast growth of imports of intermediate and capital goods, stemming from the Government's initiatives on infrastructure projects and transport for fertilizers, are expected to widen the trade deficit.

32. Developments in the trade balance will be financed by increased inflows in current transfers and the financial account. External aid financing is estimated to continue to increase in both grants and loans to reach 14 percent of GDP in the coming fiscal year. Increased net inflows to the balance of payments are projected to result in an overall international reserves position of around 6.2 months of imports of goods and non-factor services. Given the comfortable level of reserves, the BOT will continue to rely more heavily on foreign exchange sales to ease any consequent pressures on liquidity.

33. With regard to exchange rate management, the Government believes the real exchange rate is broadly in line with fundamentals. While moderate movements around the current level are expected, the Government is conscious of the fact that any excessive future depreciations or appreciations could hamper macroeconomic stability. Hence, the BOT will limit its interventions in the foreign exchange market to facilitate liquidity management and smoothing any short-run excessive fluctuations in the exchange rate.

34. The Government will persist in pursuing active negotiations with pending creditors for debt relief agreements under HIPC comparable terms. On the trade front, the Government is working within the framework of the EAC and SADC. Further progress in harmonization of any remaining conflicts within and outside the regional trade blocks is anticipated along with increased intra-regional trade in the coming years.

E. Monetary Policy

35. Monetary policy for 2005/06 will be directed towards ensuring that growth in monetary aggregates is consistent with the objectives of low inflation and higher economic growth, while maintaining sufficient official foreign reserves. Reflecting the ongoing expansion of financial intermediation, velocity is expected to continue to decline. Consistent with the expected increase in money demand, the BOT will target annual M3 growth of 27.0 percent, which would allow a further increase of credit to the private sector of about 33.2 percent. In line with the above objectives, the BOT will target a reserve money increase of

26.6 percent. We are committed to adjusting our policies as appropriate to meet these targets and objectives, which are fully consistent with the programme supported by the PRGF.

36. To meet reserve money targets, the BOT will continue to sterilize the liquidity injected through inflows of donor support to the budget and maturing debt instruments by offering adequate monetary policy instruments for rolling over the maturing securities and mopping up the excess liquidity in the economy, including through sales of foreign exchange. The BOT recognizes the tradeoffs involved in the mix of sterilization instruments. The absorption of excess liquidity through open market operations can lead to short-and medium-term increases in interest rates, while sterilization through foreign exchange sales can result in possible appreciation of the exchange rate, and loss of competitiveness. In light of these tradeoffs, the BOT will continue to sell foreign exchange in the IFEM to complement open market operations in liquidity management and reduce pressure on interest rates on Treasury bills.

37. We recognize the challenges in implementing our monetary programme, particularly in light of the upward pressure on liquidity emanating from rising capital and aid flows. In support of the BOT's efforts to adequately forecast and manage those pressures, we will continue to pursue reforms to improve existing monetary policy instruments and to undertake policy-oriented research to enhance the efficacy of monetary policy implementation, as well as to improve liquidity forecasting. On the latter point, we will continue to strengthen capacity and policy coordination, including urging ministries to further strengthen their efforts to share information with the BOT on their planned expenditures. The Government recognizes the potential risks to inflation from higher M3 growth, but is confident that our inflation and economic growth objectives will be met, given continued strong demand for credit in productive sectors of the economy and other favourable conditions such as the ample supply of labor. We are committed to closely monitoring the economy for any signs of higher inflationary pressure.

F. Financial Sector Reform

38. During 2005/06 and over the medium term, the Government will implement Tanzania's comprehensive second generation Financial Sector Reform Programme (FSRP), which builds on the recommendations of the FSAP. The programme, which aims to optimise financial sector contribution to investment and growth of the economy, focuses on objectives in nine sectors, namely: policy framework (including legal reforms); banking supervision; financial markets; pension funds; insurance; microfinance; employment in the financial sector; land issues; and long-term development financing. The plan was finalized and submitted to Government in June 2005 rather than in May as envisaged in the structural benchmark under the PRGF, to allow additional time to incorporate input from the Bretton Woods Institutions, development partners, and other stakeholders. It is expected that the Inter-Institutional Committee for the FSRP will oversee broad implementation of the plan, with technical and financial support from development partners.

39. Our near-term priority is to put in place the Bank of Tanzania Act and Banking and Financial Institutions Act (BFIA). The critical importance of this legislation for updating the legal framework is discussed in more detail in our letter of intent of February 10, 2005. The two acts will modernize the regulatory and supervisory framework and capacity of the Central Bank, and cement in law the current operating practices of the BOT, while enhancing accountability of the BOT to the Government. Our reforms in this area are consistent with best practices of the legal and operational framework for the financial sector in the region. The amendments to the BOT Act will include a strengthening of the Board's role as the BOT's decision-making body, a strengthening of the transparency and accountability of the Bank for conduct of monetary policy, and an increase in the number of Deputy Governors. The amendments have been approved by cabinet and the Government will submit them to Parliament for first reading by end-July 2005.

40. In addition, the Government will take steps to ensure that the impact of costs of liquidity management, including interest on liquidity paper, do not influence monetary policy. The Government will protect the BOT's profitability during 2005/06 and beyond through direct payment of interest costs on liquidity paper which exceeds 15 percent of BOT's revenue.

41. The preferred bidder for the partial privatization of the National Microfinance Bank (NMB) was approved and announced by Government in April 2005, a structural performance criterion under the PRGF programme. The final negotiations with the preferred bidder will be concluded shortly. The Government is also pursuing the restructuring of the Tanzania Postal Bank, as part of our ongoing strategy to further boost competition and efficiency in the sector.

42. As noted in our letter of February 10, 2005, the Government is undertaking efforts to further improve the availability of medium-term credit to key sectors of the economy. The World Bank has been providing assistance in this area. To this end, the Government is taking or encouraging initiatives in three areas. First, the Government will soon launch a Development Finance Guarantee Facility (DFGF), to be managed initially by the BOT, which will provide partial government guarantees to commercial banks for their loans to development- and export-oriented projects. The DFGF scheme will have a governance and operating structure consistent with the following principles: (i) operate on market principles, be appropriately funded from the budget, and protect public resources; (ii) include strong and transparent governance; and (iii) provide for appropriate risk-sharing with commercial banks with a maximum share of risk to the Government of 50 percent. With a view to starting the scheme on a prudent basis, we will limit the Government's initial exposure under the DFGF to T Sh 120 billion (about 0.8 percent of GDP), not including a credit guarantee already in place.

43. Second, the Government hopes to facilitate creation of a privately owned and managed long-term financing facility (LTFF) that would channel funds from nonbanks or banks and potentially development partners (without government guarantee) to be on-lent to commercial banks on a long-term basis. The commercial banks would be fully responsible

for repayment of the loans, and the Government will explicitly state that there will not be any government guarantee under the LTFF, and that participation of all parties involved would be on a fully voluntary basis.

44. Third, the Government will transform the Tanzania Investment Bank into a Development Finance Institution (DFI). The DFI will channel multilateral and bilateral donor funds and government seed money voted in the budget, but not take any new deposits from the public other than its credit customers. The DFI would not raise any funds under government guarantee, other than concessional funds from donors and will operate with strong governance structures.[1] The Government is receiving advice from the World Bank on best practices in this area.

45. To help maintain high standards and public confidence in the DFGF and the DFI, and generally to promote transparency and good governance, the Government will ensure that both facilities are subject to an annual independent operational audit to verify that the funds are being used for the purposes intended and that proper governance procedures have been followed. While we believe these schemes can play a positive role in the near-term, we expect that the acceleration of structural reforms in the financial sector will ensure that these schemes will eventually diminish substantially.

46. Consistent with the FSRP plan, the Government will advance reforms in the pension fund sector. The system is currently solvent, though with low overall coverage of the population, and it plays an important role in the financial sector. To address potential weaknesses, the inter-agency committee on financial sector reforms will submit to Government a proposed unified legal and regulatory framework for all pension funds, along with investment guidelines by June 2006. The World Bank is expected to provide technical assistance in this regard. We expect this effort, particularly the development of investment guidelines, to facilitate the channeling of pension funds' resources into longer term lending through commercial banks.

G. Other Structural Reforms

47. The Government is actively pursuing governance and business environment reforms in a number of areas. As noted above, a draft new Anti-Corruption Law prepared by the Law Reform Commission is being reviewed by Government. In order to provide a comprehensive framework for the effective prosecution of incidents of corruption.and to facilitate convictions and recovery of assets from prosecutions, the new law contains provisions that would allow the Prevention of Corruption Bureau unfettered access to information and evidence deemed necessary to conduct investigations as well as provisions for forfeiture and seizure of assets. The provisions contained in the new draft Law would be in line with

---

[1] For the definition of nonconcessional loans, see para. 9 of the Technical Memorandum of Understanding attached to the Government's letter of July 22, 2004.

Tanzania's obligations under the UN Convention Against Corruption, the African Union Convention on Preventing and Combating Corruption, and the SADC Protocol Against Corruption which the Parliament ratified in 2004. Cabinet approval of the new Anti-Corruption Law is expected by April 2006 and will be a structural benchmark of the programme.

48. Consistent with the structural benchmark in the PRGF programme, draft anticorruption strategies and action plans for all Local Government Authorities were prepared and submitted to the Good Governance Coordination Unit (GGCU) in June 2005, with implementation starting in 2005/06 The Government will introduce, on a pilot basis, the mechanism for complaints and grievances to deal with unethical conduct of civil servants in two MDAs in November 2005, and extend the mechanism to 10 MDAs by November 2006 and roll it out to all MDAs by November 2007.

49. A draft bill on Business Activities Registration and Reform of the Regulatory Licensing System has been prepared and is expected to be submitted to Parliament in July 2005. To establish a well functioning, transparent, and efficient business registration system, the Government is undertaking additional actions including the harmonization of mandatory sectoral regulatory licenses, and will prepare the necessary regulations upon enactment of the Business Activities Registration Law. The Government has approved the Strategic Plan for the Implementation of the Land Laws that will operationalize the Land and Village Land Acts. The implementing mortgage regulations for the Act were approved on June 30, 2005.

50. A review of the crop boards has been undertaken and a strategy for the implementation of the Crop Board Reform Study was adopted by Government in June 2005. Under the strategy, cash crop levies will be abolished with the Government assuming direct funding of the boards, and the Crop Board Acts will be amended to streamline crop board functions and to provide a clearer delineation of public and private functions in the areas of market regulation, product quality, and input markets. The Government will also consider options to reduce and rationalize the regulatory fees imposed by various self-financing government regulatory agencies on private businesses that hamper their development. In this regard, the Government will consider whether the regulatory bodies could be funded through the budget and not through the imposition of regulatory fees as a source of revenue.

51. The Government continues to monitor closely the developments in the energy sector, with a view to avoiding power shortages or escalation of the cost of energy. In this connection, the Government is considering options for restructuring the long-term debt of TANESCO, and is discussing the feasibility of another gas-to-electricity project with private sector participation in southern Tanzania. To create the environment conducive to further private sector participation, the Electricity, Water and Utilities Regulatory Authority (EWURA) has been established and the Electricity Act is being reviewed. Recruitment of key staff for EWURA is under way.

Table 1. Tanzania: Quantitative Performance Criteria and Benchmarks Under the Poverty Reduction and Growth Facility Arrangement, March 2005 - June 2006

	2005					2006	
	March		June	Sep.	Dec.	March	June
	Performance Criteria	Actual	Benchmark	Performance Criteria	Indicative Targets	Indicative Targets	Indicative Targets
Net domestic financing of the government of Tanzania (ceiling) 1/ 2/	48	-81	157	-101	-144	-42	164
Accumulation of budgetary arrears (ceiling; indicative target only)	0	0	0	0	0	0	0
Net domestic assets of the Bank of Tanzania (ceiling; indicative target only) 2/	-769	-885	-776	-894	-963	-806	-641
Reserve money (ceiling)	984	977	1,028	1,133	1,235	1,250	1,302
Net international reserves of the Bank of Tanzania (floor) 3/	1,545	1,639	1,589	1763	1921	1790	1685
Accumulation of external payments arrears (ceiling) 4/	0	0	0	0	0	0	0
Contracting or guaranteeing of external debt on nonconcessional terms (ceiling)	0	0	0	0	0	0	0
Memorandum item:							
Foreign program assistance (grants and loans) 1/	596	702	709	442	758	823	838

Note: For precise definitions of the aggregates shown and details of the adjustment clauses, see the technical memorandum of understanding (TMU) attached to the government's letter of July 22, 2004.

1/ Cumulative from the beginning of the fiscal year (July 1).

2/ To be adjusted upward for the Tanzania shilling equivalent of any shortfall in foreign program assistance from the amounts shown in the memorandum item. Figures are different from BoT (NDA) in the monetary authorities' accounts, as they are adjusted for the program exchange rate.

3/ To be adjusted downward for any shortfall in foreign program assistance from the amounts shown in the memorandum item.

4/ Continuous performance criterion; excludes arrears on debt-service payments pending the conclusion of debt-rescheduling agreements.

Table 2. Tanzania: Structural Performance Criteria and Benchmarks Under the Poverty Reduction and Growth Facility Arrangement, January 2005-June 2005

Measure	Date of Implementation	Status
Tax policy and administration		
Expand the coverage of the Large Taxpayer Department to 250 taxpayers. 1/	End-June 2005	Observed.
Complete the quality assurance review of the Customs and Excise Department reforms under the TRA's second corporate plan, including an updating of the action plan focusing on post-clearance auditing and compliance. 1/	End-June 2005	Observed.
Submit to parliament an amendment of the Tanzania Investment Act, to limit the applicability of fiscal stability clauses to at most 5 years. 1/	End-February 2005	Observed.
Financial sector reform		
Issue final bid instructions for the sale of the National Microfinance Bank (NMB). 2/	End-January 2005	Observed.
Government approval and announcement of preferred bidder for National Microfinance Bank (NMB). 2/	End-June 2005	Observed.
Submit to Parliament amendments to the Bank of Tanzania Act and the Banking and Financial Institutions Act. 2/	End-April 2005	Delayed. Waivers requested. Submission expected in July 2005.
Finalize and submit to government the Financial Sector Reform Implementation Action Plan. 1/	End-May 2005	Met with slight delay.
Governance		
Draft anti-corruption strategies and action plans to be completed for all Local Government Authorities and submitted for final government approval. 1/	End-June 2005	Observed.
Publicizing of the list of companies, individuals, and NGO's that have received tax exemptions each quarter under the Treasury voucher scheme. 1/	Quarterly	Observed.

1/ Structural benchmark.

2/ Performance criterion.

Table 3. Tanzania: Structural Performance Criteria and Benchmarks Under the Poverty Reduction and Growth Facility Arrangement, July 2005-June 2006

Measure	Date of Implementation
Tax policy and administration	
Integrate the destination inspection program with customs procedures at all customs offices in the Dar es Salaam region as described in paragraph 27 of the MEFP. 1/	End-January 2006.
Increase the number of staff in the post-clearance audit section of customs to 32 as described in paragraph 27 of the MEFP. 1/	End-March 2006.
Financial sector reform	
Limit Government guarantees under the three medium-term credit facilities as described in paragraphs 42-44 of the MEFP. 2/	Continuous.
Inter-agency committee on financial sector reform will submit to government a proposed unified legal and regulatory framework for all pension funds, and investment guidelines, as described in paragraph 46 of the MEFP. 1/	End-June 2006.
Governance	
The government will ensure that the instruments establishing the Development Finance Guarantee Facility and Development Finance Institution require an annual independent operational audit to verify that the funds are being used for the purposes intended and that proper governance procedures have been followed, as indicated in paragraph 45 of the MEFP. 1/	End-March 2006.
Cabinet approval of the new Anti-Corruption Law, as described in paragraph 47 of the MEFP. 1/	End-April 2006.
Publish the list of companies, individuals, and NGO's that have received tax exemptions each quarter under the Treasury voucher scheme. 1/	Quarterly.

1/ Structural benchmark.
2/ Performance criterion.