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

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LETTER OF INTENT

Dar es Salaam
December 19, 2012

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Madam Lagarde:

1. The attached Memorandum of Economic and Financial Policies (MEFP) reports recent economic developments and reviews progress in implementing the Government of the United Republic of Tanzania's economic program under the Policy Support Instrument (PSI) and the 18-month Standby Credit Facility (SCF) arrangement approved by the IMF Executive Board on July 6, 2012. It also sets out macroeconomic policies and structural reforms that the Government will pursue in the financial year 2012/13 and in the medium term.
2. The Government of Tanzania remains committed to policies that will sustain macroeconomic stability while promoting accelerated economic growth and poverty reduction. These goals are being successfully pursued under the economic and financial program supported by the PSI and the SCF arrangement.
3. Policies have remained broadly on track. As of end-June 2012 all assessment/performance criteria and structural benchmarks were met. For end-September 2012 all quantitative indicative targets were met with the exception of a small shortfall for tax revenues. It was noted that a grant element of 34.68 percent of the US\$920 million gas pipeline loan, contracted in November 2012, was computed using a calculator from the Commonwealth Secretariat debt management reporting system rather than the IMF loan calculator. It was on this basis that decisions were made in good faith. Fund staff has advised that the resulting grant element using the program methodology is 33 percent, below the required 35 percent. This caused non-observance of the continuous external nonconcessional debt ceiling performance/assessment criterion for which a waiver is requested. All structural benchmarks through end December 2012 are largely on track except for a delay in preparation of a cost of service study for the power utility TANESCO and implementation of its findings, and preparation of a report on Tanzania's macroeconomic management of the new gas economy. We request that these benchmarks be reset (see MEFP) to allow us sufficient time for their completion.
4. Economic activity has remained robust, and projected GDP growth of 6.5 –7.0 percent in 2012 (6.7 percent in 2012/13) is likely to be achieved. Real GDP growth reached 7 percent in the first half of 2012 compared with 6.6 percent in the corresponding period of 2011. This positive performance was broad based—it was especially strong in transport and communications, financial intermediation, trade and repairs, and manufacturing.
5. The overall inflation rate has receded from a peak of 19.8 percent in the year ending December 2011 to 12.9 percent in October 2012 following improved food supply and slow down

in the increase of fuel prices. Headline inflation is projected to continue easing in the months to come, and return to single digits by end-June 2013.

6. The Government is pursuing continued fiscal consolidation in 2012/13 to progressively rebuild fiscal buffers after responding to the last global recession with counter-cyclical fiscal policies. The budget aims to reduce the overall fiscal deficit to 5½ percent of GDP in 2012/13, down from the 6 percent of GDP average for the past three years. Over the medium-term, further deficit reduction to debt-stabilizing levels is targeted.

7. Tanzania's current account deficit in 2012/13 is projected to record a deficit of 16 percent of GDP and decline in the next years as domestic gas powered electricity generation leads to lower demand for imported petroleum fuels.

8. The Government of Tanzania requests completion of the fifth review under the PSI and first review under the SCF arrangement based on overall performance under the program and the Government's policy intentions going forward. The Government is confident that the policies and measures set forth in the attached Memorandum will deliver the objectives of its program. We stand ready to take any further measures that may become appropriate for this purpose. In this context, we request a modification of performance criteria on reserve money and external nonconcessional debt, and propose the introduction of two new structural benchmarks on a VAT reform and an action plan for TANESCO.

9. The Government will consult with the IMF at its own initiative or whenever the Managing Director of the IMF requests such a consultation before the adoption of any such measures or changes to the policies described in the attached Memorandum. The Government will provide the Fund with such information as the Fund may request in connection with the progress made in implementing the economic and financial policies and achieving the objectives of the program. In particular, before signing contracts we will share with Fund staff the terms of new external loans that are close to the concessionality threshold, so that their degree of concessionality can be assessed.

10. Mounting pressures on the balance of payments have recently emerged. Should these persist, we reserve the right to draw on the SCF arrangement. It is expected that the sixth and final review of the PSI and second review of the SCF arrangement will take place before June 3, 2013 and third review of the SCF arrangement by December 31, 2013. In order to align the availability dates of the 3rd and 4th disbursements with the contemplated review dates, the government also requests the rephrasing of the SCF arrangement.

11. The Government of Tanzania intends to disseminate this letter, the attached MEFP and Technical Memorandum of Understanding (TMU), as well as related Fund staff reports, and hereby authorizes the IMF to publish the same on its website after consideration by the Executive Board.

Yours Sincerely,

/s/

Dr. William A. Mgimwa (MP)
MINISTER FOR FINANCE
UNITED REPUBLIC OF TANZANIA

/s/

Prof. Benno Ndulu
GOVERNOR, BANK OF TANZANIA
UNITED REPUBLIC OF TANZANIA

Attachments:

Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding on Selected Concepts and Definitions Used in
the Monitoring of the Program supported by the PSI and the SCF arrangement

Attachment I. Memorandum of Economic and Financial Policies

December 19, 2012

I. MACROECONOMIC DEVELOPMENTS AND PROGRAM PERFORMANCE

A. Recent Macroeconomic Development

Output and inflation

1. Economic activity has remained robust, and projected GDP growth of 6.5–7.0 percent in 2012 (6.7 percent in 2012/13) is likely to be achieved. Indeed, during the first 7 months of 2012, performance was strong for most coincident indicators of economic activity, including tax revenue, imports of industrial raw materials, manufactured exports, and electricity generation. Real GDP growth reached 7.0 percent during the first half of 2012 compared with 6.6 percent in the corresponding period of 2011. This positive performance was broad based—it was especially strong in transport and communications, financial intermediation, trade and repairs, and manufacturing.
2. Consumer price inflation has receded from its peak level of 19.8 percent in December 2011 to 12.9 percent in October 2012. This slowdown in prices has been somewhat more pronounced in recent months, following improved food supply from good seasonal harvests and slowdown in the increase of fuel prices. Core inflation (excluding food and energy) rose gradually to a peak of 9.2 percent in August 2012, before declining to 8.6 percent in October 2012.

Fiscal performance in 2011/12

3. **Overall fiscal position.** The 2011/12 overall fiscal deficit was 5 percent of GDP, lower than the program target by 1.2 percentage points of GDP, and well below the outturn for 2010/11. The fiscal consolidation stemmed from strong revenue performance and government efforts to slow down non-priority expenditure growth while protecting key infrastructure projects and social spending. Although not all domestic arrears were cleared, the stock outstanding at end-June 2012 was 0.5 percent of GDP, a notable decline from 1.1 percent of GDP at end-June 2011.
4. **Revenues:** Tax revenues were higher than the program target by 0.3 percentage points of GDP, supported by strong economic activity and administrative measures taken by the Tanzania Revenue Authority (TRA). Income taxes (i.e., P.A.Y.E., corporate income tax, and withholding tax) were the main driver of the good tax performance. In particular, corporate income tax payments from the mining, beer, and transportation industries increased, while withholding taxes were buoyed on account of one-off sales of shares by British Petroleum and dividend payments of a large mining company. In addition, boosted offshore oil exploration activities contributed to withholding tax and P.A.Y.E. Continued efforts in strengthening the implementation of the

recently taken administrative measures (i.e., close monitoring of block management system; establishment of tax service centers in the concentrated business areas in Dar es Salaam to improve tax compliance; intensified risk-based and quality tax audits; and enforcement on the use of Electronic Fiscal Devices (EFDs)) also contributed to tax performance. Nontax revenue fell short of the program target by a small margin. Total foreign grants were 4.9 percent of GDP, 1.1 percent of GDP below projections.

5. **Expenditure:** Total expenditure was lower than the program target by 3.2 percentage points of GDP. Following the decision to scale down recurrent spending to align with available resources, the government cut or postponed spending on goods and services and transfers to Local Government Authorities (LGAs), some of which are considered critical in the medium term. The wage bill was also reduced by postponing new recruitments planned for the year. As a result, the savings from recurrent spending amounted to 2 percentage points of GDP. Part of the savings were used to finance the domestic component of development projects, including TSh 136 billion transfers to TANESCO and TSh 253 billion for clearing arrears associated with infrastructure projects. Foreign-financed development expenditure was below the program estimate by 2 percentage point of GDP, largely attributable to lower-than-projected disbursements of project funds.

6. **Financing:** During 2011/12, net foreign financing amounted to TSh 1,735 billion, 4.2 percent of GDP. The government contracted US\$660 million external non-concessional borrowing (ENCB) out of the planned US\$822 million. Longer than expected negotiations with potential creditors for non-concessional borrowing and the government approval process led to delays in contracting ENCB. Disbursements of ENCB amounted to US\$505 million, while concessional external borrowing amounted to US\$ 635 million during 2011/12. Domestic financing of the deficit was 0.8 percent of GDP compared with 1.0 percent programmed.

Monetary policies

7. In the face of protracted high inflation, the Bank of Tanzania (BoT) continued with tight monetary policy. Reserve money remained on track during 2011/12 closing 4.2 percent below the program ceiling for end June 2012, but liquidity conditions varied as reflected by movements in money market interest rates. Having risen to a peak of 27.7 percent in mid-April 2012, the overnight interbank cash market rate declined to 7.9 percent at end October 2012. The annual growth of money supply (M3) was 11.8 percent in June 2012, compared with the projection of 20.0 percent, while credit to the private sector grew by 18.7 percent, against 23.0 percent. Growth of M3 continued to decelerate in the year ending September 2012, while nominal exchange rate continued to stabilize in the second half of 2011/12, consistent with measures taken by the Bank of Tanzania at the end of 2011— reducing the limit on banks' net open foreign exchange positions from 20 to 10 percent of core capital, and tightening enforcement of existing restrictions on lending to nonresidents. Meanwhile, credit to private sector grew by 16.1 percent, compared to the projection of 13.9 percent.

External developments

8. During 2011/12, the current account deficit rose to US\$ 4,214 million or 16.3 percent of GDP from US\$ 2,215 million or 9.4 percent of GDP in 2010/11, reflecting a surge in imports of oil and capital goods. The increase in oil imports reflects higher global prices as well as greater volumes of oil imports to fuel new petroleum-based thermal and back-up power generators. The rise in imports of capital goods reflects higher foreign direct investment for oil and gas exploration. Exports of goods and services were 14.0 percent higher than the amount recorded in the corresponding period in 2010/11, largely due to an increase in travel receipts and the prices and export volumes of gold and traditional agricultural produce.

B. Program performance

Quantitative targets

9. Following the continued fiscal consolidation and tight monetary policy, all quantitative assessment criteria under the Policy Support Instrument program for end June 2012 were met. Net domestic financing (NDF) was TSh 334.9 billion, which is lower than the adjusted ceiling of TSh 697.0 billion. The change in net international reserves (NIR) was above the adjusted program floor by USD 131 million and average reserve money (ARM) was TSh 188 billion below the program ceiling. The continuous performance/assessment criterion on non-accumulation of external arrears was met while the continuous observance of the ceiling on non-concessional borrowing was breached in November due to the determination that a US\$920 million loan for the gas pipeline—originally thought to be concessional—turned out to be non-concessional (33 percent grant element) under the program’s methodology.

10. All indicative targets for end September 2012 were met, except for tax revenues by a small margin (2 percent of the target). NDF registered a repayment of TZS 108.0 billion, against the borrowing target of TZS 500.0 billion following moderate government spending. Cumulative change in NIR was above the target by USD 215.5 million, mainly due to lower than expected government external obligations; while ARM was TZS 152.2 billion below the target of TZS 4,735.0 billion. The indicative target on priority social spending of Tsh 517 billion was exceeded by Tsh 31 billion (6 percent of the target).

Structural benchmarks

11. Some progress was made in the power sector. A first draft of the Cost of Service Study (COSS) was made available for public comments on August 13, 2012 and the final report was completed in October 2012. As a result, the structural benchmark on completion of the COSS for TANESCO and implementation of its findings has been delayed.

12. The structural benchmark on identifying steps to be taken to prepare Tanzania’s macroeconomic management for the new gas economy has been delayed. However, the Government recognizes the need to build capacity to effectively regulate the sub-sector, including effective fiscal regime, legal and regulatory frameworks to maximize the government

take through this natural resource. In this regard, the Government is working on the relevant policy, legislation, regulations and model Production Sharing Arrangement (PSA) to address specific downstream requirements. In addition, the Government is working on a new Natural Gas Master Plan as well as a Natural Gas Management Bill, with the latter expected to be tabled in the Parliament before the end of 2012. Thus, the authority requests for postponement of this benchmark to end-April, 2013.

13. The Government continues to compile report of all government debt guarantees on quarterly basis. The report for the first quarter of 2012/13 indicates that there were no new guarantees issued during the quarter. The report was shared with IMF in November 2012.

14. Progress has been made in the establishment of Debt Management Office (DMO) under the Ministry of Finance. The duly established organization structure of the DMO was submitted to the President's Office Public Service Management (PO-PSM) in November, 2012 for review and approval. The DMO is expected to be in place by end-December 2012 but will not become fully operational until next year, pending further legislative changes. Compilation of quarterly BoP estimates for the quarter ending September 2012 has reached an advanced stage, and the plan to publish the data by end December 2012 is feasible.

II. ECONOMIC PROGRAM FOR 2012/13 AND THE MEDIUM TERM

A. Economic prospects for 2012/13 and the medium term

15. Leading indicators such as electricity generation, production and consumption-based tax revenues, importation of industrial raw materials, and exports of manufactured, mineral and agricultural commodities have shown strong performance during the first half of 2012. Given such impressive performance, coupled with continued efforts to stabilize power supply and implementation of other economic policies under the five year development plan I (FYDP I), the overall performance of the economy in 2012 and beyond is expected to remain buoyant with GDP growth projected at about 7 percent in 2013. In the medium-term, growth is expected to pick up further supported by additional FDI, particularly in oil and gas explorations.

16. The prices of staple foods are expected to continue declining in the coming months following good harvest in June – August 2012. In addition, food Self Sufficiency Ratio is projected at 113 percent during 2012/13. Several other factors point in the direction of easing inflationary pressure in the coming months, including: reduction in the production costs due to stability in power supply; continued stability in the world market oil prices; improved food supply in Kenya and Uganda which is manifested by substantial decline in food inflation in July and August; and continued stability of the shilling against US Dollar observed since January 2012. Based on these factors, headline inflation is expected to continue easing, reaching a single digit level by June 2013.

17. In 2012/13, the current account balance is projected to record a deficit of 16.2 percent of GDP compared to 16.3 percent of GDP in 2011/12. The deficit is projected to narrow to about 14 percent of GDP in 2013/14 and decline further in subsequent years, as domestic gas powered electricity generation leads to lower demand for imported petroleum fuels.

18. The large trade deficit for 2012/13 is projected to slowly unwind in the medium term as domestic natural gas substitutes for liquid petroleum-based thermal power generation. Over the medium term, improved trade performance will also be needed to offset any decline in donor grant and loan funding relative to Tanzania's fast-growing economy. Given the need for smaller trade and current account deficits in future years, economic policies will be focused on strengthening the business environment and maintaining a competitive currency. While non-concessional financing will continue to be used for high return projects, borrowing will be limited to levels consistent with maintaining debt sustainability.

19. Following countercyclical fiscal policies in 2009/10 and 2010/11, which helped Tanzania weather the global recession, a first step toward rebuilding fiscal buffers was taken in 2011/12. This process will continue over the coming years with a view to reducing annual borrowing and stabilizing the public debt-GDP ratio at less than 50 percent of GDP. Consistent with this strategy, the government will make sure that the fiscal deficit (after grants) does not exceed 5.5 percent of GDP in 2012/13 and is further reduced in subsequent years to achieve a medium-term debt-stabilizing deficit. This fiscal consolidation will help support the adjustment toward smaller current account deficits. The pace of consolidation in 2013/14 and beyond will be reviewed ahead of the 2013/14 budget, taking into account economic conditions at that time.

B. Fiscal policies for 2012/13

20. The government's policy objectives for 2012/13 remain focused on maintaining macroeconomic stability, in particular, strengthening domestic revenue collection and prudent spending to contain the fiscal deficit. This is in line with the overarching objective of the Five Year Development Plan I as well as MKUKUTA II of ensuring economic growth and sustainable poverty reduction.

21. The budget will slow but not fully halt the upward trend in the public debt-GDP ratio, reflecting government borrowing from both domestic and external sources, including on non-concessional terms. The rise in the debt ratio from about 39 percent of GDP at end-June 2012 to 42.3 percent of GDP at end-June 2013 largely reflects borrowing equivalent to 2.7 percent of GDP contracted to finance construction of a new gas pipeline to be managed commercially by the Tanzania Petroleum Development Corporation (TPDC) (see below) and other investment in infrastructure.

Revenues

22. The ratio of overall revenue collection is expected to increase by 1.2 percentage point of GDP in 2012/13 compared with the previous fiscal year.

- **Tax.** Most of the tax measures envisaged as of the fourth review are included in the Finance Bill and implemented effective July 1, 2012. Possible risks to the attainment of tax revenue projections stem from: (i) policy reversals mainly on VAT and excise taxes exemptions; (ii) the extension of exemptions intended to support the textile and milk

sub-sectors; and (iii) the retention of 100 percent VAT relief, from the expected reduction to 55 percent, to a certain category of VAT relief beneficiaries. These measures are estimated to cause revenue losses to the tune of TSh 37.7 billion, being less than 0.1 percent of GDP.

- **Nontax.** All increases in user fees and charges were implemented as planned (TSh 129.1 billion), effective July 1. The main sources of the increase are as follow: land rents, administered by the Ministry of Lands, were also increased effective from July 1 TSh 62 billion. Work permit administered by Ministry of Home Affairs (Immigration) (TSh 8.6 billion); Mining royalty administered by the Ministry of Energy and Minerals (TSh 58.6 billion). The additional revenue from land rents revenue is expected to finance an urban development project, but the ministry will not proceed with the project until revenue increases from rent collection has been on track.
- **Tax administration.** Most administrative measures agreed as of the fourth review are being taken. A downside from the last review is a delay in the introduction of National Identification Cards (IDs) from August 2012 to year 2014.

23. The government considers the introduction of a new VAT law as high priority and has started to review the VAT Act, cap 148. The new law will seek to follow international good practices through reducing exemptions and preferential treatments, which would also reduce the administrative burden. The new VAT law is expected to increase tax collection by 1 percentage point of GDP or more. In August 2012, consultative meeting was held with key stakeholders drawn from the Ministry of Finance, Tanzania Revenue Authority (TRA), Researchers and Academia, Confederation of Tanzania Industries (CTI), Tanzania Chambers of Commerce Industries and Agriculture (TCCIA) with a view to collecting their opinions. The draft law will be finalized after further consultation with stakeholders in February 2013. The VAT Bill will be submitted to the Parliament in April 2013 (new structural benchmark for end-April 2013).

Expenditure policies

24. The overall 2012/13 expenditure envelope approved by the Parliament is closely in line with what was agreed during the fourth PSI review. Development expenditure is guided by the Five Year Development Plan I. The recurrent spending envelope allocates resources to the priority areas, in particular, education, health, and social protection that were postponed in 2011/12. In addition, other areas of spending increase during 2012/13 are related to establishment of new administrative areas (4 Regions, 19 Districts, and 34 Local Government Authorities), some of which were also postponed in 2011/12. Accordingly, non-wage, non-interest recurrent spending will increase to 10.9 percent of GDP in 2012/13, compared to an outturn of 9.2 percent of GDP in 2011/12. The wages and salary bill (excluding parastatals) will decline from the outturn of 6.6 percent of GDP in 2011/12 to a budgeted 6.5 percent of GDP in 2012/13. Public sector employment is expected to expand at a slower pace than in 2011/12, while wage and salary increases would be somewhat lower than the average for recent years, consistent with plans to reduce inflation. Domestically-financed development spending is expected to be maintained at

the same level as in the 2011/12 outturn of 4.6 percent of GDP. As a result, total expenditure is estimated to increase by 1.7 percentage points of GDP to 28.1 percent of GDP. Throughout the fiscal year, the government is committed to aligning expenditure with resource availability, both from domestic and external sources.

25. With the rebalancing from recurrent to development spending, the ratio of recurrent spending to recurrent incomes (revenues plus general budget support grants) declined from 10 percent in 2010/11 to 88 percent in 2011/12. The ratio is projected to increase to 94 percent in 2012/13 on account of the unwinding of recurrent spending cut, and remain below 95 percent in the medium term.

Fiscal contingencies

26. Building on two years of increased tax revenues in relation to GDP, the government is confident that further gains in tax administration, growing collections from the natural resources sector, and the tax policy measures in the budget will allow it to meet its 2012/13 revenue goals. To safeguard the fiscal adjustment program, tax revenue collections will be monitored closely against an indicative quarterly target (MEFP Table 1). In the event of a shortfall relative to this target, the government will take prompt corrective steps, as needed, to keep the fiscal program on track. These would include (a) further efforts to streamline non-wage, non-interest recurrent spending with savings in lower priority areas; and (b) a less ambitious increase in domestically-financed capital spending, possibly by delaying outlays on new projects into the subsequent year. Priority spending on agricultural inputs and health and education transfers to local government authorities will be maintained above the indicative quarterly floor, even in the event of such tightening of the spending budget (MEFP Table 1).

Financing

27. The government is planning to borrow external non-concessional loans of 5.1 percent of GDP in 2012/13, a major increase compared to the previous year, owing to a large pipeline project. The government intends to use all ENCB exclusively for infrastructure investment projects. The projects financed through ENCB will be carefully selected based on proper cost-benefit-analysis to ensure value-for-money. Preparations for the external non-concessional borrowing are well-advanced, and the government does not see risks of a financing shortfall. Donor-funded concessional loans are expected to be stabilized at the level of 2011/12, while the government's net domestic financing, excluding the on-lending to TPDC associated with the pipeline project, is expected to be equivalent to 1 percent of GDP.

28. As part of the government's energy strategy (see Section D below), TPDC will oversee the construction of a new gas pipeline over an 18-month period starting in 2012/13 with implications for the public sector borrowing requirement. The pipeline will be constructed at a cost of \$1.2 billion (4.2 percent of 2012/13 GDP), financed by external non-concessional loans and a budget contribution of about 5 percent. The government contracted the two loans (US\$920 million and US\$245 million) in November 2012 extending counterpart credit to the TPDC, which will operate the pipeline on a commercial footing. Operating income from the pipeline will be dedicated to servicing TPDC's obligations to the government as determined in the official on

lending agreement, which will, in turn, service the external credits. Actual disbursements for this project are projected at US\$ 814.8 million in 2012/13 and US\$ 393.3 million in 2013/14.

C. Public Finance Management

29. The government is committed to further strengthening Public Finance Management (PFM) systems in the context of the Public Financial Management Reform Program (PFMRP) IV, which was launched in June 2012. The program will be implemented over five years starting July 2012 with assistance from development partners and the IMF. Under the PFMRP IV, government efforts to strengthen PFM systems will focus on revenue management; planning and budget management; budget execution, transparency and accountability; budget control and oversight and management, programme monitoring and evaluation. Progress in the implementation of PFMRP IV has been made in a number of areas including: finalization and approval of PFMRP IV guiding documents including PFMRP IV strategy, Memorandum of Understanding and Operational Manuals; and reduction of the number of Local Government Authorities' bank accounts to six. The first PFMRP IV review mission was successfully concluded in September 2012.

Audit and payments systems

30. The Government has responded to the issues raised in the Controller and Auditor General (CAG) report for 2010/11. In particular, the first phase of the five year migration from the International Public Sector Accounting Standards (IPSAS) cash basis to accrual basis for the central government financial statements will begin with FY 2012/13. The government will also enhance transparency and accountability in public expenditure by strengthening capacity of the government internal auditor general department in order to ensure adherence to the public finance procedures and regulations.

31. Steps have been taken to strengthen the internal control systems and develop risk management strategies for central government and local government authorities. In an effort to improve the performance of internal Audit in ministries, departments and agencies (MDAs) and LGAs, the internal audit division in collaboration with the Japan International Cooperation Agency (JICA), has developed and disseminated internal audit Handbook and Handbook Aid that provide internal auditors in the public sector with modern audit tools and techniques. The division has also acquired software for payroll audit (IDEA) and trained three internal auditors in the usage of the software. By December 2012 the division is expecting to train two more internal auditors on how to use the software. Further, to enhance performance of internal auditors, the division has procured consultants to develop the following documents; internal audit manual in line with International Professional practice Framework (IPPF), a Quality Assurance Improvement Program Procedure manual, and Guidelines on implementation of Institutional Risk Management Framework. These documents are expected to be completed and disseminated to internal auditors by December, 2012. Also training to 300 internal auditors is expected to be conducted by December, 2012. All these initiatives are aimed at improving performance of internal auditors in all MDAs and LGAs.

32. The Accountant General has been charged with enhancing the accountability of LGAs' financial management through newly established section within the Accountant Generals

Department. LGAs submit own source revenue and expenditure to the Ministry of Finance in compliance with Treasury Circular No. 7 of 2011/12. Currently, 133 councils out of 167 are fully connected with IFMIS using IFMIS EPICOR 9.05 to process their transactions, and the Local Government Finance Act 1982 and Public Finance Act 2001 are being harmonized.

33. The total number of dormant government bank accounts closed during 2010/11 and 2011/12 was 16,760. Another 8,256 dormant bank accounts have been identified for subsequent closure. Consistent with government decision, beginning July 2012 each LGA maintains six bank accounts which are operational. The government has also improved its financial management system for better service delivery. The significant improvements include (i) the upgrade of Epicor from version 7.03.05 to version 9.05, with the new version already in operation; (ii) the development of a software system to accommodate pension payments that is in process, with the aim to do away with double payments to pensioners; and (iii) the connectivity of Electronic Payment System (TISS/EFT) to RAS offices and sub treasuries, which is expected to start on the second quarter of the financial year 2012/13. This will help making payments on real time to customers, reducing expenditure float and number of government bank accounts at commercial banks.

Other PFM reforms

34. In order to address the challenges facing the current budget preparation calendar and thus, meeting the requirements of key stakeholders (including the Legislature, and Development Partners, private sector, academia, and non-state actors) over involvement in providing timely inputs for preparation of national budget, the Government has adopted a new budget preparation calendar cycle for July-June fiscal year. The following are key important steps of the new budget cycle:

- the Plan and Budget Guidelines will be prepared and finalized between August-October of each year, four months earlier than the old calendar;
- scrutinization of sectoral plans and budget will be done in March of each year; and
- detailed scrutiny and approval of plans and budget proposals by Sectoral Parliamentary Standing Committees will be done in April of each year.
- approval of the final budget by the Parliament will be done before the start of the fiscal year.

35. In efforts to better track domestic arrears, the government has been compiling data on unpaid claims reported from MDAs—which are yet to be verified as arrears—on a quarterly basis, and has been sharing the data with the IMF and other development partners. The Government will develop and implement an expenditure arrears management strategy, including establishing the stock of expenditure arrears through stocktaking, verification and proper classification of the verified claims, and developing and implementing an arrears liquidation strategy. Verification of the stock of arrears will be undertaken in time to permit clearing the arrears by the end of 2012/13. Further efforts to reduce domestic arrears will include strengthening financing plans for multi-year projects and contracting, and registering all expenditure commitments in the IFMIS.

Public debt management

36. The government continues to strengthen its debt management capacity. In particular, efforts under way include:

- ensuring that the financing needs of the government are met at minimum borrowing costs and debt sustainability is preserved, consistent with the Government's medium term debt strategy. Non-concessional borrowing decisions will be made under this strategy, and public investment decisions will be made with a view to maximizing returns on investments;
- compiling a record of all government debt guarantees on a quarterly basis, and sharing these data with the IMF, within six weeks of the end of each quarter, beginning with the first quarter of 2012/13 (benchmark for end-November).
- establishing Debt Management Office (DMO) in the Ministry of Finance (benchmark for end-December 2012). The DMO will set up an effective and efficient debt management system, a crucial element for sustainability of the economy and will support the overall efforts in strengthening governance by improving transparency and accountability in managing public debts. The DMO will be tasked with monitoring new borrowing to ensure debt sustainability.

37. Tanzania's external non-concessional external debt ceiling for infrastructure projects amounts to US\$ 1,768 million over the PSI-supported program period ending in June 2013. As of end-June 2012, the government had cumulatively contracted US\$ 764 million (excluding the gas pipeline loan) to finance government infrastructure projects in the energy, roads, and other sectors.

38. In 2012/13, an additional US\$ 1,343 million were contracted on non-concessional terms through end-November, for the gas pipeline and a Dar es Salaam water supply project, bringing cumulative ENCB to US\$ 2,107 million. Consistent with our request for a waiver, we are requesting an increase in the cumulative ENCB ceiling by the US\$920 amount originally intended as concessional for the gas pipeline, to a new ceiling of US\$2,688. The government expects to use the remaining space of US\$581 million for various infrastructure projects and a planned government borrowing of US\$ 20 million for the power utility TANESCO. To ensure compliance with the non-concessional external debt ceiling, which includes all borrowing by parastatals, the government is closely monitoring all external non-concessional borrowing by the public enterprise sector.

Fiscal transparency

39. In line with the continuous efforts to improve fiscal transparency, the Ministry of Finance has published on its internet website the complete 2012/13 budget documents as submitted to the Parliament. The ministry also published on its website the approved 2012/13 budget in September 2012 and the summary 2012/13 "citizens' budget" in November 2012.

40. The government considers expanding the coverage of fiscal reporting essential to properly capture quasi-fiscal risks. In this regard, the Ministry of Finance has started reporting key financial indicators for TANESCO to the IMF on a quarterly basis starting from end-September 2012. The report includes financial flows and stock balance sheets of the parastatals. In the medium term, the government intends to implement more projects on a public-private partnership (PPP) basis. In order to successfully proceed with the plan, the government will strengthen the assessment of value-for-money and long-term fiscal implications (budgetary affordability) of PPP projects. The government will also strengthen fiscal reporting requirements to ensure a more consistent recording of liabilities from PPPs and to provide information on the fiscal risks associated with PPPs. To ensure this is done, the Government is enhancing institutional capacity on the management of PPP projects through strengthening the PPP desk in various Ministries and the PPP Unit at the Ministry of Finance and PPP Coordination Unit at Tanzania Investment Center.

D. Energy sector policies

41. In 2011, Tanzania suffered severe power shortages when droughts in late 2010 undercut hydropower capacity. In response, the Government implemented an Emergency Power Plan (EPP), procuring temporary power generating capacity from the private sector. With expensive liquid-fuel generated thermal energy replacing cheap hydropower, the financial situation of TANESCO deteriorated. Accordingly, under emergency procedures, the Energy and Water Utility Regulatory Authority, EWURA, approved an increase in electricity tariffs of 40.29 percent in January 2012. Further, with the view to implementing a complete tariff reform and safeguard TANESCO's financial viability, EWURA commissioned a comprehensive review of power tariffs. An external consultant was retained to conduct a cost of service study (COSS) for TANESCO and design a multi-year tariff structure. Moreover, going forward the new tariff-setting mechanism envisages periodic adjustments to reflect changes in fuel prices, exchange rates and costs of other inputs. On its part, TANESCO has launched an aggressive program to minimize losses due to power theft, and efforts to improve collections and recovery of arrears.

42. However, additional measures are needed to make TANESCO financially sustainable while ensuring an adequate supply of electricity to the economy. The authorities have prepared a draft action plan to achieve financial sustainability of TANESCO, which has been shared with the World Bank and the IMF. Although the Government provided TSh 100 billion to TANESCO for arrears clearance, accumulation of new liabilities imply that the outstanding arrears as of end-October remains at US\$252 million (1 percent of GDP) from US\$250 million as of end-September. The operational deficit of TANESCO for 2012 is forecast at US\$200-250 million (0.8-1 percent of GDP). The government's preliminary projections suggest that the operational deficits would be in the order of US\$270-310 million for 2013-2014, under the technical assumptions of unchanged tariffs and an unchanged mix of hydro power versus fuel power generation. From mid-2014, abundant gas supply is expected to become available as the new gas pipeline begins its operations. In the interim, the deficits would be lower in the event of a tariff increase or a higher share of hydro power generation that might stem from a return to abundant rainfall. The remaining deficits would be closed by budget support in the form of loans, equity injection, or direct transfers—with the mix of these measures depending on the medium-term projections which are being finalized. The independent energy regulator, EWURA, has announced that the

current tariffs are in place until end-December 2012. The COSS has been finalized, but a decision on tariffs for the next calendar year has not been reached. Despite the challenges in this area, the government remains fully committed to the existing program targets for FY 2012/13 for the budget deficit and the ENCB, and will reallocate resources within the existing fiscal framework during the mid-year review to cover any remaining gaps. For FY 2013/14, any budget support should also be properly allocated for. The action plan will be finalized, with assistance from the World Bank, to include further specific steps aimed at optimizing operational costs, strengthening governance, and identifying financing modalities (new structural benchmark for January 2013).

43. The Government's medium-term objective is to ensure a steady supply of electricity to the economy at lower costs. To this end, in November 2012, the Government launched construction of a new gas pipeline to bring lower-cost natural gas from Songo Songo and Mnazi Bay gas reserves to Dar es Salaam and surrounding areas for electricity generation and other uses. Two independent external evaluations confirmed that the project is commercially viable. The broader economic benefits will far exceed the commercial return as Tanzania will benefit from lower-cost power supply boosting its competitiveness and growth prospects.

44. Tanzania has seen favorable natural gas exploration results. There appear to be good prospects that commercial quantities of natural gas will be confirmed, resulting in multi-billion dollar foreign direct investments in Tanzania's natural gas sector over the next 5 years, and subsequent large export and budget revenue flows around the end of the decade. The total proven and probable reserves are estimated at between 24 – 33 TCF (trillion cubic feet). For the top of the range the estimated onshore is 8 TCF and offshore 25 TCF. The challenge is to prepare the country for the gas economy and establish strong foundations to best take advantage of this potential resource wealth. The government has already developed a Natural Gas Policy and a multi-donor mission has visited Tanzania in October 2012 to help the authorities develop a comprehensive policy and legal framework and assess technical assistance needs. The government is finalizing a report outlining steps to be taken to prepare the country for a new gas economy (benchmark for end-December). Among other things, this will comprise design of a gas revenue management framework integrated with the budget and possibly underpinned by a sovereign wealth fund; review of Tanzania's fiscal regime (including tax, production-sharing, and other non-tax instruments) to ensure its adequate coverage of the gas sector; and development of staff expertise in the Tanzania Revenue Authority (TRA) on tax issues associated with gas exploitation. The report will also identify the nature of any technical assistance needs.

45. The Government is keen to explore additional renewable energy resources in Tanzania, in particular hydro and wind power. Assistance in this area is being provided by a number of development partners, in particular the World Bank, which is assessing Tanzania's energy capacity under its ongoing Energy Sector Capacity Assistance Program (ESCAP).

E. Monetary, financial sector, and exchange rate policies

Monetary and exchange rate policies

46. In the face of sticky core inflation, the BoT will continue to pursue a tight monetary policy, with average reserve money remaining the operating target. The objective is to attain a single digit inflation rate by end June 2013 and maintain the rate at around 5 percent in the medium term. The BoT is committed to undertaking further measures to tighten the stance of monetary policy in the event that projected inflation 12 months ahead is above the targeted rate. Meanwhile, the BOT is taking various measures to improve policy formulation and implementation, including (i) operationalizing the use of interest rates as a *tool* for managing liquidity with assistance from the East AFRITAC and (ii) short term inflation forecasting in collaboration with the International Growth Center (IGC) and East AFRITAC. Looking ahead, the BOT is also in the process of developing a web based questionnaire for evaluating business conditions and inflation expectations, and develop indices of leading economic indicators in order to further strengthen its monetary policy framework

47. The program target for average reserve money will be an annual growth of 15.7 percent through June 2013 (year-on-year). The annual growth rate of M3 and credit to the private sector will be at 17.3 percent and 18.7 percent, respectively.

48. The exchange rate will remain market determined and the BoT will continue to participate in the foreign exchange market only for liquidity management purposes and to smooth out short-term fluctuations in the exchange rate, while maintaining an adequate level of international reserves.

Financial sector stability and efficiency

49. The BoT in collaboration with other stakeholders continued to take measures aimed at enhancing the stability and efficiency in the financial sector. The banking sector remained sound, profitable and liquid. At the end of June 2012, the ratios of core capital and total capital to risk-weighted assets were 17.5 percent and 18.1 percent, compared with the legal minimum requirements of 10.0 percent and 12.0 percent, respectively. In the same period, the ratio of non-performing loans to total loans was 8.0 percent, compared to 9.0 percent at the end of June 2011. The ratio of liquid assets to demand liabilities was 39.4 percent, against the statutory requirement of 20 percent.

50. The Bank of Tanzania recognizes the importance of strengthening banks' buffer capital in order to enable banks to withstand financial crisis. The BoT has increased minimum capital requirement for commercial banks and community banks from TSh 5.0 billion to TSh 15.0 billion, and TSh 250.0 million to TSh 2.0 billion, respectively. Capital Enhancement Orders for fully fledged commercial and community banks were published in the Government Gazette on 23rd February 2012 and 22nd June 2012 respectively, with a moratorium of three years provided for existing banks to fully comply with the minimum capital requirements. As at 31st August 2012, 22 out of 33 commercial banks had complied, while community banks are yet to comply. The BoT is

strengthening its cross border banking supervision framework by participating in the EAC regional supervisory college.

51. Pursuant to the publication of the regulations for supervision of development finance institutions in March 2012, the process of restructuring Tanzania Investment Bank (TIB) into a two tier development finance institution (DFI) is in the final stage. This will enable TIB to provide DFI as well as Corporate Bank services. In August 2012 the BoT received one application for license from a prospective Development Finance Institution.

52. On efforts to develop mortgage financing in Tanzania, the Tanzania Mortgage Refinance Company (TMRC) started refinancing activities in November 2011 and has so far refinanced mortgages worth TSh 4.25 billion. Efforts to increase shareholding in TMRC and amend the financing instruments to allow pre-financing of the mortgages are ongoing.

53. The BoT launched the Credit Reference System on September 28, 2012. The infrastructure is comprised of a Credit Reference Databank administered by BoT and private Credit Reference Bureau licensed and supervised by the BoT. The BoT has already granted license to one private credit reference bureau to carry out Credit Reference business. The process of licensing a second bureau is underway and 26 commercial banks have joined the system while 9 have successfully uploaded debtors' information to the system.

54. Mobile payment services have become the fastest growing segment of the financial sector in recent years, with the number of subscription accounts increasing from 112,000 at the end of December 2008 to 32 million at the end of August 2012. In the same period, the balances in trust accounts which underlay the mobile payment services rose from TSh 25.2 billion to TSh 160.3 billion. In a bid to address the current legal and regulatory challenges of supervising and regulating mobile payment services, draft Regulations for Mobile Payments are at the final stages of being developed, before being approved and promulgated by the Government by the end of 2012/13.

55. In an effort to modernize and develop capital markets in Tanzania, Capital Markets and Securities Authority (CMSA) is pioneering the establishment of the Enterprise Growth Market (EGM), a market segment aimed at serving the Small and Medium Enterprises (SMEs) to access capital markets by easing the issuing and listing conditions.

56. On August 31st 2012, the BoT launched a web based, enhanced Government Securities System (GSS), which offers a combination of online bidding and central depository facilities such as collateral management and transfer of ownership. The system is open to banks and brokers/dealers, referred to as Central Depository Participants (CDPs). The system is robust and conforms to international best practice, including Know Your Customer (KYC) principle. It will also promote secondary market trading in government securities and liquidity optimization through Real Time Gross Settlement. The system will also facilitate requests for standby facilities as well as Repo operations.

57. The East African Cross Border Payment System (EAPS) was implemented successfully in April, 2012, and live operations are expected to commence before the end of 2012/13. This

system will facilitate banks to send payments across the East African region through their domestic Real Time Gross Settlement Systems (RTGS) using local currencies.

58. Significant progress has been made since the 2009 IMF safeguards assessment of the BoT, but risks remain. The BoT is committed to implement recommendations of the safeguard assessment, including reporting to the Board on compliance with the ceilings on advances to the government. Capacity building programs with the assistance of the World Bank are ongoing through the Reserve Advisory and Management Program (RAMP) to improve skills and competencies on reserves management. Risk management framework has fully been developed and will become operational before the end of 2012. On the assurance side, the audit practices and processes would undergo an external quality assessment review in 2013 to evaluate the impact and effectiveness of the measures undertaken by the BoT. Also, there are ongoing programs to update and expose the members of the audit committee to emerging topical issues on auditing to improve oversight monitoring and accountability to the Board of the BoT. And finally, in consultation with the government, non-core activities, including the Credit Guarantee Schemes, would be hived off from the BoT.

Social security system reforms

59. The government is determined to prevent public finances from being undermined by off-budget liabilities. The Social Security Regulatory Authority (SSRA) is working closely with the Ministry of Finance to address the actuarial shortfalls identified by the review of the public pension system conducted in collaboration with the World Bank. This includes a central government budget allocation to the SSRA for the preparation of new benefits guideline that harmonizes contributions rates and benefit package. Further, SSRA in collaboration with the Ministry of Labour and Employment is developing a Social Security Reform Program that outlines the Social Security Schemes (SSS) reform process.

60. Following the issuance of Social Security Schemes investment guidelines in March 2012, with implementation starting from May 2012, the SSS have been tasked to present a compliance plan within 90 days with a view to strengthening the schemes' investments income. All of them have submitted Compliance Plans and New Investment Policies in compliance with guidelines

61. In April 2012, the Parliament approved amendments of Acts of Social Security Schemes. This is an important step in the harmonization of the legal and regulatory framework of the Social Security Sector. The amendments will enable SSRA to issue a number of guidelines including: actuarial valuation guidelines, data guidelines, membership guidelines, totalization guidelines and benefits guidelines, which are important inputs in the preparation of the mortgage lending guidelines.

62. The Government also intends to reform pension entitlement rules to help restore actuarial balance in the funds, with technical assistance provided by the World Bank. Meanwhile, the government has approached the World Bank for a possible multi-year loan package which could provide resources to support near-term benefit payments pending the beneficial impact of the policy reforms.

Anti-money laundering policies

63. Tanzania continued to make progress in its action plan on Anti-money Laundering and Counter-terrorism (AML/CFT) as agreed with the Financial Action Task Force (FATF). The February 2012 AML/CFT law established a fully operational Financial Intelligence Unit (with full staff, budgetary independence, modalities for hiring and firing staff) and designated competent authorities to ensure compliance with AML/CFT requirements in the Mainland and Zanzibar. In that regard, the country amended the Prevention of Terrorism Act, 2002 and the Proceeds of Crime Act, 1991 through the Written Laws (Miscellaneous Amendments) Act no. 2/2012 in order to move closer to adequate criminalization of money laundering and terrorist financing. These amendments were signed into law by the President on July 27, 2012.

64. Further to this, Tanzania revoked the Prevention of Terrorism (General Regulations), 2007 and replaced them with the Prevention of Terrorism Regulations, 2012 in order to establish more adequate procedures for identification and freezing of terrorist assets and adequate record-keeping requirements. The new regulations were signed on August 31, 2012 by the Minister for Home Affairs. Furthermore, the country revoked the Anti-Money Laundering Regulations, 2007 and replaced them with the Anti-Money Laundering Regulations, 2012 in order to accommodate the new amendments introduced by the Anti-Money Laundering Act, 2012 which was passed by Parliament in February, 2012. These regulations were signed on September 7, 2012 by the Minister for Finance which established effective know-your-customer framework. The government is reviewing the AML/CFT Guidelines to ensure proper guidance on implementation of the law.

III. OTHER PROGRAM ISSUES

Statistical issues

65. The National Bureau of Statistics in collaboration with the BOT is finalizing compilation of CPI for core inflation using methodology recommended by the EAC. The index will be compiled using data from October 2009 as a base year, with the results expected to be shared with stakeholders by the end-January 2013.

66. The Ministry of Finance in collaboration with the National Bureau of Statistics has made progress in compiling fiscal accounts in Government Finance Statistics Manual (GFSM) 2001 format. The new format will cover data from 2009/10 onwards and preliminary data were shared with the IMF in October 2012 for improvement. The Ministry plans to submit final data for inclusion in the Statistical Yearbook by end-January 2013. Improving the annual fiscal accounts will be an important step toward compiling quarterly provisional fiscal outturns in the format, which the government is intended to start and share with the IMF from the first quarter of 2013/14. In the medium term the Government will continue to improve data on public sector financial and nonfinancial assets, including valuation and verification of non-financial assets.

67. The BoT has started compiling Balance of Payments (BoP) estimates on quarterly basis, and plans to produce the data for the quarter ending September 2012 by end December 2012 (benchmark for end-December 2012). The Visitors' Survey in the high and low tourist seasons,

together with a survey on resident travelers and compilation of the Survey of Companies with Foreign Liabilities (SCLF) will be conducted semi-annually, starting in 2013/14.

68. The Ministry of Finance in collaboration with the BoT started compiling the Gross External Debt Position (GEDP) data on a quarterly basis in September 2012 for publication in the Quarterly External Debt Statistics (QEDS) database, with a view to ensuring consistency in external debt data.

Program monitoring

69. Progress in the implementation of the policies under this program will be monitored through assessment criteria (ACs), performance criteria (PCs), indicative targets (IT), and structural benchmarks (SBs) as documented in the attached tables. The sixth and final review under the PSI and the second review under the SCF arrangement are expected to be completed by June 3, 2013 and the third review under the SCF arrangement by December 31, 2013.

**MEFP Table 1. Tanzania: Quantitative Assessment Criteria (AC), Performance Criteria (PC) and Indicative Targets Under the Policy Support Instrument and Stand-by Credit Facility Arrangement
June 2012-June 2013**

	June 2012				September 2012				December 2012		March 2013		June 2013	
	<u>AC/PC</u>				<u>Indicative Target</u>				<u>AC/PC</u>		<u>Indicative Target</u>		<u>PC</u>	
	Country Rpt 12/23	Adjusted Preliminary Met?	Criteria		Country Rpt 12/185	Adjusted Preliminary Met?	Criteria		Country Rpt 12/185	Revised	Country Rpt 12/185	Revised	Country Rpt 12/185	Revised
	(Billions of Tanzania Shillings; end of period, unless otherwise indicated)													
Net domestic financing of the government of Tanzania (cumulative, ceiling) ^{1,2}	397	697	335	✓	200	500	-108	✓	300	300	400	400	484	484
Average reserve money (upper bound) ³	4,464	4,464	4,276	✓	4,735	4,735	4,583	✓	4,835	4,800	4,866	4,855	5,108	4,999
Average reserve money target ³	4,420				4,688				4,788	4,752	4,817	4,807	5,058	4,949
Average reserve money (lower bound) ³	4,376				4,641				4,740	4,704	4,769	4,759	5,007	4,900
Tax revenues (floor; indicative target) ¹	...	...	...	...	1,880	1,880	1,843	X	3,961	3,961	5,968	5,968	8,001	8,001
Priority social spending (floor; indicative target) ¹	...	...	...	...	517	517	548	✓	1,033	1,033	1,550	1,550	2,066	2,066
	(Millions of U.S. dollars; end of period)													
Change in net international reserves of the Bank of Tanzania (floor) ^{1,4}	258	79	210	✓	155	-34	182	✓	310	310	432	432	273	273
Accumulation of external payment arrears (continuous AC/PC ceiling)	0	0	0	✓	0	0	0	✓	0	0	0	0	0	0
Contracting or guaranteeing of external debt on nonconcessional terms (continuous AC/PC ceiling) ^{5,6}	1,050	1,050	764	✓	1,668	1,668	2,107	X	1,668	2,688	1,668	2,688	1,668	2,688
Memorandum item:														
Foreign program assistance (cumulative grants and loans) ¹	1,062	1,062	889		397	397	349		567	567	746	746	785	785
External nonconcessional borrowing (ENCB) disbursements to the budget ¹	575	575	505		240	240	38		429	429	619	619	737	737

Note: For precise definitions of the aggregates shown and details of the adjustment clauses, see the Technical Memorandum of Understanding (TMU).

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

² To be adjusted upward by up to TSh 300 billion for the U.S. dollar equivalent of a shortfall in the combined total of foreign program assistance and ENCB from the amounts shown in the memorandum item. To be adjusted downward by any ENCB disbursed for budget financing above programmed amount for the year as a whole (US\$575 million for 2011/12)

³ Assessment criteria and benchmarks apply to upper bound only.

⁴ Floor will be adjusted downward by the amount in U.S. dollars of any shortfall in foreign program assistance and ENCB financing of the government up to the equivalent of TSh 300 billion.

⁵ The revision of the continuous cumulative ENCB ceiling from USD 1,668 million to 2,688 million stems from (i) USD 920 million loan for the gas pipeline that had originally been intended as concessional but turned out to be non-concessional (see the MEFP); and (ii) corrections of the staff error whereby the text and the board's intentions were for a cumulative ceiling of USD 1,768 million, but the table reported this ceiling as USD 1,668 million.

⁶ The ENCB figure reported in the "September 2012" column refers to November 2012, when the continuous PC was breached.

**MEFP Table 2. Structural Benchmarks for Fifth and Sixth Reviews under the PSI
and First and Second Reviews under the SCF Arrangement**

	Benchmark	Macroeconomic rationale	Date	¶	Status
1)	Regulatory authority completion of cost of service study for the power utility, TANESCO, and implementation of any findings in regard to the power tariff regime.	Addresses contingent fiscal liabilities by ensuring financial viability of TANESCO.	End-August 2012	MEFP for 4 th PSI review	Not Met
2)	The Ministry of Finance, Planning Commission, and TRA will prepare a report identifying steps to be taken to prepare Tanzania's macroeconomic management for the new gas economy, and identifying the nature of any corresponding technical assistance needs.	Supports early preparation for major macroeconomic challenges in the years ahead.	End-April 2013	MEFP for 3 rd PSI review	Reset from end-Dec 2012
3)	Establish a new Debt Management Office (DMO) in the Ministry of Finance to consolidate public debt management functions.	Seeks to ensure strong, consolidated monitoring of debt liabilities to underpin sound public debt management.	End-December 2012	36	
4)	Compile and share with IMF a quarterly report of all government debt guarantees within 6 weeks of the end of each quarter. This will start with the first quarter of 2012/13.	The more frequent monitoring of debt guarantees will strengthen public debt management.	End-November 2012	36	Met
5)	Compile and publish full preliminary balance of payments data on a quarterly basis within 3 months of the end of the relevant quarter.	Seeks to strengthen macroeconomic and policy analysis	End-December 2012 (for data through end-September 2012)	67	
6)	Prepare an action plan to restore Tanesco's financial sustainability.	Addresses contingent fiscal liabilities by ensuring financial viability of TANESCO	End-January 2013	42	New benchmark
7)	Submit a new VAT Bill to Parliament	Improve economic efficiency and increase revenue-to-GDP ratio	End-April 2013	23	New benchmark

Attachment II. Technical Memorandum of Understanding on Selected Concepts and Definitions Used in the Monitoring of the Program Supported by the PSI and SCF Arrangement

December 19, 2012

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 Tanzania's program supported by the SCF arrangement and PSI, comprising the quantitative assessment criteria under the PSI arrangement; the performance criteria under the SCF arrangement; and the indicative targets and structural benchmarks jointly monitored under the SCF arrangement and PSI.
2. The principal data sources are the standardized reporting forms, 1SRF and 2SRF, as provided by the Bank of Tanzania (BoT) to the IMF, and the government debt tables provided by the Accountant General's office.

II. DEFINITIONS

Net international reserves

3. Net international reserves (NIR) of the BoT are defined as reserve assets minus reserve liabilities. The change in NIR is calculated as the cumulative change since the beginning of the fiscal year. 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, of original maturities less than one year; and (ii) outstanding purchases and loans from the IMF.
4. NIR are monitored in U.S. dollars, and for program monitoring purposes assets and liabilities in currencies other than U.S. dollars shall be converted into dollar equivalent values using the exchange rates as of June 30, 2012 (as recorded in the balance sheet of the BoT).

	US\$ per currency unit
British pound	1.5607
Euro	1.2589
Japanese yen	0.0126
Australian dollar	1.5106
Canadian dollar	0.9739
Chinese yuan	0.1573
SDR	1.5106

Reserve money and reserve money band

5. Reserve money is defined as the sum of currency issued by the BoT and the deposits of Other Depository Corporations (ODCs) 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 (PSI), performance criterion (SCF), or indicative target.

Net domestic financing of the Government of Tanzania

6. 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 ODCs) and the nonbank public.

7. 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 promissory notes (including liquidity paper issued by the BoT for monetary policy purposes), minus all government deposits with the BoT;

(ii) all BoT accounts receivable due from the Government of Tanzania that are not included under (i) above;

(iii) loans and advances to the government by other depository corporations and holdings of government securities and promissory notes, minus all government deposits held with other depository corporations; and

(iv) the outstanding stock of domestic debt held outside depository corporations, excluding: government debt issued for the recapitalization of the NMB and TIB; debt swaps with COBELMO (Russia) and the government of Bulgaria; mortgage on acquired sisal estates; compensation claims; and debt of parastatal companies assumed by the government.

8. For 2012/13 and 2013/14, NDF will be measured net of any accumulation of central government claims on the Tanzania Petroleum Development Corporation (TPDC) as a result of the on-lending of an external credit to finance a gas pipeline.

Government deposits at the BoT

9. Government deposits at the BoT include government deposits as reported in the BoT balance sheet, 1SR -including counterpart deposits in the BoT of liquidity paper issued for monetary policy purposes, and foreign currency-denominated government deposits at the BoT, including the PRBS accounts and the foreign currency deposit account.

External payment arrears

10. External payment 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. The ceiling on external payment arrears is continuous and applies throughout the year.

Priority social spending

11. Priority social spending comprises spending on agricultural inputs, and central government transfers to local governments for health and education.

Tax revenues

12. Tax revenues include import duties, value-added tax, excises, income tax, and other taxes.

Contracting or guaranteeing of external debt on nonconcessional terms

13. The term "external debt" will have the meaning set forth in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt (Executive Board's Decision No. 6230-(79/140), as amended by Decision No. 14416-(09/91), effective December 1, 2009). External debt will be determined on the basis of currency of denomination of the debt. Government external debt is outstanding debt owed or guaranteed by the Government of Tanzania, the Bank of Tanzania, subnational governments, and companies in which the government has at least 50 percent ownership, unless otherwise stipulated.¹ The ceiling on external debt is continuous and applies throughout the year.

14. Government debt is considered nonconcessional if the grant element is lower than 35 percent, computed using the IMF grant calculator discount rates based on Organization for

¹ Excluded for these purposes, except if the government offers an explicit guarantee on the debt, are: Tanzania Investment Bank; Tanzania Port Authority; Tanzania Petroleum Development Corporation; Dar es Salaam Rapid Transport Authority; Economic Processing Zones Authority; National Development Corporation; Small Industries Development Organization; National Housing Corporation; National Identity Authority; Dar es Salaam Water and Sewage Authority; and Tanzania Airport Authority.

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 PSI assessment criterion and SCF performance criterion apply not only to debt as defined in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt (Executive Board's Decision No. 6230-(79/140), as amended by Decision No. 14416-(09/91), effective December 1, 2009), but also to commitments contracted or guaranteed for which value has not been received.

Foreign program assistance and program exchange rates

15. Foreign program assistance is defined as budget support and basket grants and loans received by the Ministry of Finance (MoF) through BoT accounts and accounts at other depository corporations 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 assistance does not include nonconcessional external debt as defined in paragraphs 7 and 8. Foreign program assistance is measured excluding bilateral loans in 2012/13 and 2013/14 for purposes of construction of the gas pipeline.

16. The program exchange rate for the period July 1, 2012 through June 30, 2013 is TSh/USD 1605.

III. ADJUSTERS

Net international reserves

17. The end-September 2012, end-December 2012, end-March 2013, and end-June 2013 quantitative targets for the change in the BoT's net international reserves will be adjusted downward by the amount in U.S. dollars of any shortfalls in (a) foreign program assistance and (b) external nonconcessional borrowing (ENCB) financing of the government budget in U.S. dollars (up to a limit equivalent to TSh 300 billion at the program exchange rate).

18. The shortfalls will be calculated relative to projections for foreign program assistance shown in table attached to the applicable Letter of Intent and Memorandum of Economic and Financial Policies of the Government of Tanzania titled "Quantitative Assessment Criteria, Performance Criteria, and Indicative Targets under the PSI and SCF arrangement". For purposes of the adjuster, ENCB is measured excluding any non-concessional financing contracted in 2012/13 and 2013/14 for purposes of the gas pipeline.

19. Each quarterly shortfall will be converted from U.S. dollars to Tanzanian shillings using the program exchange rate (paragraph 16). The cumulative shortfall will be the sum of all quarterly shortfalls in Tanzanian shillings from the beginning of the fiscal year up to the date of assessment.

Net domestic financing

20. The end-September 2012, end-December 2012, end-March 2013, and end-June 2013 quantitative limits on the net domestic financing of the Government of Tanzania will be adjusted upward for any shortfalls in foreign program assistance and ENCB financing of the government budget in U.S. dollars (up to a limit of TSh 300 billion).

21. The shortfalls will be calculated relative to projections for foreign program assistance and ENCB financing shown in the Table on "Quantitative Assessment Criteria, Performance Criteria, and Indicative Targets under the PSI and SCF arrangement" attached to the MEFP. For purposes of the adjuster, ENCB is measured excluding any non-concessional financing contracted in 2012/13 and 2013/14 for purposes of the gas pipeline. Each quarterly shortfall will be converted from U.S. dollars to Tanzanian shillings using the program exchange rate (paragraph 16). The cumulative shortfall will be the sum of all quarterly shortfalls in Tanzanian shillings from the beginning of the fiscal year up to the date of assessment.

22. The limits referred to in the previous paragraph will be adjusted downward for any ENCB financing of the government budget in excess of the amount programmed for the year as a whole, indicated in the table referred to in the previous paragraph.

IV. DATA REPORTING REQUIREMENTS

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
The quarterly national account statistics in constant prices.	NBS	Quarterly	3 months
Balance sheet of the BoT (1SRF) and the currency composition of official foreign assets and official foreign liabilities.	BoT	Monthly	1 week
Consolidated accounts of other depository corporations and the depository corporations survey (2SRF and the DCS).	BoT	Monthly	4 weeks
Summary of stock of external debt, external arrears, and committed undisbursed loan balances by creditor.	MoF	Monthly	2 weeks
External trade developments.	BoT	Monthly	4 weeks
Balance of payments	BoT	Quarterly	4 weeks
Standard off-site bank supervision indicators for other depository corporations.	BoT	Quarterly	6 weeks
Financial Soundness Indicators for other depository corporations.	BoT	Quarterly	6 weeks
Other depository corporation lending by activity.	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;	BoT and MoF	Quarterly	4 weeks

Information	Reporting Institution	Frequency	Submission Lag
(iii) stock of external arrears; (iv) new contracting or guaranteeing of external debt on nonconcessional terms; and (v) net international reserves. ¹			
Amount of payment claims outstanding of more than 30 days, 60 days, and 90 days for all government ministries. For each ministry, total claims outstanding to be divided into: (i) unverified claims; and (ii) claims verified but not yet paid.	MoF	Quarterly	4 weeks
The flash report on revenues and expenditures.	MoF	Monthly	4 weeks
The TRA revenue report	TRA	Monthly	4 weeks
The monthly domestic debt report. ¹	MoF	Monthly	4 weeks
Monthly report on central government operations.	MoF	Monthly	4 weeks
Detailed central government account of disbursed budget support grants and loans, and external debt service due and paid.	MoF	Monthly	4 weeks
Detailed central government account of disbursed donor project support grants and loans.	MoF	Monthly	4 weeks
Statement on new external loans contracted and guarantees provided by the entities listed in paragraph 13 of the TMU during the period including terms and conditions according to loan agreements.	MoF	Quarterly	4 weeks
Report on priority social spending	MoF	Quarterly	6 weeks

¹ The MoF 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 MoF.