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May 30, 2008

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United Republic of Tanzania: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

May 3, 2008

The following item is a Letter of Intent of the government of United Republic of Tanzania, which describes the policies that United Republic of Tanzania intends to implement in the context of its request for a policy support instrument from the IMF. The document, which is the property of United Republic of Tanzania, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

May 3, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Strauss-Kahn:

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

1. The Government of Tanzania is implementing a financial and economic program supported by the Fund under the Policy Support Instrument (PSI), which was approved by the Executive Board on 16th February, 2007. We have recently discussed progress in the implementation of the programme with the Fund staff, and we hereby transmit the Memorandum of Economic and Financial Policies (MEFP), which reviews recent economic developments and progress in the implementation of our program in the first half of 2007/08, the outlook to end-June 2008, and sets out policies the Government intends to pursue in 2008/09.
2. Program implementation during the period July to December, 2007 has been satisfactory. All quantitative assessment criteria and benchmarks for end-December 2007 were met and the structural reform program remains broadly on track. Notably, the harmonization of the regulatory framework for pension funds is under way, progress has been made in drawing up a plan to transfer government deposits in commercial banks to the BoT, and the production of three-month cash flow forecasts has facilitated monetary policy operations. However, integration of the Customs' and Excise Department and Tiscan's import clearance processes has been delayed until end-2008.
3. Measures recently implemented to improve the conduct of monetary policy are yielding equally satisfactory results, with a notable decline in domestic interest rates. Following the conclusion of the Special Audit of the External Payments Arrears (EPA) account at the BoT, the Government is pursuing remedial measures, including investigation, prosecution, and recovery. In addition, the BoT is reviewing its internal controls and has requested the Fund to undertake a voluntary safeguards assessment of the BoT to assist it in strengthening its governance. The Government is accelerating implementation of the second generation of financial sector reforms, and will continue to undertake improvement of the business environment to promote investment as the prerequisites for accelerated and sustainable growth in a stable macroeconomic environment.

4. Other core reforms, especially the public service reforms and the tax and customs administration reforms, have also continued to yield good results. In line with MKUKUTA objectives, we continue to prioritise broad based growth through investment in productive infrastructure and social services, as the necessary basis for sustainable poverty reduction.

5. In support of our policies described in the MEFP, the Government requests the completion of the third review under the PSI. The Government of Tanzania believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program but it will, in consultation with the Fund, take any other appropriate measures for this purpose.

6. In the context of the PSI framework, we will regularly update the IMF on developments in the economic and financial policies, and provide the data needed for the monitoring of the programme. The Government will also consult regularly with the Fund on any relevant developments at the initiative of the Government, or the Fund. We would request that the fifth review of the PSI take place by April 30, 2009.

7. The Government of Tanzania intends to make this letter and the attached MEFP, together with Fund staff reports related to this review under the PSI, available to the public and hereby authorises the IMF to publish the same on its website once the review is completed by the Executive Board.

Yours Sincerely,

/s/

Mustafa H Mkulo (MP)

**MINISTER FOR FINANCE AND ECONOMIC AFFAIRS
UNITED REPUBLIC OF TANZANIA**

Attachment: Memorandum of Economic and Financial Policies.

TANZANIA: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

I. RECENT MACROECONOMIC DEVELOPMENTS AND PROGRESS UNDER THE PROGRAMME

Recent economic developments

1. During the year to December 2007 Tanzania continued to enjoy good economic performance, with a 7.3 percent real GDP growth estimated for 2007 compared to 6.7 percent in 2006. Particularly good performance was recorded by transport and communications (9.3 percent), mining (14 percent), construction (7.5 percent), tourism and trade (8.9 percent). During the year, the National Bureau of Statistics (NBS) revised the National Accounts series in line with the UN System of National Accounts (1993 Manual), and applied 2001 as the base year. The revision incorporates new sources of data on the production of goods and services, and introduces certain methodological changes to ensure compliance with international standards set by the United Nations Statistical Office.

2. The economy continued to experience inflationary pressures during the second half of 2007 emanating mainly from increasing energy and food prices. From 5.9 percent in June 2007, and 7.8 percent in August 2007, annual headline inflation rate eased to 6.4 percent by end December 2007 before increasing again to reach 8.9 percent in February, 2008. The government has temporarily reduced import tariffs on maize to ease any food shortages, and food prices are expected to ease in the following months.

Fiscal outturn

3. Strong domestic revenue performance continued in the first half of 2007/08, with actual collections during the six months to December 2007 being 2 percent above target and 35 percent above actual collection during the corresponding period of last year. Excise duty on petroleum products, VAT, and income tax, particularly from private companies and PAYE, exceeded targets for the period. However, nontax revenues have performed poorly (at 73 percent of the target) partly on account of a downward adjustment of some fee rates envisaged in the 2007/08 budget.

4. All major recurrent expenditure categories were below projections during the half year to December 2007, mainly on account of slow procurement and recruitment processes. Development expenditure benefited from accelerated disbursement of foreign project financing, to close above programme projections.

5. External financing of the budget during the period benefited from higher than projected programme, project, and basket loans. An AfDB programme loan carried over from

the preceding year was disbursed during the period under review, contributing to net domestic savings by Government and a higher than anticipated build up of foreign exchange reserves at the Bank of Tanzania (BoT).

6. In line with our programme to improve efficiency in the tax and customs administration, progress recorded in the first half of the year in rationalizing customs procedures include the operationalisation of the web based pre-lodgment facility of ASYCUDA⁺⁺ (the Assyscan module) at the Julius Nyerere International Airport (JNIA), thereby covering the major import points in Dar es Salaam and potentially 80 percent of all imports. An electronic Import Declaration Form (IDF) has also been introduced in handling imports that have to go through TISCAN for processing, thereby eliminating the need for importers' and clearing agents' physical visits to TISCAN offices. Combined efforts of the Customs and Excise Department and the Large Taxpayers Department (LTD) have allowed successful implementation of the new compliant trader scheme program aimed at facilitating procedures for large importers. The LTD is also making good progress with the implementation of electronic filing and with improving the quality of audits.

7. The effort to promote transparency and accountability in the management of public resources was sustained through the Audit Committees established in all MDAs. Initially, the Committees' main focus is addressing the observations in the 2005/06 report of the National Audit Office (NAO). Spending agencies are producing quarterly reports of implementation of recommendation of Controller and Auditor General (CAG) and Public Procurement Regulatory Agency (PPRA) audits.

8. The Joint BOT-MOFEA Cash Management Committee (CMC) established to improve coordination in fiscal and monetary policy implementation has developed strategies for improving the predictability of liquidity injection from Government operations, reducing the expenditure float particularly at the end of the year, and transferring Government deposits in commercial banks.

Monetary Programme

9. Starting mid-October 2007, the BOT revised its monetary policy strategy, introducing a better mix of its instruments and broadening monetary policy transparency. The sale of Treasury bills has since been complemented with almost daily sales of small amounts of foreign exchange in the market and more active use of REPO instruments. The following month, the improved liquidity management strategy succeeded to contain average reserve money growth within its target ceiling for the first time since March 2007. Reserve money has remained on track since, while at the same time Treasury bill yields have fallen sharply. In addition to relying more on other instruments for liquidity management, the BOT enhanced competition in the market for government securities by first exercising strict discipline in limiting sales to the amounts offered for all maturities and later, beginning on

January 9, 2008, moving from a weekly to a fortnightly auction schedule for Treasury bills and a monthly schedule for bonds.

10. The BOT has maintained a flexible exchange rate policy, ensuring that it remains neutral on the level of the exchange rate. Following the announcement of its new strategy for monetary and foreign exchange operations, the Tanzanian shilling experienced an initial appreciation of about 10 percent against major currencies, but has since traded within a fairly narrow range. The modest appreciation of the shilling provided a partial cushion against the sharp rise in the price of oil and dampened imported inflation on most of consumer goods.

11. Growth of broader monetary aggregates was also kept on track during this period. Extended broad money supply (M3) grew at an average rate of 21.2 percent between July and December 2007, compared to the targeted annual growth rate of 24.1 percent for December, while broad money supply (M2) averaged 26.5 percent—partly reflecting a shift toward shilling deposits—compared to its target 30.3 percent. Despite this tighter monetary policy stance, the banking system continued to meet the strong demand of private sector credit, in line with the accelerating economic growth.

12. To support its strengthened liquidity management, the BOT has established a daily liquidity management committee chaired by the Director of Economic policy. Based on data on cheques issued by Government provided by the MOFEA, the committee forecasts and manages near term liquidity. In addition, the Governor chairs weekly liquidity management committee meetings, which are held every Monday and set objectives for the week ahead.

13. These efforts have started to pay off, including by encouraging more competition and narrower spreads at commercial banks. The overall weighted average yield on Treasury bills declined from 17.1 percent in June 2007 to 7.4 percent in March 2008, resulting in significant savings to the budget in terms of interest costs. Overall time deposit rates improved from 7.83 percent in June 2007 to 8.26 percent in December 2007, while 12-month deposit rates increased from 9.25 percent to 10.2 percent. Lending rates dropped slightly from 16 percent to 15.25 percent. Negotiated rates, which reflect the competitive cost of funds by commercial banks, responded even better. By end of December 2007, the negotiated deposit rate stood at 11.04 percent and the lending rate at 11.98 percent.

14. In a move to enhance transparency in monetary policy actions and maintain stability in financial markets, the Bank of Tanzania has introduced monthly meetings with commercial banks within a day or two after the conclusion of the Monetary Policy Committee (MPC) meetings. The first meeting was conducted in December 2007. In addition, the BOT initiated quarterly meetings with commercial banks to solicit feedback on the Bank's monetary policy performance and other regulatory issues, as well as quarterly press conferences to inform the public on economic developments.

15. External developments during the first 7 months of 2007/08 have been broadly in line with the programme, despite, an unexpected decline in gold production, and a further increase in oil prices. Goods exports grew by about 18 percent during the period, reflecting mainly a very rapid increase in manufacturing exports, and a recovery of traditional exports from last year's sharp drop due to adverse weather conditions. At the same time, imports also grew at a very rapid pace—nearly 25 percent during the first 7 months of the year—driven mainly by higher fuel costs and increased investment-related imports. As a result, between July and December 2007, the current account deficit widened to USD 938.4 million, compared with USD 589.9 million registered in the same period of the previous year, consistent with program projections for 2007/08.

16. Official and private foreign exchange inflows received during the period under review supported an increase in gross official reserves from USD 2,634.5 million to USD 2,755.2 million at end-December 2007, the equivalent of about 4½ months of next year's imports. In the same period, the nominal exchange rate of the shilling to the U.S. dollar appreciated from TZS 1,281 at end July 2007 to TZS 1,132 at end December 2007.

Governance

17. The Government continues to make progress in addressing governance issues. The Prevention and Combating of Corruption Bureau (PCCB) is actively investigating several prominent cases of alleged corruption and has presented a number of cases to the public prosecutor for legal action. The Public Audit Bill, which will be discussed in the next session of Parliament beginning in early June 2008, will further strengthen the independence of the National Audit Office. Following the completion of the special audit of the EPA Account in November 2007, the Government has developed an action plan for implementing the recommendations in the audit report. Several measures have already been taken. The President has withdrawn the appointment of the former Governor of the BOT and a criminal investigation of all involved parties is underway as well as legal procedures to recover funds. The BOT has suspended all transactions in the EPA account and has initiated disciplinary action against BOT officials involved in the initiation, processing, and approving of EPA payments. Steps have also been taken to strengthen the governance structure of the BoT, including the appointment of a new Board. In addition, the Audit Committee of the Board is now chaired by a non-executive member of the Board and the Governor no longer serves on this committee, to allow unencumbered scrutiny of all financial matters.

Energy

18. EWURA approved a 21.7 percent power tariff increase for TANESCO beginning February, 2008. While this is lower than the 40 percent increase requested by TANESCO, EWURA agreed to consider another request for a tariff increase once TANESCO completes a cost of service study and takes measures to reduce nontechnical losses, notably theft.

TANESCO is currently reviewing its financial situation in view of EWURA's ruling, and could be in a position to submit later this year another application to reach cost recovery on an operational basis. In the meantime, TANESCO is using the private emergency power generators to meet intermittent power supply deficits. The procurement of its own 145MW gas-fired generation capacity is also progressing well. The Government is also continuing with consultations with development partners to secure support for the power utility's investment budget.

Performance under the program

19. Programme implementation remains broadly on track. All quantitative assessment criteria were met for end-December 2007, and substantial progress was achieved on the structural agenda (Tables 1 and 2 annexed hereto). Three-month rolling Government cash flow forecasts have been generated by the Cash Management Committee beginning February 2008, and used by both the Expenditure Ceilings Committee of the Ministry of Finance and Economic Affairs (MOFEA) and the Monetary Policy Committee of the BOT in setting monthly targets. To further improve market operations of the Bank, the Government provides the BOT with daily lists of cheques issued, thereby enabling the bank to incorporate government payments in daily liquidity projections. The Government is also implementing a pilot application of an electronic funds transfer (EFT) module, with a view to evaluating the feasibility of adopting EFT for all its payments and eliminate the expenditure float. In addition, the government has prepared an action plan to transfer government deposits in commercial banks to the BOT to be initiated during the 2008/09 fiscal year, following thorough consultation with all stakeholders. Progress with the integration of the Customs and Excise Department and TISCAN's systems has continued, but technical reasons have prevented completing the process by end-March. We now plan to finalize the integration by the end of 2008 by which time importers will only be required to file a single import declaration (December 2008 structural benchmark).

20. In line with the programme under the second generation of financial sector reforms, a proposed financial leasing law and draft amendments to the legal and regulatory framework for the Pension Sector were submitted to Parliament in February 2008. The proposals had been developed and discussed by stakeholders and the Inter-Institutional Committee on Financial Sector Reform (IIC) during 2007. Investment Guidelines for pension funds, which would come into effect upon approval of the enabling legislation, have also been developed with technical assistance from the World Bank and in consultation with other stakeholders. In addition, significant progress is underway to strengthen the legal framework with the objective of further promoting the diversification and deepening of the financial sector. The Financial Leasing Bill, which was tabled for first reading in the November 2007 parliamentary session was approved by Parliament in April 2008 session. Progress has also been made towards the enactment of a Mortgage Finance Bill. A draft Unit of Titles Bill, as well as a draft miscellaneous Bill to amend four laws, namely, the Land Act 1999; the Land

Registration Act; the Civil Procedures Act; and the Magistrate Court Act were prepared and submitted to the Ministry of Finance and Economic Affairs. It is expected that these will be adopted by the Government by end-June 2008 for onward submission to Parliament.

21. Progress was also made toward establishing a credit reference databank, however, the end-June 2008 benchmark for completing this task will not be met. The consultant's final report and operating guidelines were submitted to the BOT recently, and the process for procuring systems is expected to begin in the next fiscal year. This process is expected to require 6-12 months, before the database would be operational.

22. With the overall programme performance on track, existing programme targets for the remainder of 2007/08 will be maintained. The fiscal position to June 2008 is expected to benefit from a good revenue outturn and higher foreign financing and result in a stronger than programmed domestic financing position providing a cushion in view of the uncertainties in foreign financing for 2008/09. Monetary and foreign exchange operations have kept international reserves and reserve money on course to meet their end-June targets as well. However, inflation targets may be slightly missed on account of growing global inflation pressures and rising food prices.

II. PROGRAMME FOR 2008/09

23. Looking ahead, the Government is committed to sustaining the policies and strategies that have delivered the good macroeconomic performance in the recent past.

24. Real GDP growth is projected to reach 7.8 percent in 2008 and 8.0 percent in 2009 and 2010. In addition to a steady growth in agriculture which is expected to benefit from good weather conditions in the current year, strong performance is expected to continue in the communication, construction, financial intermediation, and manufacturing sub-sectors. Accelerating the rate of growth and poverty reduction in the medium to long term will continue to be central in the programme design and implementation. A new household budget survey is expected to be completed in mid-2008 and is expected to show a tangible improvement in poverty indicators.

25. The programme for 2008/09 projects revenue at 16.2 percent of GDP, reflecting the impact of continued strengthening of tax and customs administration, and policy measures, including implementation of the adjustments to the hunting fees announced in June 2007. In addition, the Government will consider recommendations from the planned non-tax revenue study, for which a consultant is being procured. Revenue administration measures include strengthening controls over tax exemptions, taxpayer identification and registration through the block management system along with other initiatives already underway, including the expansion of electronic filing; better management of medium taxpayers through specialised units in regional offices; and continued improvement of customs processes and controls.

26. Total expenditure for 2008/09 is cautiously projected at 26.5 percent of GDP, compared to the expected 27.3 outturn in 2007/08, mainly on account of uncertainty regarding foreign financing. Expenditures directly related to specific MKUKUTA strategies are expected to be about 70 percent of the total budget. Consistent with MKUKUTA, priority continues to be placed on growth promoting expenditures, including investment in economic infrastructure, education, and health. Infrastructure investment will benefit from the implementation of the USD 698 million 5-year Tanzania Compact Programme financed by the Millennium Challenge Account (MCA) of the government of the United States. In the education sector, priority is on increasing the supply of qualified teachers and teaching materials.

27. Recurrent expenditure as a percent of GDP is projected to remain broadly at the 2007/08 level, with the Government wage bill is projected to increase by 0.6 percent of GDP to 5.9 percent of the GDP following the agreed adjustment of the minimum wage level for civil service employees and its impact on other pay scales, itself a result of the Presidential Commission on Civil Service Pay. Development expenditure is projected at 8.9 percent from 10.1 budgeted in 2007/08, reflecting the expiry of the availability of resources freed up by MDRI, and a reduced overall resource envelope.

28. Programme loans and grants are projected at 1.4 and 2.4 percent of GDP, compared to the projected 2.4 and 3.7 percent respectively in 2007/08. To partly mitigate the impact of the temporary decline in programme external financing and protect priority expenditures, the Government may have to suspend the zero domestic financing policy to raise up to 1.0 percent of GDP from domestic sources. Should additional program financing become available later in the year, net domestic financing would be reduced accordingly. On the other hand, should external budget support fall short of the budget figures, the Government would adjust spending.

29. Over the medium term, the government aims at increasing revenue collection to 20 percent of GDP. To this effect a number of initiatives are underway. The third 5-year TRA corporate business plan will be adopted in July. Priorities include: (i) continuing capacity building with large taxpayers; (ii) adopting best practices for medium taxpayers; (iii) revamping the small and micro taxpayers regimes; (iv) strengthening risk management at customs; and (v) carrying out a smooth exit from TISCAN'S contract. Preparations for the ISO certification of the Tanzania Revenue Authority continue, with an external audit for that purpose expected by end-June 2008. Finally, starting in July 2008, the TRA will take over collection of property taxes on behalf of local authorities. On the policy side, we plan to implement the recommendations of the Presidential Committee for the Review of the Mining Sector, which has now completed its report.

30. Our effort at strengthening the public financial management (PFM) systems is focused on strategic resource allocation and ensuring value for money in budget execution. Building on achievements to date, the government has adopted a revised strategy for the Public Financial Management Reform Program (PFMRP). Phase III of the PFMRP will strengthen the management of the program, will increase ownership of the reforms by the various components, and will roll out reforms beyond the MOFEA to the line ministries and local governments. The program seeks to achieve allocative efficiency by (a) ensuring aggregate fiscal discipline and accountability, (b) allocating resources in accordance with government priorities, and (c) promoting efficient service delivery through enhanced predictability and availability of medium term resources for implementing agencies (MDAs). Measures in this regard include:

- a. Improving budget preparation by further aligning MKUKUTA, the MTEF, and the budget, including by reviewing the links between the Strategic Budget Allocation System and the IFMIS which will also allow tracking budget execution along the MKUKUTA Clusters;
- b. Strengthening the cash (Treasury) management function to ensure efficient resource utilisation and cash flow forecasting functions, in line with the recently adopted plan to this effect;
- c. Improving expenditure monitoring through the Expenditure Tracking Unit at the Treasury, the production of performance based reporting by spending agencies, and implementation of a functional classification of expenditures consistent with GFSM 2001 in the 2009/10 budget submission to Parliament (structural benchmark for June 2009);
- d. Communicating with development partners to secure predictability of their contributions over the MTEF horizon (3 years rolling commitments);
- e. Increasing capacity for transparent public procurement and external audits.

31. The Bank of Tanzania will continue to implement a prudent monetary policy, conducive to low and stable inflation. To this end, the BOT intends to further bolster its open market operations, rely substantially on foreign exchange sales for sterilizing liquidity, and continue to improve liquidity forecasting. Specifically, monetary policy for 2008/09 will aim to reduce M3 growth to 18 percent by end-June 2008. Reflecting some efficiency improvements in bank operations, such as those resulting from switching to a lagged basis for calculating reserve requirements, reserve money is programmed to grow at a slightly slower pace of 17 percent. Private sector credit is projected to continue its robust expansion at about 22 percent during the year, somewhat lower than in recent years, mainly reflecting

Government's domestic borrowing need arising from a possible drop off in donors' budget support.

32. The Bank of Tanzania remains committed to a flexible exchange rate policy. The Bank will continue to conduct its foreign exchange sales for sterilization operations, systematically on a daily basis, to maintain an orderly market and minimize its influence on the exchange rate.

33. The Bank of Tanzania is currently reviewing the existing regulatory framework governing capital account transactions with a view to adapting it to the needs of the Tanzanian economy. The BoT expects to complete its review by September 2008 (structural benchmark) as a basis for legal and regulatory changes in the course of 2008/09.

34. To consolidate the progress so far achieved on the predictability of the Bank's monetary policy stance, the Bank will continue to inform the market players and the general public, on a monthly and quarterly basis, respectively, on recent economic developments, the objectives and the rationale behind the adopted monetary policy stance.

35. The Government will continue to implement the broad-based second generation financial sector reforms aimed at deepening financial intermediation and broadening access to financial services. The National Social Security Bill, which was approved by Parliament in April, creates a single regulator for the pension fund sector and assigns to the BoT the responsibility of establishing investment guidelines. The BOT will act expeditiously to assess the financial health of the pension funds as a basis for finalizing the investment guidelines. Under the law, it is envisaged that the regulator will provide regular and comprehensive information to the BOT to enable it to play its role in ensuring the stability of the Tanzanian financial system.

36. The BOT will continue to build its capacity for banking supervision in 2008/09. With the planned expansion in staff, the BOT anticipates working closely with Fund technical assistance—especially through East AFRITAC—for staff training. In this regard, the Banking Supervision Department will further strengthen its risk-based assessment of bank soundness through stress testing and will initiate a series quarterly reports for BOT Board on financial sector stability (structural benchmark for September 2008).

Governance and accountability

37. The Government intends to further reinforce good governance and accountability. In particular, it is following up on the findings of the PPRA, which audited some 20 spending agencies in 2006/07 and a further 95 in 2007/08, with the objective of strengthening the capacity of procurement agencies to comply with procurement regulations. In line with its action plan responding to the recommendations of the EPA audit, the Government will carry

out a verification of the remaining EPA claims and develop a strategy for acknowledging and eventually settling the accounts legitimately due on the basis of guidelines for settlement of public debt. The BOT is also undertaking a fundamental review of its functions, with a view to identifying those that could be outsourced or hived off from the bank. A strategy for refocusing the BoT will be prepared by August 2008. We also plan to clarify the relationship between the MOFEA and the BOT regarding some of the tasks that the BOT conducts on behalf of the MOFEA, including the management of the EPA account. The BOT and MOFEA intend to establish a detailed Memorandum of Understanding setting out respective responsibilities, including cost sharing of monetary policy operations, by end-September 2008 (assessment criterion). To this end, we intend to seek assistance from the Fund. We also plan to review the regulatory framework for preventing money laundering and the financing of terrorism based on an assessment prepared by the regional body, the Eastern and Southern African Anti Money Laundering Group, in the final quarter of 2008.

Other structural reforms

38. Despite the improved hydrology and a recent award by EWURA for a power tariff increase by TANESCO, the financial situation of TANESCO remains vulnerable, in part because of the non-materialisation of a number of key cost-reducing measures in its Financial Recovery Plan (FRP), including the buy-out of the IPTL, the conversion of its plant, and refinancing of the Songas expansion. The Government will pursue TANESCO's implementation of the cost cutting measures demanded by EWURA without undue adverse impact on service delivery. Negotiations with IPTL's main creditors are underway, with a view to realizing the crucial action on TANESCO's FRP. The new Electricity Act, designed to promote competition and attract greater private investment to the sector, was passed by Parliament in April 2008.

39. Together with our other East African partners, we are initiating negotiations towards the establishment of an East African Common Market, which is the second stage of economic integration under the EAC Treaty. The EAC Member States also initialed an interim trade agreement with the European Union in the context of economic partnership agreements. Under this agreement, EAC Member States will continue to enjoy full duty free and quota free access for their goods exports to EU markets, with transitional arrangements for only rice and sugar. EU countries on the other hand will get gradually increasing free access to EAC markets over a transition period (to reach 82 percent of value for the EAC market within 25 years). There will be no fiscal revenue implications for Tanzania from this interim agreement during 2008-09, and a very marginal impact thereafter.

40. We are taking steps to strengthen our fiscal risk management practices. We will strengthen the MOFEA's capacity to adequately monitor risks stemming from different sources, with a view to preparing a statement of fiscal risks in the coming years. We are also working on the development of a framework for deployment of public private partnerships

(PPP). In this sense, efforts will be directed at ensuring value for money and clearly identifying and mitigating associated fiscal risks.

Statistics

41. The government will continue to strengthen its statistical base with the medium-term objective of subscribing to the Special Data Dissemination Standard (SDDS). To meet the urgent need for more current output data, the NBS will accelerate its work towards publishing quarterly GDP estimates in the course of 2008/09. A new household budget survey is expected to be completed by mid-2008, which will assist in revising the weights of the consumer price index. The Bank of Tanzania is working to improve private debt and portfolio flows statistics in the financial account of the balance of payments.

Conclusion

42. Implementation of the economic and financial programme approved by the Fund's Executive Board is progressing well, with substantial progress being noted on all fronts, except inflation where challenges persist. The Government, in collaboration with the Fund through policy advice, is implementing measures to address the inflationary pressures and promote efficiency of the banking sub sector. The programme for 2008/09, which will be monitored through the quantitative assessment criteria and indicative targets set forth in Table 1 and the structural assessment criterion and benchmarks shown in Tables 3, continues the focus on sustaining macroeconomic stability, increases domestic resource mobilisation, promotes pro-poor economic growth, and increases investment in core social services like education and health. The Government is confident that the development partners, including the Fund, will maintain and increase their support through financing and policy advice, especially in view of the large investment requirements in infrastructure, energy, water, and education.

MINISTRY OF FINANCE AND ECONOMIC AFFAIRS
DAR ES SALAAM,
TANZANIA
May 2008

Table 1. Tanzania: Quantitative Assessment Criteria and Indicative Targets Under the Policy Support Instrument, 2007/08-2008/09

| | 2007 | | | | 2008 | | | | 2009 | |
|--|---|--------|---------------------|--------|--------------------|---------------------|--------------------|---------------------|--------------------|--------------------|
| | September | | December | | March | June | September | December | March | June |
| | Indicative Targets | Actual | Assessment Criteria | Actual | Indicative Targets | Assessment Criteria | Indicative Targets | Assessment Criteria | Indicative Targets | Indicative Targets |
| | (Billions of Tanzania shillings; end of period, unless otherwise indicated) | | | | | | | | | |
| Net domestic financing of the government of Tanzania (cumulative, ceiling) 1/ 2/ | -230 | -705 | -300 | -622 | -90 | 0 | 394 | 64 | 224 | 249 |
| Accumulation of budgetary arrears (ceiling; indicative target only) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Average reserve money (upper bound) 3/ | 1,793 | 1,836 | 1,934 | 1,881 | 1,975 | 2,042 | 2,207 | 2,242 | 2,311 | 2,390 |
| Average reserve money target 3/ | 1,775 | --- | 1,915 | --- | 1,956 | 2,022 | 2,185 | 2,220 | 2,288 | 2,366 |
| Average reserve money (lower bound) 3/ | 1,757 | --- | 1,896 | --- | 1,936 | 2,002 | 2,163 | 2,197 | 2,265 | 2,342 |
| | (Millions of U.S. dollars; end of period) | | | | | | | | | |
| Net international reserves of the Bank of Tanzania (floor) 4/ 5/ | 1,881 | 2,807 | 2,367 | 2,662 | 2,312 | 2,101 | 1,862 | 2,177 | 2,163 | 2,143 |
| Accumulation of external payments arrears (ceiling) 6/ | 0 | 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 | 0 |
| <i>Memorandum item:</i> | | | | | | | | | | |
| Foreign program assistance (cumulative grants and loans) 1/ | 502 | 775 | 923 | 923 | 957 | 1057 | 71 | 545 | 652 | 795 |

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 [____], 2008.

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

2/ To be adjusted downward by up to T Sh 249 billion for the U.S. dollar equivalent of a surplus in foreign program assistance from the amounts shown in the memorandum item.

3/ Assessment criteria and benchmarks apply to upper bound only.

4/ Floors are set US\$200 million below projected levels. Floor will be adjusted upward for any surplus in foreign program assistance from the amounts shown in the memorandum item up to the equivalent of T Sh 249 billion.

5/ Actuals revised to reflect the reclassification of the settlement of US\$132 million in government liabilities related to a liquidated parastatal enterprise.

6/ Continuous assessment criterion under the PSI; excludes arrears on debt-service payments pending the conclusion of debt-rescheduling agreements.

Table 2. Tanzania: Implementation of PSI Structural Benchmarks Through April 2008

| Measure | Target Date of Implementation | Status |
|---|--------------------------------------|--|
| Fiscal | | |
| Cash Management Unit in the Accountant General's Department and Cash Management Committee (CMC), including both MoF and BoT staff, to produce updated Government's three month rolling cash flow forecast and liquidity management plan at the end of each quarter. | Continuous, beginning end-March 2008 | Initial 3-month cash-flow forecast using a modified procedure was provided to line ministries and the BoT in February 2008. In addition, BoT started receiving daily reports on cheques issued to monitor near-term liquidity. |
| Complete the integration of the Customs and Excise Department and TISCAN's import clearance processes. | End-March 2008 | Delayed due to technical difficulties. |
| Adopt a plan to transfer government deposits in commercial banks to the BOT. | End-March 2008 | Initial plan circulated to stakeholders. |
| Financial Sector | | |
| Submit to Parliament amendments for harmonizing the regulatory framework for pension funds to allow the BoT to assume the role of the regulator and supervisor of financial aspects of pension funds. | End-February 2008 | Done. Social Security Bill submitted to parliament in February 2008. |
| Establish the credit reference databank and its operating guidelines. | End-June 2008 | Delayed. Design and information requirements approved by BoT management. Procurement and installation of systems will take place in 2008/09. |

Table 3. Tanzania: PSI Assessment Criterion and Structural Benchmarks for 2008/09

| Measure | Target Date of Implementation |
|---|-------------------------------|
| Establish a Memorandum of Understanding between the MOFEA and the BOT setting out respective responsibilities, including cost sharing of monetary policy operations. ¹ | End-September 2008 |
| Fiscal | |
| Cash Management Unit (CMU) in the Accountant General's Department to produce Government's three month rolling cash-flow forecast. | Continuous |
| Introduce a functional classification of expenditures consistent with the IMF's <i>Government Financial Statistics Manual 2001</i> in the budget for 2009/10. | End-June 2009 |
| Complete the integration of the Customs and Excise Department and TISCAN's import clearance processes. | End-December 2008 |
| Financial Sector | |
| Prepare a review of the regulatory framework governing capital and financial account transactions. | End-September 2008 |
| Prepare quarterly financial stability reports for the BOT Board, including assessments of risk-based prudential supervision | End-September 2008 |
| Establish an operational credit reference databank. | End-June 2009 |

¹Assessment criterion.

**TECHNICAL MEMORANDUM OF UNDERSTANDING ON SELECTED CONCEPTS AND
DEFINITIONS USED IN THE MONITORING OF THE PSI-SUPPORTED PROGRAM**

May 2008

I. 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.

II. DEFINITIONS

Net international reserves

2. Net international reserves (NIR) of the Bank of Tanzania (BoT) are defined as reserve assets minus reserve liabilities. The source for both reserve assets and reserve liabilities is the accounting balance sheet of the BoT. The BoT's reserve assets, as defined in the IMF BOP manual (5th edition) and elaborated in the reserve template of the IMF's special data dissemination standards (SDDS), include (i) monetary gold; (ii) holdings of SDRs; (iii) the reserve position at the IMF; (iv) all holdings of foreign exchange; 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 March, June September, and December 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 and holdings of government securities and promisory notes (including liquidity paper issued by the BoT for monetary policy purposes), minus all government deposits with the BoT (including funds from liquidity paper issued by the BoT for monetary policy purposes); (ii) starting from end-June 2008, all BoT accounts receivable on the Government of Tanzania that are not included under (i) above; (iii) loans and advances to the government by the commercial banks and holdings of government securities and promisory notes, minus all government deposits held with the banks; and (iv) 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 at the BoT

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 accounts 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. For maturities of less than 15 years, the grant element will be calculated based on 6-month averages of commercial interest rates. For maturities longer than 15 years, the grant element will be calculated based on 10-year averages. 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 the sum of all verified bills that have been received by a central government spending unit or line ministry, and for which payment has not been made within 30 days during the fiscal year on wages, domestic interest, and goods and services (excluding court awards).

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.

Program exchange rate

11. The program exchange rate is set at the end-February 2008 exchange rate (T Sh 1,173 per U.S. dollar).

III. ADJUSTERS

Net international reserves

12. The quantitative targets for the BoT's net international reserves for the end-March 2008 and end-June 2008 test dates will be adjusted downward by the amount in U.S. dollars of any shortfall in foreign program assistance, up to a limit of US\$150 million, 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 Policies of the Government of Tanzania.

Net domestic financing

13. The quantitative limits on the net domestic financing of the Government of Tanzania will be adjusted:

- For the end-March 2008 and end-June 2008 test dates: (i) upward by a limit of up to T Sh 140 billion for the issuance of any debt instrument by the Government of Tanzania in relation to EPA transactions that took place during 2005/06 and 2006/07; (ii) downward for any recovery of EPA payments that give rise to an increase in government deposits at the BOT as defined in II.5 above; and (iii) upward for any shortfall in foreign program assistance in U.S. dollars, up to a limit of US\$150 million, converted into Tanzanian shillings at the program exchange rate, 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 Policies of the Government of Tanzania.

- For the end-September 2008, end-December 2008, end-March 2009, and end-June 2009 test dates: (i) downward by up to a limit of T Sh 249 billion for any overperformance in foreign program assistance evaluated at the program exchange rate 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 Policies of the Government of Tanzania; and (ii) downward for any recovery of EPA payments that give rise to either an increase in government deposits at the BOT, as defined in II.5 above, or a reduction in the BoT's claims on the Government of Tanzania.

IV. DATA REPORTING REQUIREMENTS

14. For purposes of monitoring the program, the Government of Tanzania will provide the data listed in Table 1 below.

Table 1 Summary of Reporting Requirements

| Information | Reporting Institution | Frequency | Submission Lag |
|---|-----------------------|-----------|----------------|
| Issuance of government securities. | BoT | Bi-weekly | 1 week |
| Yields on government securities. | BoT | Bi-weekly | 1 week |
| Consumer price index. | NBS | Monthly | 2 weeks |
| The annual national account statistics in current and constant prices | NBS | Annually | 6 months |
| Balance sheet of the BoT | BoT | Monthly | 1 week |
| Consolidated accounts of the commercial banks, and the monetary survey. | BoT | Monthly | 4 weeks |
| Summary of stock of external debt, external arrears, and committed undisbursed loan balances by creditor. | BoT | Monthly | 2 weeks |
| External trade developments | BoT | Monthly | 4 weeks |
| Balance of payments | BoT | Quarterly | 4 weeks |

| Information | Reporting Institution | Frequency | Submission Lag |
|---|-----------------------|-----------|----------------|
| Standard off-site bank supervision indicators for deposit money banks. | BoT | Quarterly | 6 weeks |
| Commercial bank domestic lending by borrowing sector. | BoT | Monthly | 4 weeks |
| Commercial banks interest rate structure. | BoT | Monthly | 4 weeks |
| Summary table of: (i) average reserve money; (ii) net domestic financing of the government; (iii) accumulation of budgetary arrears; (iv) stock of external arrears; (v) new contracting or guaranteeing of external debt on nonconcessional terms; and (vi) net international reserves. The MFEP and BoT will reconcile data on BoT claims on the government, to ensure that such claims recorded in the BoT balance sheet are the same as those reported by the Accountant General of the MFEP. | BoT and MFEP | Quarterly | 4 weeks |
| The flash report on revenues and expenditures. | MFEP | Monthly | 4 weeks |
| The TRA revenue report | TRA | Monthly | 4 weeks |
| The monthly domestic debt report. As discussed above, the MFEP and BoT will reconcile data on BoT claims on the government, to ensure that such claims recorded in the BoT balance sheet are the same as those reported by the Accountant General of the MFEP. | MFEP | Monthly | 4 weeks |
| Monthly report on central government operations. | MFEP | Monthly | 4 weeks |
| Detailed central government account of disbursed budget support grants and loans, and external debt service due and paid. | MFEP | Monthly | 4 weeks |
| Detailed central government account of disbursed donor project support grants and loans. | MFEP | Monthly | 4 weeks |
| Statement on new loans contracted during the period including terms and conditions according to loan agreements. | MFEP | Quarterly | 4 weeks |