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United Republic of Tanzania: Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for a Three-Year Policy Support Instrument—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Tanzania

In the context of the sixth review under the three-year arrangement under the Poverty Reduction and Growth Facility with Malawi and request for a three-year Policy Support Instrument, the following documents have been released and are included in this package:

- the staff report for the Second Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for a Three-Policy Support Instrument, prepared by a staff team of the IMF, following discussions that ended on September 29, 2006, with the officials of the United Republic of Tanzania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 21, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- a staff supplement of February 8, 2007 updating information on recent economic developments;

- a Press Release summarizing the views of the Executive Board as expressed during its February 16, 2007 discussion of the staff report that completed the review and request; and

- a statement by the Executive Director for the United Republic of Tanzania.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of the United Republic of Tanzania*
Memorandum of Economic and Financial Policies by the authorities of the
United Republic of Tanzania*
Technical Memorandum of Understanding*
*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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UNITED REPUBLIC OF TANZANIA

Sixth Review Under the Three-year Arrangement Under the Poverty Reduction and Growth Facility and Request for a Three-Year Policy Support Instrument

Prepared by the African Department

(In consultation with the Finance, Fiscal Affairs, Legal, Monetary and Capital Markets, Policy Development and Review, and Statistics Departments)

Approved by David Nellor and Michael T. Hadjimichael

November 21, 2006

- **Recommendations.** This report recommends completion of the sixth review of Tanzania's three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) and approval of the request for a three-year Policy Support Instrument (PSI). Completion of the review will entitle Tanzania to a disbursement of SDR 2.8 million (Table 1). The government's letter of intent relating to the PSI is presented in Appendix I.

- **Recent developments.** Economic growth, inflation, and the external position have evolved in a manner consistent with program objectives, and the program has remained broadly on track. All end-March and end-June 2006 quantitative targets were met, as were structural reforms, with the exception of delays in the energy and pension sectors. The PRGF was extended through end-2006 to permit a fuller articulation of the authorities' policy framework, mainly in energy. The authorities' new energy reform plan must be fully implemented to avoid a further negative impact on growth. Tanzania has received $3.8 billion under the Multilateral Debt Relief Initiative (MDRI). At the fifth PRGF review, Executive Directors commended the authorities for strong policies and urged timely action to resolve the energy crisis.

- **PSI objectives.** The goals of the proposed PSI are sustainable broad-based high growth and more rapid poverty reduction. Reforms center on three themes: (i) enhancing public resource mobilization and efficiency of spending to help support and better align expenditures with objectives, (ii) increasing the financial sector's contribution to growth and the effectiveness of monetary policy, and (iii) improving the business environment and enhancing investment.

- **Mission discussions.** Discussions were held in Dar es Salaam May 22-June 7, 2006 and in Washington September 25-29, 2006. The staff team comprised Messrs. Sharer (head), Dohlman, Sobolev, and Ms. Everaert (all AFR), and Messrs. Hobdari (PDR), Baig (FAD) and Verhoeven (FAD). The mission met with President Kikwete; the Minister for Finance, Mrs. Meghji; the Permanent Secretary for Finance, Mr. Mgonja; the Governor of the Bank of Tanzania (BoT), Mr. Ballali; and other official and private sector representatives. Mr. Masawe (Executive Director's Office) also participated in the discussions. The mission was assisted by Ms. Schmitz, Senior Resident Representative.

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List of Acronyms

ASYCUDA	Automated System for Customs Data
BEST	Business Environment Strengthening in Tanzania
BFIA	Banking and Financial Institutions Act
BoT	Bank of Tanzania
DFGF	Development Finance Guarantee Facility
DFI	Development Finance Institution
EAC	East African Community
EPA	Ex-Post Assessment for Longer Term Program Engagement
EPZ	Export Processing Zone
FRP	Medium-Term Financial Recovery Plan for TANESCO
FSAP	Financial Sector Assessment Program
FSRP	Financial Sector Reform Program
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Country
IDA	International Development Association
IFEM	Interbank Foreign Exchange Market
IFMS	Integrated Financial Management System
IPTL	Independent Power Tanzania Limited
ISO	International Standards Organization
ITRS	International Exchange Transactions Reporting System
LGA	Local Government Authority
LTFF	Long Term Financing Facility
LOI	Letter of Intent
LTD	Large Taxpayer Department
MDA	Ministries, Departments, and Agencies
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MEFP	Memorandum of Economic and Financial Policies
MKUKUTA	Swahili name for PRSP
MTEF	Medium-Term Expenditure Framework
MTPP	Medium-Term Pay Policy
NDA	Net Domestic Assets
PEFAR	Public Expenditure and Financial Accountability Review
PER	Public Expenditure Review
PPRA	Public Procurement Regulatory Authority
PRBS	Poverty Reduction Budget Support
PRGF	Poverty Reduction and Growth Facility
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSRP	Public Service Reform Program
PSI	Policy Support Instrument
SBAS	Strategic Budget Allocation System
SEZ	Special Economic Zone
TANESCO	Tanzania Electric Supply Company
TIB	Tanzania Investment Bank
TJAS	Tanzania Joint Assistance Strategy
TRA	Tanzania Revenue Authority
VAT	Value-Added Tax

Executive Summary

In the course of the PRGF, Tanzania has achieved strong economic performance and solidified its position as a mature stabilizer. With market-oriented macroeconomic and structural policies backed by development partner support, Tanzania has secured high growth, low inflation, adequate reserves, and a sustainable external debt position. The authorities have met all quantitative and structural performance criteria for the sixth review under the PRGF.

Tanzania has requested a three-year PSI-supported program as the basis for its future relationship with the Fund. A PSI would provide a clear framework for core macroeconomic and structural policies, guided by Tanzania's second generation PRSP (MKUKUTA), and the Millennium Development Goals (MDGs). It would also signal to development partners the soundness of government policies. The staff agrees that the PSI is appropriate, given Tanzania's position as a mature stabilizer and its lack of need of financial support from the Fund.

The proposed PSI seeks high and sustainable broad-based growth and more rapid poverty reduction centered on three core themes: (1) enhancing public resource mobilization and efficiency of spending to help achieve government objectives; (2) increasing the financial sector's contribution to growth and the effectiveness of monetary policy; and (3) improving the business environment and enhancing investment.

The authorities have outlined a strong three-year macroeconomic framework and structural reform agenda consistent with program objectives. Fiscal policy will help meet economic and social objectives while limiting net domestic financing to avoid crowding out. The envisaged deceleration in broad money growth is consistent with inflation objectives and would facilitate sufficient credit to the private sector. The projected level of reserves will maintain adequate import coverage. The authorities will continue to allow market forces to determine the level of the exchange rate, which remains broadly in line with fundamentals.

Key policy risks center around effective implementation of energy sector reforms, possible pressures for more direct government intervention, and institutional capacity constraints. In particular, failure to implement energy reforms would discourage investment and possibly donor support, generate price pressures, and undermine Tanzania's objectives. Exogenous factors, mainly potential drought and terms of trade shocks, could also slow progress.

The staff supports the authorities' requests for completion of the sixth review under the PRGF and approval of a three-year PSI.

I. BACKGROUND

1. **Under the current PRGF arrangement, Tanzania has consolidated its macroeconomic gains and improved social conditions.** Growth has accelerated, inflation has remained low, and foreign exchange reserves are at comfortable levels (Figure 1 and Table 2). Key structural reforms have strengthened institutional capacity, notably in expenditure management, revenue mobilization, and the financial sector. Strong macroeconomic performance has translated into rising income per capita, sharply increased outlays for poverty-reducing and social expenditures, and improved social indicators (Table 11).

2. **The government's priorities are to achieve sustainable broad-based high economic growth and enhanced income and wellbeing of households.** The authorities recognize that, despite recent successes, Tanzania remains a very poor country with low trade volume, a high cost of doing business, inadequate basic infrastructure, and a financial sector that—while growing rapidly—could contribute more to growth. Income poverty and social deprivation remain widespread, particularly in the rural areas, and Tanzania remains highly dependent on foreign aid.

3. **The authorities view a PSI as a logical successor to the PRGF,** given Tanzania's lack of need of financial support from the Fund. They believe that a PSI would reinforce appropriate macroeconomic and structural policies and signal the strength of government policies to development partners.

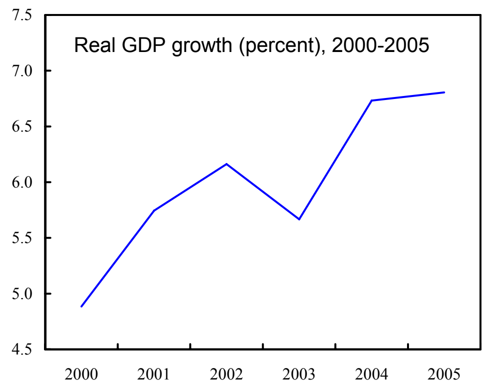
II. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PRGF PROGRAM

4. **Despite Tanzania's strong performance, an energy crisis is slowing growth and threatens Tanzania's medium-term economic and social objectives**. Reductions in energy supplies and consequent power rationing have lowered output by up to 2 percent of GDP, notwithstanding government efforts to shield the main manufacturing industries. The prolonged rationing has dented investor confidence and forced businesses to rely on relatively expensive generators. It has also adversely affected the informal business sector and the health and social sectors, which generally have limited access to alternative power.[1]

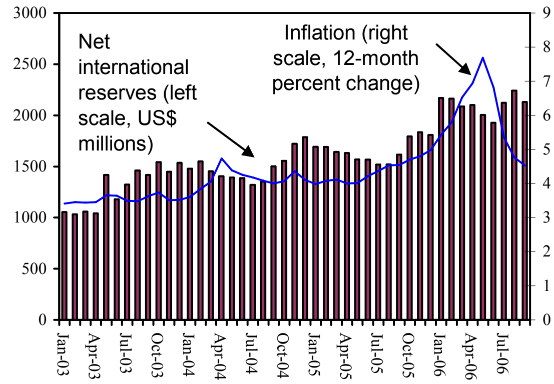
[1] The direct social impact on the population is constrained by TANESCO's limited network coverage, which is estimated to reach less than 10 percent of the population.

Figure 1. Tanzania: Recent Performance and Achievements

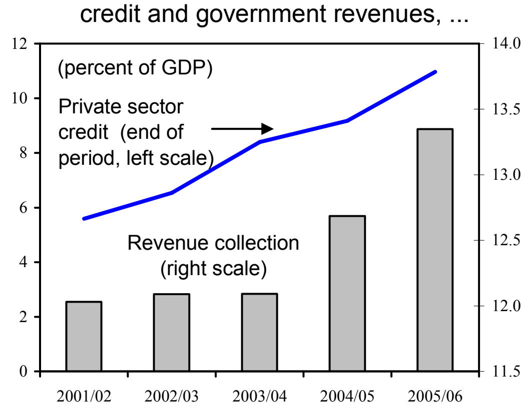
Tanzania has achieved high growth...



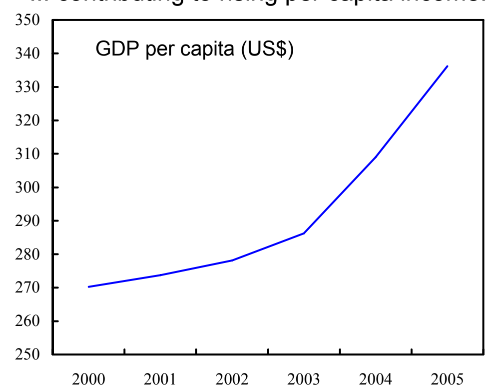
... with relatively low inflation and a comfortable foreign exchange position...



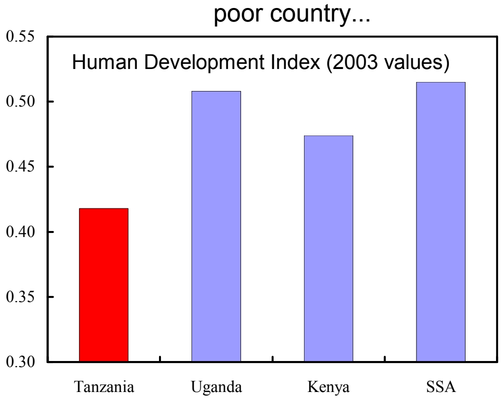
... and strong performance of private sector credit and government revenues, ...



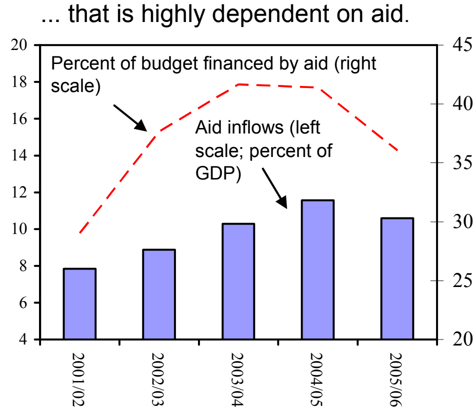
... contributing to rising per capita income.



Nevertheless, Tanzania remains a very poor country...



... that is highly dependent on aid.



Sources: Tanzanian authorities; IMF staff estimates; and UNDP *Human Development Indicators.* The Human Development Index is a summary measure based on life expectancy, literacy rate, and GDP per capita.

Consequent to the energy crisis, real GDP growth is expected to slow to 5.9 percent this year, from 6.8 percent in 2005 (Table 3). The impact of the energy crisis on inflation has so far been muted because businesses have largely absorbed higher costs.[2] To address the crisis, the authorities have recently finalized a medium-term Financial Recovery Plan for TANESCO (FRP) and expect to complete their medium-term Power Sector Reform Strategy in December 2006 (Box 1 and MEFP, paras. 54-56). Both were end-June structural benchmarks.

5. **Performance under the PRGF-supported program has remained strong** (MEFP, Tables 1 and 2). All quantitative performance criteria and indicative targets for end-March and end-June were met. The structural reform agenda has proceeded as envisaged, except for delays in the energy and pension sectors. Tax and customs administration reforms continue to contribute positively to tax revenues and customer service. The government has continued to publish a list of tax exemption beneficiaries (quarterly structural benchmark). The BoT Act and the Banking and Financial Institutions Act were submitted to Parliament (structural performance criterion) and subsequently approved. The structural benchmark limiting government guarantees on three planned medium-term credit facilities was met, though establishment of the Development Finance Guarantee Facility (DFGF) has been delayed. Moreover, difficulties in securing an expert technical advisor has delayed the development of regulatory and investment guidelines for the pension funds (end-June structural benchmark).

6. **Fiscal performance for 2005/06 was somewhat better than envisaged** (Table 4). Revenues were above target, while expenditures were below expectations, mostly because of delays in new hiring, declining interest costs, and delays in some development projects. In addition, the authorities did not implement some planned food and energy-related purchases due to procurement and planning difficulties. These factors, combined with an upward revision of the GDP deflator, resulted in a lower-than-programmed budget deficit of 6.1 percent of GDP and net domestic financing of 2.3 percent of GDP.

7. **Tanzania has been granted substantial debt relief under the MDRI** (Appendix V). Total debt stock reduction amounted to US$3.8 billion (excluding HIPC), equivalent to 47 percent of end-2005 external debt. The incremental average annual reduction in debt service from 2006/07 to 2008/09 is estimated at about US$105 million, or roughly 2.7 percent of exports of goods and services. The authorities plan to use these funds for high-priority pro-poor social outlays and growth-critical economic projects. Separately, the government has continued negotiating with remaining bilateral creditors for HIPC debt relief (Table 10).

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[2] Inflation was, however, directly affected by higher food and fuel prices, peaking at 7.7 percent in May (12-month), though falling more recently below 6 percent, helped by the impact of good rains.

Box 1: Energy Crisis and Recovery Plan

Tanzania is experiencing an energy crisis caused by exogenous shocks, notably, drought-related reductions in hydropower and higher world fuel prices, exacerbated by weak management and insufficient maintenance and investment over a number of years. Power rationing has ensued, and TANESCO's financial losses have worsened (see Country Report No. 06/138). Remedial actions to increase energy supply and put TANESCO on a sound financial footing are essential to meet the program's growth and poverty reduction objectives.

To address the crisis, the government, with key development partners, has prepared a Financial Recovery Plan (FRP) for TANESCO covering the period 2006/07–2009/10 (MEFP, paras. 54-56).[1] The FRP incorporates actions aimed at expanding generation capacity, lowering costs, and increasing the customer base through: (1) doubling available generation capacity; (2) a government buy-out of the Independent Power Tanzania Limited (IPTL) plant and its conversion to domestic natural gas; and (3) connecting mining companies to the grid and increasing the population's access to electricity.

Steady implementation of the FRP's substantial investment program will be critical. Under the plan, the government, with development partner support, will finance the bulk of the critical investments. The 2006/07 government budget includes allocations, funded by IMF MDRI, for TANESCO's procurement of urgently needed gas-fired generators to help end power rationing.

Under the FRP, TANESCO will finance its projected short-term operational deficits through tariff increases—6 percent in January 2007, followed by at least 5 percent every six months thereafter—and a government-guaranteed commercial bank loan of up to T Sh 250 billion. This will allow TANESCO to start generating operational surpluses from 2009 (compared with an expected deficit of T Sh 130 billion in 2006) and would leave TANESCO in cumulative operational balance over the next four years. In the event of any shortfalls from the envisaged financial path, the government has committed to implement tariff increases going beyond the 5 percent semi-annual increases included in the FRP.

Effective monitoring of the FRP implementation through the inter-ministerial inter-agency committee established earlier this year under the Ministry of Finance will be essential to ensure success.

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[1] A companion document, the Power Sector Reform Strategy, will aim at providing a road map for the development of the power sector, including the management and ownership structure of TANESCO. The immediate emphasis will be on continued private management of TANESCO to put it on a sound basis that would facilitate eventual privatization.

8. **Monetary aggregates expanded broadly as envisaged during 2005/06** (Tables 5 and 6; and Figures 2 and 3). The BoT continued to utilize a reserve money programming framework and met end-period reserve money targets. Broad money growth (12-month) of about 32 percent facilitated growth of credit to the private sector of 36 percent (12-month), though from a low base, while inflation remained in check. Lending has continued to go primarily to productive sectors of the economy, and financial soundness indicators have remained strong (Table 7). Velocity continued to decline, consistent with the ongoing financial deepening.[3] After peaking in December 2005, interest rates on T-bills have declined closer to their pre-election real levels, reflecting the unwinding of election uncertainties as well as increased competition at T-Bill auctions. However, ongoing liquidity management problems and fluctuations in demand have resulted in uneven movements in rates.

9. **Balance of payments developments in 2005/06 resulted in a modest depreciation of the Tanzania shilling in nominal and real terms** (Tables 8 and 9 and Figure 4). The current account deficit widened to 9.3 percent of GDP from 5.3 percent in 2004/05, as rapid growth in exports was more than offset by higher oil and drought-related imports. Nonetheless, the overall balance of payments position remained positive due to MDRI debt relief and continued strong inflows of donor assistance. The BoT continued to intervene in the foreign exchange market mainly to smooth fluctuations and for limited liquidity management operations. Gross official reserves remained broadly unchanged at about US$2 billion, equivalent to 4.4 months of imports.

III. Broad Objectives and Parameters of the PSI

10. **The proposed PSI-supported program would support the authorities' efforts to achieve sustainable broad-based high growth and poverty reduction, while maintaining macroeconomic stability**. Consistent with these objectives, discussions centered on three core reform themes.[4]

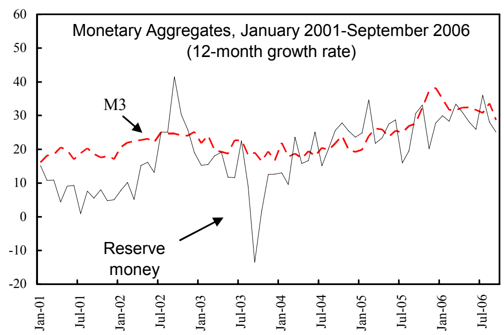
- *First,* fiscal policies and reforms will focus on enhancing domestic revenue mobilization and efficiency of spending to help support and better align government expenditures with key economic and poverty reduction objectives. To avoid crowding out, net domestic financing will be limited.

[3] The money multiplier, while continuing to trend upward, has become somewhat less volatile over the past year. This reflects in part some improvement in liquidity management, which has reduced the need for short-term interventions to achieve end-period reserve money targets.

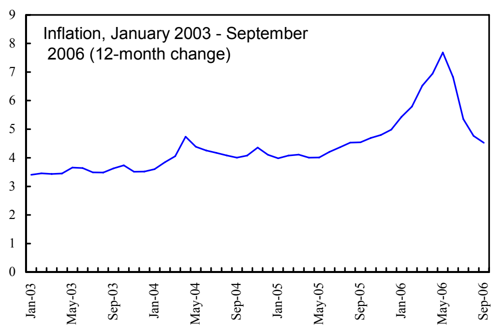
[4] These are closely aligned with the recommendations made in the recent Ex Post Assessment (Country Report No. 06/198).

Figure 2. Tanzania: Monetary Sector Developments

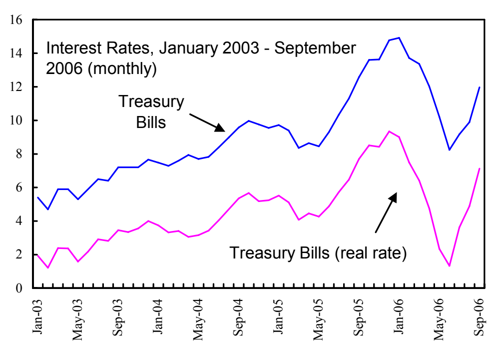
Monetary aggregates are growing at a robust but prudent pace...



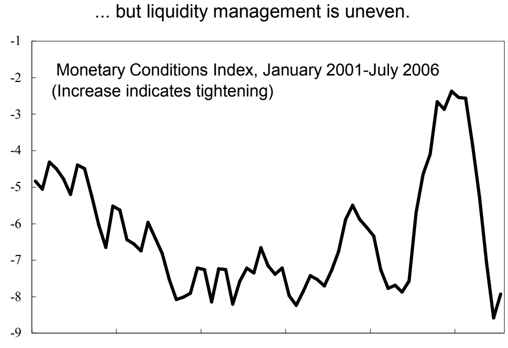
... while inflation remains in check.



Interest rates have fallen somewhat since elections...



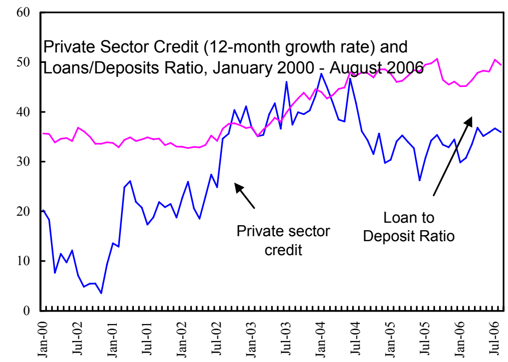
... but liquidity management is uneven.



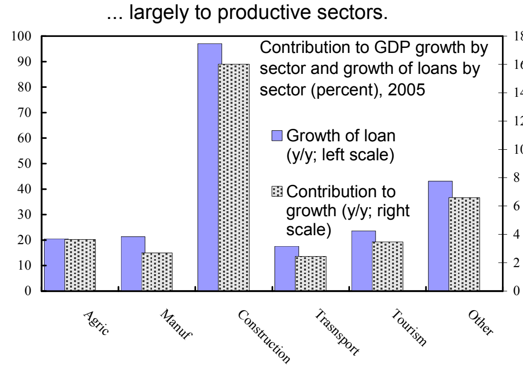
Source: Tanzania authorities; IMF staff estimates.

Figure 3. Tanzania: Financial Market Developments

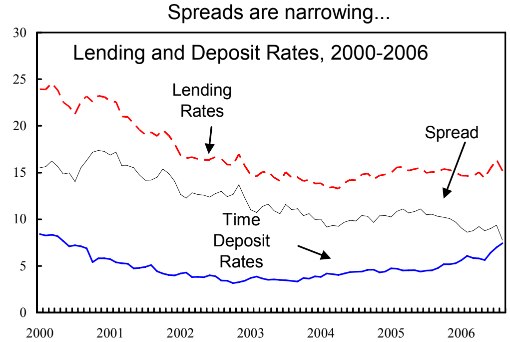
Lending is growing rapidly...



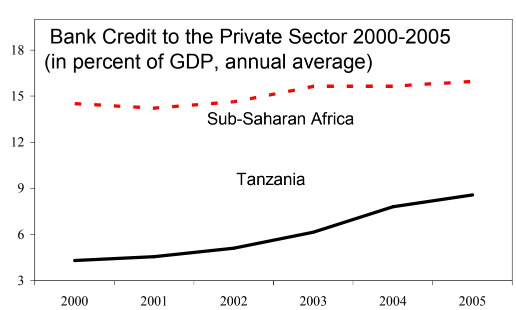
... largely to productive sectors.



Spreads are narrowing...



... but financial markets are still thin relative to the region.



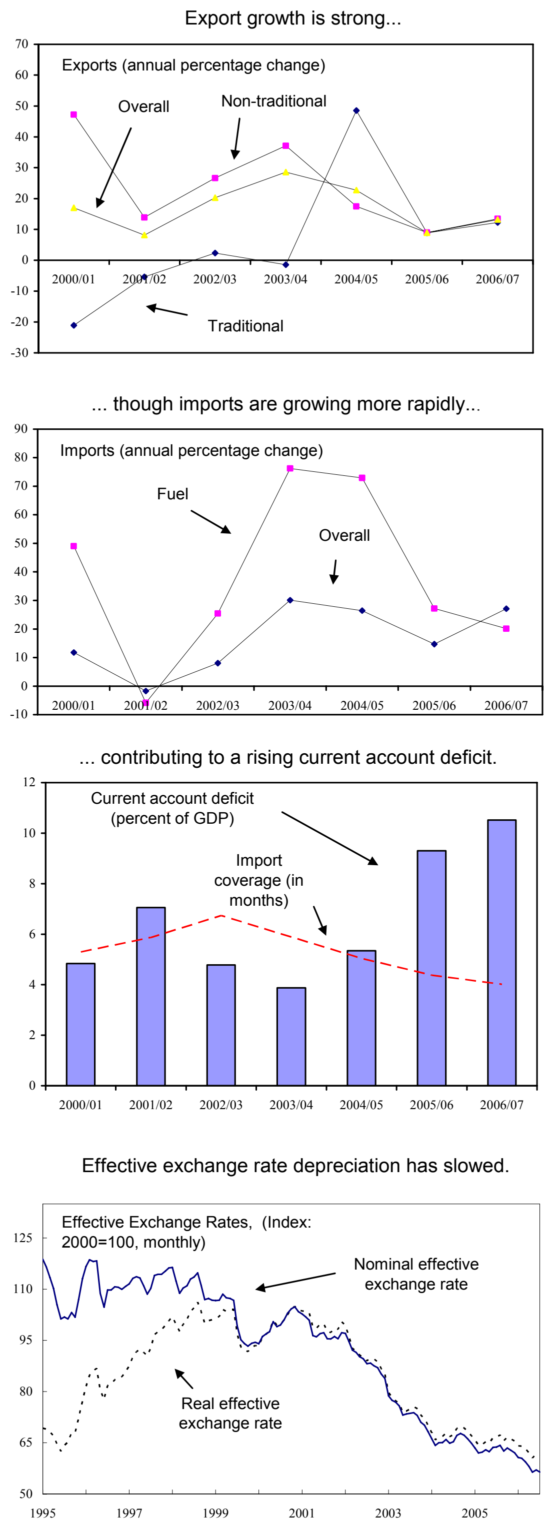
Source: Tanzanian authorities; IMF staff estimates.

- *Second,* the authorities will accelerate financial sector reforms to boost this sector's contribution to growth and enhance the effectiveness of monetary policy.

- *Third,* the government will further improve the business environment to stimulate private sector-led investment.

11. **The authorities have proposed a three-year macroeconomic framework and structural reform agenda that are fully feasible, internally consistent, and in line with government objectives.** Supported by reforms in the core areas noted above, public investment is targeted to increase from 6.7 percent in 2005/06 to about 8.5 percent of GDP and private investment is projected to increase by 1.5 percentage point to 17 percent of GDP during the PSI-supported program period. Real GDP growth would average over 7 percent. Public investment will include critical infrastructure projects to remove growth bottlenecks, financed by higher government revenues of at least 15.5 percent of GDP and foreign aid that is conservatively projected in the range of 11 to 12 percent of GDP. Additional aid is likely from development partners to finance the gap in medium-term capital investments in the energy sector, but has not yet been committed. On this basis, net domestic financing of the government will approach zero in the second and third years of the program. Broad money growth is expected to decelerate during the program period, consistent with average annual inflation projections of 5 to 6 percent, while still

Figure 4. Tanzania: External Sector Developments



Sources: Tanzania authorities; IMF staff estimates.

facilitating strong growth of credit to the private sector for productive purposes. The authorities will continue efforts to mobilize additional aid in support of their objectives under the MKUKUTA and the MDGs, while maintaining foreign exchange reserves at about four months of imports during the program period.

12. **Key policy risks center around implementation of energy reforms, possible pressures for more direct government interventions to accelerate growth and reduce poverty, and government implementation capacity constraints.** In particular, failure to implement energy reforms would discourage investment, generate price pressures, and undermine Tanzania's growth and poverty reduction objectives. Possible shortfalls in foreign aid, including for energy sector investments, also pose some risk.[5] In addition, exogenous factors, mainly potential drought and terms of trade shocks, could slow progress towards government objectives.

IV. Key Reforms to Achieve the PSI Objectives

A. Enhancing Public Resource Mobilization and Efficiency of Spending

13. **The authorities agreed on the importance of further boosting Tanzania's revenue-to-GDP ratio**. This would facilitate higher expenditures on key government priorities, particularly infrastructure and other measures to remove supply-side constraints, to help reach key objectives. Increased domestic revenues would also lay the groundwork for reducing Tanzania's aid dependency over the long term. One goal of the program is therefore to raise central government revenue to about 15.5 percent of GDP through further tax and customs administrative reforms and tax policy measures.

14. **The authorities are planning a series of tax administration measures** (MEFP, para. 18). Reforms during 2006/07 will include: (i) a further increase in coverage of taxpayers by the Large Taxpayers Department (LTD), (ii) unification of the thresholds for the VAT and the presumptive income tax regime, and (iii) extension and strengthening of the taxpayer segmentation approach for medium-size taxpayers. The staff urged that the LTD and the Domestic Revenue Department be merged into a single Domestic Tax Department to facilitate consolidation of an efficient and uniform tax administration system. The authorities thought this would be possible following consolidation of current organizational reforms.

15. **Customs reforms will enhance compliance, improve service, and increase revenues** (MEFP, para. 19). In 2006/07, Customs will roll out ASYCUDA++ to all major customs stations and finalize risk management implementation plans. It will also develop a timetable to integrate the ASYCUDA and TISCAN processes (a proposed end-December

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[5] However, donor commitment has been strong and may strengthen further in the context of pressures for "scaling up" to meet the MDGs.

2006 structural benchmark) to strengthen import procedures, enforcement and compliance, and further reduce release times.

16. **The authorities plan to implement additional tax policy measures to help attain their medium-term revenue targets.** Specifically, they will consider measures identified by a recent FAD mission and an internal government report. These include raising some excise taxes, a minimum corporate income tax regime, further reducing exemptions, and improvements in revenues from licensing natural resources (MEFP, paras. 43-44). In this context, the authorities agreed to exercise caution regarding the granting of any new tax incentives, including under the proposed Leasing Law.

17. **The government will improve its efficiency and composition of spending** (MEFP, paras. 20-24 and 45-46). In 2006/07, the authorities will better align spending with poverty-reducing and growth-engendering measures, for instance by electronically linking the Strategic Budget Allocation System (SBAS) to the Integrated Financial Management System (IFMS). This alignment will facilitate the integration and monitoring of MKUKUTA priorities with the budget planning and execution process, and strengthen tracking of the use of MDRI resources. The authorities are also targeting an increase in the share of development expenditures to address growth bottlenecks caused by inadequate infrastructure. In this regard, the staff urged the authorities to accelerate their work to further articulate inter-sectoral priorities and governance measures related to investment.

18. **The authorities will implement other reforms to improve budget execution and facilitate the conduct of monetary policy** (MEFP, paras. 25-28). Improvements in expenditure management and short-term forecasts of budget implementation remain priorities. The authorities intend to establish a Cash Management Unit and will also prepare a cash plan, with a rolling three-month cash-flow forecast, for the 2007/08 budget year (a structural benchmark for end-June 2007). The Finance Ministry and the BoT will redouble efforts to share information on the expected timing of government revenues and expenditures and find ways to reduce large government deposits held in commercial banks.

B. Increasing the Financial Sector's Contribution to Growth and the Effectiveness of Monetary Policy

19. **The authorities are undertaking reforms, centered on their FSAP-based Second Generation Financial Sector Reform Implementation Action Plan, to further deepen financial intermediation and efficiency, and broaden access to credit** (MEFP, paras. 32-38). Key elements of the plan include the following:

- **The authorities are taking measures to facilitate lending to small- and medium-sized enterprises (SMEs)**, which are viewed as a key source of economic growth with strong lending prospects. To enhance bank assessment of credit risk, the BoT is designing a new credit information system to be submitted for government approval by end-March 2007. It is also administering a small SME partial loan guarantee scheme on behalf of the government.

- **Legal and regulatory reforms to facilitate the provision of medium-term credit are under way**. A government interagency committee, with World Bank support, is working on a proposed unified legal and regulatory framework for all pension funds, and investment guidelines, that would help channel medium-term funds through appropriate intermediaries for productive purposes and stimulate growth. The proposal will be submitted to the government by end-June 2007 (a structural benchmark).

- **The authorities are also working on more direct initiatives to facilitate medium-term lending,** mainly the DFGF and their Development Finance Institution (DFI). The authorities agreed on the importance of maximizing the effectiveness, good governance, and transparency of these initiatives, while minimizing fiscal risks, and have made specific commitments in these areas. The staff further stressed that these initiatives should not distract from broader reforms to facilitate access to credit.

- **An assessment of microfinance operations is under way to help facilitate further lending in this sector.** The authorities are preparing a survey of existing operations, which will provide the basis for recommendations to further expand access to credit through this channel. Lending in this sector is expected to continue to see an influx of resources from lending by commercial banks to microfinance institutions, and from the recent privatization of the National Microfinance Bank, which has the most extensive branch network in Tanzania.

- **Other efforts to improve intermediation are under way.** Regulations to fully operationalize the recently approved banking acts are expected to be completed by early 2007. Other initiatives to remove legal and regulatory impediments to lending are discussed below.

20. **The reform agenda also includes measures to strengthen monetary operations**, which the authorities view as a particularly important area given ongoing liquidity pressures from high aid inflows.[6] In addition to the drafting of banking act regulations noted above, the following measures—centered largely on the recommendations of a recent Fund technical assistance mission—will be undertaken:

- **The authorities will strengthen liquidity forecasting by promoting better information flows and reductions in idle government balances in commercial**

[6] See Country Report No. 05/291.

banks as discussed above. The BoT will also pursue further capacity building, including development of a liquidity forecasting model.

- **Technical improvements to further deepen financial markets will be implemented,** including measures to increase the range, transparency, and usage of financial markets and instruments. This will enhance the BoT's options in conducting liquidity management.

- **The authorities are also considering measures to enhance their transparency and communication with financial markets** regarding the conduct of monetary and foreign exchange operations.

C. Improving the Business Environment and Enhancing Investment

21. **The authorities recognize the importance of further enhancing the business environment to facilitate private sector activity and investment.** The government is undertaking efforts to remove key bottlenecks and impediments, including inadequate infrastructure and energy provision, weak governance, and an overly burdensome regulatory environment.

22. **The authorities have agreed to expeditiously address the energy crisis on the basis of the FRP and to return TANESCO to sustainable financial viability.** Key elements of the plan, including regular semi-annual increases in electricity tariffs, substantial investments to expand generation capacity and improve transmission, and close monitoring of FRP implementation, have already been approved by the Cabinet. Adoption of the FRP by the government by end-December is a structural assessment criterion. Under the FRP, TANESCO would begin generating growing financial surpluses in 2009 sufficient to service its commercial bank loan.[7] The authorities are committed to raise tariffs by more than the amounts envisaged in the FRP, if necessary, to ensure that the financial objectives are met (MEFP para. 56 and Table 3). Effective implementation and monitoring of the FRP will be critical. The staff stressed that a failure to address the energy crisis would likely constrain growth, drain public finances, undermine the confidence of the private sector and perhaps donors, and set back progress in the social sectors.

23. **The authorities agreed that strong measures to further improve governance and transparency are critical** (MEFP, paras. 38 and 58-61). The government plans to submit a new Anti-Corruption Bill to Parliament by February 2007 (a structural benchmark) that integrates all anti-corruption conventions ratified by Tanzania and includes key measures to strengthen its capacity and effectiveness in this area—including stronger prosecutorial

[7] This loan is helping to cover current operational deficits resulting from the reduction in electricity generation and relatively low tariffs.

powers and independence of the Prevention of Corruption Bureau. The government is also launching this year their second National Anti-Corruption Strategy Action Plan, which covers both the central and local governments, and is moving to strengthen the National Audit Office.

24. **Measures to streamline the legal and regulatory environment are under way,** including simplification of business licensing and registration and improvements in the functioning of the legal system focusing on land titling and commercial dispute resolution.[8] Implementing these measures will facilitate business formalization, voluntary registration and compliance, revenue collection, and bank lending.

25. **The staff urged the authorities to address shortages of skilled labor** as a potentially significant impediment to growth. Business and financial sector representatives noted the lack of appropriate skills of recent graduates, as well as some difficulties in securing work permits for non-Tanzanian skilled workers. The authorities noted their plans to improve vocational training and stated their intention to streamline the procedures for granting work permits.

26. **Further efforts to facilitate international trade are important.** Analyses by the Fund, the World Bank, and the authorities suggest that addressing structural barriers to trade could significantly boost exports and stimulate trade, investment, and growth in the region. The staff urged the authorities to deepen integration in the East African Community (EAC) through measures such as lowering the maximum tariff of 25 percent, rationalizing overlapping memberships in regional trade arrangements, and harmonizing standards and investment incentives. The authorities responded that harmonization efforts are under way and that the EAC Common External Tariff will be reviewed by 2010.

V. Program Targets and Policies during 2006/07

27. **Supported by measures under the three core reform areas above, the program envisages real growth of 7.3 percent in 2007**, with productivity projected to rise in line with recent trends (Box 2). Average inflation is projected to reach 5.8 percent in 2006, and decline to 5.5 percent in 2007, in the context of a gradual pass-through of high oil prices and normal weather conditions.[9] Again, energy reforms must remain on track to achieve these objectives.

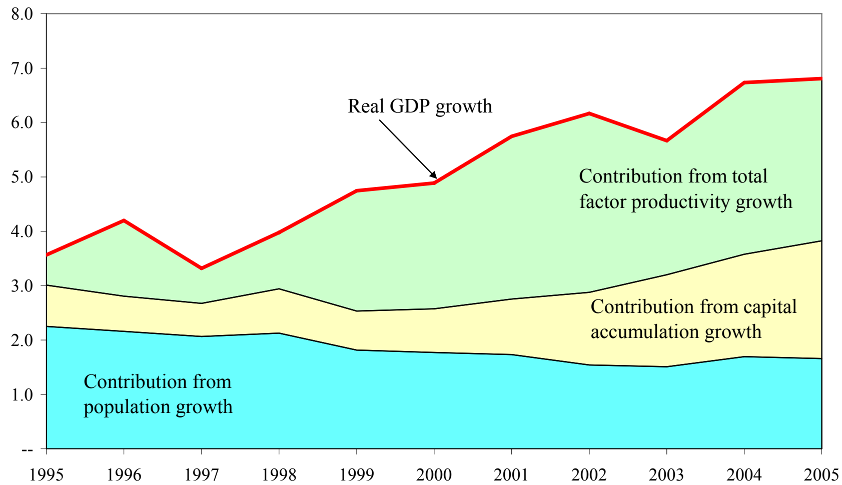
[8] A recent World Bank report on business indicators (Doing Business 2007) identified Tanzania one of the ten best reformers regarding business regulations during 2005/06.

[9] Following joint technical assistance by TGS and East AFRITAC, the authorities recently implemented a revised methodology for compiling the CPI.

Box 2: Real GDP Growth in a Growth Accounting Framework

The staff views the authorities' medium-term growth projections as feasible if recent trends in factor productivity growth and capital accumulation are sustained. Over the past decade, Tanzania's real GDP growth has been achieved primarily through rising total factor productivity and, more recently, through rising capital accumulation (Box Figure 1). Extrapolating current trends in total factor productivity, and based on conservative assumptions for capital accumulation and population (as labor proxy) growth, real GDP growth would gradually rise to nearly 8 percent in 2009, closely in line with current projections and with the growth rates envisaged in the MKUKUTA (Box Table 1).

Box Figure 1. Tanzania: Contribution to Real GDP Growth (percentage points)



Box Table 1. Tanzania: Contributions to Real GDP Growth (percentage points)

	2001-2004 Avg.	2005 Prel. Act.	2006 Proj.	2007 Proj.	2008 Proj.	2009 Proj.
Population growth	1.6	1.7	1.7	1.7	1.7	1.7
Growth in capital stock	1.5	2.2	2.2	2.2	2.2	2.2
TFP growth	3.0	3.0	3.5	3.7	3.8	3.9
Real GDP growth - extrapolated [1]	…	…	7.3	7.5	7.6	7.8
Memorandum item:						
Real GDP growth - framework projections	6.1	6.8	5.9	7.3	7.7	7.9

[1] Extrapolated on current trends for 2006-2009. Temporary deviations from medium-term trend projections, such as the drought in 2006, are not reflected in the extrapolated values for real GDP growth.

Achieving and sustaining these levels of factor productivity and capital will require sound macroeconomic policies and firm implementation of structural reforms as envisaged under the program. Addressing structural supply response and infrastructure capacity constraints—particularly in the energy sector—will be critical to improve efficiency and the business environment and further stimulate private sector led growth.

28. **Fiscal policies target the government's growth and social objectives, while limiting net domestic financing to avoid crowding out productive private sector activity** (MEFP, paras. 17-28). There was agreement that an increase of 0.6 percent of GDP in revenue (to 14.7 percent of GDP) was achievable based on tax and customs administration reforms, an increase in specific domestic duty rates, and an expected boost in payroll taxes. Total expenditures of 28.2 percent of GDP are envisaged, which should permit continued increases in MKUKUTA-related expenditures. The wage bill is budgeted to increase sharply to 5.9 percent of GDP, reflecting implementation of the government's medium-term public sector pay strategy (Box 3). Development expenditures will also increase sharply, largely due to energy-related expenditures. Taking account of higher foreign financing and grants, including MDRI, the budget deficit is projected to fall somewhat to 5.3 percent of GDP, with net domestic financing in the order of 0.4 percent of GDP.

29. **Monetary policy during 2006/07 will remain focused on maintaining low inflation while not unduly constraining the availability of credit to the private sector** (MEFP paras. 29-31). To achieve this, the authorities will continue with a reserve money programming framework, though with a shift from end-quarter targets to an average reserve money target within a band so as to encourage a smoother path of liquidity. The targeted growth in reserve money is expected to result in a deceleration of broad money growth (12-month) to about 24 percent, consistent with the inflation objective. The staff agrees this deceleration is prudent, given pressures from higher fuel prices, electricity rates, and wages. This will still allow robust growth of credit to the private sector. The BoT will continue to employ a mix of intervention tools to achieve its reserve money target so as to balance pressure on interest rates and the exchange rate. Velocity is projected to continue to decline, consistent with the ongoing deepening of the financial sector and structural changes in money demand.[10] The BoT will closely monitor developments that could influence inflation and financial sector soundness.

30. **The current account deficit is projected to increase to 10.5 percent of GDP in 2006/07, reflecting higher oil prices and critical energy-related imports** (Tables 8 and 9, and Figure 4). Export growth is expected to continue to exceed that of nominal GDP, driven by further improvements in the investment climate and favorable commodity prices. However, the trade deficit is projected to widen to about 14.5 percent of GDP, reflecting higher oil prices and energy-related capital imports. The current account deficit is expected to be largely financed by higher net inflows of concessional donor lending, taking account of MDRI debt relief. Gross international reserves would remain broadly unchanged at about US$2 billion, equivalent to four months of imports.

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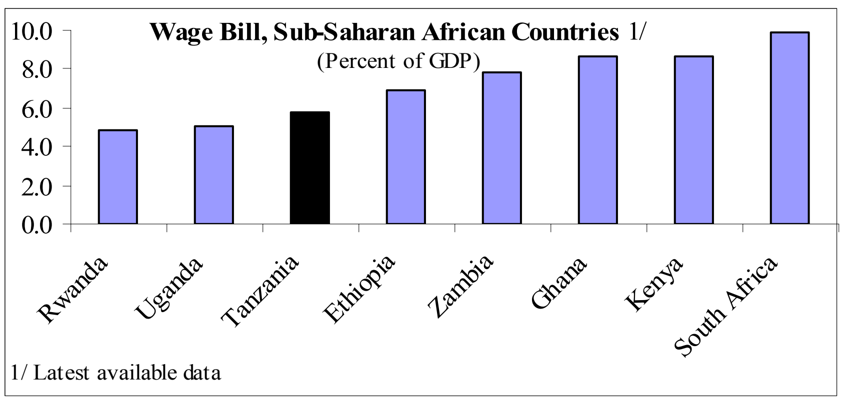
[10] The decline in velocity is consistent with recent trends and in line with the experience of other countries during periods of rapid financial sector development, such as Uganda.

Box 3: The 2006/07 Wage Bill

The government has been pursuing its Public Service Reform Program (PSRP) and Medium-Term Pay Policy (MTPP) to improve the capacity and efficiency of government operations by strengthening the retention and quality of civil servants. The 2006/07 budget provides for general salary increases of 46-50 percent for professional grade staff and funds for recruitment of 24,700 staff in education, health, agriculture, and security, and raises the wage bill allocation to 5.9 percent of GDP, from 4.3 percent in 2005/06.

The overall impact on the budget of these measures is partially mitigated by reductions in other personnel-related costs, including cuts in staff allowances and some allocations for the running of the government, amounting to 0.9 percent of GDP. These changes are consistent with the PSRP and with the MKUKUTA (MEFP, paras. 21-22).

Despite the increase, Tanzania's wage bill remains below that of many of its neighbors.



Future pay increases will be guided by reviews of the MTPP and the allowances regime now under way, and would need to be consistent with medium-term budget and MKUKUTA objectives. With the latest increase, salaries of support, and junior and mid-level professional staff have reached over 90 percent of their MTPP targets, and hence it would be important to consolidate these pay rises in the forthcoming years. For the outer years, the authorities have projected a somewhat more restrictive path for the wage bill, reflecting their desire for keeping spending under control following the large 2006/07 increase.

31. **There was agreement that the BoT's exchange rate policy remains appropriate.** The BoT currently limits its foreign exchange market interventions to smoothing fluctuations and limited liquidity management operations, while allowing the level of the exchange rate to be broadly determined by the market. The staff continues to view the real exchange rate as broadly in line with its equilibrium value.[11]

32. **Tanzania's external debt sustainability has strengthened further as a result of the MDRI** (Appendix V). Tanzania's debt remains well within sustainability thresholds, with the NPV of public and publicly guaranteed external debt currently estimated at about 16 percent of GDP—this is projected to remain broadly unchanged through 2026. Annual external public debt service is expected to average about 4 percent of exports through 2026. Moreover, Tanzania's debt remains sustainable even under the most extreme stress tests and alternative scenarios. However, the sustainability of Tanzania's external debt hinges on continued relatively high levels of foreign assistance on concessional terms. In this context, the authorities reiterated their commitment to refrain from contracting or guaranteeing external debt at nonconcessional terms.

VI. Program Monitoring

33. **The proposed PSI-supported program would be monitored through the quantitative and structural assessment criteria, indicative targets, and benchmarks specified in Tables 1 and 3 of Appendix I.** The first review is expected to be completed by end-April 2007 and the second review by end-October 2007. In addition to reviewing performance against the end-December 2006 assessment criteria and benchmarks, the first review will reach understandings on the budget for 2007/08. Understandings have been reached on indicative targets for end-March 2007. Structural conditionality focuses on fiscal, financial sector, governance, and energy sector reforms.

VII. Staff Appraisal

34. **Tanzania's economic performance under the three-year PRGF arrangement was strong.** The rate of real economic growth increased, inflation remained low, and the external position was substantially strengthened. These achievements have been built on the steady implementation of outward-looking, market-oriented policies within an appropriate

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[11] Since a 2004 staff study that found the exchange rate to be in line with fundamentals (see Country Report No. 04/284), the exchange rate has depreciated by about 10 percent in real effective terms, consistent with the deterioration in Tanzania's terms of trade.

macroeconomic framework, together with structural reforms in key areas. Tanzania has been bolstered by the support of development partners, and more recently by significant MDRI debt relief.

35. **Despite its economic progress in recent years, Tanzania remains a very poor country with significant capacity constraints and many pressing social needs.** The authorities will need to sustain sound policies and structural reforms that will mobilize and efficiently use resources for many years to come if they are to achieve their economic and social goals.

36. **The staff views the proposed PSI as an appropriate next step in Tanzania's relationship with the Fund.** Tanzania has solidified its position as a mature stabilizer and does not require financial support from the Fund at this time. The PSI will provide a sound basis for continued close collaboration with the Fund. It will also help provide clear signals to the international community on the strength of Tanzania's policies, and the authorities' firm commitment to sustained reform efforts.

37. **The staff strongly endorses the authorities' plans to enhance public resource mobilization together with their ongoing efforts to improve the efficiency of spending.** In this regard, the continued technical support of the Fund and other development partners will be essential. The targeted revenue-to-GDP ratios are achievable given planned or proposed tax and customs policy and administration reform measures. The authorities' spending program is appropriately focused on achievement of MKUKUTA goals and the MDGs. However, further articulation of spending plans, including investment, and the further linking and extension of expenditure management systems will be necessary during the course of the program. The achievement of the government's investment objectives during the PSI period and beyond will depend on the timely securing of adequate additional development partner financial support.

38. **The staff also views the planned reforms to the financial sector as essential to domestic resource mobilization and the improved effectiveness of monetary policy**. While the financial sector has grown rapidly, albeit from a very low base, increasing its contribution to growth will be essential. In this regard, efforts to improve access to credit and to strengthen liquidity management and forecasting, as well as credit information and pension reforms, could have a particularly beneficial impact. The staff views the authorities' commitments on the size and governance of medium-term credit initiatives as sufficient to ensure transparency and limit undue fiscal risks.

39. **Energy sector reforms will be critical to achieving program objectives.** The shortfall in energy production this year has been very damaging to economic performance and progress. While due mainly to exogenous factors, notably drought, the impact has been exacerbated by weaknesses in planning and financial management of the state energy

parastatal. Effective implementation of the authorities' plans to improve supply and put the energy sector on a sound and sustainable financial basis, including through appropriate tariff increases, will be critical. Failure to do so would undermine the goals and objectives under MKUKUTA and the MDGs.

40. **The authorities' plans to further improve the business environment to enhance productive private sector activity and investment will also be central to achieving sustained broad-based high economic growth**. In addition to critical energy reforms and efforts to improve infrastructure, measures to streamline regulations could make an important contribution towards program objectives. Progress on the proposed Anti-Corruption Bill and the related National Anti-Corruption Strategy Action Plan will provide strong signals to the private sector and the international community of the government's commitment to improved governance.

41. **The staff views the proposed 2006/07—2008/09 macroeconomic framework and structural reforms as consistent with program objectives.** Given price pressures, the envisaged deceleration in broad money growth is appropriate. Fiscal policies appropriately focus on meeting economic and social objectives while limiting net domestic financing of the budget in order to avoid crowding out productive private sector borrowing. Implementation of this ambitious program will pose challenges to the authorities' monitoring and implementation capacity. In this context, the staff concurs with the substantial budgeted increase in the wage bill as essential to improve the quality of the civil service. The staff notes that the authorities' medium-term plans do not envisage further significant increases.

42. **Based on the authorities' strong record of program implementation, and their commitments in the attached letter of intent, the staff recommends completion of the sixth review under the current PRGF arrangement and approval of the authorities' request for a three-year PSI.**

Table 1. Tanzania: Schedule of Disbursements Under the Poverty Reduction and Growth Facility Arrangement; and Proposed PSI Work Program, 2006 – 2009

PRGF Disbursement Schedule

Date	Millions of SDRs	Percent of quota	Event
August 2003	2.8	1.4	Effectiveness of PRGF arrangement
End-September 2003	...	...	Test date for quantitative performance criteria for first review
February 2004	2.8	1.4	Completion of first review
End-March 2004	...	...	Test date for quantitative performance criteria for second review
August 2004	2.8	1.4	Completion of second review
End-September 2004	...	...	Test date for quantitative performance criteria for third review
February 2005	2.8	1.4	Completion of third review
End-March 2005	...	...	Test date for quantitative performance criteria for fourth review
August 2005	2.8	1.4	Completion of fourth review
End-September 2005	...	...	Test date for quantitative performance criteria for fifth review
February 2006	2.8	1.4	Completion of fifth review
End-March 2006	...	...	Test date for quantitative performance criteria for sixth review
December 2006	2.8	1.4	Completion of sixth review

Proposed PSI Work Program

Board Date	Event
April 2007	Completion of the first PSI review against end-December 2006 assessment criteria
October 2007	Completion of the second PSI review against end-June 2007 assessment criteria
April 2008	Completion of the third PSI review against end-December 2007 assessment criteria
October 2008	Completion of the fourth PSI review against end-June 2008 assessment criteria
April 2009	Completion of the fifth PSI review against end-December 2008 assessment criteria
October 2009	Completion of the sixth PSI review against end-June 2009 assessment criteria

Source: Fund staff.

Table 2. Tanzania: Selected Economic and Financial Indicators, 2004/05 – 2008/09

	2004/05 Actual	2005/06 Est.	2006/07 Proj.	2007/08 Proj.	2008/09 Proj.
	(Annual percentage change, unless otherwise indicated)				
National income and prices [1]					
Nominal GDP (market prices; billions of T Sh)	12,366	14,209	16,004	18,172	20,672
Real GDP growth (factor cost)	6.7	6.8	5.9	7.3	7.6
Consumer prices (period average)	4.1	4.4	5.8	5.5	5.0
Consumer prices (end of period)	4.1	5.0	5.4	5.0	5.0
External sector					
Export, f.o.b (U.S. dollars)	1,594	1,736	1,965	2,161	2,325
Imports, c.i.f. (U.S. dollars)	-2,995	-3,776	-4,368	-4,877	-5,348
Export volume	17.7	1.8	6.7	6.7	-0.2
Import volume	9.0	4.1	9.4	13.8	12.3
Terms of trade	-10.1	-2.9	-8.7	5.0	10.4
Nominal effective exchange rate (end of period; depreciation -)	-2.5	-10.3	...	...	...
Real effective exchange rate (end of period; depreciation -)	-0.6	-7.6	...	...	...
Public finance					
Revenue (excluding grants)	21.5	19.8	18.2	17.3	15.6
Total expenditure	28.5	19.2	24.6	12.4	13.8
Recurrent expenditure	22.0	27.0	14.7	13.1	15.0
Development expenditure	47.6	0.5	54.9	10.9	11.2
Money and credit					
Broad money (M3)	25.5	31.6	24.2	23.0	21.0
Net foreign assets	8.4	38.5	4.8	7.8	10.6
Net domestic assets	108.3	14.1	83.5	49.6	34.1
Credit to nongovernment sector	26.2	35.9	36.0	35.0	32.9
Velocity of money (GDP/M3; average)	4.5	4.0	3.5	3.3	3.0
Treasury bill interest rate (percent; end of period) [2]	10.4	9.3	…	…	…
	(Percent of GDP)				
Public finance					
Revenue (excluding grants)	13.3	14.1	14.7	15.2	15.5
Total grants	7.7	6.0	8.2	7.4	6.6
Expenditure (including adjustment to cash)	25.1	26.2	28.2	27.9	28.0
Overall balance (including grants)	-4.1	-6.1	-5.3	-5.4	-6.0
Domestic financing [3]	1.1	2.3	0.4	0	0
Savings and investment [1]					
Resource gap	-10.0	-11.2	-13.0	-13.9	-14.4
Investment	21.0	22.2	23.4	24.5	25.3
Government	6.4	6.7	7.6	8.5	8.3
Nongovernment [4]	14.6	15.5	15.8	16.0	17.0
Gross domestic savings	11.0	10.9	10.4	10.6	10.9
External sector					
Current account balance (excluding current transfers)	-10.1	-13.2	-14.7	-14.7	-14.6
Current account balance (including current transfers)	-5.3	-9.3	-10.5	-10.5	-10.5
External debt	64.3	25.2	27.0	28.7	30.0
NPV of external debt	19.9	15.6	15.5	15.8	16.1
	(Millions of U.S. dollars, unless otherwise indicated)				
Balance of payments					
Current account balance (excluding current transfers; deficit -)	-1,237	-1,749	-2,022	-2,233	-2,464
Overall balance of payments (deficit -)	178	383	26	184	224
Gross official reserves	1,969	1,995	2,025	2,209	2,433
Months of imports of goods and nonfactor services	5.0	4.4	4.0	4.0	4.0
Exchange rate (eop, T Sh per U.S. dollar)	1,126	1,253	...	...	...
Exchange rate (period average, T Sh per U.S. dollar)	1,090	1,183	...	...	...

Sources: Tanzanian authorities; and Fund staff estimates and projections.

[1] Data are on calendar year basis. 2004/05 data are for calendar year 2004.
[2] Monthly weighted-average yield of 35, 91-, 182-, and 364-day treasury bills.
[3] Excluding new debt issued to recapitalize government-owned banks during their restructuring.
[4] Including change in stock.

Table 3. Tanzania: National Accounts, 2004 –09

	2004	2005 Prel.	2006 Proj.	2007 Proj.	2008 Proj.	2009 Proj.
	(Annual percentage change in real terms)					
GDP at market prices						
Nominal (billions of T Sh, calendar-year basis)	12,366	14,209	16,004	18,172	20,672	23,396
Real (percentage change)	6.7	6.8	5.9	7.3	7.6	7.9
Sectoral components of GDP						
Agriculture	5.8	5.2	4.2	5.0	5.2	5.2
Industry	10.0	10.6	7.4	9.8	10.4	10.3
Services	6.3	6.9	7.2	8.4	8.5	9.1
Agriculture (share of GDP)	46.3	45.6	44.9	43.9	42.9	41.8
Industry (share of GDP)	19.1	19.7	20.0	20.6	21.4	22.0
Services (share of GDP)	34.6	34.6	35.1	35.4	35.7	36.1
Memorandum items:						
	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Nominal GDP (billions of T Sh, fiscal-year basis)	11,522	13,287	15,107	17,088	19,422	22,034
Nominal GDP growth	14.6	15.3	13.7	13.1	13.7	13.4
Real GDP growth	6.2	6.8	6.3	6.6	7.5	7.8
CPI inflation (average) [1]	3.9	4.1	5.6	6.0	5.0	5.0
CPI inflation (end period) [1]	4.3	4.2	6.8	4.5	5.0	5.0

Sources: Tanzanian authorities; and Fund staff estimates and projections.

[1] CPI inflation is projected on the basis of the revised CPI series from September 2006 on.

Table 4. Tanzania: Central Government Operations, 2004/05 – 2008/09 [1]
(Billions of Tanzania Shillings)

	2004/05	2005/06		2006/07	2007/08	2008/09
	Actual	Prog.	Actual	Proj.	Proj.	Proj.
Total revenue	1,774	2,067	2,125	2,511	2,945	3,404
Tax revenue	1,615	1,881	1,946	2,321	2,722	3,146
Import duties	112	148	191	221	259	299
Value-added tax	680	794	803	956	1,121	1,296
Excises	239	265	262	333	391	451
Income taxes	453	530	554	643	754	871
Other taxes	132	144	137	168	197	228
Nontax revenue	158	186	178	191	224	258
Total expenditure	3,248	4,131	3,873	4,825	5,426	6,175
Recurrent expenditure	2,300	2,945	2,920	3,349	3,789	4,356
Wages and salaries	551	692	657	1,004	1,058	1,258
Interest payments	143	260	219	144	165	196
Domestic	87	184	164	122	110	138
Foreign [2]	56	76	55	22	55	58
Goods and services and transfers	1,606	1,993	2,044	2,201	2,567	2,902
Of which: MDRI (IMF) related	0	35	0	53	0	0
Development expenditure	949	1,186	953	1,476	1,637	1,820
Domestically financed	240	393	296	667	597	502
Of which: MDRI (IMF) related	0	23	0	230	160	0
Foreign-financed	709	793	657	810	1,039	1,318
Overall balance before grants	-1,475	-2,064	-1,748	-2,314	-2,481	-2,771
Grants	1,021	1,149	911	1,406	1,433	1,444
Program (including basket grants) [3]	548	508	507	708	802	909
Project	400	510	328	413	469	532
HIPC grant relief	72	73	76	2	2	2
MDRI (IMF) grant relief	0	58	0	283	160	0
Overall balance after grants	-454	-915	-837	-908	-1,048	-1,328
Adjustment to cash [4]	-87	0	-87	0	0	0
Overall balance	-541	-915	-924	-908	-1,048	-1,328
Financing	541	915	924	908	929	1,054
Foreign (net)	396	512	561	852	949	1,074
Foreign loans	503	644	669	882	1,001	1,135
Program (including basket loans) [3]	194	361	340	485	549	623
Project	309	282	329	397	451	512
Amortization	-107	-131	-108	-29	-52	-62
Domestic (net)	145	371	349	67	0	0
Bank financing	97	201	127	20	-20	-20
Nonbank financing	48	170	222	47	20	20
Amortization of parastatal debt	0	-12	-19	-11	-20	-20
Privatization proceeds	0	43	33	0	0	0
Financing Gap [5]	0	0	0	0	119	274
Memorandum items:						
Treasury vouchers	16	31	24	36	31	31
Public domestic debt	15.6	15.5	16.8	14.9	13.1	11.5
Ratio of recurrent expenditures to total revenues (percent)	130	142	137	133	129	128
Nominal GDP	13,287	14,523	15,107	17,088	19,422	22,034

Table 4 (concl). Tanzania: Central Government Operations, 2004/05 – 2008/09 [1]
(Percent of GDP)

	2004/05	2005/06		2006/07	2007/08	2008/09
	Actual	Prog.	Actual	Proj.	Proj.	Proj.
Total revenue	13.3	14.2	14.1	14.7	15.2	15.5
Tax revenue	12.2	13.0	12.9	13.6	14.0	14.3
Import duties	0.8	1.0	1.3	1.3	1.3	1.4
Value-added tax	5.1	5.5	5.3	5.6	5.8	5.9
Excises	1.8	1.8	1.7	1.9	2.0	2.0
Income taxes	3.4	3.6	3.7	3.8	3.9	4.0
Other taxes	1.0	1.0	0.9	1.0	1.0	1.0
Nontax revenue	1.2	1.3	1.2	1.1	1.2	1.2
Total expenditure	24.4	28.4	25.6	28.2	27.9	28.0
Recurrent expenditure	17.3	20.3	19.3	19.6	19.5	19.8
Wages and salaries	4.1	4.8	4.3	5.9	5.4	5.7
Interest payments	1.1	1.8	1.4	0.8	0.8	0.9
Domestic	0.7	1.3	1.1	0.7	0.6	0.6
Foreign [2]	0.4	0.5	0.4	0.1	0.3	0.3
Goods and services and transfers	12.1	13.7	13.5	12.9	13.2	13.2
Of which: MDRI (IMF) related	0.0	0.2	0.0	0.3	0.0	0.0
Development expenditure	7.1	8.2	6.3	8.6	8.4	8.3
Domestically financed	1.8	2.7	2.0	3.9	3.1	2.3
Of which: MDRI (IMF) related	0.0	0.2	0.0	1.3	0.8	0.0
Foreign-financed	5.3	5.5	4.3	4.7	5.4	6.0
Overall balance before grants	-11.1	-14.2	-11.6	-13.5	-12.8	-12.6
Grants	7.7	7.9	6.0	8.2	7.4	6.6
Program (including basket grants) [3]	4.1	3.5	3.4	4.1	4.1	4.1
Project	3.0	3.5	2.2	2.4	2.4	2.4
HIPC grant relief	0.5	0.5	0.5	0.0	0.0	0.0
MDRI (IMF) grant relief	0.0	0.4	0.0	1.7	0.8	0.0
Overall balance after grants	-3.4	-6.3	-5.5	-5.3	-5.4	-6.0
Adjustment to cash [4]	-0.7	0.0	-0.6	0.0	0.0	0.0
Overall balance	-4.1	-6.3	-6.1	-5.3	-5.4	-6.0
Financing	4.1	6.3	6.1	5.3	4.8	4.8
Foreign (net)	3.0	3.5	3.7	5.0	4.9	4.9
Foreign loans	3.8	4.4	4.4	5.2	5.2	5.2
Program (including basket loans) [3]	1.5	2.5	2.3	2.8	2.8	2.8
Project	2.3	1.9	2.2	2.3	2.3	2.3
Amortization	-0.8	-0.9	-0.7	-0.2	-0.3	-0.3
Domestic (net)	1.1	2.6	2.3	0.4	0.0	0.0
Bank financing	0.7	2.6	0.8	0.4	0.0	0.0
Nonbank financing	0.4	1.4	1.5	0.1	-0.1	-0.1
Amortization of parastatal debt	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Privatization proceeds	0.0	0.3	0.2	0.0	0.0	0.0
Financing Gap [5]				0.0	0.6	1.2

Sources: Ministry of Finance; Bank of Tanzania; and Fund staff projections.

[1] Fiscal year: July–June.

[2] Some projected external debt obligations are under negotiation for relief with a number of creditors.

[3] Basket funds are sector-specific accounts established by the government to channel donor support to fund-specific activities.

[4] Unidentified financing (+)/expenditure (-). Includes expenditure carryover from the previous fiscal year.

[5] For 2007/08 and 2008/09 projections, the financing gap reflects development spending in line with TANESCO's capital investment needs (as outlined by its Financial Recovery Plan) that is likely to be financed by external donor support, which has not yet been firmly committed.

Table 5. Tanzania: Summary Accounts of the Bank of Tanzania, 2005/06 – 2008/09
(Billions of Tanzania Shillings, unless otherwise indicated; end of period)

	2006						2007		2007/08	2008/09
	Mar		Jun		Sep	Dec	Mar	Jun		
	Prog.	Actual	Prog.	Actual	Actual	Proj.	Proj.	Proj.	Proj.	Proj.
Net foreign assets	2,300	2,518	2,154	2,381	2,675	2,627	2,697	2,505	2,765	3,132
Net international reserves	2,335	2,553	2,190	2,415	2,709	2,662	2,732	2,540	2,799	3,167
(millions of U.S. dollars)	1,979	2,086	1,856	1,927	2,129	2,119	2,161	1,954	2,138	2,361
Medium- and long-term foreign liabilities	-35	-35	-35	-35	-35	-35	-35	-35	-35	-35
Net domestic assets	-971	-1,214	-806	-1,084	-1,263	-1,076	-1,083	-832	-712	-656
Credit to government	-871	-1,012	-795	-873	-1,083	-1,092	-1,148	-961	-1,078	-1,063
Other items (net)	-100	-202	-11	-211	-180	16	65	129	366	407
Of which: MDRI (IMF)	-396	-411	-337	-421	-395	-257	-259	-149	0	0
Reserve money	1,328	1,304	1,348	1,296	1,412	1,552	1,614	1,674	2,052	2,476
Currency outside banks	910	807	932	856	941	1,033	1,075	1,148	1,412	1,709
Bank reserves	418	497	416	440	471	519	539	526	640	767
Currency in banks	95	79	95	91	98	99	101	103	115	130
Deposits	323	417	321	349	373	420	438	423	525	637
Required reserves (calculated) [1]	280	290	284	299	312	339	354	368	458	559
Excess reserves (calculated)	44	127	37	50	61	81	84	55	67	78

Sources: Bank of Tanzania; and Fund staff estimates and projections.

[1] Calculated as reserve requirement times banks' deposits minus half of bank cash in vault.

Table 6. Tanzania: Monetary Survey, 2005/06 – 2008/09
(Billions of Tanzania Shillings, unless otherwise indicated; end of period)

	2006						2007		2007/08	2008/09
	Mar		Jun		Sep	Dec	Mar	Jun		
	Prog.	Actual	Prog.	Actual	Actual	Proj.	Proj.	Proj.	Proj.	Proj.
Net foreign assets	3,061	3,286	2,905	3,241	3,619	3,469	3,557	3,399	3,664	4,053
Net domestic assets	1,123	823	1,342	1,058	930	1,450	1,563	1,941	2,903	3,894
Domestic credit	1,688	1,558	1,838	1,771	1,638	1,994	2,064	2,387	3,157	4,137
Credit to government (net)	121	26	188	114	-268	32	-18	134	115	95
Credit to nongovernment sector	1,567	1,531	1,650	1,657	1,906	1,963	2,082	2,253	3,042	4,042
Other items (net)	-565	-735	-496	-713	-708	-545	-501	-446	-254	-243
M3	4,184	4,109	4,246	4,299	4,549	4,919	5,120	5,339	6,567	7,947
Foreign currency deposits	1,204	1,273	1,215	1,354	1,499	1,432	1,580	1,651	1,912	2,119
M2	2,980	2,836	3,031	2,946	3,050	3,486	3,540	3,688	4,656	5,828
Currency in circulation	910	807	932	856	941	1,033	1,075	1,148	1,412	1,709
Deposits (Tanzania Sh)	2,071	2,029	2,099	2,089	2,109	2,453	2,465	2,540	3,244	4,119
Memorandum items:										
M3 growth (12-month percent change)	33.9	31.5	30.0	31.6	28.6	25.0	24.6	24.2	23.0	21.0
Foreign currency deposits (12-month percent change)	31.9	39.5	35.0	50.4	50.5	27.1	24.1	22.0	15.8	10.8
M2 growth (12-month percent change)	34.7	28.2	28.1	24.5	20.1	24.1	24.8	25.2	26.2	25.2
Credit to nongovernment sector (12-month percent change)	36.6	33.5	35.3	35.9	37.1	37.7	36.0	36.0	35.0	32.9
Reserve money (12-month percent change)	35.9	33.4	30.9	25.9	25.1	25.5	23.8	29.1	22.6	20.6
Currency/M3 (percent)	21.7	19.6	22.0	19.9	20.7	21.0	21.0	21.5	21.5	21.5
Reserve money multiplier (M3/reserves)	3.1	3.2	3.2	3.3	3.2	3.2	3.2	3.2	3.2	3.2
Velocity of money (M3; average)	...	...	3.9	4.0	...	3.6	...	3.5	3.3	3.0
Velocity of money (M3; end-period)	...	...	3.4	3.5	...	3.3	...	3.2	3.0	2.8
Nonbank financing of the government (net) [1]	175	199	170	222	12	73	61	47	20	20
Bank financing of the government (net) [1]	134	39	201	127	-383	-82	-133	20	-20	-20
Bank and nonbank financing of the government (net) [1]	309	238	371	349	-371	-9	-72	67	0	0

Sources: Bank of Tanzania; and Fund staff estimates and projections.

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

Table 7: Financial Soundness Indicators, 2002 – 2006
(Percent, end of calendar year)

	2002	2003	2004	2005	2006 [1]
Access to bank lending					
Claims on the private sector to GDP [2]	6.1	7.7	8.6	10.0	11.3
Capital adequacy					
Capital to risk-weighted assets	20.6	21.0	21.2	22.0	22.4
Capital to assets	8.6	9.9	10.2	10.0	10.0
Asset composition and quality					
Total loans and advances to total assets	25.4	30.2	33.7	33.7	34.0
Sectoral distribution of loans					
Trade	22.1	23.8	23.6	23.7	22.3
Mining and manufacturing	24.4	27.3	23.4	22.5	23.9
Agricultural production	12.9	14.1	13.9	12.4	10.4
Building and construction	3.6	5.5	4.0	5.8	3.6
Transport	11.8	10.3	8.7	7.6	7.4
Foreign exchange loans	28.1	27.2	28.9	32.7	32.3
Gross nonperforming loans (NPLs) to gross loans [3]	8.3	4.5	3.5	4.9	5.9
Large exposures to total capital	58.2	59.3	64.1	53.3	43.5
Earnings and profitability					
ROA	1.8	2.1	2.9	3.3	4.6
ROE	20.6	20.7	28.4	33.1	46.2
Interest margin to gross income	48.0	51.5	54.8	60.9	66.3
Noninterest expenses to gross income	70.1	67.1	61.6	56.9	47.7
Personnel expenses to noninterest expenses	41.3	39.9	39.0	39.6	42.1
Trading and fee income to total income	45.2	42.3	39.1	33.6	27.8
Interest rate earned on loans and advances	16.4	14.1	14.2	15.5	15.4
Interest rate paid on deposits	4.0	3.5	4.3	4.4	6.4
Spread (lending vs. deposit rates) [4]	12.4	10.6	9.9	11.1	9.0
Liquidity					
Liquid assets to total assets	58.0	56.3	53.6	55.0	48.2
Liquid assets to total short term liabilities	68.9	62.8	62.0	62.4	55.2
Total loans to customer deposits	34.0	41.2	44.4	42.4	45.7
Foreign exchange liabilities to total liabilities	34.1	36.5	34.7	34.9	36.5

Sources: Bank of Tanzania and Fund staff estimates.

[1] 2006 values are for June 30.

[2] Calendar year; end of period claims relative to annual GDP. The values shown here are slightly different from those in Figure 3 as the latter shows average annual values.

[3] The increase in non-performing loans to gross loans between end-2005 and June 2006 was due largely to a change in reporting standards.

[4] Difference between lending rate and time deposit rate.

Table 8. Tanzania: Balance of Payments, 2004/05 – 2008/09
(Millions of U.S. dollars, unless otherwise indicated)

	2004/05	2005/06		2006/07	2007/08	2008/09
	Act.	Prog.	Prel Act.	Proj.	Proj.	Proj.
Current account	-651	-986	-1,187	-1,410	-1,562	-1,726
Trade balance	-1,134	-1,506	-1,700	-2,012	-2,280	-2,544
Exports, f.o.b.	1,594	1,767	1,736	1,965	2,161	2,325
Traditional	327	338	356	400	431	455
Nontraditional	1,267	1,429	1,380	1,565	1,730	1,871
Imports, f.o.b	-2,728	-3,273	-3,436	-3,977	-4,441	-4,869
Services (net)	101	-67	112	88	174	207
Income (net)	-204	-80	-160	-98	-127	-127
Of which : interest payments due	-102	-122	-64	-34	-57	-55
Of which : interest on public debt	-97	-92	-49	-17	-42	-43
Of which : interest on central government debt [1]	-51	-65	-49	-17	-42	-43
Current transfers (net)	586	666	561	612	671	738
Of which : official transfers	576	664	503	555	614	680
Of which : program grants	509	464	435	553	612	678
HIPC relief	66	60	68	2	2	2
Capital account	410	821	662	4,998	454	544
Of which : project grants	368	438	281	323	403	493
Debt stock reduction under MDRI (including HIPC)	0	336	336	4,626	0	0
Of which: HIPC	0	37	37	1,157	0	0
Financial account	591	499	933	-3,561	1,292	1,405
MDRI (including HIPC)	0	0	0	-4,626	0	0
Of which: HIPC	0	0	0	-1,157	0	0
Direct investment	472	550	488	520	611	695
Other investment	117	-51	443	542	678	707
Of which: Program loans	182	303	293	379	419	465
Project loans	283	242	278	313	345	382
Government-scheduled amortization [1]	-139	-501	-87	-23	-39	-46
Errors and omissions	-172	0	-25	0	0	0
Overall balance	178	334	383	26	184	224
Financing	-178	-334	-383	-26	-184	-224
Change in BoT reserve assets (increase, -)	-231	23	-26	-30	-184	-224
Use of Fund credit	-32	-357	-357	4	0	0
Exceptional financing	85	0	0	0	0	0
Change in arrears (increase +) [2]	85	0	0	0	0	0
Debt rescheduled	0	0	0	0	0	0
Memorandum items:						
Gross official reserves (BoT)	1,969	2,086	1,995	2,025	2,209	2,433
Months of imports of goods and services (next year)	5.0	4.9	4.4	4.0	4.0	4.0
Current account deficit (percent of GDP)						
Excluding official current transfers	-10.1	-13.2	-13.2	-14.7	-14.7	-14.6
Including official current transfers	-5.3	-7.9	-9.3	-10.5	-10.5	-10.5
External debt service foregone due to MDRI (including HIPC)	...	...	33.3	171.8	170.9	169.5
IMF	...	...	33.3	71.9	66.5	61.8
IDA	...	...	0	94.6	98.8	102.0
AfDB	...	...	0	5.3	5.5	5.7
Foreign program and project assistance (percent of GDP)	11.6	12.1	10.6	11.7	12.0	12.3
Foreign direct investment (percent of GDP)	3.9	4	3.8	3.9	4.1	4.2
Nominal GDP	12,183	12,475	12,771	13,401	14,833	16,432

Sources: Tanzanian authorities; and Fund staff estimates and projections.

[1] Relief on some projected external debt obligations is being negotiated with a number of creditors.

[2] Arrears are on non-Paris Club official and commercial debt subject to rescheduling.

Table 9. Tanzania: Program Assistance, 2005/06 – 2008/09 [1 2]
(Millions of U.S. dollars)

	2005/06		2006/07					2007/08	2008/09
	FY	FY	Q1	Q2	Q3	Q4	FY	FY	FY
	Prog.	Act.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Grants	464.3	434.8	224.0	264.9	56.6	7.5	553.0	612.1	678.1
Multilateral	39.1	39.1	0.0	49.7	0.0	0.0	49.7	55.0	60.9
EU PRBS grants [3]	39.1	39.1	0.0	49.7	0.0	0.0	49.7	55.0	60.9
World Bank (PRBS)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral	425.2	395.7	224.0	215.3	56.6	7.5	503.4	557.1	617.2
PRBS [3]	271.3	246.8	198.9	118.3	21.4	0.0	338.7	374.8	415.2
Canada	21.6	0.0	0.0	0.0	21.4	0.0	21.4	23.7	26.3
Denmark	9.8	9.8	0.0	15.3	0.0	0.0	15.3	17.0	18.8
Finland	4.9	4.9	11.1	0.0	0.0	0.0	11.1	12.3	13.6
Germany	5.3	6.3	0.0	10.2	0.0	0.0	10.2	11.3	12.5
Ireland	13.5	5.9	13.2	0.0	0.0	0.0	13.2	14.6	16.2
Japan	5.0	5.0	4.7	0.0	0.0	0.0	4.7	5.2	5.8
Netherlands	12.0	12.0	0.0	19.1	0.0	0.0	19.1	21.1	23.4
Norway	15.4	15.5	0.0	27.5	0.0	0.0	27.5	30.4	33.7
Sweden	25.8	25.8	0.0	41.4	0.0	0.0	41.4	45.8	50.7
Switzerland	4.8	4.8	0.0	4.8	0.0	0.0	4.8	5.4	5.9
United Kingdom	153.2	156.8	169.9	0.0	0.0	0.0	169.9	188.0	208.3
Sectoral baskets	154.0	148.9	25.1	97.0	35.2	7.5	164.7	182.3	202.0
Belgium	5.4	0.0	0.0	5.7	1.3	0.0	7.0	7.8	8.6
Canada	18.2	24.9	0.0	5.3	1.8	0.0	7.1	7.9	8.7
Denmark	16.8	16.9	11.1	5.3	3.8	0.0	20.1	22.3	24.7
European Union	2.2	2.3	0.0	23.4	0.0	0.0	23.4	25.9	28.7
France	1.2	0.6	0.0	1.0	0.5	0.5	2.0	2.2	2.4
Finland	9.5	6.7	0.0	1.3	4.5	0.0	5.7	6.4	7.0
Germany	6.1	3.1	2.6	3.1	0.0	0.0	5.7	6.3	7.0
Ireland	9.0	10.1	7.4	5.7	0.0	1.3	14.4	15.9	17.6
Italy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Japan	0.5	0.5	0.0	0.5	0.0	0.0	0.5	0.5	0.6
Netherlands	29.1	36.4	0.0	17.8	9.7	5.7	33.2	36.8	40.7
Norway	1.6	1.6	0.0	3.2	1.6	0.0	4.8	5.4	5.9
Sweden	21.5	23.3	0.0	5.2	0.0	0.0	5.2	5.8	6.4
Switzerland	5.3	4.8	2.9	1.9	0.6	0.0	5.5	6.1	6.7
United Kingdom	27.1	17.6	0.5	11.8	11.4	0.0	23.7	26.2	29.0
Others	0.6	0.0	0.6	5.7	0.0	0.0	6.3	7.0	7.7
Loans	302.8	292.6	215.0	50.4	113.5	0.0	378.9	419.4	464.6
Multilateral	302.8	292.6	215.0	50.4	113.5	0.0	378.9	419.4	464.6
World Bank	229.1	218.9	215.0	50.4	39.7	0.0	305.1	337.7	374.1
PRBS loans	170.1	204.0	206.4	0.0	0.0	0.0	206.4	228.4	253.1
Basket loans	59.0	14.9	8.6	50.4	39.7	0.0	98.7	109.3	121.0
African Development Bank	73.7	73.7	0.0	0.0	73.8	0.0	73.8	81.7	90.5
Bilateral	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total program assistance									
US$ million	767.0	727.4	439.0	315.3	170.1	7.5	932.0	1,031.5	1,142.7
Cumulative from beginning of fiscal year	767.0	727.4	439.0	754.3	924.5	932.0	932.0	1,031.5	1,142.7
Percent of GDP	6.1	5.7	...	...	...	...	7.0	7.0	7.0

Sources: Tanzanian authorities and donors.

[1] Fiscal year: July–June.

[2] Based on currently identified aid commitments.

[3] Poverty reduction budget support.

Table 10. Tanzania: Status of HIPC Initiative Agreements by Creditor

	Debt Relief in Nominal Terms (US$ mil.)	Agreement to Provide Relief Beyond HIPC?	Comments
Multilateral Creditors			
IMF	120.0	n/a	Provided grants through PRGF-HIPC Trust fund. Average of 48 percent of debt service payments.
AfDB/AfDF	190.7	n/a	Debt service reduced by 80% annually until debt relief delivered.
IDA/IBRD	1,157.1	n/a	Debt-service relief of 69.1 and 63.6 percent on debts outstanding at end-June 1999 and 2001, respectively.
IFAD	24.5	n/a	Reduced 100 percent of debt -service due.
BADEA	14.7	n/a	Concessional rescheduling of the debt and reduced interest rate.
OPEC	9.8	n/a	Concessionnal loans and restructuring of debt.
NDF	3.2	n/a	Contribution to HIPC initative trust fund to pay 100 percent debt service.
EADB	0.6	n/a	Reduced interest rate and extension of repayment period.
EU	37.9	n/a	Provided grants at the completion point to pay off outstanding loans.
Paris Club Creditors			
Austria	31.3	Yes	Bilateral Agreement for PC VII was signed on May 7, 2002.
Belgium	74.3	No	Bilateral Agreement for PC VII was signed on November 29, 2002.
Brazil	-	No	Reminder letter to submit draft agreement for PC VII sent May 19, 2004. Awaiting reply.
Canada	31.1	Yes	Bilateral Agreement for PC VII was signed on October 16, 2002.
France	89.9	Yes	Bilateral Agreement for PC VII was signed on March 6, 2003.
Germany	60.6	Yes	Bilateral Agreement for PC VII was signed on April 29, 2003.
Italy	132.0	Yes	Bilateral Agreement for PC VII was signed on May 7, 2002.
Japan	108.9	n.a.	Bilateral Agreement signed on March 2, 2004; cancelled 100 percent of ODA loans. Not yet offered debt relief on commercial and part of bilateral (Japanese Food Agency) debts.
Norway	11.1	Yes	Bilateral Agreement for PC VII was signed on December 5, 2002.
Netherlands	99.1	Yes	Bilateral Agreement for PC VII was signed on March 17, 2002.
Russia	69.6	No	Bilateral Agreement for PC VII was signed on July 18, 2003.
United Kingdom	129.2	Yes	Bilateral Agreement for PC VII was signed on July 4, 2002.
United States	21.3	Yes	Bilateral Agreement for PC 7 was signed on July 4, 2002.
Non-Paris Club Bilateral Creditors			
Algeria	-	No	In active negotiation.
Angola	-	No	In active negotiation.
Bulgaria	23.6	No	Bilateral Agreement was signed on December 12, 2003.
China	113.1	No	15 interest-free loans maturing 31 Dec, 1999 cancelled. China has not offered HIPC debt relief.
Czech Republic	-	No	The debt originally owed to Czechoslovakia was frozen in 1998, and later written off completely.
Egypt	-	No	Request for debt relief under Paris Club VII terms sent April 17, 2002. Awaiting reply.
Hungary	13.0	No	Bilateral Agreement at Paris Club: comparable terms was signed on September 27, 2005.
India	28.9	No	Bilateral Agreement signed on September 14, 2004 cancelled all intergovernmental loans. Negotiations ongoing with the Export Credit Agency.
Iran	-	No	In active negotiations.
Iraq	-	No	Request for debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Kuwait	40.2	n.a.	Signed bilateral agreement on March 8, 2003. Rescheduled 9 pre-CD loans.
Libya	101.7	No	Bilateral Agreement for Paris Club comparable terms was signed on July 20, 2005 .
Romania	-	No	Request letter for debt relief under Paris Club VII terms sent April 17, 2002. Awaiting reply.
United Arab Emirates	12.2	n.a.	HIPC relief agreement signed in August 2006. Debt service will start in January 2007.
Yugoslavia	-	No	Request for debt relief under Paris Club VII terms sent April 17, 2002. Awaiting reply.
Zambia	-	No	Request for debt relief under Paris Club VII terms sent April 17, 2002. Awaiting reply.

Source: Bank of Tanzania.

Table 11. Tanzania: Millennium Development Goals, 1990 – 2004

	1990	1995	1998	2001	2004
1. Eradicate extreme poverty and hunger	2015 target = halve 1990 $1 a day poverty and malnutrition rates				
Population below $1 a day (percent)	49.0	..	..	58.0	..
Poverty gap ratio at $1 a day (incidence X depth of poverty)	24.0	..	..	21.0	..
Percentage share of income or consumption held by poorest 20 percent	..	..	..	7.0	..
Prevalence of underweight in children (percent of children under 5)	..	31.0	29.0	..	..
Population below minimum level of dietary energy consumption (percent)	..	..	50.0	..	44.0
2. Achieve universal primary education	2015 target = net enrollment to 100				
Net primary enrollment ratio (percent of relevant age group)	49.0	..	47.0	56.0	86.0
Proportion of pupils starting grade 1 who reach grade 5	81.0	..	81.0	99.0	76.0
Youth literacy rate (percent ages 15-24)	83.0	..	..	..	78.0
3. Promote gender equality	2015 target = education ratio to 100				
Ratio of girls to boys in primary and secondary education (percent)	96.7	..	98.3	..	..
Ratio of young literate females to males (percent ages 15-24)	86.5	..	..	..	94.2
Share of women employed in the nonagricultural sector (percent)	29.0	..	..	..	..
4. Reduce child mortality	2015 target = reduce 1990 under 5 mortality by two-thirds				
Under 5 mortality rate (per 1,000)	161.0	159.0	..	141.0	126.0
Infant mortality rate (per 1,000 live births)	102.0	100.0	..	88.0	78.0
Immunization, measles (percent of children under 12-23 months)	80.0	78.0	78.0	83.0	94.0
5. Improve maternal health	2015 target = reduce 1990 maternal mortality by three-fourths				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	..	1500.0	..
Births attended by skilled health staff (percent of total)	..	38.2	35.8	..	46.0
6. Combat HIV/AIDS, malaria, and other diseases	2015 target = halt, and begin to reverse, AIDS and other major				
Prevalence of HIV, total (percent ages 15-24)	..	..	..	..	7.0
Contraceptive prevalence rate (percent of women ages 15-49)	10.0	18.0	25.0	..	26.0
Incidence of tuberculosis (per 100,000 people)	178.9	..	..	..	347.1
Tuberculosis cases detected under DOTS (percent)	..	56.1	52.9	46.8	46.6
7. Ensure environmental sustainability	2015 target = various				
Forest area (percent of total land area)	47.0	..	..	42.0	40.0
Nationally protected areas (percent of total land area)	..	..	..	..	29.8
GDP per unit of energy use (2000 PPP dollars per kg oil equivalent)	1.0	1.0	1.0	1.0	1.0
CO2 emissions (metric tons per capita)	0.1	0.1	0.1	0.1	..
Access to an improved water source (percent of population)	46.0	..	..	..	62.0
Access to improved sanitation (percent of population)	47.0	..	..	..	47.0
Access to secure tenure (percent of population)	..	..	..	..	..
8. Develop a Global Partnership for Development	2015 target = various				
Youth unemployment rate (percent of total labor force ages 15-24)	..	..	..	..	..
Fixed-line and mobile telephones (per 1,000 people)	2.8	3.0	4.8	16.2	32.2
Personal computers (per 1,000 people)	..	..	1.7	3.4	7.4
General indicators					
Population (millions)	26.2	30.9	33.3	35.5	37.6
Gross national income (billions of U.S. dollars)	4.8	4.9	7.5	9.4	11.7
GNI per capita (U.S. dollars)	190.0	160.0	230.0	270.0	320.0
Adult literacy rate (percent of people ages 15 and over)	62.9	..	..	..	69.4
Total fertility rate (births per woman)	6.1	5.6	5.5	5.0	4.8
Life expectancy at birth (years)	53.5	49.9	48.1	46.0	46.2
Trade (percent of GDP)	50.1	59.3	42.0	41.0	45.6

Source: http://www.developmentgoals.org, retrieved November 1, 2006.

Appendix I—Tanzania: Letter of Intent

November 20, 2006

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. The Government of the United Republic of Tanzania has been implementing a financial and economic programme with support from the Fund's Poverty Reduction and Growth Facility (PRGF) under a three-year low access arrangement which was to expire on 31st August 2006, but has been extended to 31st December 2006. We recently held discussions with the Fund staff on the sixth and final review of the PRGF-supported program and on a follow-up programme. The Government's intention is to request the new Policy Support Instrument (PSI) of the Fund as the basis of its future relationship with the Fund after conclusion of the PRGF programme.

2. On behalf of the Government, I hereby transmit the attached Memorandum of Economic and Financial Policies (MEFP), which reviews recent economic developments, progress in the implementation of the 2005/06 programme, and sets out the policies that the Government intends to pursue in 2006/07 and the medium term.

3. Implementation of the 2005/06 programme has been satisfactory, with all quantitative and structural performance criteria observed during the period under review. Two structural benchmarks, submission of a proposed unified legal framework and investment guidelines for pension funds and a Financial Recovery Plan for TANESCO, were delayed mostly due to factors outside the Government's control. However, the financial recovery plan for TANESCO has since been finalised. The consultant procured with World Bank assistance for developing the regulatory framework for the pensions sector has already produced an inception report, and a comprehensive legal and regulatory framework, and investment guidelines, for the sector shall be adopted after completion of this exercise. In this regard, I request that the Fund approve the completion of the sixth and final review under the PRGF arrangement, and the consequent disbursement of the seventh

and final tranche of SDR 2.8 million, and a new three-year programme under the PSI framework.

4. Under the PSI, the Government remains committed to sustaining macroeconomic stability through maintenance of appropriate fiscal and monetary policies and implementing the necessary structural reforms, especially the Second Generation Reforms of the Financial Sector, tax and customs policy and administration reforms, and improvement of the business environment to promote investment. Within the framework of the PSI, we will continue to consult with the Fund on the measures pursued to realise these objectives.

5. In particular, the 2006/07 programme aims at continuing the fiscal and financial sector reforms currently underway. Specific measures in the 2006/07 budget have been taken to address the energy crisis, hire front line staff in the education, health and public safety sectors, and enhance the pace of public service pay reform. The Government will also continue monitoring TANESCO's financial developments, and protect the budget and other programme objectives as needed.

6. Under the three-year PSI, the Government will keep the IMF regularly updated on economic and policy developments and will provide the data needed for adequate monitoring of the program—including in the context of twice-yearly reviews. The first and second PSI reviews are expected to take place by end-April 2007 and end-October 2007, respectively, on the basis of the assessment criteria and benchmarks indicated in Tables 1 and 3 attached to this letter. During the period of this Instrument, the Government will consult with the IMF on the adoption of any measures that may be appropriate at the initiative of the Government, or whenever the Managing Director of the IMF requests such a consultation.

7. The Government of Tanzania intends to make this letter and the attached MEFP available to the public and authorises publication on the IMF website, together with Fund staff reports related to the sixth review under the PRGF and the new PSI, once the Executive Board completes the review and approves the new program.

Yours sincerely,

/s/
Zakia Hamdani Meghji (MP)
Minister for Finance
United Republic of Tanzania

Attachments**:** Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding

Appendix I—Attachment I
Tanzania: Memorandum of Economic and Financial Policies

I. RECENT MACROECONOMIC DEVELOPMENTS AND PROGRESS UNDER THE PROGRAMME

Introduction

1. Tanzania's sustained economic reforms have generated strong macroeconomic performance over the last ten years, characterised by rapid real GDP growth, low inflation, and a comfortable external position. The economy performed well in 2005, with real GDP growth of 6.8 percent, despite the onset of drought and high international oil prices, compared with 6.7 percent recorded in 2004. The sectors that have grown strongly during the year include trade and tourism, manufacturing, mining, construction, and communication, which together contributed about 40 percent of GDP.

2. The drought experienced during 2005 adversely affected food production and hydropower generation. This, coupled with persistent increases in oil prices, exerted upward pressure on inflation. After having successfully contained inflation at around 4 percent for the past three years, it began rising modestly to 5.0 percent at end-December 2005 and 7.7 percent in May 2006, before declining to 6.8 percent at end of June 2006 and 4.8 percent in August 2006. For 2005/06, average inflation was 5.6 percent.

Energy

3. The combination of a long non-investment period, a drought-related decline in TANESCO's hydro-generation capacity noted above, and high world fuel prices, has precipitated an energy crisis in Tanzania, and a financial crisis in TANESCO. As a result, economic activity has been adversely affected by power shortages while TANESCO has continued to suffer substantial operational losses due to load shedding, dependency on liquid fuel generation, and purchase of more expensive energy from independent power producers (IPPs). The Government recognizes that unless the problems in the energy sector are addressed, the rates of economic growth envisaged in the MKUKUTA cannot be attained. Detailed plans have been formulated to address these shortages and financial pressures, as discussed below.

Fiscal policy and public resource management

4. Fiscal developments during 2005/06 (July–June) were broadly in line with the programme targets. Domestic revenues were slightly above programme estimates mainly due to better than expected performance of import duties, corporation tax, and domestic excises. Revenue performance also benefited from the ongoing tax and customs administration reforms implemented by the Tanzania Revenue Authority (TRA). Despite the power load

shedding, domestic revenue reached 14.1 percent of GDP from 13.3 percent recorded in 2004/05.

5. Furthermore, in spite of additional costs associated with the postponement of general elections, budget transfers to TANESCO, procurement and distribution of food aid, and higher than anticipated pension outlays, Government expenditure remained on track and, at 25.6 percent of GDP, was below the programmed level of 28.4 percent of GDP. Expenditure was contained due to a cautious stance adopted in budget execution, and delays in hiring of new staff and in the implementation of some development projects. Expenditure on goods, services and transfers was also contained within programme projections, including expenditure for priority social services linked to the achievement of the MDGs. Foreign financing was below expectation mainly due to delays in the implementation of some reform measures relating to crop boards and elections in some donor countries. Nevertheless, domestic financing of the budget, at 2.3 percent of GDP, was in line with the programme target as the overall budget deficit was contained below programme projections.

6. Tax and customs administration reforms are progressing successfully, with improved revenue performance and taxpayer service. The Large Taxpayer Department (LTD) in the TRA reviewed its procedures with a view to achieving International Standards Organization (ISO) certification during 2006/07. The Customs Department rolled out a new "Manual for Importation, Export, and Transit" trade in June 2006. The Manual aligns requirements under EAC Customs Management Act, ASYCUDA^{++} and the destination inspection programme. The TRA also finalized the Facilitated Client Scheme, under which importers with a good track record can make use of expedited import clearing procedures. Finally, the computerized ASYCUDA^{++} System was installed at the J. K. Nyerere International Airport in Dar es Salaam, the Dar es Salaam Port, the Customs Service Centre, Tunduma, Kasumulu, and in Zanzibar. These reforms have reduced cargo release times, with the business community continuing to report improvement in the functioning of the port system.

7. Implementation of the programme to strengthen expenditure management continued, with priority given to ensuring transparency and accountability in public expenditure, consistent with the objectives of the MKUKUTA. The IFMS was rolled out to another 32 Local Government Authorities (LGAs), and we continued with training of accounting staff at both central and local Government levels. In addition, a major recruitment exercise for accountants and internal auditors was completed recently, with a view to ensuring that all Ministries, Departments, and Agencies (MDAs) and LGAs have appropriately qualified accounting and internal audit staff.

8. The Government has made substantial progress in establishing a Public Procurement Regulatory Authority (PPRA) to enhance accountability in public procurement. This went hand in hand with the decentralization of the former Central Tender Board functions. The organizational structure of PPRA was completed in February 2006 and recruitment

commenced in April 2006. Adequate resources have been set aside in the 2006/07 budget to ensure effective implementation of PPRA functions.

Monetary policy

9. Liquidity pressures eased in the second half of 2005/06. Lower than expected expenditures in the third quarter, and greater reliance on the sales of foreign exchange in the fourth quarter facilitated the easing of monetary policy through a reduction in the tender size for treasury bills from the average of T Sh 70 billion per week during December 2005 to an average of T Sh 40 billion during April - June 2006. At the same time, demand for government paper remained strong, contributing to an easing of interest rates. The weighted average yield for treasury bills came down sharply from 14.8 percent in December 2005 to 8.3 percent in June 2006. Reserve money evolved slightly below both the end-March 2006 performance criterion and the end-June 2006 indicative target.

10. During 2005/06, private sector credit continued to grow strongly at 35.9 percent (12-month) with the stock of credit reaching 11 percent of GDP. The major factors behind the high credit growth include strong credit demand from expanding economic activities supported by a growing number of credit-worthy clients. It is also a reflection of growing competition in the banking system.

11. Strong demand for credit and increasing competition pushed commercial banks to adjust deposit rates upwards so as to attract deposits. The weighted average time deposit rate improved from 5.3 percent in December 2005 to 7.3 percent in June 2006. On the other hand, posted lending rates moved slightly upwards from 14.9 percent in December 2005 to 15.4 percent in June 2006.[1]

Financial sector reforms

12. A key milestone of the financial sector reform programme was achieved in April 2006, when the Parliament approved The Bank of Tanzania Act, 2006 and the Banking and Financial Institutions Act (BFIA) 2006. These acts were recently assented into law and contain provisions for increased Central Bank autonomy and accountability and further strengthening of the financial sector's legal framework, including stronger frameworks for prompt corrective action, licensing, and measurement of the asset quality of financial institutions. The BFIA will also facilitate the shift to risk-based supervision now underway. Regulations to guide their implementation are now under development and are expected to be discussed with stakeholders in October 2006, and gazetted by March 2007. Separately, the Bank of Tanzania (BoT) is initiating a requirement for quarterly capital adequacy reporting (CAMELS) by banks, which it expects to be fully in place by June 2007.

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[1] Major bank clients are able to negotiate more favorable deposit and lending rates.

External sector developments

13. The current account deficit reached an estimated 9.3 percent of GDP in 2005/06, compared to 5.3 percent in 2004/05. These developments are mainly on account of sharply higher world petroleum prices and drought-related food imports, which more than offset the continued strong growth in exports of goods and services. Disbursements of external programme and project assistance fell short of the programmed amounts in 2005/06 from a projected US$1.5 billion to an estimated US$1.35 billion.

14. Balance of payments pressures contributed to a continued depreciation of the shilling during 2005/06. The shilling exchange rate depreciated by about 11.3 percent from T Sh 1,126 per U.S. dollar at end June 2005, to T Sh 1,253 per U.S. dollar by end June 2006. Gross official international reserves increased by slightly to US$1,995 million, equivalent to 4.4 months of 2006/07 imports of goods and services. Gross international reserves remained broadly unchanged at about US$2 billion. The BoT continued its policy of allowing the exchange rate to fluctuate freely in response to market forces, limiting its interventions in the foreign exchange market to liquidity management and smoothing temporary excessive fluctuations driven by the lumpiness of foreign exchange inflows from donor assistance and traditional exports.

15. During the year, Tanzania benefited from substantial IMF debt relief in the amount of US$336 million delivered under the Multilateral Debt Relief Initiative (MDRI). The International Development Association and the African Development Fund have also approved significant MDRI debt relief to Tanzania amounting to US$4.6 billion, effective July 1, 2006 (including HIPC), to be delivered on a maturity basis. The Government continues negotiations with remaining bilateral creditors for debt relief. These include remaining Paris Club creditors, namely Brazil and Japanese Agencies (EID/MITI/JFAD). Relief is also being sought from Non-Paris Club Creditors.

II. PROGRAMME FOR 2006/07

16. It is expected that economic performance during 2006/07 will continue to be affected by the impact of high fuel prices and the ongoing energy crisis. Consequently, the macroeconomic projections include a deceleration of the rate of GDP growth to about 5.9 percent in 2006. The Government's objectives are to attain a real GDP growth rate of 7.3 percent in 2007 and 7.6 percent in 2008. Pressure on prices is expected to moderate gradually, with inflation easing to 4.5 percent by end-June 2007. These projections assume normal rainfall and include higher electricity tariffs. Our medium-term objective is to contain inflation below 5 percent. Achieving this objective will, among others, depend critically on effective implementation of TANESCO's Financial Recovery Plan.

Fiscal Programme

17. For 2006/07, the programme envisages that domestic revenue could reach T Sh 2511 billion (equivalent to 14.7 of GDP). This reflects continued tax and customs administration reforms and the policy measures announced in the budget for 2006/07. These measures include a 7 percent increase in the specific excise duty rates for non-petroleum products, including alcoholic drinks, tobacco products, soft drinks (0.2 percent of GDP), and an increase of the excise rate on mobile telephone airtime from 5 to 7 percent (0.1 percent of GDP). The increase in the wage bill is also projected to contribute some T Sh 65 billion (0.4 percent of GDP) in revenues. Taking into account projected foreign financing, net domestic financing is expected to be contained at T Sh 67 billion, or 0.4 percent of GDP, compared with T Sh 349 billion or 2.3 percent of GDP in 2005/06.

18. Implementation of the tax administration reforms, based on the TRA's Second Corporate Plan and the Tax Modernisation Project, will be intensified to underpin the envisaged improvement in domestic revenue mobilisation in FY 2006/07 and over the medium term. The TRA's VAT and Income Tax Departments have been integrated into a single Domestic Revenue Department (DRD) and organised along functional lines. The next step will be to establish small and medium-size taxpayer segments, which we expect to implement in all regions including Dar es Salaam, during 2006/07. The LTD has already assumed the responsibility for qualifying taxpayers outside Dar es Salaam, and increased the number of cases under its jurisdiction from 286 to 370 taxpayers with effect from 1st July, 2006. We will continue to publish the list of tax exemption beneficiaries each quarter (structural benchmark).

19. The reform of the Customs Department is aimed at strengthening enforcement and compliance by importers, based on better risk management. The Department is currently implementing an action plan for combating petroleum product smuggling, focusing on a more effective use of flow meters and physical inspections, strengthening the monitoring of exemptions, and improving the control over transit shipments through Joint Enforcement Teams. We will continue the roll out of the ASYCUDA^{++} system to include six additional stations by end-December 2006 and to finalize implementation plans for risk management strategies by the same date. As a next step, customs will create a risk management database drawing information from the ASYCUDA 2.7 system, TISCAN database, and the ASYCUDA^{++} database, and develop a post-clearance audit policy by end-December 2006. Supported by TA from the Fund, Customs will develop a dated action plan for the integration of the ASYCUDA and TISCAN system-based processes by end-December 2006 (structural benchmark). The integration is scheduled to take place by end-June 2007 and will be critical for eliminating duplication of current import procedures, strengthening enforcement and compliance, and for further reductions in release times.

20. The Government has strengthened further the link between budgetary resource allocation and MKUKUTA priorities through cluster-based expenditure programming, and rolling out the Strategic Budget Allocation System (SBAS) to the Regional Secretariats, in addition to the MDAs that were already using the system. Local Government Authorities (LGAs) will begin to use the system this year for preparation of their budgetary requirements for 2007/08. This will complete the MKUKUTA–resource link, from planning to implementation. Direct MKUKUTA interventions account for 48 percent of planned expenditure in 2006/07, compared to 47 percent in 2005/06. The relevant shares of MKUKUTA Clusters are: 46 percent for Growth and Reduction of Income Poverty; 36 percent for Improvement of Quality of Life and Social Well-being; and 18 percent for Governance and Accountability.

21. Consistent with MKUKUTA implementation priorities, the Government's Public Service Reform Programme (PSRP), and the Public Service Medium-Term Pay Policy (MTPP), the wage bill has been increased from 4.3 percent of GDP in 2005/06 to 5.9 percent of GDP in 2006/07. The Government plans to recruit 24,689 staff in priority areas, including new health workers, teachers, lawyers, accountants and, internal auditors. Moreover, in order to attract and retain staff in critical areas of public service, a 46–50 percent wage increase is being implemented with priority given to middle professional cadres. The measure's overall impact on the budget is partially mitigated by reductions in personnel-related allowances that were not a part of the wage bill and in some allocations for the running of the Government (0.9 percent of GDP). This measure increases the salaries of support and junior- and mid-level professional staff to over 90 percent of their medium term targets. The planned hiring of new staff will be implemented with a clear strategic goal to improve the capacity and efficiency of Government operations, in line with the PSRP. Any future increase in the share of personal emoluments in the budget would need to be consistent with medium-term macroeconomic and fiscal sustainability.

22. Implementation of the MTPP has been lagging behind owing to budgetary constraints in view of the financing requirements for implementation of the first cycle of the Poverty Reduction Strategy. However, in recognition of the fact that without a motivated and better performing Public Service, efforts to reduce poverty can be frustrated, the Government has decided to accelerate implementation of pay reform programme. At the same time, a more comprehensive review of the MTPP is being undertaken by the Presidential Commission on Public Service Pay, which is focusing on implementing the medium term policy in relation to the employment levels for each MDA and their budgetary implications and on recommendations for an improved implementation plan in the longer term. The Commission will submit its recommendations to the Government in December 2006, subsequent to which a revised MTPP will be developed. Separately, a Government task force is undertaking a comprehensive review of the allowances regime and will propose further measures to rationalize the regime.

23. Development expenditure is projected to increase by 55 percent in 2006/07, including the use of IMF MDRI resources for investment in the energy sector to diversify TANESCO's generation sources. Other expenditures are projected to increase modestly because of the unwinding of one-off spending in last year's budget.

24. Further improvement of public expenditure planning and management capacity remains a priority objective. We intend to strengthen implementation capacity to ensure prudence in fiscal management, compliance with the public procurement regulations, and intensification of the fight against corruption. We will also improve expenditure control in LGAs, prevent the build up of expenditure arrears, and ensure that resources transferred to LGAs are used for intended purposes.

25. In addition, to improve further the efficiency in resource use, we plan to address the problem of the large idle Government balances in commercial bank accounts through a joint Ministry of Finance and BoT Cash Management Committee. The Committee will survey all Government deposits in commercial banks and formulate a phased plan for closing such accounts, or for linking them to the Treasury Single Account (TSA) as sub-accounts, by 31st December, 2006. With assistance from the East–AFRITAC, we also intend to establish a Cash Management Unit in the Accountant General's Department with the objective of developing capacity for cash flow planning. The Cash Management Committee and the Cash Management Unit will meet regularly. The Unit will produce a 2007/08 cash plan and a rolling three month cash flow forecast by end-June 2007 (a structural benchmark). These reforms will allow us to execute the budget more effectively and strengthen liquidity management, e.g., by better meeting operational cash flow requirements of MDAs and limiting idle Government balances, especially those held outside the central bank.

26. The Government will also strengthen the Expenditure Tracking and Monitoring Unit at the Ministry of Finance in order to improve further the efficiency in resource utilisation. In addition, the rolling out of the IFMS to LGAs will continue so as to reach all the 124 LGAs within the time frame of the 3-year PSI programme. Together, these measures will improve accountability in public resource utilisation at both the Central and Local levels of the Government.

27. In tandem with improving the efficiency in resource use, the Government will continue to urge donors to channel aid through the budgetary system, and move to general budget support in line with commitments under the Joint Assistance Strategy. The National Audit Office will continue to be strengthened, with implementation of its capacity building programme accelerated. On account of improved capacity, the National Audit Report for 2004/05 was finalised and released on time. In addition, audit reports are now produced in both the national language, Kiswahili, and English versions, and are published widely, including on the national website in order to increase further the transparency of the Government budget.

28. The IMF MDRI proceeds which have been placed in a special account at the BoT will be passed on to the Government solely to fund foreign exchange components of top priority growth-critical economic projects and pro-poor outlays. All such outlays will be included in the budget and subject to regular procurement and financial management laws and regulations. Administrative regulations were introduced to ensure that disbursements are made from the account in a transparent manner that can be easily tracked. It is envisaged that the MDRI account will be utilized over a period of 3 years, and be properly structured and closely monitored. In 2006/07, we plan to use about US$200 million from the account for enhancing TANESCO's leased and purchased power generation capacity and meeting the cost of food imports.

Monetary policy

29. Strong demand for credit is expected to continue in 2006/07. Small and medium sized enterprises, exporters and other investors in the productive sectors of the economy are also poised to benefit from financial sector reforms underway, including the already established credit guarantee schemes and the envisaged Development Finance Guarantee Facility (DFGF) and Development Finance Institution (DFI).

30. Monetary policy during 2006/07 will continue to focus on sustaining price stability. Given the projected demand for credit and the expected inflows of foreign assistance, the BoT will remain vigilant in containing any excess liquidity. Controlling the growth of reserve money will remain central in the implementation of monetary policy.

31. The BoT views a deceleration of the annual growth rate of broad money from 31.6 percent at end-June 2006 to about 24 percent by end-June 2007 as consistent with targeted inflation, while allowing private sector credit growth of about 36 percent. To reach this growth limit of M3, the BoT will target reserve money growth of about 29 percent, relying on a mix of sales of government paper, foreign exchange, and other instruments, including repos. The BoT will utilize an average reserve money targeting system, rather than end-period targets, which is expected to help smooth the path of liquidity.

Financial sector reforms

32. The Government will step up the pace of implementation of its second generation financial sector reforms in the context of its Financial Sector Reform Implementation Action Plan (FSIAP). The plan and its action matrix, which identifies key actions and development partner support in each of the nine major areas of reform,[2] have been prepared and the

[2] The nine areas are: (1) monetary policy reform; (2) strengthening the banking sector; (3) developing financial markets; (4) reforming the pension sector; (5) strengthening the insurance industry; (6) facilitating the provision of long term development finance; (7) strengthening micro and rural finance; (8) legal and judicial reform; and (9) land administration.

Government has signed funding instruments with development partners for implementation of some of the plan's key components. The BoT is at the same time assessing and implementing key IMF technical assistance recommendations on monetary and foreign exchange operations. These two road maps constitute the core financial sector and monetary operations reform strategies.

33. The Government recognises the importance of small and medium-sized enterprises (SMEs) as a key source of growth. Further policy measures are being developed to facilitate lending by commercial banks to SMEs. At the same time a number of banks have established SME lending units, which also help entrepreneurs prepare bankable business plans. Hitherto, 16 banks are participating in the SME Credit Guarantee Scheme established by the Government. Lending to this and other sectors is also expected to receive an important boost from better credit information. A proposed legal and regulatory framework for a credit information system is under preparation and will be submitted to the Government for its approval by end-March 2007.

34. The Government is also addressing the dearth of medium-and-long-term credit for productive sectors of the economy. A proposed unified legal and regulatory framework and investment guidelines for pension funds are being developed by an inter-agency committee on financial sector reform. The framework and guidelines will be submitted to the Government by end-June 2007 (structural benchmark).

35. Work on the planned Development Finance Guarantee Facility (DFGF) is expected to be supported by technical assistance from the World Bank. The DFGF will initially be managed by the BoT on behalf of the Government, and will provide partial guarantees for medium-and-long-term loans from banks with a focus on labor-intensive export oriented projects, in a manner that protects public resources. The Government's initial exposure under the scheme will be modest and appropriately funded from the budget. The DFGF will have strong governance structures in line with international best practices, including a provision for an independent operational audit to verify that the funds utilised under the scheme are used for the purposes intended, and that proper governance procedures are followed. Pursuant to the National Debt Strategy and the Loans, Guarantees, and Grants Act 1974, as amended, the Government will not provide any loan guarantees to private sector parties except through the DFGF, or the SMEs and Export Credit Guarantee Schemes.

36. A significant restructuring of the Tanzania Investment Bank (TIB) is underway to enhance its internal capacity and governance and facilitate its planned transformation into a development finance institution (DFI). The new TIB will channel Government seed money voted in the budget and any multilateral and bilateral donor funds made available to the productive sectors, and will not accept new deposits from the public other than its credit customers. The DFI will not raise any funds under Government guarantee, other than concessional funds from donors. The DFI will operate under strong governance structures, with the instruments establishing it requiring an annual operational audit.

37. Other second-generation financial sector reform actions include a proposed Leasing Law that will strengthen the legal framework for leasing, without providing any new tax exemptions, which is expected to be adopted by the Government by end-February 2007.[3] Additionally, the Government is developing procedures and guidelines for establishment of Savings and Credit Co-operative Societies (SACCOS) by community based groups to facilitate access to bank credit. Other reforms impacting the financial sector, including strengthening property rights, are underway in the context of the BEST programme.

38. Other measures to improve the business environment are underway. The Business Activities Registration Bill has been submitted to Parliament for first reading, and will replace the current universal licensing system with the registration system. The new registration system will facilitate formalization of businesses and property of informal operators, and collection of data, while creating the necessary environment for voluntary registration and compliance. Regulatory reforms in land titling and commercial dispute resolution are at various stages of implementation. The Government will also begin implementation of a National Identity Card Project beginning in 2006/07 which, together with land surveying, titling and commercial dispute resolution, will improve public security, support revenue collection, and facilitate the further deepening of the financial sector.

III. MEDIUM-TERM MACROECONOMIC OUTLOOK

39. The Government's overall medium-term goals are to stimulate broad-based economic growth, enhance income earnings of households, and raise the quality of life and social well being. The strategy is to build on the achievements of the past decade and scale up economic growth through continuation of economic reforms and improvement of growth-oriented investment. The primary focus in this regard is improving infrastructure (broadly defined to include transport, communication, energy, and water) given its relative importance in mitigating supply side constraints and improving productivity, and reducing income poverty in Tanzania. Other areas of importance include transformation of agriculture and value-addition processes, and enhancing the human capital base and financial services through the on-going financial sector reforms.

40. MKUKUTA acknowledges the importance of physical infrastructure in stimulating economic growth and reducing income poverty. Rural areas in particular, where 80 percent of the poor population lives, lack adequate road networks, energy, means of communications, reliable water supplies, and financial services. These gaps impede engagement in diversified economic activities and increase the work load for poor women and children. Lack of reliable and adequate road networks also limit access to markets, and investment. Poor

[3] The draft leasing law to be submitted to Government will also be accompanied by a proposal for amendments of Tax Legislation on Leasing.

infrastructure also impedes potentials for intra-regional trade, and limits movement of goods, capital, and labor between Tanzania and the neighbouring countries, thereby inhibiting progress in regional integration.

41. In the course of the PSI-supported program, the Government plans to marshal a resource mobilization drive to raise additional concessional resources, including support from the Millennium Challenge Account of the United States, and scaling up of concessional financing from the World Bank, the African Development Bank, and other key donors to address impediments to sustainable and pro-poor growth. Attention will also be given to the fastest growing sectors of tourism and mining. The objective is also to attract more private investment in these sectors and to create an enabling environment for value addition processes and sectoral synergies with the rest of the economy.

42. The MDRI relief from the multilateral financial institutions will enhance further Tanzania's debt sustainability position. Nevertheless, the Government will continue to seek debt relief on the HIPC terms from the remaining creditors and ensure that debt remains at sustainable levels. Actions in debt management will continue to be guided by the National Debt Strategy (1999) and the Loans, Guarantees and Grants Act, 1974 as amended in 2003, which include, among others, centralisation of borrowing powers in the Minister for Finance and a requirement for all new external borrowing to be from concessional sources only.

Medium-term fiscal outlook

43. While the flow of external assistance is expected to be sizable, the Government recognizes that strong domestic revenue performance is critical to protecting priority expenditure and to reducing aid-dependence. Our objective therefore is to increase the ratio of revenue to GDP to about 15.5 percent by 2008/09 (under current macroeconomic and policy assumptions). The Government would consider a number of tax policy and administrative measures to reach this goal. This would include reviewing comprehensively the level of excises on some products. Additionally, the Government will explore the feasibility of introducing an alternative corporate minimum tax regime for perpetual loss making enterprises. On the revenue administration side, registration of small enterprises will be reinforced in coordination with relevant agencies, and the registration information will be linked to the TRA database.

44. In addition to the continued reform of Tax and Customs Administration, the Government is taking various measures aimed at expanding the tax base. The Government will assess avenues for increasing domestic nontax revenue, particularly from exploitation of other natural resources and user charges without undue adverse effects on the business environment, and continually review tax exemptions with a view to reducing them. The dialogue initiated recently with large mining companies for the review of the terms of their licenses is expected to yield additional revenues in the medium term. Other specific revenue

measures will be developed in consultation with stakeholders, drawing from recent TA and Government reviews.

45. The completion of the ongoing MKUKUTA costing exercise will strengthen further prioritization of interventions and the link between resource allocations and MKUKUTA. The costing of MKUKUTA interventions for the transport, water, health and agriculture sectors is at an advanced stage, and will provide input to the next budget cycle. An investment plan for the energy sector has also been developed as part of TANESCO's Medium Term Financial Recovery Plan (described below).

46. The Government will continue to implement a Medium-Term Expenditure Framework (MTEF) to steer in a multi-year budgeting system that ensures better planning, prioritization and matching of expenditures with expected resource availability. To further improve public expenditure management, the Government will strengthen internal and external audits of public expenditure, especially the capacity of the National Audit Office, including facilitating more expeditious access to records and timely delivery of reports on the audited accounts to Parliament. The Government will also continue to use the Public Expenditure Review (PER) and the General Budget Support Annual Review to anchor broad policy consultations with all stakeholders. At the same time, the initiatives to build institutional capacity for public financial management will continue through the Public Financial Management Reform Programme (PFMRP).

47. In order to support private sector credit and development, fiscal policy will be targeted at limiting domestic financing of the budget in the medium term to around zero, with Government spending oriented towards growth engendering and poverty reducing items, in line with MKUKUTA. Development expenditure is therefore expected to increase from 6.3 percent of GDP in 2005/06 to 8.3 percent of GDP by 2008/09, with slightly higher amounts in the intervening years on account of MDRI from the Fund. Overall budget expenditure is expected to be around 28 percent of GDP during 2007/08-2008/09.

48. The Government will finalise the Medium-Term Transportation Infrastructure Investment Plan by December 2006 which, combined with the Power Sector Reform Strategy, will guide investment in the two critical sectors. In this connection, the Government will undertake a review of governance measures applicable to the selection and financing of large infrastructure projects. Specifically, the Government will seek expert advice as needed to ensure best practices with regard to prior assessment of the economic and financial viability of projects and Build Operate Own/Build Operate Transfer guidelines.

49. The recently launched Agricultural Sector Development Programme is expected to revamp economic development in rural areas. Strategies to promote private sector investment in this and other sectors include streamlining and simplifying the regulatory environment, improving the functioning of the legal system, addressing human resource

constraints through improved vocational training, and streamlining the procedures for granting work permits to enhance availability of scarce skilled labour.

50. Tanzania's high aid dependency poses a challenge to policy implementation. While substantial progress has been made in development partner harmonisation and coordination, the task is not yet complete. Harmonisation efforts seek to reduce the transaction costs associated with aid delivery, enhance the Government's management of external resources, strengthen Government systems, and ensure domestic accountability. To achieve this, the Government will work with development partners to secure joint programming of their assistance in the context of the JAS, which targets, among others, improving aid predictability and effectiveness.

External sector over the medium term

51. The external current account deficit, including grants, is projected to increase further to an average of about 10.5 percent of GDP during 2006/07-2008/09. Exports of goods and services are projected to grow by an annual average of about 10 percent during the next three years, driven by continued strong growth in non-traditional exports. Imports are projected to grow by an annual average of about 12 percent during the same period, mainly reflecting significant capital investments needs of the energy sector, as well as expectations of continued high oil prices. The projected moderate increase in the current account deficit is expected to be covered by higher external assistance in the form of grants and concessional loans as well as a continued increase in foreign direct investments.

52. The Government remains committed to further trade liberalization to enhance competitiveness, including by strengthening trade integration with our key regional trading partners Kenya and Uganda in the context of the East African Community (EAC). Following the introduction of EAC Customs Union (CU) in January 2005, a timetable was approved in April 2006 for launching a common market by 2010. To that end, the EAC Secretariat in Arusha will shortly commission a study on the main aspects of the common market, which will be characterized, *inter alia*, by zero intra-EAC custom tariffs and a free movement of labor. The Government of Tanzania, together with its EAC partners, also remains committed to review, by 2010, the level of the common external tariff (CET) of the EAC CU, with a view to possibly lowering the CET. The Government is further working to lower existing non-tariff barriers within the EAC CU relating to standardization, quality assurance, and metrology.

Monetary programme in the medium term

53. Monetary policy over the medium-term will be geared toward maintaining inflation below 5 percent, while facilitating economic growth through adequate provision of credit to the private sector for productive purposes, and maintaining adequate foreign exchange reserves. Effectiveness of monetary policy is expected to increase over the course of the PSI-supported programme based on measures to be undertaken to improve liquidity management

and the efficiency of the financial markets, in line with the financial sector reforms noted above. The BoT will continue to allow the level of the exchange rate to be determined by market forces.

Energy

54. To address the energy crisis and put TANESCO's finances on a sound footing, the Government, in collaboration with stakeholders including the IMF, the World Bank, and the domestic private sector, has prepared a Medium-Term Financial Recovery Plan (FRP) for TANESCO covering the period 2006/07–2009/10 and a draft Power Sector Reform Strategy covering the immediate, medium- and long-term perspectives. The FRP is critical for turning around TANESCO's financial situation. It involves a number of actions, including the Government's acquisition of the Independent Power Tanzania Limited (IPTL) plant and its conversion to use cheaper domestic natural gas instead of imported liquid fuel, installation of leased and newly purchased gas-fired generators, installation of privately owned coal generation capacity, a substantial increase in the utility's customer base (including particularly connection of the large mining operators to the grid) and increasing the population access to electricity and strengthening the transmission and distribution network. These measures, which require substantial capital investment, will have to be supplemented by tariff adjustments to minimize TANESCO's financial losses and to ensure that electricity consumers contribute to the financial viability and sustainability of the utility. In this regard, the FRP will be adopted formally by the Government by end-December 2006,[4] together with a tariff increase of 6 percent to be implemented effective January 2007.

55. The adopted FRP envisages that TANESCO will finance its projected short term operational deficits through semi-annual tariff adjustments supported by a Government guaranteed commercial loan of up to T Sh 250 billion, with the Government—supported by development partners—financing the critical investments. In addition to the January 2007 tariff increase, the FRP provides for further semi-annual tariff increases of at least 5 percent beginning July 2007.[5] TANESCO's medium to long term outlook remains sound and, according to the FRP, TANESCO will reach an operational break-even point in the first half of 2009, and subsequently begin generating rising cash-flow surpluses.

56. The Government budget for 2006/07 includes allocations for TANESCO's procurement of urgently needed leased generation capacity, and acquisition of own gas fired generators to end power rationing. The Government believes that, together with the planned

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[4] Structural assessment criterion.

[5] The July 2007 tariff hike to keep TANESCO on its path to financial viability, consistent with paras. 54-56, is an end-July structural benchmark.

acquisition and conversion of IPTL from heavy fuel to natural gas and refinancing of the expensive Songas expansion investment, these actions will assure the people of Tanzania, investors, and Tanzania's development partners of its resolve in addressing the current energy crisis, and allow it to obtain concessional funding for implementing TANESCO's capital investment plan estimated at some US$1 billion over the 2006 to 2010 period. To ensure TANESCO's adherence to the agreed revenue and expenditure targets, the monthly reporting and monitoring procedure established early this year under the Treasury, and including TANESCO, the Ministries of Energy and Minerals, and Planning, Economy and Empowerment, as well as key stakeholders, will be sustained. In the event of any shortfalls from the envisaged financial path to TANESCO's financial viability, the Government is committed to implement tariff increases going beyond the 5 percent semi-annual increase included in the FRP. Finally, to ensure management continuity for TANESCO following the expiration of the current management contract at the end of 2006, the Government is actively working on a TANESCO management succession plan.

Privatisation

57. Privatisation of public enterprises will continue, with the objective of improving the performance and contribution of the respective enterprises to the economy and expand the role of the private sector. In pursuit of the dual objectives of Government divestiture from commercial enterprises and development of local capital markets, the divestiture programme includes, among others, the sale to the public of the remaining Government shares in previously divested enterprises through the Stock Exchange. After successfully divesting more than 400 enterprises, the tenure of the Public Sector Reform Commission (PSRC) has been extended to December, 2007 in order to complete the privatisation transactions for the remaining 36 public enterprises. In undertaking this task, due caution will be exercised in the privatisation of large public utilities in order not to disrupt economic activities.

Governance

58. The Government is committed to strengthening governance and fighting corruption to minimise resource leakages and strengthen accountability. The new PSI represents an opportunity to reinforce the Government's efforts in this area. A key vehicle for strengthening the legal framework for fighting corruption will be the launching this year of the second National Anti-Corruption Strategy Action Plan (NACSAP II) and the new Anti-Corruption Bill. The draft Bill will integrate all anti-corruption conventions ratified by Tanzania and will contain key measures to strengthen the capacity and effectiveness of Government in this area, particularly with respect to strengthening prosecution powers of the Prevention of Corruption Bureau (PCB). The Anti-Corruption Bill will be discussed by stakeholders, and then submitted to parliament by February 2007 (a structural benchmark under the PSI).

59. Progress has been made in ensuring that the National Audit Office (NAO) has suitable qualified staff and working tools in order to meet NAO's important objective of developing appropriate capacity to carry out computer based audits of Government accounts maintained in the IFMS. In this regard, staff has already been trained and procurement and installation of computer equipment at the NAO has been completed for auditing computerised accounts of revenue collection at the TRA. With regard to the auditing of Government expenditure accounts, equipment has been installed and staff training was completed in May 2006. This is expected to facilitate transition to an audit through IFMS in the near future. The NAO has also continued with its staff training programme to strengthen audit capacity.

60. The Government has vigorously pursued other elements of its anticorruption agenda. NACSAP II incorporates interventions at both the central and local Government levels. MDAs are already in the process of updating their Anti-Corruption Plans in line with the new NACSAP. With the support of the World Bank and other donors, the Government is also scaling up its efforts to implement its comprehensive Legal Sector Reform Programme. In addition, the Government, through a programme supported by the Millennium Challenge Corporation of the US Government, plans to build capacity of oversight and watchdog institutions as well as the media and civil society as part of its efforts to increase their effectiveness in ensuring accountability and therefore act as a deterrent to corruption. Government declarations against corruption are continuing to be a common feature of political statements, and efforts are under way to build the capacity of the civil society, especially the media, to report corruption incidents professionally and accurately.

61. An Anti-Money Laundering Bill was submitted to Parliament for first reading in July 2006. One of the key elements of this Bill is establishment of a Financial Intelligence Unit (FIU) to monitor and report questionable financial transactions to relevant authorities. Other actions against corruption include strengthening of the procurement function in public institutions by developing the procurement cadre, and capacity building in the PPRA, spending agencies, and civil society especially the media to report corruption incidents professionally and accurately.

MINISTRY OF FINANCE
DAR ES SALAAM, TANZANIA

Table 1. Tanzania: Quantitative Performance Criteria and Indicative Targets Under the PRGF Arrangement, March-June 2006, and Proposed Quantitative Assessment Criteria and Indicative Targets Under the Policy Support Instrument, December 2006-June 2007

	2006							2007	
	March			June			December	March	June
	Performance Criteria	Adjusted	Actual	Indicative Targets	Adjusted	Actual	Assessment Criteria	Indicative Targets	Assessment Criteria
	(Billions of Tanzania shillings; end or period, unless otherwise indicated)								
Net domestic financing of the government of Tanzania (cumulative, ceiling) [1] [2]	309	397	238	371	420	349	-9	-72	67
Accumulation of arrears (ceiling; indicative target only)	0	0	0	0	0	0	0	0	0
Net domestic assets of the Bank of Tanzania (ceiling; indicative target only) [2] [3]	-735	-647	-1,123	-570	-521	-943	---	---	---
Reserve money (ceiling)	1,328	1,328	1,304	1,348	1,348	1,296	---	---	---
Average reserve money (upper bound) [4]	---	---	---	---	---	---	1,551	1,620	1,680
Average reserve money target [4]	---	---	---	---	---	---	1,536	1,604	1,664
Average reserve money (lower bound) [4]	---	---	---	---	---	---	1,520	1,588	1,647
	(Millions of U.S. dollars; end of period)								
Net international reserves of the Bank of Tanzania (floor) [5]	1,779	1,705	2,086	1,656	1,616	1,927	1,919	1,961	1,754
Accumulation of external payments arrears (ceiling) [6]	0	0	0	0	0	0	0	0	0
Contracting or guaranteeing of external debt on nonconcessional terms (ceiling) [6]	0	0	0	0	0	0	0	0	0
Memorandum item:									
Foreign program assistance (cumulative grants and loans) [1]	688	688	614	767	767	727	754	924	932

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 November 20, 2006.

[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.
[3] Net domestic asset figures here are different from BoT (NDA) in the monetary authorities' accounts, because they are adjusted for the program exchange rate. NDA ceilings are set at the Tanzania shilling equivalent of US$ 200 million above the projected levels.
[4] Assessment criteria and indicative target apply to upper bound only.
[5] Floors are set US$ 200 million below projected levels. Floor will be adjusted downward for any shortfall in foreign program assistance from the amounts shown in the memorandum item.
[6] Continuous performance criterion under the PRGF and continuous assessment criterion under the PSI; excludes arrears on debt-service payments pending rescheduling agreements.

Table 2. Tanzania: Structural Peformance Criteria and Benchmarks Under the Poverty Reduction and Growth Facility Arrangement, April 2006-June 2006

Measure	Date of Implementation	Status
Financial sector reforms		
Submit to Parliament the Bank of Tanzania Act and the Banking and Financial Institutions Act, consistent with paragraph 23 of the MEFP.[2]	End-April 2006.	Observed.
Limit Government guarantees under the three medium-term credit facilities as described in paragraphs 42-44 of the MEFP attached to the Government's July 14, 2005 letter of intent.[1]	Continuous.	Observed.
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 attached to the Governnment's July 14, 2005 letter of intent.[1]	End-June 2006.	Delayed. Consultant (through World Bank) commenced work in August, 2006.
Energy Sector		
The Government will finalize a financial recovery plan, including tariff increases as appropriate, and a medium-term Power Sector Strategy through FY 2008/09 for TANESCO, consistent with paras. 32-33 of the MEFP.[1]	End-June 2006.	Delayed. Financial recovery plan has been finalized. The medium-term strategy will be finalized by end-December.
Governance		
The Government will ensure that the instruments establishing the Development Finance Guarantee Facility 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 attached to the Government's July 14, 2005 letter of intent.[1]	Continuous.	Establishment of the DFGF has been delayed.
Publish the list of companies, individuals, and NGOs that have received tax exemptions each quarter under the Treasury voucher scheme.[1]	Quarterly.	Observed.

Note: MEFP references relate to the March 24, 2006 letter of intent, unless othewise specified.

[1] Structural benchmark.

[2] Performance criterion.

Table 3. Tanzania: Structural Assessment Criteria and Benchmarks under the Policy Support Instrument, December 2006-July 2007

Measure	Date of Implementation
Fiscal Reforms	
Develop a dated action plan for integration of ASYCUDA and TISCAN system-based processes, consistent with para. 19 of the MEFP. [1]	End-December 2006.
Cash Management Unit, with representatives from the Ministry of Finance and the Bank of Tanzania, to complete 2007/08 Government cash plan, including a three month cash flow forecast, consistent with para. 25 of the MEFP. [1]	End-June 2007.
Monetary and financial sector reform	
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, consistent with para. 34 of the MEFP. [1]	End-June 2007.
Governance	
Submit Anti-Corruption Bill to Parliament, consistent with para. 58 of the MEFP. [1]	End-February 2007.
Publish the list of companies, individuals, and NGOs that have received tax exemptions each quarter. [1]	Continuous.
Energy	
Government to adopt the Medium-Term Financial Recovery Plan for TANESCO, consistent with paras. 54-56 of the MEFP. [2]	End-December 2006.
Raise electricity tariffs effective July 2007 to keep TANESCO on its path to financial viability, consistent with paras. 54-56 of the MEFP. [1]	End-July 2007.

Note: MEFP references relate to the November 20, 2006 Letter of Intent, unless othewise specified.

[1] Structural benchmark.

[2] Assessment criterion.

Appendix I—Attachment II

Technical Memorandum of Understanding on Selected Concepts and Definitions Used in the Monitoring of the PSI-Supported Program

November 20, 2006

Introduction

1. The purpose of this Technical Memorandum of Understanding (TMU) is to describe concepts and definitions that are being used in the monitoring of the quantitative assessment criteria and indicative targets under the Tanzania's PSI-supported program.

Net international reserves

2. Net international reserves (NIR) of the Bank of Tanzania (BoT) are defined as reserve assets minus reserve liabilities. The BoT's reserve assets include (i) monetary gold; (ii) holdings of SDRs; (iii) the reserve position at the IMF; (iv) holdings of foreign exchange, including the Tanzanian government's Poverty Reduction Budget Support (PRBS) and all of its foreign currency deposits at the BoT, and (v) other liquid and marketable assets readily available to the monetary authorities. Reserve assets exclude assets pledged or otherwise encumbered, including but not limited to assets used as collateral or guaranteed for a third-party external liability (assets not readily available). The BoT's reserve liabilities include (i) all short-term foreign exchange liabilities to nonresidents, and (ii) all liabilities to the IMF. Reserve liabilities exclude medium and long-term foreign liabilities.

Reserve money and reserve money band

3. Reserve money is defined as the sum of currency issued by the BoT, including the vault cash of commercial banks, and the deposits of the commercial banks with the BoT. The reserve money targets are the projected daily averages of December 2006, March 2007, and June 2007, within a symmetrical one percent band. The upper bound of the band serves as the assessment criterion or indicative target.

Net domestic financing of the Government of Tanzania

4. Net domestic financing of the Government of Tanzania (NDF) includes financing of the budget of the central (union) government of Tanzania ("government") by the banking system (BoT and commercial banks) and the nonbank public. NDF is calculated as the cumulative change since the beginning of the fiscal year in the sum of (i) loans and advances

to the government by the BoT (including paper issued by the BoT for monetary policy purposes) minus all government deposits with the BoT (including funds from paper issued by the BoT for monetary policy purposes); (ii) loans and advances to the government by the commercial banks minus all government deposits held with the banks; and (iii) the outstanding stock of domestic debt to nonbanks excluding: government debt issued for the recapitalization of the NMB and TIB; debt swaps with COMELCO (Russia) and the government of Bulgaria; mortgage on acquired sisal estates; compensation claims; and debt of parastatal companies assumed by the government.

Government deposits

5. Government deposits at the BoT include government deposits as reported in the BoT balance sheet, and foreign currency-denominated government deposits at the BoT, including the PRBS account and the foreign currency deposit account.

External payments arrears

6. External payments arrears consist of the total amount of external debt service obligations (interest and principal) of the government and the BoT that have not been paid at the time they are due, excluding arrears on external debt service obligations pending the conclusion of debt-rescheduling arrangements.

Contracting or guaranteeing of external debt on nonconcessional terms

7. The term "debt" will have the meaning set forth in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 (Decision No. 12274-(00/85)). Government debt is outstanding debt owed or guaranteed by the Government of Tanzania or the Bank of Tanzania.

8. Government debt is considered nonconcessional if the grant element is lower than 35 percent, calculated using discount rates based on Organization for Economic Cooperation and Development (OECD) commercial interest reference rates (CIRR), adjusted as appropriate for different maturities. This assessment criterion applies not only to debt as defined in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 (Decision No. 12274-(00/85)), but also to commitments contracted or guaranteed for which value has not been received.

Budgetary arrears

9. Budgetary arrears are defined as new arrears accumulated during the fiscal year on wages, domestic interest, and goods and services.

Foreign program assistance

10. Foreign program assistance is defined as grants and loans received by the Ministry of Finance through BoT accounts and commercial banks and is calculated as the cumulative sum, since the beginning of the fiscal year, of the receipts from (i) program loans and (ii) program grants.

Adjusters

Net international reserves

11. The quantitative targets for the BoT's net international reserves will be adjusted downward by the amount in U.S. dollars of any shortfall in foreign program assistance, relative to projections shown in the Quantitative Assessment Criteria and Indicative Targets Table attached to the applicable Letter of Intent and Memorandum of Economic and Financial Polices of the Government of Tanzania.

Net domestic financing

12. The quantitative limits on the net domestic financing of the Government of Tanzania will be adjusted upward for any shortfall in foreign program assistance in U.S. dollars, converted into Tanzania shillings at the average quarterly exchange rate.

Data reporting requirements

For purposes of monitoring the program, the government of Tanzania will provide the data listed below.

13. The following tables related reporting on the developments in relation to the program's assessment criteria and indicative targets to be provided quarterly:

Table of Quantitative Assessment Criteria and Indicative Targets.
Table of Structural Assessment Criteria and Benchmarks.

14. Other data to be provided monthly, quarterly, or other frequency of compilation:

The balance sheet of the BoT.
The consolidated balance sheet of the commercial banks.
The monetary survey.
Commercial banks domestic lending by borrowing sectors.
Commercial banks interest rate structure.
The flash report on revenues and expenditures.

The TRA revenue report.
The Monthly Domestic Debt Report.
Monthly report on Central Government Operations.
The external cash-flow statement, including details on payments of interest and principal on government external debt.
Program grants and loans.
Exports and Imports.
Balance of payments.
The published consumer price index report of the National Bureau of Statistics (NBS).
The annual national accounts statistics in constant and current prices as prepared by the NBS.

Appendix II—Tanzania: Relations with the Fund
(As of September 30, 2006)

I. Membership Status: Joined 09/10/62; Article VIII

II.	General Resources Account:	SDR million	Percent Quota
	Quota	198.90	100.00
	Fund holdings of currency	188.90	94.97
	Reserve position in Fund	10.00	5.03
III.	**SDR Department:**	SDR million	Percent Allocation
	Net cumulative allocation	31.37	100.00
	Holdings	0.07	0.23
IV.	**Outstanding Purchases and Loans:**	SDR million	Percent Quota
	Poverty Reduction and Growth Facility Arrangements	8.40	4.22

V. Latest Financial Arrangements:

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
PRGF	08/16/2003	12/31/2006	19.60	16.80
PRGF	04/04/2000	08/15/2003	135.00	135.00
PRGF	11/08/1996	02/07/2000	181.59	181.59

VI. Projected Payments to Fund
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	**2007**	**2008**	**2009**	**2010**
Principal					0.28
Charges/interest	0.32	1.26	1.26	1.26	1.25
Total	0.32	1.26	1.26	1.26	1.53

VII. Implementation of HIPC Initiative:

	Enhanced framework
Commitment of HIPC assistance	
Decision point date	Apr 2000
Total assistance (US$ million)	2,026.00
Of which: Fund assistance (US$ million)	119.80
Completion point date	11/21/01
Delivery of Fund assistance (SDR million)	
Amount disbursed	88.95
Interim assistance	26.68
Completion point balance	62.27
Additional disbursement of interest income[1]	7.45
Total disbursements	96.40

VIII. Implementation of MDRI Assistance:

1.	Total debt relief (SDR million)[2]	234.03
	Of which: MDRI	207.00
	HIPC	27.03

2. Debt relief by facility (SDR million)

	Eligible Debt		
Delivery date	**GRA**	**PRGF**	**Total**
January 2006	N/A	234.03	234.03

[1] Under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative, an additional disbursement is made at the completion point that corresponds to interest income earned on amounts committed but not disbursed during the interim, calculated using the average return (during the interim period) on the investment of resources held by or for the benefit of the PRGF-HIPC Trust.

[2] The Multilateral Debt Relief Initiative (MDRI) provides 100 percent debt relief to eligible member countries that are qualified for the assistance. The debt relief covers the full stock of debt owed to the Fund as of end-2004 which remains outstanding at the time the member qualifies for such debt relief. The MDRI is financed by bilateral contributions and the Fund's own resources, as well as the resources already disbursed to the member under the HIPC Initiative (see Section VII above).

IX. Safeguards Assessments:

Under the Fund's safeguards assessment policy, the BoT was subjected to an assessment with respect to the PRGF arrangement, which was approved on August 16, 2003 and is scheduled to expire on December 31, 2006. A safeguards assessment of the BoT was completed on December 5, 2003, which concluded that whereas the bank had a relatively strong internal control environment, some vulnerabilities existed, notably in the external audit and financial reporting areas. Staff proposed recommendations are reported in Country Report No. 04/58. The BoT has implemented most of the recommendations of the safeguards assessment.

X. Exchange Arrangements:

The currency of Tanzania is the Tanzania shilling. The official exchange rate is determined in relation to the rate established in the interbank market for foreign exchange. The middle rate in terms of the U.S. dollar, the intervention currency, was T Sh 1,295 per U.S. dollar as of October 31, 2006. The exchange system is free of restrictions on the making of payments and transfers for current international transactions.

XI. Article IV Consultation:

The most recent Article IV consultation was concluded on August 6, 2004 (Country Reoprt No. 04/285). The next Article IV consultation is scheduled to take place in early 2007.

XII. Technical Assistance, 2003–06:

Department	Date	Form	Purpose
Fiscal Affairs	2002–03	Long-term consultant	Public expenditure management
	Mar.–May 2003	Peripatetic advisor	Tax administration
	April 2003	Mission	Inspection and tripartite review
	June–Sep. 2003	Long-term consultant	Public expenditure management
	Sep.–Oct. 2003	Peripatetic advisor	Tax administration
	Oct 2003	Mission	Tax administration
	November 2003	Multicountry mission	EAC tax harmonization
	April 2004	Mission	Customs administration
	July 2004	Peripatetic advisor	Tax administration
	July 2004	Mission	Public Expenditure Management Assessment and Action Plan
	September 2004	Mission	Review of mining taxation
	September 2004	Mission	Tax administration (Zanzibar)
	April 2005	Mission	Customs administration
	July 2005	Mission	Improve the effectiveness of the Ministry of Finance
	Aug.- Sep. 2005	Mission	Tax administration
	Oct.–Nov. 2005	Mission	Strengthen macro fiscal analysis at the Ministry of Finance
	December 2005	Mission	Tax policy
	April 2006	Peripatetic advisor	Strengthen macro fiscal analysis in Ministry of Finance

	April - May 2006	Expert	Customs Administration
	October 2006	Mission	Customs Administration
Legal	March – April, 2003	Mission	Income tax law
	Sept. 2003	Mission	Income tax law
	June 2004	Mission	Income tax law
	July 2004	Mission with MFD	Central and commercial bank legislative reform
	July–November 2004	Desk review	Foreign Exchange Act, Evidence Act, Bills of Exchange Ordnance, National Payment System bill, Electronic Transactions bill
Monetary and Capital Markets	Feb. 2003	Mission	Pre-FSAP mission
	May 2003	Mission	FSAP
	November 2003	Mission	FSAP follow-up workshop
	March 2004	Mission	Accounting and banking supervision
	June 2004	Mission	BoT accounting
	July 2004	Mission	Central and commercial banking legislation reform with LEG
	August 2004	Mission	Financial sector reform/FSAP follow-up
	November 2004	Mission	BoT accounting
	December 2004	Mission	Second FSAP follow-up workshop
	May 2005	Mission	Financial sector reform/FSAP follow-up
	September 2005	Mission	Credit reference database and IFRS-generated reports
	January 2006	Mission	Monetary and foreign exchange operations
	January 2006	Mission	Problem bank resolution
	February 2006	Mission	Prudential regulations
Statistics	2002–03	Long-term consultant	Multisector statistics
	August 2003	Mission	Government finance statistics
	Jan.-Feb. 2005	Mission	Monetary statistics
	October 2005	Mission	Balance of payments statistics
	December 2005	Mission	Technical assistance evaluation
	February 2006	Mission	CPI software application

XIII. Resident Representative: Ms. Lelde Schmitz has been the Senior Resident Representative since January 2005.

Appendix III—Tanzania: Relations with the World Bank Group

Partnership in Tanzania's Development Strategy

Tanzania's development strategy is set forth in the MKUKUTA (2005-2010). It is a successor to the Poverty Reduction Strategy Paper (PRSP) that covered 2000-2004. The MKUKUTA addresses three clusters of outcomes: (i) growth and the reduction of income poverty, (ii) improving the quality of life and social well-being, and (iii) strengthening governance and accountability.

Bank Group Strategy

The Bank's Board approved the current Country Assistance Strategy (CAS) for Tanzania on June 15, 2000. The CAS emphasizes higher economic growth, poverty reduction, and institutional reforms to improve governance. It conforms with the government's main strategy of adherence to macroeconomic stability, increased private sector participation in the economy, a renewed emphasis on rural development, and improved delivery of social services. It also supports the government's desire to enter into new relationships with its development partners, phasing in a switch from projects to programs, for more effective and efficient use of aid resources.

In support of Tanzania's efforts to strengthen donor harmonization and aid effectiveness, the Bank is integrating the preparation of a new CAS with the Joint Assistance Strategy for Tanzania (JAST) process, which was launched by the government in 2004. The JAST establishes general principles for development cooperation between the Government of Tanzania and all of its development partners (including the World Bank Group) with the objectives of achieving MKUKUTA goals, strengthening national ownership and improving aid effectiveness through harmonization and alignment of government and development partners processes. Development partners are currently working on a joint programming document that will put the JAST principles into action and define development partners' assistance to MKUKUTA implementation. The Bank's next CAS will be part of this joint document, which is expected to be finalized in early 2007.

The Bank is supporting implementation of the MKUKUTA through its full range of instruments, including general and sectoral budget support, project support, analytic and advisory activities, guarantees, and equity investments by IFC.

General budget support is provided in the form of Poverty Reduction Support Credits (PRSCs), jointly with a group of 13 other donors. There is joint performance assessment and a common review process. Tanzania's first PRSP was supported through a series of three PRSCs (2003-2005). After the finalization of Tanzania's second PRSP, the Bank together with the other budget support donors developed a new Performance Assessment Framework based on Tanzania's new PRSP. Its implementation is expected to be supported by the Bank through a series of five PRSCs, the first of which (PRSC-4) was approved by the Bank's Board of

Executive Directors on May 9, 2006. It covers six focus areas. These are the three clusters of the MKUKUTA (i.e., growth and the reduction of income poverty, improvements of quality of life and social well being, and governance and accountability), macroeconomic stability, resource allocation and budget consistency, and public financial management. The most recent annual review of general budget support to Tanzania was held in October 2006. PRSC-5 in the indicative amount of US$200 million is expected to be presented to the Board in April 2007, contingent on satisfactory progress as assessed against the joint GBS Performance Assessment Framework and the PRSC-5 triggers and prior actions.

In the social sectors, the Bank provides support through a sectoral development policy credit and grant for secondary education (US$150 million each), the third and last tranche (US$50million) of which is expected to be disbursed in FY07. The objectives are to improve education, expand school access, and increase retention at both primary and secondary levels. Bank support has already facilitated a significant increase in school enrollments. After the focus on primary and secondary education, in FY07 the Bank will also support reforms of higher education and science and technology in Tanzania through a proposed credit in the amount of US$150 million. The Bank contributes to the health sector multidonor "basket fund," which supports sector reforms and funds nonwage expenditures. A multisector HIV/AIDS project supports Tanzania's efforts to reduce HIV transmission and mitigate the adverse consequences of AIDS. In the water sector, one project supports technical, commercial, and financial rehabilitation of the water supply and sanitation services in Dar es Salaam. Another supports access to improved and sustained water and sanitation services in rural communities. A new Water Sector Support Program project (US$150 million) which will support GoT's strategy for improving governance of water resources management and sustainable delivery of water supply and sanitation services is expected to be presented to the Board in FY07. The objective of the IDA-funded Tanzania Social Action Fund (TASAF) is to enhance the capacities of communities and other stakeholders to prioritize, implement, and manage sustainable development initiatives and in the process improve socioeconomic services and opportunities. The Bank's Board approved the Tanzania Second Social Action Fund (US$150 million) on November 30, 2004, to continue the successful outcomes from TASAF-1.

In the agriculture sector, the Bank's Board approved in FY06 a project to support Tanzania's Agriculture Sector Development Program. In addition, the Participatory Agricultural Development and Empowerment Project Credit supports investments in technologies to reduce soil fertility decline.

A Forest Conservation and Management Project helps the government implement policy, particularly by building a framework for long-term sustainable management and conservation of Tanzania's forests. The Marine and Coastal Environment Management Project, aims to strengthen the management of the marine and coastal environment. The Lake Victoria Environmental Project is working to improve management of the Lake Victoria ecosystem.

Efforts to improve Tanzania's infrastructure are supported by road and railway projects. In April 2004, the Bank's Board approved a credit of US$122 million to (1) upgrade strategic road links,

(2) enhance road management capacity, and (3) improve the operations of Tanzanian Railways (TRC and TAZARA). In FY07, Bank support to this project is expected to be increased by a supplementary credit of US$100 million. The policy dialogue is now helping prepare a new Road Act, which will be the basis for strengthening the policy and institutional framework for road building and maintenance.

The Bank has also helped the government implement the Power Sector Restructuring Program. It has encouraged the government to build the domestic gas market and generate lower-cost power through the Songo Songo Gas Development and Power Generation Project, and is currently assisting the government in implementation of the Financial Recovery Plan for TANESCO and the development of a medium to long term strategy for the energy sector, which will provide the basis for further investment support. A credit to support rural electrification and access to ICT in the amount of US$80 million is under preparation for presentation to the Board in FY07.

The Local Government Support Project (US$150 million) is designed to strengthen fiscal decentralization, improving accountability in the use of local government resources, and improving management of intergovernmental transfers. Other project objectives are to increase access to infrastructure and services in unplanned areas of Dar es Salaam and improve revenue performance for sustainable operations and maintenance.

In December 2005, the Board approved a private sector competitiveness project to support Tanzania's efforts to create an enabling environment for its private sector and enhance its competitiveness; the focus is on micro-, small, and medium enterprises. The project will support Tanzania's Business Environment Strengthening (BEST) program, help set up computerized land and business registries, support judicial reform, and develop the financial sector.

An accountability, transparency, and integrity project was approved by the Board in May 2006. The project contributes to improved access to judicial and legal services and the accountable and transparent use of public financial resources. This will be achieved by improving the skills and systems to deliver judicial/legal services and public financial management, and strengthening the capacity of oversight institutions to perform their role.

The International Finance Corporation's (IFC) strategic focus in Tanzania is on the financial, agribusiness, tourism, infrastructure and SME sectors. Recent activities include a US$10 million investment in Bonite Bottlers, a carbonated soft drinks manufacturer, a US$5 million Exim Bank trade facility, and a US$5 million Tier II facility to Stanbic Tanzania. At present, the Multilateral Investment Guarantee Agency (MIGA) has no exposure in Tanzania and no projects planned.

Tanzania joined the World Bank Group in 1962. Beginning with an IDA credit for education in 1963, it has received a total of 138 credits, 7 grants and 27 loans, totaling US$6.2 billion (US$5.8 billion from IDA). Total disbursements amounted to US$5.1 billion as of October 31, 2006 (US$4.5 billion from IDA, US$356 million from the IBRD, and US$201 million in IDA grants). Currently, the portfolio comprises 25 active projects, with commitments of US$1.9 billion, in all major sectors; the undisbursed balance is US$1.1 billion.

Statement of Loans, Credits, and Grants (As of October 31, 2006; U.S. dollars)

	IBRD	IDA Credits	IDA Grants	Total
Original Principal	361,030,400	5,572,469,393	274,400,000	6,207,899,793
Cancellations	5,477,944	233,311,023	0	238,788,967
Disbursed	355,552,456	4,546,146,739	200,860,081	5,102,559,275
Undisbursed	0	969,942,689	81,496,226	1,051,438,915
Repaid	355,462,456	470,308,974	0	825,771,430
Due	0	1,007,628,114	0	1,007,628,114
Exchange Adjustment	0	0	0	0
Borrower Obligation	0	1,007,628,114	0	1,007,628,114

Source: World Bank Group

Bank-Fund collaboration in specific areas

The IMF and World Bank staffs collaborate closely in supporting Tanzania's structural reforms. As part of its assistance—through lending, country analytic work, and technical assistance—the Bank, in collaboration with the Fund, supports policy reforms in the following areas:

- **Public expenditure management.** Improvements in public expenditure management have been a top priority of the Tanzanian government since 1995. The Bank, the Fund, and other donors have worked closely to give the government needed support for institutional and policy reforms. The Fund is leading the dialogue on fiscal policy; the Bank concerns itself with strategic resource allocation and operational efficiency of public expenditures. To enhance strategic resource allocation and operational efficiency, the Bank is supporting a government-led, participatory public expenditure review/medium-term expenditure framework (MTEF) process. This effort has helped to strengthen and open up the budget process and the allocation of resources to pro-poor priority areas. The Bank is also involved in the fiscal decentralization process through analytical work and the Local Government Support Project. The Bank and the Fund work together to support institutional budget and expenditure management reforms. The annual Bank-led Public Expenditure and Financial Assessment Report (PEFAR) - the most recent one was issued in May 2006 - is the main instrument for the donor community to assess progress in these areas. It also integrates the assessment of Tanzania's financial management and procurement systems, which previously had been assessed through separate Country Financial Accountability Assessment and Country Procurement Assessment Reports.

- **Tax policy and administration reform.** The Bank and the Fund have, over the past few years, cooperated closely to support the government's efforts to modernize the tax system and enhance domestic revenue collection. The Fund has taken the lead in reforms of tax policy; the Bank has taken the lead in reforms to strengthen tax administration.

- **Financial sector reforms.** Tanzania has instituted far-reaching reforms in the financial sector with strong support from both the Bank and the Fund. Besides contributing to the policy dialogue, the Bank has provided significant technical assistance for financial sector reforms, primarily through two financial institution development projects that support government withdrawal from banking and nonbanking financial institutions while strengthening financial sector supervision. Among successful outcomes of these reforms are the privatization of Tanzania's largest bank and the entry of a fairly large number of international banks into the Tanzanian market. The Bank has also been involved in reform of the capital and securities authority, reform of pension systems, and liberalization of capital accounts. Through a separate project, the Bank supports the development of rural and microfinance services. A joint Bank-Fund Financial Sector Assessment Program (FSAP) was completed in June 2003. The recommendations of the FSAP have been incorporated into a reform strategy document for the financial sector. The Bank and the Fund have been allocated specific donor responsibilities in implementing the strategy document and have been active in coordination of the implementation process, including donor coordination.

- **Public service reform and improved service delivery.** In recent years, the government of Tanzania, with support from the Bank and other donors, has launched a number of major initiatives to improve performance and increase accountability, transparency, and integrity in the public sector. Among them are (i) the Public Service Reform Program (PSRP); (ii) the Local Government Reform Program; (iii) the Public Finance Management Reform Program; (iv) the National Anti-Corruption Strategy and Action Plans for Tanzania; (v) the National Framework on Good Governance, delineating a comprehensive approach to improving governance; (vi) the establishment of a Good Governance Coordination Unit in the president's office; and (vii) the launch of the Legal Sector Reform Program. The PSRP has been central to these reforms because its objective is to improve the accountability, transparency, and resource management of service delivery. The reforms are closely linked with other major reforms in public finance and decentralization. The PSRP aims to transform public service into a service that has the capacity, systems, and culture for client orientation and continuous improvement. Cooperation between the Bank and the Fund covers those areas where public sector reform directly affects fiscal stability and public sector financial management.

- **Energy sector.** The Bank and the Fund are working closely to find ways to address the crisis in the energy sector. The Bank takes the lead in assisting the authorities with developing emergency power generation plans to alleviate power supply shortages.

- **Trade reforms.** The Bank and the Fund are working closely to help Tanzania establish a pro-growth trade program. Within the context of the Integrated Framework, the Bank led the preparation of a Diagnostic Trade Integration Study that was issued in July 2005. The Bank is working toward trade expansion though its regional trade facilitation project. It is also active at the regional level in the dialogue on trade reforms within the East African Community.

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Appendix IV—Tanzania: Statistical Issues

The authorities cooperate fully in providing data to Fund missions in a timely manner. Tanzania's economic and financial database is adequate for surveillance and program-monitoring purposes, but remains weak despite progress in some areas and considerable technical assistance. Tanzania has few statistical publications and no fully articulated publication policy. Only limited data are reported for Zanzibar. The authorities are committed to improving the production and dissemination of macroeconomic and socio-demographic statistics through the General Data Dissemination System (GDDS). In October 2000, a GDDS multisector statistics mission assessed Tanzania's statistical systems and provided guidance on statistical practices and development in the areas of national accounts, prices, foreign trade, balance of payments, fiscal, monetary, and socio-demographic data. Tanzania's GDDS metadata were first posted on the IMF's Dissemination Standards Bulletin Board (DSBB) in July 2001 and were last updated in May 2004 and November 2005. A mission to prepare the data module for a Report on the Observance of Standards and Codes (data ROSC) was completed in October 2002, and the report was published in March 2004.

National accounts

National accounts statistics for mainland Tanzania are prepared by the National Bureau of Statistics (NBS) on the basis of data collected by its regional offices and by other government entities. Separate accounts for Zanzibar are compiled by the Office of the Chief Government Statistician for Zanzibar. The data sources for compiling the estimates for Tanzania by expenditure category, the external sector data, and the indicators used to extrapolate benchmark production levels have deficiencies that impede the accurate estimation of the savings-investment relationship. The accounts are largely based on the *1968 System of National Accounts* (*1968 SNA*) , but also includes certain elements of the *1993 SNA*, such as the inclusion of the elements of government expenditure (health and education) as household consumption, and the valuation of imports of goods at free-on-board (fob) prices. Annual national accounts are published at current prices and constant (1992) prices. Annual GDP estimates are also compiled at current prices for 21 regions of Tanzania. To improve the quality of the national accounts, the authorities, with help from donors, are changing the base year of the national accounts from 1992 to 2001. The revised series will be based on the Household Budget Survey (HBS) 2000/01, Integrated Labour Force Survey (ILFS) 2000/01 and Annual Survey of Industrial Production 1999/2000. An East AFRITAC mission to Tanzania in April 2006 provided training and assistance in the compilation of quarterly national accounts (QNA). These have been compiled at current prices since 2001 but have not been yet released. The series have some methodological shortcomings and in particular suffer from poor source data in the retail and wholesale sector. Recommendations have been made for improvements and for the compilation of constant (2001) price QNA pending on movement of annual accounts to the new base year.

Prices

The NBS compiles a monthly consumer price index (CPI) for mainland Tanzania based on consumer expenditure in 20 urban centers. A separate CPI (urban) is compiled for Zanzibar. The CPI has, since September 2004, been compiled (retroactively to January 2003) using weights based on the 2000/01 HBS data. Key changes then were a reduction in the weight given to food from 71 percent to 56 percent and an expansion of the number of products. The index excludes imputations for the price changes of owner-occupied housing. However, methodological problems that may have understated inflation led to the release of a revised CPI from September 2006, though this has not been backdated. The NBS has plans for a new HBS to be conducted in 2006/07 which should eventually lead to revision of the CPI weights.

Government finance statistics

The authorities provide Fund missions with monthly data on central government revenue, expenditure, and financing on a timely basis. Although the underlying concepts broadly follow the *Government Finance Statistics Manual 1986*, the reporting differs from international standards in the treatment of lending minus repayments, transfer payments and coverage. Coverage of data on the operations of the central government refers to Tanzania mainland only – recently the Ministry of Finance of Zanzibar established a unit tasked with developing a fiscal reporting framework for Zanzibar. The data also exclude the operations of extra-budgetary units and funds. Data for general government is not available because no information is yet provided on the financial position of local governments, although the authorities stated their intention to produce such reports.

Despite improvements in the recording of government transactions, discrepancies remain between revenue and expenditure data, on the one hand, and financing data, on the other. The discrepancies are related to the lack of a fully integrated set of accounts and the delineation of the public sector and its sub-sectors, differing source data, and timing differences.

The Ministry of Finance created a database of donor-funded projects in 2001/02 (July-June), with donor assistance. The number of foreign-financed projects reported by and channeled through the budget has increased significantly.

The government has completed the computerization of its accounting system for budgetary units. Although the authorities indicated that it would allow resumption of reporting in the *Government Finance Statistics Yearbook (GFSY)*, no data were reported for the 2005 *GFSY*. The computerized accounting system does not yet provide details about donor funded development expenditure and has not yet been extended to cover the extra-budgetary units. The authorities regularly report data for inclusion in the *IFS*.

Monetary statistics

Tanzania's monetary statistics are broadly adequate for policy and analysis purposes. Nevertheless, the October 2002 data ROSC and January-February 2005 monetary and financial statistics missions determined that the quality of monetary statistics was compromised by various methodological problems. In particular, the latter mission identified the following shortcomings: (a) exclusion of savings banks from the institutional coverage of monetary survey, (b) arbitrary application of the residency criterion by the commercial banks, (c) inadequate subdivision of the resident sector data, (d) misclassification of certain accounting data between statistical aggregates, (e) discrepancies between reported interbank positions, (f) non-transparent treatment of repurchase agreements, and (g) key information gaps in the bank reporting system. It was also found that international reserves data included certain assets that did not qualify as reserve assets.

To address these problems, the mission recommended that the Bank of Tanzania: (i) extend the institutional coverage of monetary statistics to include the postal bank and other savings banks, (ii) instruct commercial banks to classify accounts according to the client's properly determined residency status, (iii) use a more detailed scheme for sectorizing resident sector data, in accordance with the *Monetary and Financial Statistics Manual*, (iv) reclassify the misclassified accounting data and ensure that accurate statistical aggregates are constructed, (v) resolve discrepancies between reported interbank positions, (vi) treat repurchase agreements with commercial banks as a new financial instrument for providing or taking loans, and (vii) modify the bank reporting system to introduce certain additional sectors that are needed for collecting the currently missing information. The mission also recommended that the coverage of international reserves be redefined to include only those foreign assets that can provide ready external financing.

These recommendations have been implemented only partially. To help the authorities implement all remaining recommendations and assist in the development of the standardized report forms for reporting monetary data, a monetary and financial statistics mission is scheduled to visit the Bank of Tanzania in late 2006.

Balance of payments statistics

Foreign trade data are prepared by Fund staff missions on the basis of customs data from the Bank of Tanzania, which in turn are compiled by the Tanzania Revenue Authority (TRA) based on customs records. A balance of payments statistics mission in May 2002 found continued and significant under-recording of trade and a dearth of information on invisible transactions. The authorities acknowledged these problems in their response to the data ROSC report published in March 2004 and have indicated that the Bank of Tanzania plans to commission a joint study by the NBS and the TRA to determine the magnitude of underrecorded trade and design an appropriate method of estimation. This study is expected to take place in 2006/07. Re-exports are now included in the compiled trade data. Partial international investment position (IIP) data are reported to STA. Annual IIP and balance of payments data are reported to STA for publication in the *IFS*.

Tourism revenues are now estimated using the model that was developed from the International Visitor's Exit Survey conducted in 2001. Using the model and subsequent annual surveys, estimates have been made for 2001 through 2005.

Information on official grant and loan receipts is prepared by Fund staff based on contacts with official agencies. The data on current and capital transfers (grants) are estimates, based in part on data provided by the Ministry of Finance and in part on United Nations Development Program projections. Disaggregation of the data has improved, but more work is needed here and in the coverage and periodicity of data.

Data on private capital flows are presently minimal. While some information on private banking sector flows can be derived from the monetary survey, other private capital flows are not adequately captured through the International Transaction Reporting System (ITRS) records and are largely reflected in "errors and omissions." However, the authorities have made commendable progress in collecting information on certain integral components. The results of the Private Capital Flows Survey for 2000 and 2004 have now been incorporated into the balance of payments and IIP accounts, which considerably increased estimates of foreign direct investment inflows as well as dividend payments and distributed branch profits in the current account. The Private Capital Flows Survey is designed to capture information on foreign direct investment and also asks investors to report committed and projected (for the near future) direct investment flows.

Data on the gross and net official reserves of the Bank of Tanzania are provided monthly with a short lag and are available to the Fund more often on request. Similarly, data on the foreign assets and liabilities of the banking system are provided with relatively short lags.

Significant improvements in the quality of external debt data have been made in the context of the creditor reconciliation exercise under the HIPC Initiative. At present, all multilateral and Paris Club debts (accounting for about 80 percent of total external debt) have been fully reconciled. However, less progress has been made in reconciling debt owed to other bilateral and commercial creditors. Information on external debt not guaranteed by the public sector, mostly private sector debt, is also limited and not captured in a timely manner.

TANZANIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of October 31, 2006)

	Date of latest observation	Date received	Frequency of data[6]	Frequency of reporting[6]	Frequency of publication[6]	Memo Items: Data Quality – Methodological soundness[7]	Memo Items: Data Quality Accuracy and reliability[8]
Exchange Rates	October 2006	October 2006	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	October 2006	October 2006	D, M	D, M	M		
Reserve/Base Money	October 2006	October 2006	D	D	M	LO, LO, LO, LO	LO, O, O, O, LO
Broad Money	September 2006	October 2006	M	M	M		
Central Bank Balance Sheet	September 2006	October 2006	M	M	M		
Consolidated Balance Sheet of the Banking System	September 2006	October 2006	M	M	M		
Interest Rates[2]	September 2006	October 2006	M	M	M		
Consumer Price Index	September 2006	October 2006	M	M	M	O, LO, O, LO	LNO, LNO, LNO, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	...	...	...	...	...	LNO, LNO, LNO, LO	LO, O, O, LO, O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	August 2006	October 2006	M	M	Q		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	June 2006	October 2006	M	M	A		
External Current Account Balance	June 2006	September 2006	A	A	A	LO, LO, LO, LO	LO, LNO, O, LNO, LNO
Exports and Imports of Goods and Services	2005	May 2006	A	A	A		
GDP/GNP	2005	May 2006	A	A	A	LO, LO, LO, LO	LNO, LNO, O, LO, LO
Gross External Debt	June 2006	September 2006	M	M	A		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC published March 23, 2004 and based on the findings of the October 2002 mission for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[8] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies

Appendix V—Tanzania: External Debt Sustainability[1]

Tanzania's external debt sustainability has strengthened further following completion of the Multilateral Debt Relief Initiative (MDRI). The debt relief provided during 2006 by the IMF, World Bank (IDA) and African Development Bank under the MDRI (including HIPC) amounted to about US$4.9 billion, equivalent to around 60 percent of Tanzania's total external debt stock at end-2005. As a result, the NPV of external debt has declined to around 15.5 percent of GDP and 60 percent of exports, whereas debt service declined to around 5 percent of exports of goods and services (Table 1). All these indicators are significantly below the indicative debt-burden thresholds that apply to Tanzania, indicating low risk of debt distress.[2]

The baseline scenario assumes that Tanzania's performance during the recent past will be sustained (Table 2)**.** In particular, it assumes somewhat higher real GDP, and slightly higher levels of donor assistance and FDI relative to the average of the past 10 years, reflecting strong overall ratings of Tanzania's macroeconomic policies, as well as ongoing structural reforms in key areas.

The bound tests indicate that Tanzania's external debt will remain sustainable under the individual standardized shocks and their combination (Table 2). Given that Tanzania does not breach any of the indicative thresholds for low-income country DSA in any scenario or bound test, staff classifies Tanzania as "low risk" according to the Fund-Bank interim guidance for debt distress assessments.[3] However, Tanzania's external debt sustainability hinges on continued financing of its significant current account deficit at highly concessional terms. Currently, total donor assistance amounts to about 10.6 percent of GDP, of which about 4 percent of GDP is in the form of grants, and the remainder has a grant element of about 50 percent. As shown in Table 2, for example, even a 2 percentage point increase in the interest rate on new borrowing, while leaving unchanged the long grace and maturity periods, and the significant amount of external grants assumed under the baseline, would gradually increase Tanzania's NPV-to-GDP ratio to about 25 percent of GDP by 2021 and keep it at that level through 2026. Furthermore, if the share of grants to GDP were to decline by only 2 percentage points, with the gap having to be financed at commercial terms, Tanzania would breach the indicative external debt thresholds towards the end of the projection period.

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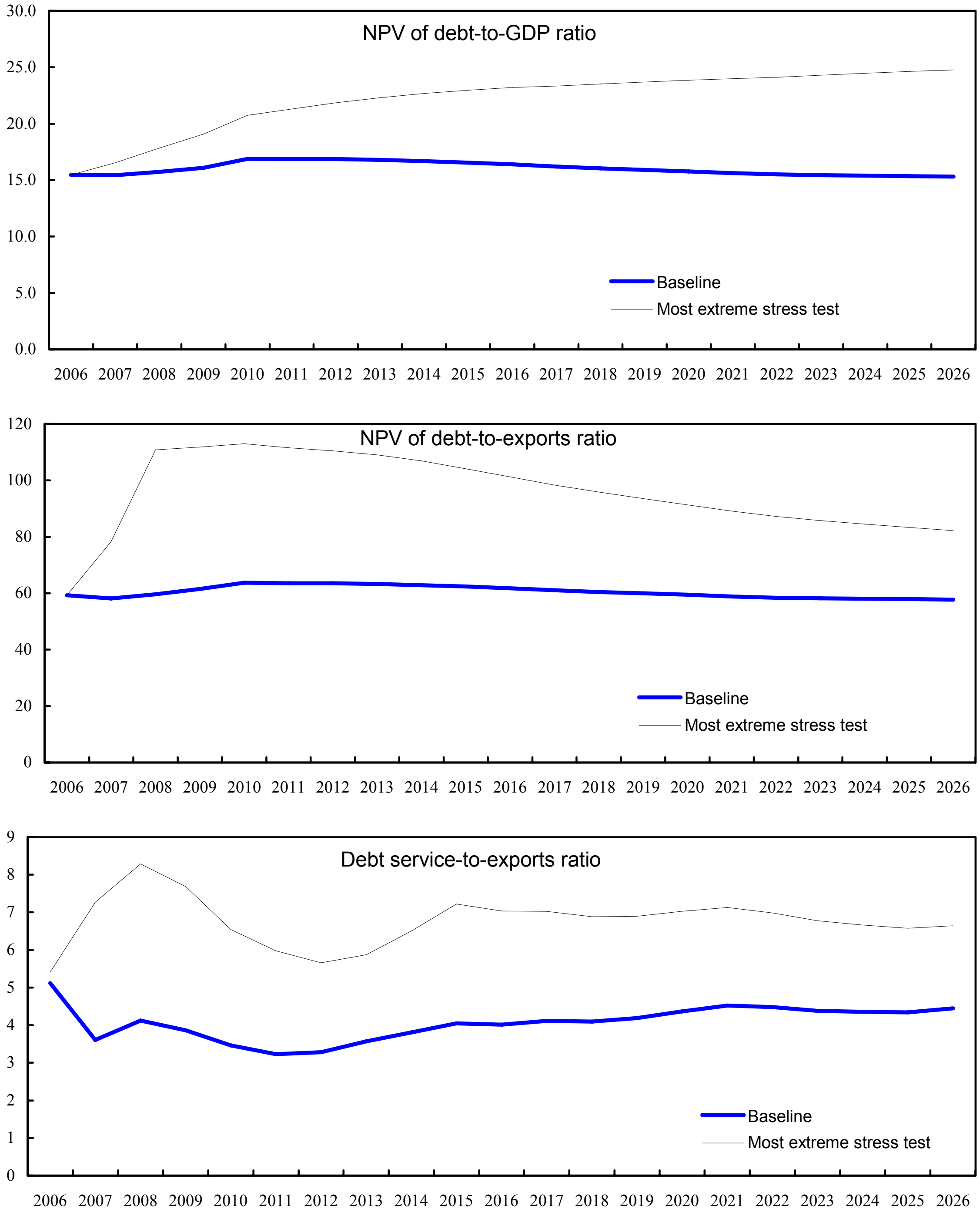
[1] This DSA was prepared according to the Interim Guidance for Debt-Sustainability Assessments in low-Income Countries (LIC DSA). The DSA scenarios assume relief in HIPC-comparable terms for all creditors with which there are pending agreements. See Table 10 of the Staff Report.

[2] According to the World Bank's Country Policy and Institutional Assessment Index, Tanzania is classified as a "strong performer". Its thresholds therefore are: 50 percent of NPV of debt-to-GDP ratio, 200 percent of NPV of debt-to-exports ratio, and 25 percent of debt service-to-exports ratio.

[3] The latest DSA (see Country Report No. 05/291, Appendix V) considered Tanzania's external debt risks to be "moderate". This reduction in risks reflects implementation of the MDRI.

Figure 1. Tanzania: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2006-2026
(Percent)



Source: IMF staff projections and simulations.

Table 1. Tanzania: External Debt Sustainability Framework, Baseline Scenario, 2006-2026 [1]
(Percent of GDP, unless otherwise indicated)

	Actual										Historical Average [6]	Standard Deviation [6]	Projections									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005			2006	2007	2008	2009	2010	2011	2006-11 Average	2016	2026	2012-26 Average
External debt (nominal) [1]	**93.9**	**95.0**	**91.7**	**91.7**	**85.0**	**71.8**	**75.2**	**78.6**	**75.8**	**64.3**			**25.2**	**27.0**	**28.7**	**30.0**	**31.6**	**31.9**		**32.2**	**30.7**	
of which: public and publicly guaranteed (PPG)	93.7	94.8	91.5	91.4	84.8	71.4	74.8	77.3	74.5	64.2			24.6	26.3	28.2	29.7	31.3	31.7		32.1	30.7	
Change in external debt	...	1.1	-3.3	0.0	-6.7	-13.2	3.4	3.4	-2.8	-11.5			-39.1	1.8	1.7	1.3	1.6	0.3		-0.1	-0.1	
Identified net debt-creating flows	...	-11.0	-0.8	3.9	-4.2	-1.7	-0.9	-3.6	-6.8	-4.1			2.5	4.9	4.5	4.2	4.3	4.0		3.7	2.8	
Non interest current account deficit	**0.8**	**4.5**	**9.7**	**9.0**	**4.9**	**4.5**	**5.5**	**3.6**	**4.2**	**6.8**	**5.8**	**2.2**	**9.8**	**10.3**	**10.3**	**10.4**	**11.2**	**11.1**		**10.5**	**10.3**	**10.5**
Deficit in balance of goods and services	9.4	9.4	14.9	12.7	8.3	8.5	7.3	6.6	7.5	10.4			13.8	14.3	14.2	14.3	14.9	14.7		14.2	13.9	
Exports	22.0	16.2	13.5	13.5	14.4	15.2	16.4	19.6	22.5	23.3			26.1	26.5	26.4	26.1	26.5	26.5		26.5	26.5	
Imports	31.4	25.6	28.3	26.2	22.7	23.6	23.7	26.2	30.0	33.7			39.9	40.8	40.6	40.4	41.4	41.3		40.7	40.4	
Net current transfers (negative = inflow)	-8.3	-5.7	-5.1	-3.9	-4.3	-4.4	-3.0	-3.8	-4.4	-4.6	-4.8	1.4	-4.6	-4.5	-4.5	-4.3	-3.9	-3.8		-3.7	-3.4	-3.6
Other current account flows (negative = net inflow)	-0.3	0.8	-0.1	0.1	0.9	0.4	1.3	0.7	1.2	0.9			0.6	0.6	0.6	0.4	0.2	0.2		0.0	-0.2	
Net FDI (negative = inflow)	**-2.3**	**-2.1**	**-3.3**	**-3.1**	**-5.1**	**-3.5**	**-4.2**	**-4.6**	**-4.3**	**-3.8**	**-3.6**	**1.0**	**-4.0**	**-4.0**	**-4.2**	**-4.4**	**-4.9**	**-5.0**		**-5.3**	**-6.1**	**-5.6**
Endogenous debt dynamics [2]	**...**	**-13.4**	**-7.2**	**-1.9**	**-4.1**	**-2.8**	**-2.2**	**-2.6**	**-6.8**	**-7.1**			**-3.3**	**-1.5**	**-1.6**	**-1.8**	**-2.0**	**-2.1**		**-1.5**	**-1.4**	
Contribution from nominal interest rate	...	0.8	1.3	1.0	0.4	0.5	0.4	0.9	0.6	0.5			0.4	0.2	0.2	0.3	0.3	0.3		0.3	0.3	
Contribution from real GDP growth	...	-2.8	-3.2	-3.1	-4.4	-5.1	-5.0	-4.1	-4.8	-4.6			-3.8	-1.7	-1.9	-2.0	-2.3	-2.4		-1.8	-1.7	
Contribution from price and exchange rate changes	...	-11.4	-5.3	0.3	0.0	1.8	2.5	0.5	-2.6	-3.0			…	…	…	…	…	…		…	…	
Residual [3]	**...**	**12.0**	**-2.6**	**-3.9**	**-2.4**	**-11.5**	**4.3**	**7.0**	**4.0**	**-7.3**			**-41.6**	**-3.1**	**-2.7**	**-2.9**	**-2.7**	**-3.7**		**-3.8**	**-2.9**	
of which: exceptional financing	...	-6.4	-7.0	-2.9	-2.6	-10.3	-4.7	-4.4	-2.2	-2.1			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of external debt [4]	...	...	...	...	...	...	...	...	...	15.9			16.2	16.2	16.3	16.5	17.2	17.1		16.4	15.3	
Percent of exports	...	...	...	...	...	...	...	...	...	68.1			61.9	61.0	61.7	63.0	64.7	64.4		61.8	57.7	
NPV of PPG external debt	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**16.7**	**15.8**			**15.6**	**15.5**	**15.8**	**16.1**	**16.9**	**16.9**		**16.4**	**15.3**	
Percent of exports	...	...	...	...	...	...	...	...	74.3	67.7			59.6	58.4	59.8	61.7	63.8	63.6		61.8	57.7	
Debt service-to-exports ratio (percent)	16.2	12.2	25.9	20.2	16.1	14.7	11.2	14.4	12.9	6.8			7.5	6.3	6.1	5.2	4.4	4.0		4.1	4.4	
PPG debt service-to-exports ratio (percent)	**15.2**	**11.2**	**24.8**	**18.4**	**14.9**	**12.5**	**8.8**	**7.6**	**7.1**	**6.3**			**5.1**	**3.7**	**4.2**	**3.9**	**3.5**	**3.3**		**4.0**	**4.4**	
Total gross financing need (billions of U.S. dollars)	...	...	...	0.7	0.2	0.3	0.3	0.2	0.3	0.6			1.0	1.1	1.2	1.3	1.4	1.5		1.9	3.7	
Non interest current account deficit that stabilizes debt ratio	...	3.4	13.0	9.0	11.6	17.7	2.0	0.2	7.1	18.3			48.9	8.6	8.6	9.1	9.6	10.8		10.6	10.4	
Macroeconomic assumptions																						
Real GDP growth (percent)	4.5	3.5	3.7	3.5	5.1	6.2	7.2	5.7	6.7	6.8	5.3	1.4	5.9	7.3	7.6	7.9	8.2	8.4	7.6	6.0	6.0	5.8
GDP deflator in US dollar terms (change in percent)	...	13.8	5.9	-0.3	0.0	-2.1	-3.3	-0.7	3.4	4.1	2.3	5.3	-4.7	3.3	2.7	2.4	0.2	0.1	0.7	2.4	2.4	2.5
Effective interest rate (percent) [5]	1.2	1.0	1.5	1.1	0.5	0.6	0.6	1.3	0.8	0.7	0.9	0.4	0.7	0.9	0.9	1.0	1.0	1.1	0.9	1.1	1.2	1.1
Growth of exports of G&S (US dollar terms, percent)	25.9	-13.0	-8.7	3.4	12.2	9.5	12.2	25.4	26.8	15.3	10.9	13.9	12.8	12.8	10.0	9.4	10.1	8.5	10.6	8.5	8.5	8.5
Growth of imports of G&S (US dollar terms, percent)	-3.9	-4.0	21.7	-4.6	-8.8	8.2	3.8	16.4	26.1	25.1	8.0	13.4	19.3	13.5	10.1	9.9	11.1	8.2	12.0	8.2	8.5	8.4
Grant element of new public sector borrowing (percent)						...	...	...	...	...	...	...	56.1	42.1	38.0	37.9	36.9	44.1	42.5	39.5	28.5	35.8
Memorandum item:																						
Nominal GDP (billions of US dollars)	6.5	7.6	8.4	8.6	9.1	9.4	9.8	10.3	11.3	12.6			12.7	14.1	15.6	17.2	18.7	20.3		30.5	69.0	

Source: IMF Staff simulations.

[1] Includes both public and private sector external debt.
[2] Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
[3] Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
[4] Assumes that NPV of private sector debt is equivalent to its face value.
[5] Current-year interest payments devided by previous period debt stock.
[6] Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2. Tanzania: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2006–26
(Percent)

	Projections							
	2006	2007	2008	2009	2010	2011	2016	2026
NPV of debt-to-GDP ratio								
Baseline	16	15	16	16	17	17	16	15
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 [1]	16	13	11	9	7	4	-5	-9
A2. New public sector loans on less favorable terms in 2007-26 [2]	16	17	18	19	21	21	23	25
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	16	16	17	17	18	18	18	16
B2. Export value growth at historical average minus one standard deviation in 2007-08 [3]	16	18	22	22	23	22	20	17
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	16	16	18	18	19	19	18	17
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 [4]	16	17	19	19	20	20	18	16
B5. Combination of B1-B4 using one-half standard deviation shocks	16	18	23	23	24	24	22	18
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 [5]	16	22	22	23	24	24	23	22
NPV of debt-to-exports ratio								
Baseline	60	58	60	62	64	64	62	58
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 [1]	60	48	40	33	25	15	-20	-35
A2. New public sector loans on less favorable terms in 2007-26 [2]	60	62	68	73	78	80	87	93
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	60	58	60	62	64	64	62	58
B2. Export value growth at historical average minus one standard deviation in 2007-08 [3]	60	79	111	112	113	112	101	82
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	60	58	60	62	64	64	62	58
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 [4]	60	65	73	74	75	75	70	60
B5. Combination of B1-B4 using one-half standard deviation shocks	60	71	89	90	91	90	83	70
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 [5]	60	58	60	62	64	64	62	58
Debt service ratio								
Baseline	5	4	4	4	3	3	4	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 [1]	5	6	6	5	4	3	1	-1
A2. New public sector loans on less favorable terms in 2007-26 [2]	5	6	6	6	5	5	5	6
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	5	6	6	5	4	4	4	4
B2. Export value growth at historical average minus one standard deviation in 2007-08 [3]	5	7	8	8	7	6	7	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	5	6	6	5	4	4	4	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 [4]	5	6	6	6	5	4	5	5
B5. Combination of B1-B4 using one-half standard deviation shocks	5	7	7	7	6	5	6	6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 [5]	5	6	6	5	4	4	4	4
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) [6]	34	34	34	34	34	34	34	34

Source: Staff projections and simulations.

[1] Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non interest current account as percent of GDP, and non debt creating flows.

[2] Assumes that the interest rate on new borrowing is 2 percentage points higher than in the baseline, while grace and maturity periods are the same.

[3] Export values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels.

[4] Includes official and private transfers and FDI.

[5] Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

[6] Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

INTERNATIONAL MONETARY FUND

UNITED REPUBLIC OF TANZANIA

Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for a Three-Year Policy Support Instrument—Supplement, and Supplement to Letter of Intent

Prepared by the African Department

(In consultation with the Finance, Fiscal Affairs, Legal, and Policy Development and Review Departments)

Approved by David Nellor and Michael T. Hadjimichael

February 8, 2007

SUPPLEMENT

1. This supplement to the staff report on the sixth PRGF review and request for a PSI provides an update on macroeconomic developments and reports on developments regarding the alleged impropriety in the management of a government account at the Bank of Tanzania (BoT).

Safeguards issues

2. **Following issuance of the staff report for Tanzania's sixth and final PRGF review and request for a three-year PSI, the staff learned of an alleged impropriety involving payments to third parties by the BoT.** The allegation raised questions regarding program implementation, capacity to repay the Fund, and the consistency of the BoT's practices with the Fund's safeguards policy, including the BoT's own commitments following the December 2003 Safeguards Assessment. The alleged impropriety has also given rise to reputational risks for both the Fund and the BoT. As a result, Board consideration of the report, scheduled for December 6, was postponed and the PRGF was extended to mid-August 2007 to allow the staff additional time to seek from the authorities (i) clarification of the nature of the alleged impropriety; and (ii) reasonable assurances that no systemic problem exists that give rise to safeguards concerns. The staff has also reached understandings on the adoption of remedial actions.

3. **The information relating to the alleged impropriety was brought to the staff's attention by the external audit firm that had been conducting the audit of the BoT's**

2005/06 accounts. The external auditor informed the Fund that while undertaking the audit, it identified an issue of major concern that would have resulted in a qualification or disclaimer of the audit opinion if not resolved satisfactorily. Subsequent information indicated that the transactions highlighted by the external auditor were payments made to third parties amounting to about $30.7 million[1] that were justified by documentation that the external auditor believes were not valid and appeared to have been forged. The external auditor indicated that the BoT subsequently terminated the audit contract. The authorities informed the external auditor that the termination was pursuant to the new Bank of Tanzania Act of June 2006, in which parliament had included a provision that the government's Controller and Auditor General (CAG) be legally designated as responsible for the annual BoT audit.

4. **Since this issue arose, there have been constant communications between the authorities, including at the highest level, and Fund management and staff.**[2] The authorities have indicated their firm commitment to addressing the concerns raised by the staff and have undertaken a series of specific actions and commitments:

- **First, the authorities have provided further background information to staff** indicating that the payments in question were from the government external payments arrears account at the BoT. This account relates to liabilities to domestic importers dating mostly from the mid-1980s when Tanzania experienced foreign exchange shortages and strict controls were in place. The authorities explained that residents making private external payments for imports of goods and services would lodge the local currency equivalent with the then state-owned National Bank of Commerce, and the foreign exchange obligations would be kept in a pipeline. The system was discontinued in the early 1990s with the stock of such obligations in the pipeline equivalent to about $620 million. The authorities reported that in subsequent years, payments in local currency totaling the equivalent of about $350 million have been made including payments equivalent to about $100 million in 2005/06. Responsibility for these losses was assumed by the government in the context of the privatization of the National Bank of Commerce. As the foreign exchange position improved, the original depositors initiated litigation against the government seeking payment on their original claims, and these cases were won by the claimants. Subsequently, the government agreed to compensate claimants gradually over time subject to adequate documentation being provided and as resources became available. The payments made on the account are domestic currency payments to domestic residents. As the

[1] The external auditor indicated that these amounts are based on analysis of a sample of payments selected for testing.

[2] In addition to communications with the authorities from Washington, management and senior staff have met with President Kikwete, Minister Meghji, Governor Ballali, and other government officials.

exchange rate has depreciated substantially over the period, settlement in local currency equivalent to the original external obligations involves substantially higher payments to the claimants and significant losses in domestic currency to the government. It is the documentation provided by the claimants that the external auditor alleges is forged.

- **Second, given the seriousness of the allegations, the Minister for Finance issued a press release announcing that in response to the alleged impropriety in the accounts at the BoT, the government was instituting a special audit to be conducted by an independent auditor, under the authority of the CAG.** The authorities have informed the staff that the special audit will be conducted by an international ISA-compliant firm experienced in International Financial Reporting Standards (IFRS), selected through a competitive bidding process.[3] Terms of Reference (TOR) for the special audit are under preparation, and the authorities have agreed to incorporate the staff's comments. The special audit will include discussions with the CAG about the scope, coverage, and findings of his audit of the BoT's 2005/06 accounts. The special audit would be followed by any relevant remedial measures under Tanzanian law. These remedial actions would be discussed with the staff in the context of the reviews under the PSI.

- **Third, the authorities have stated that they believe the incident is not indicative of a systemic problem** and is an isolated occurrence. They noted that the BoT was the first entity in Tanzania to become IFRS compliant, and that the BoT received an unqualified audit opinion by the same external auditor on its 2004/05 accounts. Available information indicates that the concerns raised by the auditor relate only to the external payments arrears account noted above.

- **Fourth, the government has requested the CAG to allow future annual audits of the BoT's accounts to be undertaken by an external audit firm experienced in IFRS,** which the CAG is empowered to do under Tanzanian law. This will retain consistency with the recommendations of the 2003 Safeguards Assessment (Country Report No. 04/58). The authorities have informed the staff that the CAG has agreed to this request.

5. **These actions and commitments are reflected in the attached letter received from the authorities dated February 8, 2007. They are being undertaken against the background of good progress in improving governance in Tanzania in recent years,** including the recent launch of Tanzania's second generation National Anti-Corruption

[3] Even before conducting the special audit, the authorities instituted their own investigation of the allegations. They are committed to follow both due process and transparency in follow-up actions to the issues raised by the allegations, and to publicize the results of their investigations.

Strategy and a new Anti-Corruption Bill now expected to be considered by parliament in February 2007.

Recent economic developments

6. **Provisional data for the second half of 2006 indicate that macroeconomic developments are broadly consistent with earlier projections.** Inflation (12-month) reached 6.7 percent through December, modestly above the program projections. Indications are that growth has been broadly on track notwithstanding the problems in the energy sector. Provisional data on fiscal developments indicate that the overall deficit before and after grants, as well as net domestic financing of government, have been evolving below the levels projected in the program. The strong outturn thus far reflects tax and nontax revenue collections moderately exceeding projections, together with significant under spending in the categories of goods and services and development expenditure. Available data show that exports have been somewhat weaker than expected largely due to unfavorable weather conditions which delayed the start of the procurement season for traditional exports. Provisional data indicate that disbursements of external program assistance during the first half of 2006/07 have been somewhat lower than projected. Preliminary indications are, however, that international reserves have remained stable and in line with the program as the lower inflows were likely offset by lower-than-programmed imports, in part reflecting lower oil prices.

7. **The authorities have been implementing the program agreed with the staff under the proposed PSI.** Though final data through December 2006 are not available for most economic variables, provisional data indicate that monetary policy has evolved broadly as expected—though interest rates have been somewhat volatile. Provisional data also indicate that the end-December NIR target was likely met with an ample margin while the proposed reserve money assessment criterion may have been missed by a very small margin, most likely due to an unanticipated surge in government outlays in the last week of December as well as weak demand for government securities which complicated the mopping-up of liquidity. The staff will verify the provisional data and collect other necessary quantitative data during the first review of the PSI. The authorities have developed an action plan for the integration of the ASYCUDA and TISCAN system-based processes (originally proposed as an end-December structural benchmark), and implementation has already started. Other structural reforms are proceeding as envisaged.

8. **Progress is being made in resolving the energy crisis, although a number of issues remain outstanding.** The 6 percent tariff increase was approved in January (effective February 1, 2007), and the staff has received confirmation that the government has approved the Financial Recovery Plan (FRP) for TANESCO. This was originally a proposed end-December 2006 structural assessment criterion, but can no longer be established as such in light of the delay in the Board's consideration of the PSI beyond end-December and the fact that information on the implementation of that measure became available before the Board

considered the PSI. No other structural assessment criteria are proposed. The proposed end-December 2006 quantitative assessment criteria are not affected since the authorities' Letter of Intent was issued before end-December and the related end-December data are not available or are still provisional.

9. **Other envisaged near-term measures relating to the power sector are moving forward, albeit with some delays.** The Power Sector Reform Strategy, which addresses medium- and long- term perspectives for the sector, was recently finalized but has not yet been considered by Cabinet. A new Managing Director of TANESCO was appointed in November 2006. However, a full senior management team has not yet been put in place following the departure of the previously contracted management group at end-December. The commercial bank loan that is a key component of the FRP has not yet been secured, which is placing further pressure on TANESCO's finances. It will be essential that the monitoring provisions of the FRP be effectively implemented and that the authorities stand ready to take action, as appropriate, including further tariff increases to ensure that the path to financial sustainability is maintained. New generation capacity is coming on stream albeit somewhat slower than expected. However, the availability of hydropower has recently improved following good rains and power rationing was suspended.

Staff appraisal

10. **At this stage, the staff is not in a position to discount or confirm the alleged impropriety.** However, the staff believes that the allegation, even if later proven, would most likely relate to weaknesses in the validation of payments made on behalf of the government and not of the central bank accounts, and thus do not pose undue reputational or safeguards risks to the Fund. The alleged improper transactions relate to local currency payments made by the central bank to domestic residents on behalf of the government and they do not affect the accuracy of the reported holdings of gross international reserves.

11. **Available information since the issuance of the staff report indicates that notwithstanding ongoing concerns about the energy sector, economic developments are continuing to evolve broadly as envisaged** and the thrust of the staff appraisal in the staff report remains valid.

12. **On the basis of the authorities' commitments and the proposed course of actions, the staff recommends completion of the last PRGF review and approval of the PSI.** This approach maintains responsibility for addressing the allegations directly with the authorities in a transparent manner in consultation with the Fund. This would also allow the Fund to assess progress on addressing any identified control system weaknesses in the context of the reviews under the PSI. The first and second reviews under the PSI will focus on the results of the special audit and the adoption and implementation of remedial measures as appropriate.

ATTACHMENT: SUPPLEMENT TO THE LETTER OF INTENT

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

February 8, 2007

Dear Mr. de Rato:

1. This letter, which supplements Government's Letter of Intent dated November 20, 2006, lays out our agenda for addressing the allegations of an impropriety in the management of the government external payment arrears (EPA) account which is managed by the Bank of Tanzania (BoT). The allegations pertain to the validity of documentation for payments made from the EPA account during 2005/06. The account was established in the mid-1990s to settle arrears incurred during the 1980s and early 1990s when foreign exchange shortages and controls prevented settlement of private sector import-related payments.

2. In discussions with the Fund over the past several weeks, including at the highest levels, we have underscored our commitment to our reform program and to address any issues that may arise from the alleged impropriety. While we believe that the impropriety alleged by the external auditor of the BoT represents an isolated occurrence, the authorities take the allegations seriously and are determined to address them in a comprehensive and transparent manner. We are therefore undertaking a number of measures.

3. In response to the allegations, Government is committed to take the following actions:

- As noted in my Press Release of December 2, 2006 (attached) Government has asked the Controller and Auditor General (CAG) to conduct a special audit of the central bank account related to the alleged improper transactions by an international audit firm. The contract for the audit will be awarded through competitive bidding to an international firm that is compliant with International Standards of Auditing (ISA) and experienced in International Financial Reporting Standards (IFRS). The results of the audit will be shared with the Fund staff.

- The Terms of Reference for the special audit will be agreed with Fund staff and will be broadly drawn to cover all the transactions from the EPA account during 2005/06, as well as the verification, monitoring, and control procedures related to the account.

- Government is committed to the adoption and implementation of appropriate remedial measures. These will be discussed with Fund staff in the context of the reviews under the PSI.

4. Even in advance of this special audit, we have initiated our own internal investigation of all payments under the EPA scheme during 2005/06, and we will share the results with Fund staff. Moreover, to ensure that future audits of the Bank of Tanzania meet the highest standards, we have requested the Government's CAG to commit to engage an ISA-compliant international external auditor, experienced in IFRS, to conduct future annual audits of the BoT accounts, consistent with Tanzanian law. The CAG has agreed to this request.

5. Finally, I would note that subsequent to my letter of November 20, 2006, Government has adopted the medium-term Financial Recovery Plan (FRP) for TANESCO consistent with paragraphs 54-56 of the Memorandum of Economic and Financial Policies (MEFP) attached to the November 20, 2006 letter. Also, Government has observed the originally proposed end-December structural benchmark on developing an action plan for integration of ASYCUDA and TISCAN system-based processes consistent with paragraph 19 of the MEFP. These actions, reflected in an updated Table 3 (attached), should therefore no longer be considered as a structural assessment criterion and a structural benchmark respectively under the PSI.

6. On the basis of these additional commitments, we request that the Fund approve completion of the sixth and final review under the PRGF arrangement and the new three-year PSI. Government intends to make this letter available to the public and authorizes publication on the IMF website, once the Executive Board meeting is concluded.

Yours sincerely,

/s/
Zakia Hamdani Meghji (MP)
Minister for Finance
United Republic of Tanzania

Attachments

Table 3 (updated). Tanzania: Structural Assessment Criteria and Benchmarks under the Policy Support Instrument, December 2006-July 2007

Measure	Date of Implementation
Fiscal Reforms	
Develop a dated action plan for integration of ASYCUDA and TISCAN system-based processes, consistent with para. 19 of the MEFP. [1]	Observed.
Cash Management Unit, with representatives from the Ministry of Finance and the Bank of Tanzania, to complete 2007/08 Government cash plan, including a three month cash flow forecast, consistent with para. 25 of the MEFP. [2]	End-June 2007.
Monetary and financial sector reform	
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, consistent with para. 34 of the MEFP. [2]	End-June 2007.
Governance	
Submit Anti-Corruption Bill to Parliament, consistent with para. 58 of the MEFP. [2]	End-February 2007.
Publish the list of companies, individuals, and NGOs that have received tax exemptions each quarter. [2]	Continuous.
Energy	
Government to adopt the Medium-Term Financial Recovery Plan for TANESCO, consistent with paras. 54-56 of the MEFP. [3]	Observed.
Raise electricity tariffs effective July 2007 to keep TANESCO on its path to financial viability, consistent with paras. 54-56 of the MEFP. [2]	End-July 2007.

Note: MEFP references relate to the November 20, 2006 Letter of Intent, unless othewise specified.

[1] Originally a proposed structural benchmark to be implemented by end-December 2006.

[2] Structural benchmark.

[3] Originally a proposed structural assessment criterion to be implemented by end-December 2006.

UNITED REPUBLIC OF TANZANIA
Ministry of Finance

PRESS RELEASE

The Government has been informed of an alleged impropriety in the management of external commercial debt account at the Bank of Tanzania.

Given the seriousness of the allegation, the Government has asked the Controller and Auditor General to appoint an independent Auditor to conduct a special audit, and report results of the audit to the Government.

/s/
Zakia H. Meghji (MP)
Minister for Finance

2nd December, 2006

Press Release No. 07/26
FOR IMMEDIATE RELEASE
February 16, 2007

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Sixth Review Under Tanzania's PRGF Arrangement and Approves a Three-Year Policy Support Instrument

The Executive Board of the International Monetary Fund (IMF) today completed the sixth and last review of Tanzania's economic performance under a three-year Poverty Reduction and Growth Facility (PRGF) arrangement (see Press Release No. 03/128). The completion of the review enables a further release of SDR 2.8 million (about US$4.2 million) and will bring the total disbursements under the arrangement to SDR 19.6 million (about US$29.4 million).

The Executive Board also approved a three-year Policy Support Instrument (PSI) for Tanzania to support the country's economic efforts. The PSI seeks high and sustainable growth and more rapid poverty reduction based on enhancing public resource mobilization and efficiency of spending, increasing the financial sector's contribution to growth and the effectiveness of the monetary policy, and improving the business climate. Approval of a PSI for Tanzania signifies IMF endorsement of the policies outlined in the program.

The IMF's framework for PSIs is designed for low-income countries that may not need, or want, IMF financial assistance, but still seek IMF advice, monitoring and endorsement of their policies. PSIs are voluntary and demand driven. PSI-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PSI-supported programs are consistent with a comprehensive framework for macroeconomic, structural and social policies to foster growth and reduce poverty. Members' performance under a PSI is normally reviewed semi-annually, irrespective of the status of the program. (see Public Information Notice No. 05/145).

Following the Board's discussion on Tanzania, Mr. Murilo Portugal, Deputy Managing Director and Acting Chairman, stated:

"Tanzania has achieved sustained strong economic performance through market-oriented policies within an appropriate macroeconomic framework. To consolidate recent successes, Tanzania will need to maintain sound policies and steadily pursue key structural reforms, including in the critical energy sector, and capacity building to remove key impediments to growth and achieve lasting inroads against poverty.

“The Tanzanian authorities are undertaking actions and commitments to address the allegations of an impropriety in the management of the government external payment arrears account managed by the Bank of Tanzania. The authorities remain committed to transparency and to consult with the Fund in adopting and implementing appropriate remedial measures.

“The Policy Support Instrument is viewed as the appropriate next step in the Fund’s relations with Tanzania. Tanzania’s macroeconomic framework and structural reform agenda are consistent with the government’s objectives of high and sustained broad-based economic growth and poverty reduction within a stable macroeconomic environment.

“Tanzania is undertaking structural reforms in three key areas. First, tax, customs, and capacity-building reforms are expected to further mobilize public resources, improve the efficiency of government spending, and support economic and social objectives. Second, financial sector reforms, including improvements in credit information, pension investment guidelines, and liquidity management, will help enhance this sector’s contribution to growth and the effectiveness of monetary policy. Third, improvements in the business environment, including anti-corruption efforts, are expected to facilitate productive private sector activity and investment.

“Fiscal policy should remain focused on economic and social objectives while limiting net domestic financing to avoid crowding out private sector credit. The monetary framework remains appropriate, with the envisaged deceleration of broad money growth consistent with inflation objectives while still facilitating adequate credit to the private sector.

“Recent energy production shortfalls have been damaging. Resolving energy supply issues on a timely basis, including through appropriate increases in generation capacity and tariffs as envisioned under the PSI, will be critical to maintaining strong economic performance and putting the finances of the energy parastatal, TANESCO, on a sound and sustainable basis,” Mr. Portugal said.

ANNEX

Recent Economic Developments

In the last three years Tanzania has achieved strong economic performance, securing high growth, low inflation, adequate reserves, and a sustainable external debt position. Due to an energy crisis caused notably by drought-related reductions in hydropower and higher fuel prices, real GDP growth is expected to slow to 5.9 percent in 2006, from 6.8 percent in 2005. The impact of the energy crisis on inflation has been limited so far, as businesses largely absorbed higher costs. The current account deficit, however, widened to 9.3 percent in 2006 from 5.3 percent in 2005, as rapid growth in exports was offset by higher oil an drought-related imports. Nonetheless, the overall balance of payments position remained positive due to continued strong inflows of donor assistance and debt relief of $3.8 billion received under the Multilateral Debt Relief Initiative (MRDI) in 2006.

Program Summary

Tanzania's program under the PSI aims to achieve sustainable broad-based high growth and poverty reduction, while maintaining macroeconomic stability. The program includes three core objectives:

• *Enhancing public resource mobilization and efficiency of spending.* Boosting Tanzania's revenues would facilitate higher expenditures on key government priorities, particularly infrastructure, and reduce the country's aid dependency over the long term. One goal of the program is therefore to raise central government revenue to about 15.5 percent of GDP through further tax customs administrative reforms and tax policy measures. In addition, the government intends to improve efficiency in spending by better aligning spending with poverty-reducing and growth-enhancing measures.

• *Increasing the financial sector's contribution to growth and the effectiveness of monetary policy*. The program includes measures to facilitate lending to small and medium-sized enterprises, considered a key source of economic growth with strong lending prospects, as well as further efforts on legal and regulatory reforms for the provision of medium-term credit. The reform agenda also considers measures to strengthen monetary operations, which the authorities see as an important area given ongoing liquidity pressures from high aid inflows. Strengthening liquidity forecasting by promoting better information flows, and enhancing transparency and communication with financial markets are part of this agenda.

• *Improving the business environment and enhancing investment*. Further improving the business environment will facilitate private sector activity and investment. The program envisages efforts to remove key bottlenecks and impediments, including inadequate infrastructure and energy provision, weak governance and an overly burdensome regulatory environment.

Statement by Peter Gakunu, Executive Director for United Republic of Tanzania and Joseph L. Masawe, Senior Advisor to the Executive Director
February 16, 2007

On behalf of my Tanzanian authorities, I would like to thank staff for the constructive dialogue on the sixth and final review of the PRGF, and on a three-year PSI-supported program which will form a basis for future relationship with the Fund.

It is encouraging to note that the hard work and commitment by the authorities and staff on the program, with the support of the international community, has resulted in continued robust performance of the Tanzanian economy although challenges still remain. The Tanzanian authorities are in general agreement with the assessment by staff on the overall economic developments and program implementation during the review period.

They regret that the Board discussion on Tanzania had to be postponed due to alleged impropriety in the management of the government external payment arrears (EPA) account at the Bank of Tanzania (BOT). The account was established in the mid-1990s to settle arrears incurred during the 1980s and early 1990s when foreign exchange shortages and controls prevented settlement of private sector import payments. The allegations pertain to the validity of documentation for payments made from the account during 2005/06.

My authorities would like to reiterate that the government is keen to find out the truth about the allegations and as pointed out by staff in their supplement to the report, they have fully cooperated with staff during their initial inquiry and will continue to do so in future. The government is instituting a special audit at the BOT, to be conducted by an international ISA-compliant audit firm and the terms of reference for the special audit will be agreed with staff. My authorities are committed to adopting and implementing appropriate remedial measures, which will be discussed by staff in the context of the reviews under the PSI. The government will also continue to delegate all future BOT audits to ISA-compliant auditing firms, selected competitively.

Without prejudging the outcome of the audit, my authorities believe that this is an isolated incident and do not pose reputational or safeguards risks at the BOT. The BOT has been the first institution in Tanzania to become IFRS compliant and remains so.

Performance on Quantitative and Structural Benchmarks

The PRGF-supported program has remained on track and all quantitative performance criteria and indicative targets for end-March and end-June were met. The structural reform agenda has also proceeded as envisaged in the program, except for unexpected delays in the two benchmarks relating to the pension and energy sectors. The Inter-agency Committee on financial sector reform could not submit to the Government a proposed unified legal framework and regulatory framework for pension funds and investment guidelines by end June 2006 due to difficulties in securing an expert technical advisor. A consultant has now been secured with World Bank support and has already produced an inception report, with a comprehensive work plan. The proposal will be submitted to Government by end-June 2007.

The authorities have also implemented the end-December structural benchmark on developing an action plan for integrating ASYCUDA and TISCAN system based processes at the Tanzania Revenue Authority (TRA).

Economic Performance and Policy Developments

Overall, macroeconomic developments in Tanzania continued to be robust over the review period, supported by prudent economic management, strong external inflows and continued structural reforms. During the year ending December 2005, GDP grew strongly by 6.8 percent, despite a severe drought, which adversely affected agricultural production, and higher operational costs to the economy originating from high international oil prices. This was driven by strong performance in trade and tourism, manufacturing, mining and construction, which accounted for a combined total of 40 percent of the GDP. However, inflation inched upwards from 4.2 percent in June 2005 to 5 percent in December 2005, following the impact of rising oil prices and a countrywide drought, which affected food production and hydropower generation.

Recent information from authorities show that annual inflation reached 6.7 percent in December 2006, slightly above the program projection, also on account of the high oil prices. Monetary policy targets for December 2006 appear to have been broadly achieved, including Net International Reserves of the Bank of Tanzania (BOT) which appear to have been met with a comfortable margin. Reserve money target however may have been slightly missed, due to poor market demand on government paper.

Fiscal Policy

Consistent with the objectives of the MKUKUTA, the Government continued to take measures aimed at enhancing revenue and consolidating expenditure, to ensure that the budgeted fiscal deficit target for the year was attained. These measures resulted in better than programmed fiscal performance for the year ending June 2006, despite the energy crisis which led to long periods of power rationing. Revenue collection reached 14.4 percent of GDP, up from 13.3 percent in the same period last year, following efforts to improve tax administration.

Government expenditure over the fiscal year remained on track, despite pressures arising from the postponement of last year's elections, subsidies to TANESCO, and food aid outlays to drought affected areas. Over the budget period, the government continuously re-prioritized its expenditure to match actual developments. The overall budget deficit before grants was contained at 11.6 percent of GDP, below the programmed level of 14.2 percent. Similarly, financing of the budget remained at 2.3 percent of GDP envisaged under the program, despite shortfalls in foreign financing. The authorities continued to implement measures to strengthen expenditure management, including broadening the Integrated Financial Management Information System (IFMIS) and capacity building in government Ministries, Departments and Agencies (MDAs).

Most current provisional data show that despite weaknesses in the energy sector, fiscal developments remain broadly in line with program projections. There appears to be an over performance in overall deficit, before and after grants. Similarly, net domestic financing of the government appears to be well below program projections. However, program budgetary support and exports both appear to be lower than projected. Nevertheless, net international position remains at comfortable levels, due to lower-than-projected imports and also lower-than-projected international oil prices.

Monetary Policy and Financial Sector Policies

The monetary policy stance of the Bank of Tanzania continued to be well balanced, while maintaining the primary objective of price stability. Liquidity pressures remained subdued over the period and the Treasury Bills market remained vibrant, with interest rates falling in line with the declining level of inflation. Demand for credit from the banking system remained strong, with deposit rates increasing substantially as banks tried to satisfy the increased demand for credit. The declining interest rates in the Treasury bills market have been reflected in the lowering of commercial banks' lending rates and a consistently declining velocity for money, giving room for the growth in money supply to finance the growing level of economic activity.

In April 2006, the parliament approved key amendments to the Bank of Tanzania Act and the Banking and Financial Institutions Act. The amendments in the two laws are aimed at further strengthening the autonomy and accountability of the Central Bank, while facilitating the development of a stronger financial sector with a robust framework for corrective action. In line with this objective, the Bank of Tanzania initiated a risk-based supervision of the banking system and a prudential requirement for quarterly capital adequacy reporting.

External Sector

Developments in the external sector over the review period were highly influenced by developments in global oil prices. A sharp increase in international prices of oil, coupled with increased demand for food imports following the countrywide drought, erased the gains of higher exports recorded over the period, with consequent widening of the current account deficit. Despite a marked depreciation of the Tanzanian shilling during the year ending June 2006, and a widening of the current account deficit, gross official reserves remained strong, equivalent to about 4 ½ months of imports.

According to most recent provisional information, external sector developments appear to be broadly in line with projections, despite lower than projected exports and donor inflows.

Policies Under the New PSI

The Tanzanian authorities have agreed in principle, with staff recommendations on broad policies to be implemented under the PSI, given their consistency with the

authorities' medium term growth strategy, the MKUKUTA. Under the PSI, key policy objectives will be:

- enhancing domestic revenue mobilization and improving the efficiency of spending to help support and better align government expenditures with key economic and poverty reduction objectives, while minimizing net domestic financing of the budget to avoid the crowding-out effect;
- accelerating financial sector reforms to boost growth and increase the effectiveness of monetary policy;
- improving further the business environment to stimulate private sector-led investment and growth.

Against this background, fiscal policies will continue to focus on broad based growth, while ensuring improved efficiency and composition of spending. The authorities recognize that the current level of revenue to GDP ratio is low even by regional standards and need to be elevated. This will be mainly driven by enhanced reforms in tax administration. On the expenditure side, ongoing efforts to improve expenditure planning and management capacity will be enhanced. The authorities intend to improve their spending by better aligning poverty spending with growth-promoting spending, including gradual increase in the share of development spending to improve infrastructure, which has been a growth bottleneck for a long time. In this regard, they will use the MDRI proceeds for top priority growth critical economic projects and pro-poor outlays. Therefore, all development partners need to complement these efforts by ensuring that all development assistance is channeled through the budget, in line with commitments under the Joint Assistance Strategy (JAS). Meanwhile, the authorities will continue to consolidate their efforts to gradually reduce Tanzania's dependence on aid, through policies that will promote economic diversification, while enhancing structural reforms to mobilize and efficiently use domestic resources.

Monetary policy will continue to focus on sustaining price stability, while at the same time, facilitating an increased flow of credit to the productive sector. The Bank of Tanzania intends to sharpen its liquidity forecasting framework to ensure that it becomes more efficient in determining the correct level of liquidity in the economy. To facilitate credit growth, the central bank will ensure that the established credit guarantee schemes continue to facilitate an efficient and effective flow of credit to the economy. In the meantime, efforts to operationalize the envisaged Development Finance Guarantee Facility (DFGF) will be enhanced. Financial sector reforms will be stepped up in the context of the Financial Sector Implementation Action Plan (FSIAP), to which development partners have generously pledged their support.

Risks and Challenges

The Tanzanian authorities recognize that there are many downside risks to the attainment of the PSI objectives. They understand that **despite the successful completion of the PRGF,** the reform effort must be strengthened and deepened under the PSI, while consolidating macroeconomic stability and significantly addressing poverty. The energy crisis is a major constraint to growth and poverty reduction. The authorities have finalized the preparation of a Power Sector Reform Strategy, which aims at addressing medium and long term inadequacies in the sector and will be discussed by the Cabinet soon.

In December 2006, the government appointed a former BOT Governor to head the power utility company. The new CEO is expected to announce his senior management team soon. The Financial Recovery Plan (FRP) for TANESCO, which was a benchmark for December 2006, has been finalized and approved by the government. The first 6 percent increase in electricity tariffs was approved in January 2007 and will be implemented in February, 2007. Now that the FRP for TANESCO has been approved, the team will be aiming at substantially expanding investment on energy generation capacity and improving transmission, while substantially bringing the electricity power company back to profitability. It is encouraging that power rationing in Tanzania has now ended, following good rains received over the last few months, which facilitated stepped-up electricity generation from all hydro plants. Efforts to step up gas based generation capacity are also going on.

In tandem with the reforms in the energy sector, measures to improve the business environment will be implemented. These include the passage of a new bill that will facilitate a more efficient business climate, while creating room for voluntary registration of informal activity and improved tax compliance by informal business operators.

The government is committed to public sector reforms including improving wages for middle professional cadres, in order to attract and retain staff in critical areas of public service. The authorities are also undertaking appropriate policies to further enhance the business environment. They plan to improve vocational training to boost the level of specialized technical skills among Tanzanians and raise the quality of education to regional standards. A National Identity Card Project will also be implemented in 2006/07, which, together with other measures, will improve public security and support revenue collection.

In conclusion, I would like to reiterate that my authorities regret the circumstances leading to the postponement of the Board discussion but reaffirm their commitment to the proposed three-year macroeconomic framework and reform agenda under the PSI, which as admitted by staff, is fully feasible and internally consistent. They are confident that with the continued support of this Board and the international community, the envisaged polices for the year ahead will propel Tanzania to a higher and more sustainable growth path.