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December 22, 2008

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

December 3, 2008

The following item is a Letter of Intent of the government of Tanzania, which describes the policies that 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 Tanzania, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

Letter of Intent

Dar Es Salaam
Tanzania

December 3, 2008

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

Dear Mr. Strauss-Kahn:

1. Implementation of the financial and economic program supported by the Fund under the Policy Support Instrument (PSI) and implemented by the Government of Tanzania continued successfully during January to June 2008. We have recently held detailed discussions with the Fund Staff regarding progress in all areas of the programme. I hereby transmit the Memorandum of Economic and Financial Policies (MEFP) developed after consultations with the staff, and which reviews progress in the implementation of our program, economic developments in the second half of 2007/08, and the outlook to June 2009. The Memorandum also sets out the economic and financial policies that the Government intends to pursue in the medium term.

2. Program implementation during the period January to June, 2008 was broadly on track; with one exception, all quantitative assessment criteria and benchmarks for end-June, 2008 were met. Similarly, the broad structural reform program, which is aimed at raising Tanzania's growth potential and therefore sustainably reduce poverty, moved forward. A memorandum of understanding between the Ministry of Finance and Economic Affairs and the Bank of Tanzania was adopted, albeit with a small delay (assessment criterion for end-September). The preparation of the first quarterly financial stability report by the Bank of Tanzania (structural benchmark for end-September) was also delayed and postponed to end-December. The reform programme is anchored on our growth and poverty reduction strategy (MKUKUTA) which prioritises broad based growth through investment in productive infrastructure and social services.

3. Other core reforms, especially the tax and customs administration reforms, the local government reforms, the legal sector reforms and public service reforms, have also continued at a good pace.

4. Despite mounting exogenous shocks emanating from the protracted surge of international oil and foods prices, the conduct of monetary policy continued to yield good results, with inflation contained within single digit and low domestic interest rates. The Government is accelerating implementation of the second generation financial sector reforms, and improving the business environment to promote investment as the prerequisites for accelerated and sustainable growth in a stable macroeconomic environment. The voluntary safeguards assessment of the Bank of Tanzania (BoT) by the Fund, which was completed in August 2008, validated the steps already taken and provided valuable input for the BoT's strategy to strengthen its internal governance as reflected in the its corporate plan.

5. Notably, the harmonization of the regulatory framework for pension funds is underway, and the Social Security (Regulatory Authority) Act of 2008 came into effect on 1st November, 2008. Progress has also been made in planned transfer of government deposits in commercial banks to the BoT, and cash management generally.

6. The Government of Tanzania is confident that the policies set forth in the attached MEFP are adequate to achieve the objectives of its programme but it will, in consultation with the Fund, take any other appropriate measures for this purpose. The Government therefore requests the Board to support these policies as described in the MEFP by completing the fourth review under the PSI arrangement. We would request that the sixth review of the PSI take place by October 31, 2009.

7. In the context of the PSI framework, we will regularly update the IMF on developments in our 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.

8. 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

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

Attachment I
Tanzania: Memorandum of Economic and Financial Policies

December 3, 2008

I. RECENT MACROECONOMIC DEVELOPMENTS AND PROGRESS UNDER THE PROGRAMME

Recent economic developments

1. During the year to June 2008, the economy was subject to external pressures emanating from high global fuel and food prices but good performance continued, with a 7.3 percent real GDP growth estimated for 2007/08 compared to 6.9 percent in 2006/07. The transport and communications (10.1. percent), mining (9.8 percent), construction (9.4 percent), and tourism and trade (8.7 percent) sectors continued to reflect particularly good performance. The inflationary pressures experienced in the second half of 2007, mainly due to high global oil prices, were sustained during the half year to June 2008. From 5.8 in June 2007, end of period annual inflation increased to 9.3 percent in June, 2008¹.

Fiscal outturn

2. Tanzania continued to experience strong fiscal performance during 2007/08 with domestic revenue, and programme support, exceeding projections for the year to June 2008. Income Tax (especially PAYE and corporate income tax) and VAT performed particularly well. The overall outturn for the year reflects a 33 percent increase over actual collections during the preceding year. Although posting a good 31 percent growth, non-tax revenue performed below expectations.

3. All major categories of expenditure during the year to June 2008 were below projections, mainly on account of slow procurement. Implementation of foreign financed projects, which had benefited from accelerated disbursement in the first half of the year, closed at 71 percent of projections for the year. Nevertheless, expenditure on priority social services continued to benefit from the strong fiscal position, with timely disbursements made against the backdrop of the continued observance of the cash budget system.

4. The combination of above-target revenue and foreign financing on one hand, and below-projection expenditure on the other contributed to net domestic savings by the Government and a higher than anticipated build up of foreign exchange reserves at the BoT.

Tax Reforms:

5. Building on the success of recent measures to broaden the tax base, the Tanzania Revenue Authority (TRA) scaled up its block management and physical surveys programme, and registered an additional 57,011 taxpayers during the 2007/08 fiscal year.

¹ Period average inflation for 2007/08 was 8.4 percent, from 6.3 percent in 2006/07.

In furtherance of the already implemented integration of tax and customs post-clearance audits, TRA is strengthening the ITAX audit and debt management modules as part of a programme to build integrated capacity for tax law enforcement. Large Taxpayers Units (LTUs) to cater for medium sized taxpayers have been established in nine tax regional offices of the Domestic Revenue Department—accounting for the bulk of tax collection—building on the experience of the Large Taxpayers’ Department (LTD)². The modernisation programme has been accelerated too, with 273 traders trained on e-filing during the fiscal year and 112 domestic tax returns submitted electronically by taxpayers in the pilot districts. Following successful piloting of a Quality Management System in the LTD since December 2006, TRA has rolled over to an enterprise-wide implementation of the system after an independent auditing firm recommended TRA’s ISO certification.

6. Customs reform continued to focus on increasing capacity for trade facilitation, and interfacing operations with domestic revenue operations. Progress with the integration of the Customs and Excise Department’s and TISCAN’s systems has continued, and is scheduled for completion by the end of 2008 by which time importers will only be required to file a single import declaration (December 2008 structural benchmark). In addition, the plan prepared for a successful transition from private contractors in customs (TISCAN and NECOR) is being implemented as planned.

Public Financial Management

7. The Government remains committed to the strengthening of the planning and budget management systems and processes to achieve MKUKUTA desired results. The priority in this regard is to ensure consistency of the annual and medium term budgets with MKUKUTA through, among others, integrating MKUKUTA objectives and targets in the strategic plans (SP) and budgets of the various implementing institutions. The Government has continued to customise further the Strategic Budget Allocation System (SBAS) tool for facilitating complex resource allocation between votes and cross-cutting MKUKUTA cluster strategies. The focus has been also on updating the budget module in IFMS for accommodating new requirements of capturing MTEF objectives and targets as well as MKUKUTA elements. The capacity building for strengthened public financial management is coordinated under the Public Financial Management Reform Programme (PFMRP) and supported by several donors.

8. The Government and the BoT have signed a Memorandum of Understanding setting out the respective responsibilities on sharing the costs of sterilization as well as the clearance of outstanding claims regarding historical sterilization costs. The MoU stipulates an explicit sharing formula for the cost of sterilization going forward, providing for quarterly transfers from government to the BoT. The division of labour on debt management is guided by the Government (Loans, Guarantees, and Grants) Act 1974 as amended in 2003. Capacity building for all institutions involved in debt management is being scaled up in preparation for increased financing from non-traditional sources, including through international bond markets, for scaled up investment in infrastructure.

9. The Audit Committees established in all MDAs continued to monitor action addressing the observations of the Controller and Auditor General (CAG). Spending

² Ilala, Temeke, Kinondoni, Arusha, Mbeya, Mwanza, Kilimanjaro, Tanga and Morogoro.

agencies are producing quarterly reports of implementation of recommendations of Controller and Auditor General (CAG) and Public Procurement Regulatory Agency (PPRA) audits. The National Audit office (NAO) and PPRA are evaluating the actions taken in the context of subsequent audit work.

Poverty Reduction

10. The recently released preliminary results of the 2007 Household Budget Survey (HBS) indicate that the incidence of poverty declined from 35.7 percent in 2001 to 33.3 percent in 2007. Acquisition of consumer durables has increased beyond expectation. Ownership of radios, bicycles, telephones, and mosquito nets has increased very substantially, with ownership for some of these increasing several fold. It is also noteworthy that the share of food in total household spending has declined by 5 percent. Improvement is reported in primary and secondary school enrolment and attendance, adult literacy, and housing. While the proportion of sick people consulting a health provider was more or less constant since 2001, a higher proportion of respondents reported satisfaction with services in public health facilities, and fewer reported lack of drugs at health facilities generally. However, the proportion of the population with access to piped water declined from 39 percent to 34 percent (against a 2-points increase in access to water from any other protected source), and access to grid electricity remains limited especially for rural communities. Although reflecting a recovery from a shrinkage of the banked population during the initial phase of reforms in the sector (when banks closed branches, new banks imposed high minimum balance conditions, and formal employment opportunities declined following privatisation of most public enterprises), access to financial services remains low, with only 17.8 percent of the households having a bank account or access to an informal savings group compared to 23.1 percent and 10.0 percent in 1991 and 2001 respectively.

11. Given the priority accorded to the provision of basic social services in our poverty reduction strategies hitherto, these results indicate the need for scaling up both the amount and quality of investment in the sectors in order to protect the gains already achieved. This will in turn require increased mobilisation of resources from both domestic and foreign sources, and scaling up investment in the productive sectors in order to accelerate growth and ensure sustainable expansion of the domestic resource base. Once completed, the HBS results will constitute an important input in the preparation of the third growth and poverty reduction strategy in 2009.

Monetary Programme

12. The Bank of Tanzania continued with the monetary policy strategy adopted since October 2007 whereby the policy instrument mix was changed with a view to reducing over-reliance on government securities, which had caused excessive increase in real interest rates on the securities amidst depreciating shilling. The Bank also continued with the reduced frequency of Treasury bills and bonds auctions introduced in January 2008. These measures improved competition and contributed to a substantial reduction in interest rates on government securities and a strengthening of the shilling. However, the change in frequency of auctions caused a temporary mismatch between the timing of redemption and new issues, which made liquidity management less effective during the first half of 2008.

13. The Bank also intensified the use of REPOs for monetary policy. The BOT continued to make small but steady sales of foreign exchange in the IFEM to sterilize aid-related liquidity injections, while maintaining neutrality on the exchange rate. Owing to the sharp increase in government expenditure towards the end of the financial year and sizeable redemption of government securities, the PSI criterion for average reserve money for June 2008 was missed by TZS 12 billion (0.6 percent).

14. Reflecting the high liquidity pressure towards the end of the fiscal year, the growth of extended broad money supply reached 22.7 percent in 2007/08, slightly higher than the PSI target of 20 percent. Meanwhile, a shift into shilling holdings which was induced by the weakening of the dollar in the first quarter of 2008, coupled with higher than programmed increase in credit to the private sector, pushed the growth of the broad money supply (M2) up to 30.8 percent in the year to June 2008, which was well above the program target of 24.2 percent. The decline in interest rates on government securities in the second half of 2007/08 drove banks into more lending to the private sector. This coincided with an unprecedented huge amount of syndicated loans which together led to 44.6 percent annual expansion of credit. This growth was much higher than the provision of 39.8 percent made in the PSI program.

15. Interest rates on treasury bills declined from 11.4 percent in December 2007 to 7.0 percent in May 2008 before picking up slightly to 7.8 percent and 10.2 percent in June and September 2008, respectively. Reflecting the decrease in interest rates on the government securities, overall bank lending interest rates took a downward trend from 15.3 percent in December 2007 to a minimum of 14.7 percent in April before rising to 14.9 percent in September 2008. The overall time deposit rate on the other hand, registered a continuous decline from 8.3 percent to 6.2 percent in the same period.

16. The Bank of Tanzania continued with the monthly meetings with chief executive officers of commercial banks introduced in December 2007. The meetings, which occur within a day or two after the conclusion of the Monetary Policy Committee (MPC) meetings, have proved to be a useful instrument for soliciting feedback from the banks who are the key counterparts of implementation of monetary policy. In addition, the Bank continued with quarterly meetings with press to inform the public on economic developments and explain the Bank's monetary policy stance.

17. In an effort to deal with the rapid expansion of credit and money supply, the BOT imposed a 10 percent minimum reserve requirement on government deposits beginning in June 2008. This measure is intended to restrain the banks' credit creation capacity based on government deposits. In the first quarter of 2008/09, monetary aggregates expanded at a rapid pace reaching a growth rate of 24.2 percent for M3, and 31.5 percent for M2 during the year ending September 2008. The rapid growth was in line with the annual expansion of credit to the private sector that soared to record high of 48 percent.

18. The current account deficit widened in 2007/08 but remained largely financed by FDI and concessional donor assistance. External developments in 2007/08 were characterized by a 27 percent increase in the U.S. dollar value of goods exports against an increase of 31 percent in goods imports, which led to further widening of the deficit in the merchandise trade. Growth in the value of goods was explained mainly by remarkable increase in manufactured exports and strong performance in the volume of traditional exports, particularly cotton. The increase in the volume of traditional exports is partly associated with recovery from last year's sharp drop due to adverse weather conditions.

The sharp increase in imports of goods was driven mainly by higher fuel costs and the continued increase in imports of capital goods. As a result, the current account deficit widened to USD 2012 million, compared with USD 1496 million registered in 2006/07.

19. Despite the widening of the current account deficit, net flows in the capital and financial accounts led to an increase in gross official reserves from USD 2,153.4 million at the end of June 2007 to USD 2,648.5 million at end-June 2008, equivalent to about 4.4 months of projected current year imports of goods and services. In the same period, the nominal exchange rate of the shilling to the U.S. dollar appreciated from an average of TZS 1,281.9 in 2006/07 to an average of TZS 1,185.9 in 2007/08.

20. A Bill for the establishment of an independent regulator of social security schemes was discussed and passed by the Parliament in the April 2008 session. The Law gives BOT powers to regulate the financial aspects of the Social Security schemes. The Social Security (Regulatory Authority) Act, 2008 was assented by the President of United Republic of Tanzania on 6th June, 2008 and came into effect on 1st November 2008. Meanwhile the draft Investment guidelines for pension funds have been prepared by BOT. The draft Investment guidelines are waiting for the Pension Funds Regulator to be operational. The BOT is making internal arrangements needed for supervision, regulation of financial aspects and monitoring investment guidelines.

21. The Bank of Tanzania completed its review of the existing regulatory framework governing capital account transactions in September 2008 (structural benchmark) as a basis for legal and regulatory changes in the course of 2008/09.

22. The BOT has continued to take measures to improve its internal operations. All transactions under the EPA account have remained suspended. Disciplinary actions have been taken against BOT officials involved in the transactions. The internal audit function has been strengthened, including by reducing the number of Executive Board Members in the internal audit committee to one. The Bank is also in the process of commissioning M/S Lazard Frères to review the status of EPA operations and find ways to deal with the remaining claims.

Infrastructure

23. Investment in economic infrastructure continues to receive special priority in resource allocation. Consistent with the MKUKUTA objective of reducing the cost of production and enhancing market access for rural producers, the government is accelerating implementation of its roads construction programme, with support from various development partners. To address constraints that resulted in slow implementation of some projects in the past, more emphasis is now being placed on the technical capacity of potential contractors of infrastructure relative to the financial bids. The Procurement Units in Ministries are also being strengthened, and the Government has decided to move oversight responsibility over the procurement cadre and function from the Ministry of Infrastructure Development to the Ministry of Finance and Economic Affairs whereby the newly created position of a Director for Procurement Policy at the Ministry of Finance and Economic Affairs Ministries is expected to increase attention on efficient procurement in MDAs. Moreover, Ministries have been required to strengthen coordination of sector-wide expenditure plans and the related procurement, and ensure that Annual Procurement Plans are prepared as required under the Public Procurement Act. The Expenditure Tracking

Unit in the Ministry of Finance will continue monitoring implementation of projects, and recommend ways to expedite implementation.

24. In the energy sector, the national power utility company (TANESCO) continued to strengthen its management and governance, and has reverted to sustainable operational cash flow. Installation of TANESCO's own 100MW gas-fired plant has been completed and the capacity became available in September 2008. Procurement of another 45MW of internal gas-fired generation capacity is also progressing well. These measures, together with the coming to end of the emergency power contracts procured at the height of the drought in 2006, are expected to strengthen TANESCO's financial position substantially in the medium term.

Performance under the program

25. Programme implementation remains broadly on track. With the exception of the assessment criterion on reserve money, all quantitative assessment criteria for end-June, 2008 were met and substantial progress was achieved on the structural agenda (Tables 1 and 2 annexed hereto). The use of three-month rolling Government cash flow forecasts which the Cash Management Committee had generated since February 2008 was disrupted in the early months of 2008/09 because of uncertainty on the disbursement of foreign financing and a tight domestic markets situation. This has since restarted after confirmation of the disbursement schedule of external financing. The Cash Management Unit in the Accountant General's Department initiated training for the staff of Ministries and Departments in order to ensure preparation of quality cash projections. In addition, the Government provides the BOT with daily lists of cheques issued, thereby enabling the bank to incorporate government payments in daily liquidity projections. The process of transferring Government balances from commercial banks to the BOT is ongoing after establishing an updated list of the respective accounts, and on the basis of which the relevant stakeholders are consulting. The Accountant General Department continued the pilot application of an electronic funds transfer (EFT) module aimed at evaluating the feasibility of adopting EFT for all Government payments and eliminate the expenditure float.

26. Good progress was made in the second generation financial sector reform program. The Social Security (Regulatory Authority) Act, an important milestone in the reform of the financial sector and especially the pensions' sub sector, was passed by Parliament in April, 2008, and became operational in November, 2008. The Act provides for the establishment of a unified regulatory framework for the pensions subsector, and for the issuance of investment guidelines for all registered social security schemes by the Bank of Tanzania. The Financial Leasing Bill, which was tabled for first reading in the November 2007 parliamentary session was approved by Parliament in April 2008 session and became operational in July 2008. Progress has also been made towards the enactment of a Mortgage Finance Bill and toward establishing a credit reference databank. The government has adopted a policy paper on mortgage finance. It is expected that the Unit Titles Bill together with the Miscellaneous Amendments bill be submitted to the Parliament in November 2008. The regulations guiding the licensing and operations of the credit reference bureaus have been sent to the Attorney General's Chambers for review.

27. With the overall programme performance on track, implementation for the coming period will focus on mitigation of the adverse international economic environment on domestic macroeconomic policies, and on implementation of the core reforms as

stipulated in the programme. Fiscal policies will therefore continue monitoring revenue and foreign financing developments carefully, and remain vigilant to implement correction measures as necessary to maintain overall macroeconomic stability. Monetary and foreign exchange operations shall target keeping international reserves and reserve money on course to meet revised inflation targets.

Governance

28. The agenda to strengthen governance, guided by the second National Anticorruption Strategy and Action Plan (NACSAP II), is progressing well. The capacity of the Prevention and Combating of Corruption Bureau (PCCB) is being strengthened through recruitment, training and equipping. The Public Audit Bill, which widens the mandate and auditing scope of the Controller and Audit General (CAG) to include environmental, forensic and performance audits and further strengthens the independence of the National Audit Office became operational in July, 2008. Efforts are also underway to enhance the efficiency of the judiciary through appointment of more judges and magistrates, and an enhanced financial budget. Implementation of the Government action plan on the recommendations of the special audit on the management of the external payments areas is also well advanced and on track. Consistent with the commitment to follow up on the findings of its procurement audits, the PPRA directed audited institutions to prepare and submit action plans for addressing the observed discrepancies as a basis for subsequent monitoring. A government-supported programme to train investigative journalists is also bearing results, as evidenced by increasingly bold reporting of corruption cases in the local media.

II PROGRAM FOR 2008/09 AND IN THE MEDIUM TERM

29. Despite vulnerabilities from the volatile international economic outlook, the economy is expected to continue to perform well. Real GDP growth for the year to June 2009 is projected at 7.7 percent compared to 7.3 percent for the year to June 2008. On a calendar year basis, double digit real growth is expected to be sustained during 2008 and 2009 from the communications, mining and quarrying, construction, financial intermediation, and trade and repairs subsectors, thereby lifting real GDP growth to 7.5 percent in 2008, 8 percent in 2009 and 2010. Inflation is expected to decline to 6.8 percent by June 2009, as pressures from global oil and food prices abate. This is somewhat higher than the 5.3 percent initially projected, reflecting the lagged pass-through of international commodity prices.

30. The programme for 2008/09 projects domestic revenue at 17.1 percent of GDP, reflecting the impact of continued strengthening of tax and customs administration, and policy measures. Legislative changes to the fiscal regime of the mining sector based on the recommendations of the Presidential Committee on the Mining Sector have been prepared and will be presented to Parliament in the February, 2009. A consultancy service for a study on increasing non tax revenue will be completed during the year and its recommendations feed into the next budget cycle. In addition, the Government is reviewing all principal and subsidiary legislations on tax exemptions with a view to eliminating those that have outlived their objectives. In the 2008/09 budget, the Government announced measures to tighten controls over tax exemptions enjoyed by NGOs by, among others, requiring them to demonstrate annually what programmes are implemented and the public benefits that arose from those programmes.

31. The Government has adopted the Third TRA Corporate Plan, and implementation begun in July, 2008. The plan, which targets a doubling of nominal revenue collections under baseline macro assumptions over the next five years, aims at consolidating the institution development gains and integration of operations established under the Second Corporate Plan. Specifically, the plan prioritises: (i) building capacity for handling large taxpayers; (ii) adopting best practises for the medium and small taxpayers; (iii) building capacity at customs to ensure a smooth exit from the TISCAN's contract, as well as strengthening risk management at Customs; and (iv) maintaining favourable ISO Certification of TRA's operations.

32. Total expenditure is projected to increase significantly in 2008/09 from 22.9 percent of GDP in 2007/08 to 27.2 percent, mainly on account of increased development spending, increase in the wage bill, as well as expenditure on goods and services. The wage bill is high partly due to the retroactive payment of salary increases for civil servants. Expenditures directly related to specific MKUKUTA strategies constitute about 72 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. In the education sector, priority is on increasing the supply of qualified teachers and teaching materials. In order to accelerate improvements on the health indicators, the government has adopted a Primary Health Development Programme the implementation of which commenced with the budget for 2008/09.

33. The wage bill is projected to be 6 percent of GDP in 2008/09, compared to 5 in 2007/08, following a partial implementation of the recommendations of the Presidential Commission on Civil Service Pay. The Government remains committed to implementing civil service pay reforms in order to enhance efficiency while safeguarding macroeconomic fundamentals and the competitiveness of the economy. In the medium term, government wage bill is projected to stabilise at the 2008/09 level relative to GDP, consistent with the foreseen central government's commitment to raise salaries for employees, new recruitments and adjustments for inflation.

34. The government remains committed to targeting zero net domestic financing, as reflected in the 2008/09 budget. However, should foreign program assistance fall short of the anticipated level, the government may seek recourse to net domestic financing of up to T Sh 250 billion (about 1 percent of GDP).

35. Public Financial Management reforms continue to take hold, with primary priority on enhancing strategic resource allocation and ensuring value for money in budget execution. These reforms are being implemented and monitored jointly with other stakeholders (including development partners) through the revised strategy for the Public Financial Management Reform Program (PFMRP). 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). In this regard, the Government has adopted the Public Expenditure and Financial Accountability (PEFA) tool as the principal guiding framework and Monitoring and Evaluation tool for gauging progress in PFM reforms. Reforms are being implemented in the areas of aligning MKUKUTA, the MTEF, and the budget; strengthening the Treasury management function; expenditure monitoring through the Expenditure Tracking Unit; capacity for transparent public procurement and external

audits. The government is also consulting with development partners with a view to enhancing in year and medium term (3 – 5 years) predictability of aid.

36. Following the recent admission of new members to the East African Community, preparations are underway for their implementation of the Customs Union obligations, including the Common External Tariff and internal tariff elimination by January 2010. The original Members of the Community have also each established National Committees for addressing non-tariff barriers (NTBs) as they get identified. The revenue implications of these developments have been fully anticipated in the budget frame. Negotiations on an EAC Common Market have also commenced, with a view to accelerating the integration of the regional economies. The EAC Member States also jointly initialled an Economic Partnership Agreement with the European Union whereby the EAC Member States will continue to enjoy full duty free and quota free access for their goods exports to EU markets. The temporary export ban on maize, which was imposed in early 2008 in the face of extraordinary circumstances, has now been lifted.

37. Monetary policy will remain focused on bringing inflation down to the medium term target of around 5 percent. In view of the recent developments in inflation, which partly manifested the first round impact of high world prices of oil and food, the target for June 2009 has been slightly revised up to 6.8 percent. This is based on the assumption of average weather conditions and a lagged effect of the recent increase of the world price of oil. Consistent with these assumptions, monetary policy will aim at reducing the growth of M3 to 20 percent and that of M2 to 21 percent by end-June 2009. The expansion of credit to private sector is projected to slow down to 30 percent.

38. The BOT remains committed to a flexible exchange rate policy. Accordingly, the Bank's involvement in the foreign exchange market will be mainly for liquidity sterilization purposes and it will constitute a steady supply of small amounts so as to minimize its influence on the exchange rate.

39. The Bank is also undertaking a fundamental review of its functions, so as to re-focus its mission on its core activities of monetary policy and financial supervision. This will include reviewing tasks that the Bank undertakes on behalf of the government. Following this review, a strategy for refocusing the Bank will be prepared and incorporated in BOT's corporate plan to be adopted by end-May 2009.

40. Following the conclusion of the voluntary Safeguards assessment mission from the Fund in June 2008, the Bank is implementing measures, in the context of its corporate plan, aimed at strengthening its internal financial controls. The BOT is strengthening the internal audit function by reinforcing its capacity and independence. Extensive recruitment and training is already underway. To ensure compliance with the requirements of the Public Procurement Act, a Procurement Management Unit has been established within the Bank. The corporate plan has also provided for reviewing the risk profile in the BOT operations and implement a strategy to mitigate risks. Measures aimed at the enhancement of checks and balances and capacity building in International Financial Reporting Standards (IFRS) in the Directorate of Finance and are also being implemented. The preparation of the 2007/08 external audit was speeded up: the audit report is expected to be completed by mid November 2008, and thereafter approved by the BOT Board. The final report will be submitted to the MOFEA by end-November 2008.

41. The Bank is also committed to continue with enhancement of its communication with the financial market players and the general public. To this end the Bank will continue with the monthly and quarterly meetings for CEOs of banks and the quarterly meetings for the press, where economic developments and the justification of the monetary policy stance will be presented and discussed.
42. The government intends to revise the regulatory framework governing capital account transactions with a view to reaping the benefits of further integration with the world economy and preparing for further harmonization with its EAC partners. Based on its recent review, the BOT will prepare an action plan setting out the different steps to further liberalize capital account transactions. This action plan, which will be completed by end-March 2009, will be based on the following principles: (i) the approach will be gradual in order to avoid any disruptive capital flows—starting with the liberalization of inflows; (ii) it will draw on experiences of other countries; and (iii) the necessary legislative and regulatory changes will be implemented with a view to ensuring harmonization of all relevant regulations. In the meantime, the BOT will strengthen its capacity to monitor capital flows and associated risks, including by widening the coverage of data collection.
43. Further financial sector development is a critical ingredient for long-term growth. Ongoing legal reforms in the context of the second-generation financial sector reforms will provide a welcome boost to the residential mortgage market. The new, single regulator for the pension fund sector became effective since 1st November, 2008, and the Bank of Tanzania is in the process of issuing the investment guidelines for pension funds. In providing financial oversight over the pension funds, the Bank of Tanzania has started to collect regular financial information from pension funds. These will be integrated in its quarterly financial stability reports. The BoT now expects its first financial stability report to be ready for internal discussion by end-December 2008.
44. The Government is seeking to scale up infrastructure investment, which is a prerequisite for long-term economic growth in Tanzania. The Government is therefore preparing a medium term public investment program (MPIP) to guide its investment in infrastructure, with particular focus on transportation, energy, and water sectors. The projects included in the MPIP shall be based on detailed economic and social impact evaluation. In addition to an enhanced allocation from the general budget, investment in transportation and other infrastructure is an important element on the agenda of the dialogue with development partners, including among others the USD 698 million 5-year Tanzania Compact Programme financed by the Millennium Challenge Account (MCA) of the government of the United States.
45. The government's first priority is to seek additional concessional financing sources. However, should sufficient concessional financing be unavailable, the government will consider alternative options. A policy and legal framework for Public - Private Sector Partnerships (PPPs) is expected to be completed within this fiscal year. While targeting increased participation of the private sector in the implementation of infrastructure projects, the proposed PPP framework will ensure fair sharing of risks associated with such projects. Government Departments are generally expected to drive the process in their respective sectors, having regard to centrally established guidelines on the process, and requisite control mechanisms from the Ministry of Finance and Economic Affairs. Preparations are also underway to seek a sovereign credit rating in preparation for a possible issue of a sovereign bond on the international debt market. To ensure that any

nonconcessional financing is consistent with long-term fiscal sustainability, the MOFEA is strengthening its debt management capacity.

Other structural reforms

46. Following the recent further divestiture of the National Microfinance Bank (NMB) through sale of its 21 percent shares in the bank, the Government will focus on the reform of the remaining three state-owned banks. The Tanzania Investment Bank (TIB), designated as the national development financial institution, will be strengthened to provide long term financing for growth enhancing projects in agriculture, manufacturing, tourism, and other sectors. The consultants engaged to determine the best way TIB can be transformed into a development finance Institution, and have submitted their draft report which was discussed by stakeholders on 9th September 2008. The consultants have finalized their report, awaiting appropriate action by the Government. In tandem, a Rural Financing Strategy that aims at ensuring access to financial services for the rural population is expected to be adopted before the end of 2008/09.

47. Implementation of the new Electricity Act is also expected to be fully on course before the end of the year, after finalisation of the Regulations thereunder. The Act provides for more competition in the power sector by opening up to private generation, provides for the strengthening and specific functions for TANESCO, establishes frameworks to ensure rural electrification and better regulation of the sector, and promotes regional cooperation in the power sector through regional interconnection. As part of its ongoing financial restructuring, TANESCO is expected to complete a cost-of-service study and a study on technical and commercial losses by end-March 2009. The Government will continue to monitor TANESCO's implementation of the cost cutting measures in order to ensure appropriate pricing of electricity without undue adverse impact on service delivery.

Governance and accountability

48. Good governance and accountability, an important pillar of MKUKUTA, will continue to be reinforced through the strengthening of public participation in the monitoring of public affairs. In this regard, Government is enhancing expenditure tracking capacity at the local level through training of communities to analyse budget information. The PCCB is also being strengthened through additional human and financial resources, and expansion of its office network to the district level. Coordination of the core public sector reforms, recently strengthened through creation of a Reforms Coordination Unit in the Office of The Chief Secretary, is also being priority in the governance agenda. To increase capacity in public procurement, the PPRA will follow up to ensure that all tenders are published publicly as required by law, and that the results of the tenders are made public. To facilitate this, the PPRA has established a website and a Procurement journal. Tanzania is also scheduled for mutual evaluation by the Eastern and Southern African Anti Money Laundering Group (ESAAMLG) in November, 2008.

Statistical Issues

49. The government intends to further strengthen its statistical base. In the first place, the National Bureau of Statistics, assisted by development partners, has initiated a revision of the CPI weights, in light of the recent Household Budget Survey (HBS). In addition, the NBS will use the HBS results to revise and rebase the national accounts and will

strengthen their reliability by improving the source data. The ultimate objective is to produce quarterly national accounts, a step necessary to meet the government's objective of subscribing to the Special Data Dissemination Standard (SDDS). In addition, the BoT is upgrading its monetary and financial statistics (MFS) to conform with the IMF's 2000 MFS Manual. The new integrated financial sector data base will be extended to nonbank financial institutions, including pension funds and insurance companies.

Conclusion

50. Against a very challenging external environment, Tanzania has continued to record good progress in implementing its economic and financial programme with the policy support from the Fund. Inflation remains as the main challenge in our pursuit of accelerating growth, reducing poverty, and meeting the MDGs. The programme for 2008/09 and beyond, 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, will continue to especially focus on addressing the inflationary pressures and increase factor productivity through growth enhancing investment. 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 the infrastructure for transportation, energy, water, and education.

**MINISTRY OF FINANCE AND ECONOMIC AFFAIRS,
DAR ES SALAAM,
TANZANIA.
December, 2008**

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

	2008								2009				
	March		June		September			December		March		June	
	Indicative Targets	Actual	Assessment Criteria	Actual	Indicative Targets	Adjusted Indicative Targets	Prel.	Program Assessment Criteria	Proposed Assessment Criteria	Program Indicative Targets	Proposed Indicative Targets	Program Indicative Targets	Proposed Assessment Criteria
	(Billions of Tanzania shillings; end of period, unless otherwise indicated)												
Net domestic financing of the government of Tanzania (cumulative, ceiling) 1/ 2/	-90	-430	0	-336	394	167	105	64	-174	224	-124	249	0
Accumulation of budgetary arrears (ceiling; indicative target only)	0	0	0	0	0	0	0	0	0	0	0	0	0
Average reserve money (upper bound) 3/	1,975	1,916	2,042	2,054	2,207	2,207	2,350	2,242	2,343	2,311	2,374	2,390	2,463
Average reserve money target 3/	1,956	---	2,022	---	2,185	2,185	---	2,220	2,320	2,288	2,350	2,366	2,438
Average reserve money (lower bound) 3/	1,936	---	2,002	---	2,163	2,163	---	2,197	2,297	2,265	2,327	2,342	2,414
	(Millions of U.S. dollars; end of period)												
Net international reserves of the Bank of Tanzania (floor) 4/	2,312	2,663	2,101	2,541	1,862	1,862	2,535	2,177	2,559	2,163	2,573	2,143	2,587
Accumulation of external payments arrears (ceiling) 5/	0	0	0	0	0	0	0	0	0	0	0	0	0
Contracting or guaranteeing of external debt on nonconcessional terms (ceiling) 5/	0	0	0	0	0	0	0	0	0	0	0	0	0
<i>Memorandum item:</i>													
Foreign program assistance (cumulative grants and loans) 1/	957	1,039	1,057	1,122	71	---	264	545	550	652	777	795	1,036

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 December 3, 2008.

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

2/ For the 2008/09 program, 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.

For the 2008/09 proposed revised program, to be adjusted upward by up to T Sh 250 billion for the U.S. dollar equivalent of a shortfall 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. For the 2008/09 proposed revised program floor will be adjusted downward for any shortfall in foreign program assistance from the amounts shown in the memorandum item up to the equivalent of T Sh 250 billion.

5/ 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 Program through November 2008

Measure	Target Date of Implementation	Status
<p>Establish a Memorandum of Understanding between the MOFEA and the BOT setting out respective responsibilities, including cost sharing of monetary policy operations. 1/</p> <p>Fiscal</p> <p>Cash Management Unit (CMU) in the Accountant General's Department to produce Government's three month rolling cash-flow forecast.</p> <p>Introduce a functional classification of expenditures consistent with the IMF's <i>Government Financial Statistics Manual 2001</i> in the budget for 2009/10.</p> <p>Complete the integration of the Customs and Excise Department and TISCAN's import clearance processes.</p>	<p>End-September 2008</p> <p>Continuous</p> <p>End-June 2009</p> <p>End-December 2008</p>	<p>MoU was signed in December 2008.</p> <p>Done.</p> <p>On track. MoFEA has received technical assistance for mapping expenditures.</p> <p>On track. TRA is implementing an alternative to TISCAN, which is expected to be completed by end-December 2008.</p>
<p>Financial Sector</p> <p>Prepare a review of the regulatory framework governing capital and financial account transactions.</p> <p>Prepare quarterly financial stability reports for the BOT Board, including assessments of risk-based prudential supervision</p> <p>Establish an operational credit reference databank.</p>	<p>End-September 2008</p> <p>End-September 2008</p> <p>End-June 2009</p>	<p>Done.</p> <p>Delayed until December 2008.</p> <p>On track. BoT to request technical assistance to complete the task.</p>

1/ Assessment criterion.

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

Measure	Target Date of Implementation
Financial Sector	
Adopt a strategy for refocusing the Bank of Tanzania on its core activities. ¹	End-May 2009
Issue investment guidelines for pension funds prepared by the Bank of Tanzania.	End-March 2009
Prepare an action plan for the liberalization and improved monitoring of capital account transactions.	End-March 2009
Prepare quarterly financial stability reports for the BOT Board, including assessments of risk-based prudential supervision.	End-December 2008
Establish an operational credit reference databank.	End-June 2009
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

¹ Assessment criterion

Attachment II

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

December 3, 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. The principal data source is the standardized reporting forms, 1SR and 2SR, as provided by the Bank of Tanzania to the IMF, and the government debt tables provided by the Accountant General's office.

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 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; (ii) all BoT accounts receivable on 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 promisory 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 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, 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 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 budget support and basket grants and loans received by the Ministry of Finance and Economic Affairs (MoFEA) 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 exchange rate

11. For 2008/09, the end-of-period program exchange rates are set at T Sh 1185 per U.S. dollar, T Sh 1200 per U.S. dollar, and T Sh 1215 per U.S. dollar for quarters II–IV, respectively. The period average program exchange rates are set at T Sh 1177 per U.S. dollar, T Sh 1192 per U.S. dollar, and T Sh 1208 per U.S. dollar for quarters II–IV, respectively. For 2008/09 as a whole, the program average exchange rate is set at T Sh 1188 per U.S. dollar.

III. ADJUSTERS

Net international reserves

12. The end-December 2008, end-March 2009, and end-June 2009 quantitative targets for the BoT's net international reserves will be adjusted downward by the amount in U.S. dollars of any shortfall in foreign program assistance in U.S. dollars, up to a limit of T Sh 250 billion, converted into U.S. dollars at the program average exchange rate, for the end-quarter test dates in 2008/09, 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 end-December 2008, end-March 2009, and end-June 2009 quantitative limits on the net domestic financing of the Government of Tanzania will be adjusted upward for any shortfall in foreign program assistance in U.S. dollars, up to a limit of T Sh 250 billion,

evaluated using the program average exchange rate, relative to projections shown in the Quantitative Assessment Criteria and Indicative Targets Table attached to the applicable.

14. Letter of Intent and Memorandum of Economic and Financial Polices of the Government of Tanzania.

IV. DATA REPORTING REQUIREMENTS

15. 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 (1SR)	BoT	Monthly	1 week
Consolidated accounts of other depository corporations and the depository corporations survey (2SR and the DCS).	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
Standard off-site bank supervision indicators for deposit money banks and for other depository corporations.	BoT	Quarterly	6 weeks
Financial Soundness Indicators for deposit money banks and 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

Information	Reporting Institution	Frequency	Submission Lag
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 MoFEA 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 MoFEA.	BoT and MoFEA	Quarterly	4 weeks
The flash report on revenues and expenditures.	MoFEA	Monthly	4 weeks
The TRA revenue report	TRA	Monthly	4 weeks
The monthly domestic debt report. As discussed above, the MoFEA 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 MoFEA.	MoFEA	Monthly	4 weeks
Monthly report on central government operations.	MoFEA	Monthly	4 weeks
Detailed central government account of disbursed budget support grants and loans, and external debt service due and paid.	MoFEA	Monthly	4 weeks
Detailed central government account of disbursed donor project support grants and loans.	MoFEA	Monthly	4 weeks
Statement on new loans contracted during the period including terms and conditions according to loan agreements.	MoFEA	Quarterly	4 weeks