

Tanzania: First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for waiver of Performance Criterion— Staff Report; Staff Statement; and Press Release on the Executive Board Discussion

In the context of the fourth review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for waiver of performance criterion, the following documents have been released and are included in this package:

- the staff report for the first review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for waiver of performance criterion prepared by a staff team of the IMF, following discussions that ended on **November 21, 2003**, with the officials of Tanzania on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on February 10, 2004.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **February 24, 2004** updating information on recent developments.
- a Press Release summarizing the **views of the Executive Board as expressed during its February 25, 2004 discussion** of the staff report that completed the review.

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

Letter of Intent sent to the IMF by the authorities of Tanzania*

*May also be included in Staff Report

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

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INTERNATIONAL MONETARY FUND

TANZANIA

**First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility
and Request for Waiver of Performance Criterion**

Prepared by the African Department

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

Approved by Anupam Basu and Michael T. Hadjimichael

February 10, 2004

- Tanzania continues to enjoy macroeconomic and political stability and has made further significant progress in the implementation of its structural reform agenda. Growth remains strong, year-on-year inflation at end-2003 was below 5 percent, and international reserves are at a comfortable level. All quantitative and structural performance criteria have been met, with the exception of the submission to parliament of the new income tax law, which was delayed to February 2004.
- Discussions for the first review under the new PRGF arrangement were held in Dar es Salaam and Zanzibar during November 6-21 and in Washington during December 15-19 by a staff team comprising Messrs. Sharer (head), Treichel, Tjirongo, Zhan (all AFR), Pivovarsky (FAD), Ms. Reif (PDR), and Mr. Abdi (Senior Resident Representative). The mission met with the Senior Permanent Secretary at the Ministry of Finance (Mr. Mgonja), the Governor of the Bank of Tanzania (Mr. Ballali), and senior officials from these and other government departments. The mission also met with representatives of the business, banking, and donor communities, and with NGO representatives. The mission collaborated closely with World Bank staff.
- Completion of this first review will entitle Tanzania to a disbursement of SDR 2.8 million (Table 1). The government's letter of intent (LOI) relating to this review is presented in Appendix I. Other appendices summarize Tanzania's relations with the Fund and the World Bank Group.
- In approving the new PRGF arrangement on July 28, 2003, Executive Directors commended the authorities for their strong implementation of macroeconomic policies and structural reforms, noting that this had boosted economic growth and resulted in a steady increase in per capita income. They noted, however, the persistence of extensive poverty, and urged the authorities to address key impediments to higher growth through structural reforms to improve the domestic supply response.

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Executive Summary

- **Tanzania continues to enjoy macroeconomic and political stability.** Macroeconomic developments in 2003 have continued to evolve broadly in line with the program. Despite a drought, which adversely affected agricultural production, real GDP is estimated to have grown by 5.5 percent in 2003, as other sectors of the economy, notably mining, manufacturing, construction, and tourism continued to grow rapidly. Inflation increased marginally, from 4.5 percent in November 2002 to 4.6 percent in November 2003.
- **Performance under the current PRGF arrangement has been satisfactory.** All quantitative and structural performance criteria have been met, with the exception of the submission to parliament of the new income tax law, which was delayed to February 2004. Amendments to the Land Act, which aim at removing impediments to bank lending and were agreed with stakeholders, were submitted to parliament in October and are expected to be approved in February 2004. Discussions on the first review centered on a supplementary budget, and further structural reforms in the fiscal and financial sector areas.
- **On account of emerging unanticipated spending needs,** including the purchase of a government plane, and an emergency subsidy to the electricity utility TANESCO, the projected net domestic financing requirement is expected to be 0.8 percent of GDP, compared with the 0.4 percent previously projected. Reflecting growing concerns over the electricity sector, high-level discussions between the government and the World Bank on the strategy for reform of the electricity sector will take place in early 2004, following which a short-term action plan will be elaborated.
- **Key elements in the implementation of the TRA corporate plan through June 2004** will be the integration of the Income Tax and VAT Departments in the Large Taxpayer Department (LTD), as well as a steady increase of its coverage. To further streamline administrative efficiency, the VAT threshold will also be revised upward by June 2004 to reduce the number of VAT taxpayers.
- **The government has developed a comprehensive financial sector reform agenda based on the recommendations of the FSAP.** Broadening access to financial services, developing financial institutions, strengthening financial markets, and managing the excess liquidity emanating from large donor assistance and other inflows are key challenges of the financial sector reform agenda. The first step will be the establishment, in March 2004, of an interagency, interministerial Financial Sector Reform Committee to oversee and guide the reform process.

I. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

1. **Macroeconomic developments in 2003 continued to evolve broadly in line with the program (Table 2).** Despite a prolonged drought¹, which has adversely affected agricultural production, real GDP is expected to have grown by 5.5 percent in 2003, as other sectors of the economy, notably mining, manufacturing, construction, and tourism continued to grow rapidly. Inflation increased marginally, from 4.5 percent in November 2002 to 4.6 percent in November 2003, as food prices rose by 5.8 percent, while nonfood inflation declined to 1.4 percent, partly reflecting the stability of the exchange rate and of oil prices (Figure 1).

2. **In Fiscal Year (FY) 2002/03 (July-June), the overall fiscal deficit (including grants) was about 1 percentage point of GDP lower than programmed, accompanied by a substantially better-than-projected revenue performance, as well as higher-than-expected expenditure (Tables 3 and 4).** Revenue exceeded projections by 0.3 percent of GDP on account of buoyant value-added tax (VAT) and nontax revenue. Total expenditure exceeded projections by 1.2 percent of GDP, due to a higher-than-projected end-of-year catch-up in recurrent expenditures and the upward revision of development expenditures financed with foreign grants.²

3. **In the first quarter of 2003/04, revenue exceeded projections by 0.1 percent of GDP, as tax revenue continued to be strong, partly as a result of the implementation of measures to curtail smuggling of petroleum imports, and expenditures remained below budget.** The latter outcome mainly reflected lower-than-expected payments of interest on external debt. Net domestic financing at end-September was below the program target by about T Sh 40 billion (Appendix I, Table 1).

4. **Further progress was made in the reform of tax administration and expenditure management.** Following approval of the five-year corporate plan by the board of the Tanzania Revenue Authority (TRA) at end-June 2003, organizational and personnel steps were taken toward its implementation.³ Also, effective July 2003, the government abolished a large number of local government taxes that had been seen as nuisance taxes by the business community. To reduce the abuse of tax exemptions and increase transparency, the government expanded the application of the treasury voucher system for the administration of exemptions from indirect taxes. In the area of expenditure management, recently

¹ About 2 million people have been experiencing food insecurity.

² Foreign-financed development expenditure is based on data from the Ministry of Finance's External Finance Database, obtained directly from donors. While the Accountant General has been encouraging donors to channel projects through the government's Integrated Financial Management System (IFMS), donors have not yet responded to the extent expected.

³ See paras. 5-6 of the LOI.

introduced codes for priority sector expenditures were utilized to monitor expenditure execution in the first quarter of 2003/04.⁴ Furthermore, the Accountant General continued to prepare monthly reports on the payment of utility bills, which demonstrated that spending agencies were meeting their obligations on a timely basis. Moreover, regularly conducted audits suggest that spending agencies are not incurring arrears in other areas.

5. **Through September 2003, the Bank of Tanzania (BoT) tightened liquidity conditions substantially, with a view to meeting the established reserve money targets (Tables 5 and 6).** Reserve money and net domestic assets of the BoT remained below the June and September targets, as the BoT more stringently enforced requirements for the transfer of TRA receipts to the BoT and, in addition, actively engaged in open market operations. As a result, money supply growth at end-September remained below projections by more than 1 percentage point. The liquidity squeeze resulted in some commercial banks being unable to meet reserve requirements and led to temporarily high interest rates on the interbank market. In October 2003, the liquidity situation loosened as a result of the BoT's injection of liquidity and a drawdown of deposits by the government. Through October 2003, credit to the private sector increased (from a low base) by 40 percent, substantially above projections, fueled in part by increased competition in the banking system and the reduction in interest rate spreads.

6. **Through the first quarter of 2003/04, balance of payments developments remained in line with projections (Tables 7–10), as imports, notably petroleum imports, accelerated and export growth was in line with expectations.** International reserves substantially exceeded projections, as scheduled debt-service payments to Japan and Brazil were not made⁵ and the BoT sold less foreign exchange than anticipated. The exchange rate against the U.S. dollar depreciated slightly after June 2003 to about T Sh 1070 per dollar. In real effective terms, it depreciated by about 2 percent, which combined with a modest recovery of the terms of trade, improved the environment for exports (Figure 2).

7. **Progress in structural reforms was broadly in line with the program, except that the income tax law was not submitted to parliament by end-October 2003, as envisaged,** as extensive consultations with stakeholders could not be finalized on time. On the positive side, at end-November, the names of individuals, businesses, and nongovernmental organizations (NGOs) that were granted exemptions under the treasury voucher scheme and the amounts received were published on the government's web page.⁶ Also, amendments to

⁴ See paras. 8-9 of the LOI.

⁵ Debt agreements with Japan and Brazil are yet to be signed. The creditors, through the Paris Club Secretariat, have extended the deadline for bilateral agreements to June 30, 2004.

⁶ The authorities indicated that the publication of all statutory and discretionary exemptions (amounting to about 3 percent of GDP) was neither feasible nor served the intended purpose of this measure, which aimed at increasing transparency, and that no discretionary exemptions had been granted outside the treasury voucher scheme.

the Land Act—agreed with stakeholders—that aim at removing impediments to bank lending, were submitted to parliament for first reading in October, with approval expected in February 2004. In addition, a paper on a new, substantially simplified business licensing system has been submitted to the cabinet, and is expected to be approved in early 2004.⁷ The authorities have also formulated a private sector development strategy, which they are discussing with stakeholders⁸.

8. **Public enterprise reform is continuing to make progress.** The electricity utility, TANESCO, has significantly strengthened its financial performance under the guidance of a private management team, but the use of expensive thermopower-generating facilities in the aftermath of the drought is placing an unsustainable burden on the corporation and resulting in additional budgetary transfers. Also, after the takeover by a concessionaire, the financial and operational management of the water utility, DAWASA, is improving.⁹ In the banking sector, following intensive consultations, parliament approved the government's privatization strategy for the National Microfinance Bank (NMB), including offering a maximum share of 49 percent to foreign investors.

II. REPORT ON THE DISCUSSIONS

9. The discussions centered on (i) a review of the financial program for 2003/04; (ii) further steps to promote tax reform; (iii) emerging unanticipated spending needs; and (iv) the future agenda for financial sector reform, against the background of recommendations of the recent Financial Sector Assessment Program (FSAP).

A. Macroeconomic Outlook and Poverty Reduction Strategy

10. **The macroeconomic framework presented in the previous staff report (EBS/03/100) remains appropriate.** The authorities indicated that, with normal rainfall, a substantial recovery is foreseen in agricultural production in 2004, and that, with sustained good performance in other sectors, the projected real growth rate of 6.3 percent in 2004 is achievable. With a return to normal food supplies, the inflation rate is projected to decline to about 4 percent by end-2004.

11. **Tanzania is finalizing the third poverty reduction strategy paper (PRSP) progress report and has started consultations with stakeholders that will lead toward a comprehensive update of the full PRSP.** Mindful of the critical importance of agricultural development to reduce income poverty, the government will carry out a review of crop

⁷Under the new system every business license is expected to be issued within one day.

⁸ See para. 18 of the LOI.

⁹ The drought has nonetheless resulted in severe water shortages.

boards, with a view to ending their involvement in procurement and marketing, and limiting their functions to a regulatory role. In addition, with the purpose of enhancing the availability of rural financing, the government is finalizing the implementing regulations for the legal, regulatory, and supervisory framework for microfinance institutions, and strengthening the administrative capacity for implementing the Land Act.

B. Fiscal Policy for 2003/04

12. **Main challenges in the fiscal area remain the structural reforms of tax administration and tax policy, together with a strengthening of expenditure management and of the efficiency of government operations.** In this context, the discussions focused on the next steps toward the full implementation of the TRA's corporate plan, the reform of the exemptions regime, and the new income tax law. The discussions also explored further steps to improve expenditure management and the tracking of poverty-reducing expenditure.

13. **Based on revised fiscal projections for 2003/04**, the overall deficit, after grants, is expected to be higher by 0.9 percent of GDP than that presented in the last staff report, and the projected net domestic financing requirement would be 0.8 percent of GDP, compared with the 0.4 percent previously projected.¹⁰ The larger deficit reflects two factors: first, reflecting additional, unanticipated spending needs (detailed below), expenditure projections have been revised upward by about 1 percent of GDP; and second, based on developments in the first quarter of 2003/04, revenue is projected to be higher by 0.1 percent of GDP and donor support (program grants and loans) by 0.5 percent of GDP. Given Tanzania's low domestic debt burden, the proposed increase in net domestic financing would not adversely affect debt sustainability.¹¹

14. **Two items account for more than half of the supplementary budget of TSh 157 billion, to be presented to parliament in February:** (i) the purchase of a government plane to replace the existing aircraft; and (ii) an emergency subsidy to TANESCO (0.4 percent of GDP), which in the aftermath of the drought was forced to rely increasingly on expensive thermopower generating facilities. Additional expenditures are also foreseen for contributions to the pension fund, replenishment of the Strategic Grain Reserve (SGR), the registering of voters, and payments to local governments to compensate for the abolition of a number of local taxes and fees.¹²

¹⁰ The original projection for 2003/04 foresaw 2 percent of GDP in net domestic financing (Country Report No. 03/238).

¹¹ See analysis of Tanzania's debt sustainability in Country Report No. 03/2 (Chapter IV).

¹² Further details of the supplementary budget request are in the LOI, paras. 26–28.

15. **In justifying the intended replacement of the government plane, the authorities indicated that the current 28-year-old plane is no longer considered safe.** They also explained that, prior to the recent signing of a memorandum of understanding for the purchase of the plane, a comprehensive assessment of alternative options had been carried out, and that transparent procurement procedures had been followed. The staff agreed that the authorities have a legitimate need to ensure safe and efficient means of transportation. Taking into account allocations made in previous budgets, the additional cost for the plane is expected to amount to about US\$40 million. In light of Tanzania's comfortable international reserves position, the staff proposed—and the authorities agreed—that the plane be financed through domestic financing. Payments for the purchase of the plane would be accommodated by adjusting the program targets for domestic financing and net international reserves. Priority sector expenditures will not be affected by the purchase of the plane.

16. **Regarding the delays in submitting the new income tax law to parliament, the authorities explained that more time for consultations with stakeholders had been required.**¹³ As a result, while they would submit the law to parliament in February for a first reading, approval is expected to take place in April. The staff regretted the further delay in approving the Income Tax Law, but expressed understanding for the need to give parliament adequate time for consideration. The staff and the authorities agreed that the approval of the new income tax law was a critical step toward implementing the medium-term reform program of substantially strengthening tax administration and reining in exemptions and closing loopholes. In particular, the discretionary powers of the Minister of Finance to grant tax exemptions will only be used in emergency situations, and require prior clearance from the cabinet.

17. **Key elements in the implementation of the TRA corporate plan through June 2004 will be the integration of the Income Tax and VAT Departments** (see para. 31 of the LOI). The TRA explained its strategy of starting this integration process in January 2004 with district offices. By June 2004, the TRA plans to also integrate operations in the Large Taxpayer Department (LTD). The TRA will also steadily increase the coverage of the LTD, effective June 2004,¹⁴ and for this purpose, recruit more auditors and other managerial staff. To further streamline administrative efficiency, the VAT threshold will be revised upward by June 2004 to reduce the number of VAT taxpayers and the remaining stamp duty on receipts will be abolished.¹⁵ The authorities furthermore announced that they will undertake a comprehensive review of customs administration in the first half of 2004, with technical assistance from the Fund, in order to design a customs reform strategy.

¹³ Following extensive consultations with the business community, the proposed draft law was revised to introduce some limited investment incentives (para. 30 of the LOI).

¹⁴ The initial increase would be from 100 to 200 taxpayers.

¹⁵ The presumptive tax will be revised to avoid any reduction in the tax base.

18. **The authorities underscored their commitment to a reform of the exemptions regime as an essential element of their strategy.** To this end, and in line with the authorities' previous LOI, all government notices issued prior to 1997 will be revoked, after those that in the view of the Ministry of Finance need to be maintained have been incorporated in the relevant tax laws. As a further step, all tax laws are being comprehensively reviewed, with a view to limiting discretionary powers to grant exemptions.¹⁶

19. **The staff and the authorities discussed future policy concerning the licensing of operators for export processing zones (EPZs)** (see para. 20 of the LOI). The authorities explained that, in light of the EPZ's purpose as a vehicle for strengthening Tanzania's export performance and the existence of preferential trade agreements other than those for the African Growth and Opportunity Act (AGOA)/Everything But Arms (EBA) initiative markets, it would be appropriate to permit the licensing of all companies for EPZs that are in a position to benefit from preferential trade agreements.¹⁷ The staff concurred with the authorities' view, particularly against the background of their commitment to exercising prudence by licensing only companies that export 100 percent of their output and enforcing strict regulations for EPZs that aimed at preventing leakage of products into the domestic market.

20. **The staff stressed that the front-loading of budget support as a result of the coordination with the Poverty Reduction Budget Support (PRBS) of donors and the improved predictability of disbursements should permit a relaxation of the cash-budgeting system.** It should also allow a more balanced time profile of expenditure. The authorities noted that the cash-budgeting system had been central in attaining the critical goal of sustained low inflation by containing domestic financing in the face of often uncertain timing of donor assistance. They agreed, however, that new procedures for providing donor budget support would permit enhanced flexibility in expenditure execution. To this end, they had begun to expand the process of fully funding high-priority expenditures on a quarterly basis. They also noted that, while the ratio of priority sector expenditures to GDP would increase to 10.8 percent in 2003/04, the share of these expenditures in total expenditures had remained roughly flat, reflecting partly the effect of the supplementary budget.

21. **The authorities emphasized the importance they attached to strengthening expenditure management in light of increased demands on accountability stemming from larger allocations of donor assistance to budget support.** Key measures in this area

¹⁶ The authorities explained that their earlier intention to completely transfer to parliament the authority to grant exemptions was not practical given the need to be able to respond flexibly to emergencies.

¹⁷ The existing benchmark refers to companies that are exclusively oriented to export to the AGOA/EBA markets.

during 2003/04 are an expenditure-tracking study in the education sector and the preparation of an auditing procedures manual.¹⁸

22. **The staff also held discussions with the Zanzibari authorities.** These focused on their fiscal policy stance, following recent wage increases and poor revenue collections that had resulted in drastic compression of nonwage expenditures. The Zanzibari authorities noted the fiscal impact of the weakened economy, including sharply lower world prices for cloves and the decline in tourism following terrorism warnings, although tourism receipts had recently shown signs of recovery. The staff urged the authorities to actively address their economic and financial situation, including through the recently established Joint Finance Commission with mainland Tanzania. The Zanzibari authorities are also seeking increased donor involvement.

C. Monetary Policy and Financial Sector Reform

23. **The authorities reiterated their commitment to maintain tight reserve money management, with a view to maintaining inflation below 5 percent.** The BoT agreed that the significant liquidity squeeze experienced at end-September, which had led to a number of bank's being unable to meet reserve requirements, highlighted the need to improve banks' liquidity management, as well as the BoT's liquidity forecasting. To avoid large fluctuations in reserve money at the end of each quarter, the authorities confirmed that transfers of TRA deposits from commercial banks to the BoT would be enforced on a weekly basis. Furthermore, the BoT expected that the introduction of a Lombard facility and the signing of a master repurchase agreement by commercial banks, expected for early 2004, would further strengthen the interbank market and thus help alleviate liquidity shortages.

24. **The revised monetary program foresees a slightly higher than projected money supply growth in 2004, given the continued higher-than-expected demand for credit to the private sector and for deposits.** This higher money growth is justified because the actual velocity for June 2003 turned out lower than projected, indicating that the demand for money and financial deepening are continuing to increase in line with the ongoing development of the financial sector. In view of the higher-than-expected money multiplier, reserve money targets have remained broadly unchanged.

25. **The government has developed a comprehensive financial sector reform agenda based on the recommendations of the FSAP.**¹⁹ The Tanzanian financial sector is sound but substantially underdeveloped by regional standards. Broadening access to financial services, developing financial institutions, strengthening financial markets, and managing the excess liquidity emanating from large-scale donor assistance and other inflows are key components of the financial sector reform agenda. The first step in implementing the FSAP proposals will

¹⁸See paras. 32-36 of the LOI

¹⁹ See paras. 39-41 of the LOI.

be the establishment, in March 2004, of an interagency, interministerial Financial Sector Reform Committee, chaired by the Governor of the Bank of Tanzania, to oversee and guide the reform process.

26. **With a view to removing restrictions that have hampered banks' flexibility, the BoT will continue to review the legal framework for lending.** In this context, the government intends to revise and amend the Bank of Tanzania Act (1995) and the Banking and Financial Institutions Act (1991), with Fund technical assistance. Following parliamentary approval of the privatization strategy of the NMB, the authorities expect to bring it to the point of sale by end-2004. The staff queried whether the new strategy, which did not permit majority ownership of the bank by a strategic foreign investor or consortium, would make the bank less attractive to prospective investors. The authorities did not expect the proposed equity shares to present a major impediment, and stressed that parliament had mandated majority local ownership in the NMB's privatization and had encouraged its continued focus on microfinance.

27. **Owing to the BoT's efforts to strengthen banking supervision, indicators of banking soundness have improved significantly over the last two years.** Notwithstanding the robust growth in private sector credit, the share of nonperforming loans has halved over the past two years (to 5.8 percent of banks' portfolio), and the capital adequacy ratio (currently 14.5 percent) has remained significantly above the threshold. The BoT has agreed to implement the recommendations of the safeguards assessment, in particular, to adopt International Accounting Standards and to have an external audit conducted in accordance with International Standards on Auditing.

D. External Outlook

28. **For the current fiscal year, the staff expects the current account deficit (excluding official transfers) to be 12.2 percent of GDP, compared with the 11.7 percent previously envisaged, reflecting higher imports of intermediate and capital goods, and a less robust increase in mining sector exports.** Traditional exports should be slightly higher, reflecting higher-than-projected export volumes. The level of international reserves is expected to exceed slightly the previous target on account of continued and large investment and donor inflows. The authorities continue to be committed to a freely floating regime, intervening only to smooth large exchange rate fluctuations.

29. **Debt negotiations with Brazil, Japan, and other creditors are proceeding,** although progress is uneven. The authorities have placed US\$5 million in an escrow account to signal their readiness to settle with non-Paris Club creditors.

30. **Progress in regional integration continues within the framework of the East African Community (EAC) and through continued implementation of the Southern African Development Community (SADC) tariff reduction program.**²⁰ The presidents of

²⁰ See paras. 46-47 of the LOI.

Kenya, Uganda, and Tanzania are expected to sign the customs union protocol shortly, establishing a three-band (0, 10, and 25 percent) common external tariff (CET). Tanzania presently has four tariff bands (0, 10, 15, and 25 percent). The authorities informed the staff that the majority of goods now classified at 15 percent would fall under the new 10 percent band. However, they also indicated that the discussions have not yet been concluded. The authorities reiterated their commitment to further reduce the maximum CET from 25 percent to 20 percent within five years, if this were also acceptable to the EAC partner countries. They also expressed their interest in pursuing a code of conduct within the EAC that would help in harmonizing taxation and avoiding harmful competition on investment incentives within the region.

E. Structural Reforms

31. **The authorities are continuing to pursue the structural reform agenda.** To this end, the authorities will continue to undertake a range of measures aimed at (i) improving public enterprise performance, in particular in the energy sector; (ii) fighting corruption, enhancing transparency, and generally improving governance; and, (iii) strengthening the business environment.

32. **Discussions between the authorities and World Bank and Fund staff on the energy sector centered on the need to improve efficiency while limiting the fiscal drain from the growing subsidies for TANESCO.** Since the takeover of TANESCO's management by a private firm, its operational efficiency has improved significantly. TANESCO continues, however, to depend to a large extent on budget support, mainly stemming from capacity and operational charges for the IPTL thermopower plant. This dependency may grow further, owing to the coming onstream of the Songo-Songo plant and the costs associated with a comprehensive debt restructuring. The staff and the authorities agreed that the complex issues associated with the sector required the immediate attention of policymakers from the Ministry of Finance, the Ministry of Energy, and other agencies. In early 2004, the government and the World Bank will hold high-level discussions on the strategy for reform of the electricity sector, following which a short-term action plan will be elaborated that lays out measures in key areas, and could possibly be covered by conditionality in the next review.

33. **The government is continuing its effort to improve governance.** Quarterly updates on the National Anticorruption Strategy and Action Plans (NACSAP) continue to be published. An updated NACSAP for 2003-05 has been drafted, and an assessment report on the human and financial resources required for implementation is being prepared. The Prevention of Corruption Bureau has, however, made limited progress on investigation and prosecution, with most cases in which formal investigations were opened not leading to specific disciplinary actions. Also, anticorruption plans for local governments were not included in the 2003/04 budget, as planned, since they are still being developed. Furthermore, the government is revising the code of conduct for all public servants and putting in place a mechanism to deal with grievances concerning unethical conduct of civil servants.

34. **The authorities confirmed their commitment to further improvements in the business environment, which had already benefited from the ongoing dialogue with the business community through the Investors' Roundtable.** They noted that the recent meeting in Ngorongoro had underscored the importance of addressing the growing shortage of skilled labor, and indicated that government was planning to tackle this issue as a priority.

III. PROGRAM MONITORING

35. The program will be monitored through the quantitative and structural performance criteria and benchmarks specified in Tables 1–3 of Appendix I.²¹ Submission to parliament of the new Income Tax Law is a prior action, and its final consideration by Parliament in April 2004, is an end-April 2004 performance criterion. Quantitative performance criteria and benchmarks have been set for March and June 2004, respectively, as well as a continuous performance criterion on the accumulation of external payments arrears. Structural benchmarks have been agreed for specific dates through June 2004, and a continuous benchmark on the publicizing on a quarterly basis of the names of recipients of exemptions administered through the treasury voucher system has been established. Program implementation will be assessed during the second review.

IV. STAFF APPRAISAL

36. Tanzania's performance under the program during 2003-04 thus far has continued to be strong, driven by the authorities' high degree of commitment and the continued active support of the donor community. Macroeconomic stability has been sustained, with reasonably high growth and low inflation. In addition, significant progress has been made on structural reforms, including amending the Land Act, demonstrating the government's resolve to improve the environment for private sector activity. Notwithstanding this success, income levels in Tanzania remain very low, and poverty is widespread. Tanzania's continued progress toward the growth and poverty reduction objectives articulated in its PRSP will depend on sustained economic reform efforts, including the implementation of prudent macroeconomic policies, for many years to come. The involvement of the donor community, including the provision of financial support and technical assistance to help address capacity constraints, will be critical to assist the authorities' efforts.

37. Central to the medium-term reform program are efforts to reform the tax system, improve the efficiency and management of fiscal operations and reform the financial sector. The former objective involves broadening the tax base and limiting exemptions, which will facilitate the mobilization of higher revenue and thus strengthen the robustness of

²¹ Structural conditionality covers broadly the same areas as those discussed in Box 6 of Country Report No. 03/238.

macroeconomic stability and limit aid dependency. The authorities have made a strong start in implementing the comprehensive reform plan set forth in the recently approved TRA corporate plan. The approval by parliament of the new income tax law, planned for April 2004, the launching of key administrative reforms, as well as strict control of exemptions, are critical first steps toward accomplishing the program's ambitious medium-term objectives. It will be crucial that the authorities rigorously pursue these efforts on a timely basis. In addition, the planned inclusion of fiscal terms of mining agreements exclusively in tax laws will be a critical step to rationalize the tax regime for mining companies. Effective use of technical assistance to help build capacity at the TRA will also be essential.

38. The authorities' efforts to improve accountability and strengthen the effective management of resources are central to their plans to improve absorptive capacity. In this respect, the staff welcomes the authorities' progress in implementing the assessment and action plan aimed at improving the tracking of poverty-reducing expenditure, and their efforts to strengthen auditing and procurement procedures. Of particular importance in this area will be the expenditure-tracking studies that are planned for the current fiscal year. The trend by donors to increasingly channel assistance in the form of program support gives added urgency to the authorities' efforts.

39. The staff notes with concern the rising fiscal pressures emanating from the growing subsidies for the energy sector and urges the authorities to give high priority to the design and implementation of a comprehensive strategy for the sector. In addition to improving the reliability of the supply of electricity—a critical factor for the business environment—the strategy should aim at establishing the sector's financial sustainability.

40. The staff welcomes the authorities' resolve to address the issue of further reform of the financial sector, as evidenced by their response to the FSAP. In view of the breadth of the reform agenda, establishment of a high-level interministerial, interagency committee to guide the reform agenda is an essential first step. The authorities should also give high priority to the timely completion of the privatization of the NMB, the largest bank in terms of deposits and branch networks, which should facilitate higher access to bank lending in rural areas, and hence enable the financial sector to play a more constructive role in growth and poverty reduction.

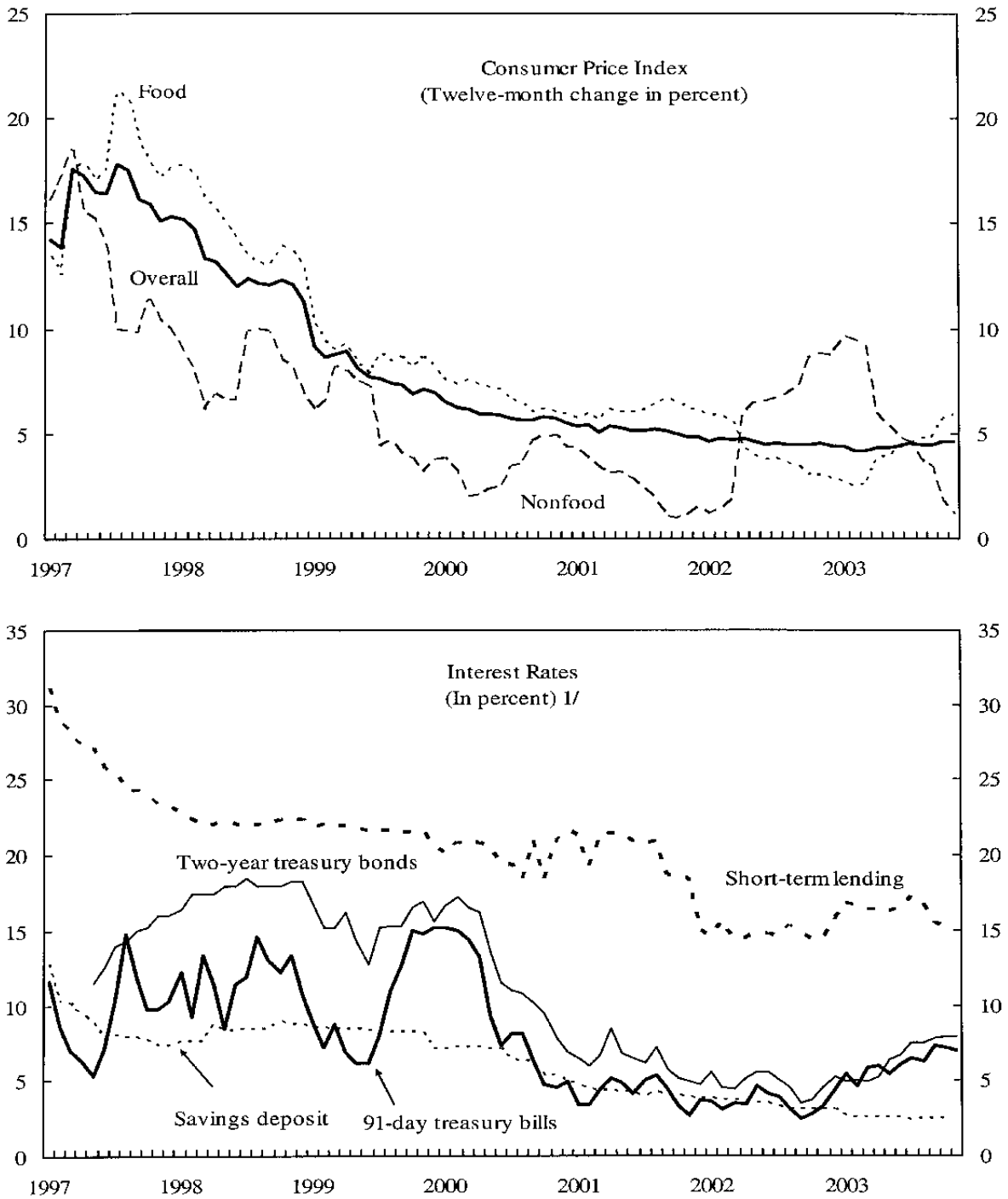
41. The staff welcomes the authorities' commitment to closer regional integration in the context of the East African Community. The common external tariff that is being adopted may lead to some liberalization of Tanzania's trade regime. In order to boost efficiency and sustain progress in this area, the staff urges the authorities to pursue with their EAC partners as soon as possible further tariff reductions, particularly for the maximum tariff, and reduce nontariff barriers. The authorities should also pursue efforts to better align EAC tax regimes.

42. The dialogue with the business community has increased the momentum for improving the business environment. Nonetheless, shortcomings in the business environment in Tanzania remain pervasive, and will require the continued engagement of the authorities to attain the level of investment required to sustain and, it is hoped, accelerate the rate of increase in real per capita incomes. The staff fully supports the authorities' strategy for

improving the business environment, including through enhancing the infrastructure. In this area, it will be critical to identify priority projects to improve transport and utilities, which have been persistent concerns of the business community. The staff furthermore urges the authorities to intensify their anticorruption efforts as a crucial element to improve governance and business confidence.

43. Based on the authorities' continued record of good program implementation and their commitments made in the attached letter of intent, as well as the temporary nature of nonobservance of the performance criterion, the staff recommends that the Executive Board grant a waiver for the nonobservance of the structural performance criterion on submission to parliament of the income tax law and complete the first review under the current PRGF arrangement.

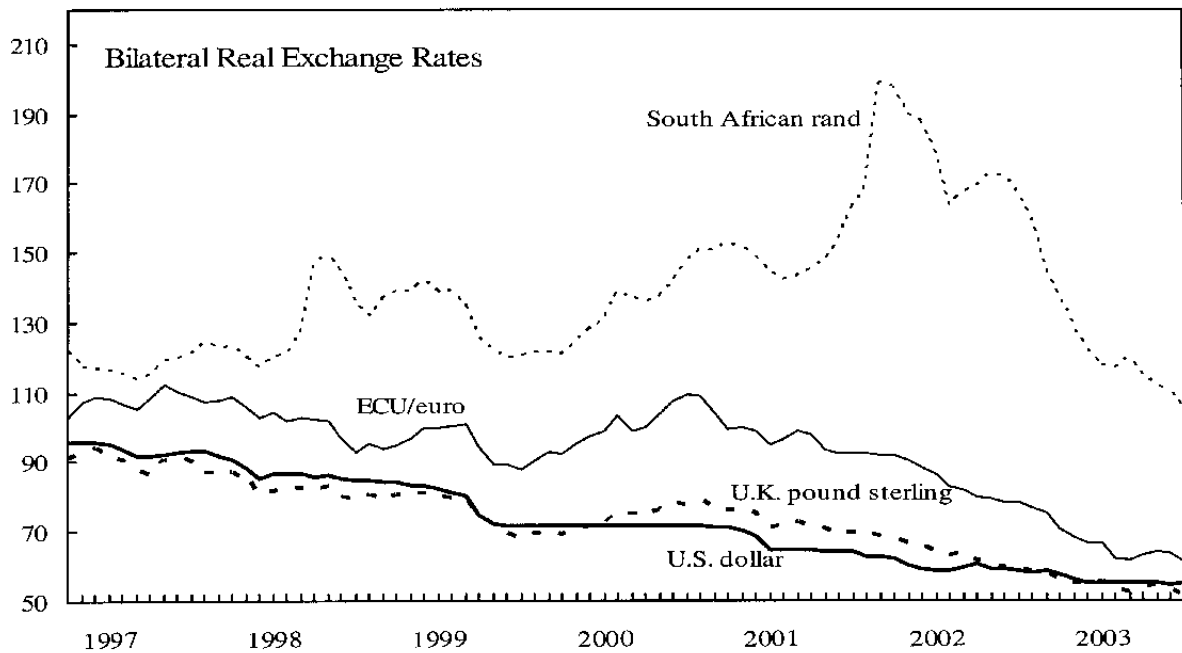
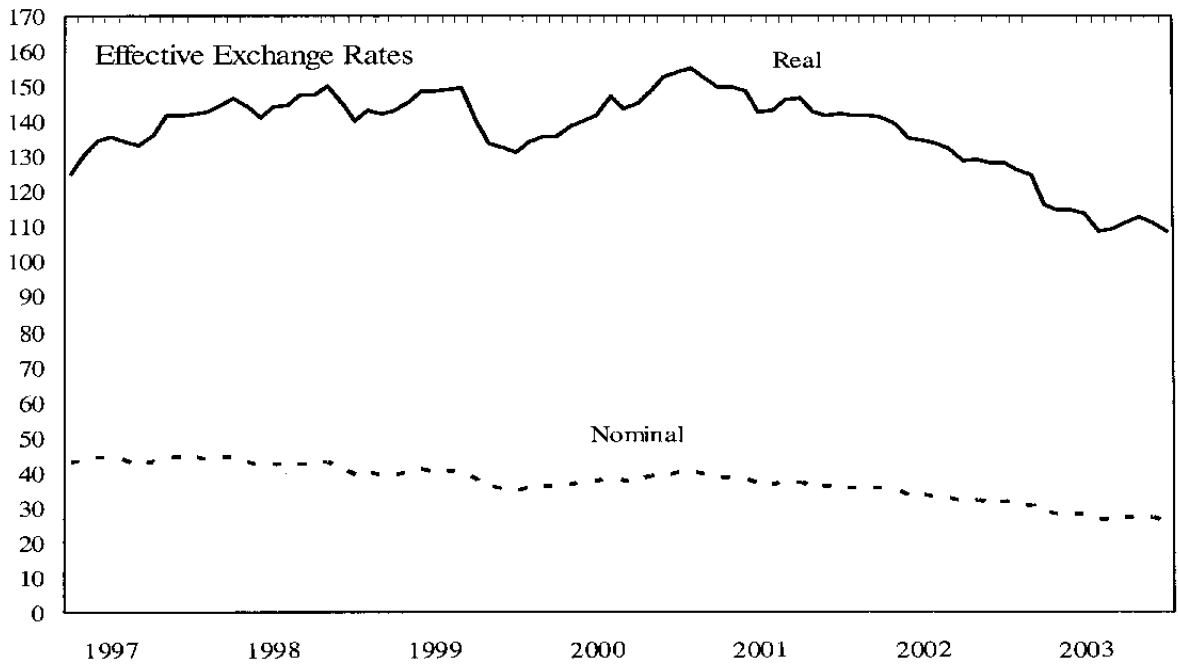
Figure 1. Tanzania: Prices and Interest Rates, January 1997-November 2003



Source: Tanzanian authorities.

1/ Savings and short-term lending rates information up to October 2003.

Figure 2. Tanzania: Exchange Rates, January 1997-October 2003
(1995=100; foreign currency per Tanzania shilling)



Sources: Tanzanian authorities; and IMF, Information Notice System.

Table 1. Tanzania: Phasing of Performance Criteria, Reviews, and Disbursements Under the Poverty Reduction and Growth Facility (PRGF) Arrangement, 2003 -06

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

Source: Fund staff.

Table 2. Tanzania: Selected Economic and Financial Indicators, 2001/02-2003/04

	2001/02	2002/03	2003/04	
			Prog.	Proj.
(Annual percentage change, unless otherwise specified)				
National income and prices ^{1/}				
Nominal GDP (billions of Tanzania shillings)	9,068	10,030	11,163	11,163
Real GDP growth	6.2	5.5	6.3	6.3
Real GDP per capita	4.2	3.5	4.0	4.0
Consumer prices (period average)	4.6	4.5	5.0	5.0
Consumer prices (end of period)	4.4	5.5	4.0	4.0
External sector				
Export, f.o.b (in U.S. dollars)	816.1	1,010.1	1,169.7	1,141.3
Imports, c.i.f. (in U.S. dollars)	-1,687.7	-1,823.6	-2,335.3	-2,351.8
Export volume	15.0	15.1	10.0	5.9
Import volume	2.6	1.8	14.6	20.5
Terms of trade	-6.0	-1.6	2.7	-0.3
Nominal effective exchange rate (end of period, depreciation -)	-12.3	-19.1	...	...
Real effective exchange rate (end of period, depreciation -)	-9.5	-17.4	...	...
Public finance				
Revenue (excluding grants)	12.2	16.7	14.7	15.0
Total expenditure	15.7	30.7	8.4	26.1
Current expenditure	18.7	27.1	12.0	29.1
Development expenditure and net lending	1.8	71.9	-3.1	17.2
Money and credit				
Broad money	22.1	22.7	17.2	19.1
Net foreign assets	31.4	46.2	9.7	11.3
Net domestic assets	4.4	-33.0	69.9	59.5
Credit to government ^{2/}	-34.4	-3.4	-136.8	28.4
Credit to nongovernment sector	27.4	36.6	24.5	32.2
Velocity of money (GDP/M3: average)	5.3	4.8	4.5	4.4
Treasury bill interest rate (in percent; end of period) ^{3/}	4.6	6.1	...	...
(In percent of GDP)				
Public finance				
Revenue (excluding grants)	12.1	12.8	13.1	13.2
Total grants	4.5	6.5	6.3	6.5
Expenditure	17.6	20.8	22.5	23.7
Overall balance (including grants)	-1.1	-1.7	-3.1	-4.0
Domestic financing ^{4/}	-0.3	-0.4	0.4	0.8
Savings and investment ^{1/}				
Resource gap	-8.1	-9.9	-10.4	-10.8
Investment	16.7	18.2	18.8	18.9
Government	3.3	4.4	5.1	5.1
Nongovernment	13.4	13.8	13.8	13.8
Gross domestic savings	8.6	8.4	8.4	8.0
External sector				
Current account balance (excluding official transfers)	-8.9	-7.7	-11.7	-12.2
Current account balance (including official transfers)	-4.8	-2.5	-6.1	-6.3
(In millions of U.S. dollars, unless otherwise indicated)				
Balance of payments current account balance (excluding grants; deficit -)	-832.4	-735.0	-1,161.5	-1,193.5
Overall balance of payments (deficit -)	-27.0	440.2	150.6	164.0
Gross official reserves	1,212.7	1,670.4	1,818.7	1,831.3
In months of imports of goods and nonfactor services	6.0	6.7	7.0	7.0

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

^{1/} Data are on calendar-year basis. 2001/02 data are for calendar-year 2002.

^{2/} The substantial increase in net credit to government in 2003 represents a net repayment to the banking system.

^{3/} Weighted-average yield of 91-, 182-, and 364-day treasury bills.

^{4/} Excluding new debt issued to recapitalize government-owned banks.

Table 3. Tanzania: Central Government Operations, 2001/02-2003/04 1/

	2001/02	2002/03		2003/04	
		Program	Actual	Prog.	Proj.
(In billions of Tanzania shillings)					
Total revenue	1,042.9	1,194.7	1,217.5	1,393.0	1,400.6
Tax revenue	938.5	1,088.6	1,105.4	1,275.2	1,273.2
Import duties	88.9	103.4	106.4	123.4	126.7
Value-added tax (VAT)	352.3	410.0	424.3	471.9	498.6
Excises	177.6	186.9	187.3	221.2	223.8
Income taxes	228.4	276.7	275.9	321.9	307.6
Other taxes	91.3	111.6	111.5	136.8	116.5
Nontax revenue	104.5	106.0	112.1	117.8	127.4
Total expenditure	1,521.9	1,869.4	1,989.5	2,383.3	2,509.6
Recurrent expenditure	1,171.4	1,426.6	1,488.6	1,803.4	1,922.4
Wages and salaries	342.0	411.5	397.8	464.1	464.1
Interest payments	121.1	114.5	99.8	149.4	152.8
Domestic	64.6	48.9	57.0	71.9	73.6
Foreign	56.5	65.7	42.8	77.6	79.2
Goods and services and transfers	708.3	900.6	991.1	1,189.9	1,305.5
Clearance of domestic arrears	59.1	0.0	0.0	0.0	0.0
Development expenditure	291.3	442.7	500.9	579.9	587.2
Domestically financed	50.2	95.7	95.7	140.1	140.1
Foreign financed	241.1	347.1	405.2	439.8	447.1
Adjustment to cash 2/	0.6	79.4	13.5	0.0	0.0
Overall balance, before grants	-479.5	-754.1	-785.5	-990.2	-1,109.0
Grants	385.2	505.9	622.3	666.0	684.8
Program (including basket grants) 3/	183.0	305.6	293.9	362.3	378.2
Project	140.2	148.9	255.5	223.9	223.2
HIPC grant relief	62.0	51.4	72.9	79.8	83.3
Overall balance after grants	-94.3	-248.2	-163.2	-324.3	-424.2
Financing	94.3	248.2	163.2	324.3	424.2
Foreign (net)	118.5	272.7	199.7	279.0	341.9
Foreign loans	187.4	358.6	301.1	408.9	447.1
Program (including basket loans) 3/	86.5	160.4	151.3	193.0	223.2
Project	100.9	198.2	149.7	215.9	223.8
Amortization	-68.9	-86.0	-101.3	-129.9	-105.1
Domestic (net)	-22.6	-14.4	-36.3	42.7	82.7
Bank financing	-59.2	-23.4	-10.3	42.7	45.8
Nonbank financing	36.6	9.0	-26.0	0.0	36.9
Amortization of parastatal debt	-1.6	-10.0	-0.3	-14.4	-14.4
Privatization proceeds	0.0	0.0	0.0	17.0	14.0
Memorandum items:					
Primary balance (excluding grants and foreign-financed development expenditure)	-117.3	-213.1	-280.5	-401.0	-509.1
Expenditure on defense and national service	118.6	...	...	...	...

Table 3. Tanzania: Central Government Operations, 2001/02-2003/04 1/ (concluded)

	2001/02	2002/03		2003/04	
		Prog.	Actual	Prog.	Proj.
(In percent of GDP, unless otherwise indicated)					
Total revenue	12.1	12.5	12.8	13.1	13.2
Tax revenue	10.9	11.4	11.6	12.0	12.0
Import duties	1.0	1.1	1.1	1.2	1.2
VAT	4.1	4.3	4.4	4.5	4.7
Excises	2.1	2.0	2.0	2.1	2.1
Income taxes	2.6	2.9	2.9	3.0	2.9
Other taxes	1.1	1.2	1.2	1.3	1.1
Nontax revenue	1.2	1.1	1.2	1.1	1.2
Total expenditure	17.6	19.6	20.8	22.5	23.7
Recurrent expenditure	13.6	14.9	15.6	17.0	18.1
Wages and salaries	4.0	4.3	4.2	4.4	4.4
Interest payments	1.4	1.2	1.0	1.4	1.4
Domestic	0.7	0.5	0.6	0.7	0.7
Foreign	0.7	0.7	0.4	0.7	0.7
Goods and services and transfers	8.2	9.4	10.4	11.2	12.3
Clearance of domestic arrears	0.7	0.0	0.0	0.0	0.0
Development expenditure	3.4	4.6	5.2	5.5	5.5
Domestically financed	0.6	1.0	1.0	1.3	1.3
Foreign financed	2.8	3.6	4.2	4.2	4.2
Adjustment to cash 2/	0.0	0.8	0.1	0.0	0.0
Overall balance, before grants	-5.6	-7.9	-8.2	-9.3	-10.5
Grants	4.5	5.3	6.5	6.3	6.5
Program (including basket grants) 3/	2.1	3.2	3.1	3.4	3.6
Project	1.6	1.6	2.7	2.1	2.1
HIPC grant relief	0.7	0.5	0.8	0.8	0.8
Overall balance after grants	-1.1	-2.6	-1.7	-3.1	-4.0
Financing	1.1	2.6	1.7	3.1	4.0
Foreign (net)	1.4	2.9	2.1	2.6	3.2
Foreign loans	2.2	3.8	3.2	3.9	4.2
Program (including basket loans) 3/	1.0	1.7	1.6	1.8	2.1
Project	1.2	2.1	1.6	2.0	2.1
Amortization	-0.8	-0.9	-1.1	-1.2	-1.0
Domestic (net)	-0.3	-0.2	-0.4	0.4	0.8
Bank financing	-0.7	-0.2	-0.1	0.4	0.4
Nonbank financing	0.4	0.1	-0.3	0.0	0.3
Amortization of parastatal debt	0.0	-0.1	0.0	-0.1	-0.1
Privatization proceeds	0.0	0.0	0.0	0.2	0.1
Memorandum items:					
Primary balance (excluding grants and foreign-financed development expenditure)	-1.4	-2.2	-2.9	-3.8	-4.8
Share of expenditures financed from foreign sources (percent) 4/	36.0	44.2	44.2	42.8	43.3
Share of current expenditures financed from foreign sources (percent) 5/	23.0	32.7	29.9	30.8	31.3
Ratio of recurrent expenditures to domestic revenues (percent)	112.3	119.4	122.3	129.5	137.3
Priority sector spending	8.8	10.1	10.2	11.5	10.8
Expenditure on defense and national service	1.4	...	...	...	...
Nominal GDP (market prices; billions of Tanzania shillings)	8,627	9,549	9,549	10,594	10,594
Foreign grants and loans (net)	5.8	8.2	8.6	8.9	9.7

Sources: Ministry of Finance; and Fund staff projections.

1/ Fiscal years run from July to June.

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

3/ Basket funds are sector-specific accounts established by the government for channeling donor support to fund specific activities in different sectors.

4/ Defined as a ratio of gross grant and loan inflows to a sum of total expenditures and amortization payments.

5/ Defined as a ratio of current expenditures to a sum of program grants and loans (including basket funding).

Table 4. Tanzania: Central Government Expenditure on Priority Sectors, 2001/02 - 2003/04 1/

(In billions of Tanzania shillings, unless otherwise indicated)

	2001/02	2002/03		2003/04	
		Prog.	Actual	Prog.	Proj. 4/
Total expenditure in priority sectors	761.9	966.2	973.7	1,219.9	1,139.5
(in percent of GDP)	8.8	10.1	10.2	11.5	10.8
(in percent of total expenditure)	52.1	51.7	48.9	51.2	45.4
Education	344.9	414.8	436.2	480.6	490.1
Health	142.1	172.3	186.7	231.2	210.1
Water	32.5	58.5	51.9	81.5	61.6
Agriculture (research and extension)	31.9	62.6	60.2	118.7	90.5
Lands	8.1	21.2	20.1	6.0	6.0
Roads	179.6	208.4	190.2	249.6	228.5
Judiciary	18.8	23.8	23.2	32.2	32.3
TACAIDS 2/	4.0	4.5	5.3	20.1	20.3
Recurrent expenditure in priority sectors	497.6	681.6	724.6	808.3	824.3
(in percent of GDP)	5.8	7.1	7.6	7.6	7.8
(in percent of total recurrent expenditure)	42.5	47.8	48.7	44.8	42.9
Education	282.1	400.0	422.9	453.9	460.6
Health	90.9	128.6	149.1	170.7	175.6
Water	15.5	16.9	16.5	17.4	17.5
Agriculture (research and extension)	17.2	34.2	36.0	47.6	47.7
Lands	7.4	4.8	4.8	5.4	5.4
Roads	65.7	73.6	71.9	84.3	84.5
Judiciary	14.8	18.9	18.9	24.8	24.9
TACAIDS 2/	4.0	4.5	4.5	4.3	8.1
Development expenditure in priority sectors	264.2	284.6	249.1	411.6	315.2
(in percent of GDP)	3.1	3.0	2.6	3.9	3.0
(in percent of total development expenditure)	90.7	64.3	49.7	71.0	53.7
Education	62.8	14.8	13.3	26.8	29.5
Health	51.2	43.7	37.6	60.5	34.5
Water	17.0	41.6	35.4	64.1	44.2
Agriculture (research and extension)	14.7	28.4	24.2	71.1	42.7
Lands	0.7	16.4	15.3	0.6	0.6
Roads	113.9	134.8	118.3	165.3	144.0
Judiciary	4.0	4.9	4.2	7.4	7.4
TACAIDS 2/	0.0	0.0	0.8	15.8	12.2
Memorandum items:					
Total expenditure 3/	1,462.8	1,869.4	1,989.5	2,383.3	2,509.6
Recurrent expenditure	1,171.4	1,426.6	1,488.6	1,803.4	1,922.4
Development expenditure	291.3	442.7	500.9	579.9	587.2
GDP (market prices)	8,627	9,563	9,563	10,594	10,594

Source: Ministry of Finance.

1/ Fiscal year runs from July to June.

2/ Government agency created in 2001 to coordinate AIDS-related interventions.

3/ Excludes clearance of domestic arrears and recapitalization of banks.

4/ Priority sector expenditures have been revised downwards, mainly due to corrections to the earlier estimate of foreign-financed development expenditure.

Table 5. Tanzania: Summary Accounts of the Bank of Tanzania, December 2002 - June 2004
(In billions of shillings; end of period)

	2002		2003				2004				
	Dec.	June	Act.	Prog.	Act.	Dec.	Est.	Mar.	June	Est.	
	Act.	Est.		Act.	Prog.	Prog.		Prog.	Prog.		
Net foreign assets	991.3	1,249.3	1,191.8	1,348.1	1,436.6	1,360.3	1,556.7	1,387.6	1,510.9	1,411.8	1,411.9
Net international reserves	1,033.2	1,291.1	1,233.6	1,389.9	1,478.4	1,402.2	1,598.5	1,429.5	1,552.7	1,453.7	1,453.8
(in millions of U.S. dollars)	1,057.9	1,195.5	1,178.8	1,287.0	1,415.2	1,298.3	1,480.1	1,323.6	1,437.7	1,346.0	1,346.1
Medium- and long-term foreign liabilities	-41.8	-41.8	-41.8	-41.8	-41.8	-41.8	-41.8	-41.8	-41.8	-41.8	-41.8
Net domestic assets	-295.6	-556.6	-552.2	-584.4	-748.7	-534.2	-730.6	-579.4	-702.6	-583.9	-599.4
Credit to government (net, excl. liquidity paper) 1/	-101.7	-133.5	-155.7	-326.8	-282.2	-284.0	-350.0	-295.1	-200.0	-96.4	-100.0
Liquidity paper 2/	-244.9	-292.6	-312.1	-127.6	-380.3	-120.4	-280.2	-154.0	-402.3	-357.0	-399.1
Other items (net)	50.9	-130.5	-84.4	-130.0	-86.2	-129.8	-100.3	-130.3	-100.3	-130.4	-100.3
Reserve money	695.7	692.7	639.7	763.7	687.9	826.1	826.1	808.3	808.3	828.0	812.5
Currency outside banks	495.4	490.8	473.7	543.3	504.9	590.4	590.4	591.5	580.3	605.8	570.1
Bank reserves	200.3	202.0	166.0	220.5	183.0	235.8	235.8	216.8	228.0	222.2	242.4
Currency in banks	51.2	53.2	48.9	53.5	58.7	53.7	50.8	55.6	59.7	56.1	61.1
Deposits	149.1	148.8	117.1	167.0	124.3	182.1	184.9	161.2	168.3	166.1	181.4
Required reserves (calculated) 3/	129.6	141.0	148.8	152.0	149.9	161.6	163.1	161.0	160.1	165.4	175.2
Excess reserves (calculated)	19.4	7.8	-31.7	15.0	-25.6	20.4	21.9	0.2	8.2	0.7	6.2

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

1/ Changed December and March projections reflect the changed profile of inflows of foreign donor assistance and of drawdowns of government deposits at the BoT

2/ Upward revision of liquidity paper reflects BoT's decision for a more extensive use of market operations.

3/ Calculated as reserve requirement times banks' deposits minus half of bank cash in vault.

Table 6. Tanzania: Monetary Survey, December 2002 - June 2004
(In billions of shillings, unless otherwise indicated; end of period)

	2002		2003				2004				
	Dec.	June	Sep.		Dec.	March		June			
	Act.	Prog.	Actual	Prog.	Act.	Prog.	Proj.	Prog.	Proj.	Prog.	Proj.
Net foreign assets	1,527.7	1,842.4	1,848.1	1,941.2	2,051.9	1,969.6	2,192.8	1,996.9	2,147.0	2,021.1	2,056.7
Net domestic assets	520.0	324.0	357.8	389.3	245.3	505.7	282.5	483.1	333.0	518.8	570.5
Domestic credit	802.8	744.2	820.0	652.8	706.8	695.8	670.9	846.9	843.4	941.2	1,077.7
Credit to government (net) 1/	232.1	143.7	161.5	-6.3	-58.2	-1.3	-142.2	111.7	6.8	186.4	207.4
Credit to nongovernment sector	570.7	600.5	658.5	659.1	765.0	697.1	813.0	735.2	836.6	754.8	870.3
Other items (net)	-282.8	-420.2	-462.2	-263.5	-461.5	-190.1	-388.4	-363.7	-510.4	-422.4	-507.2
Of which : liquidity paper (issued by BoT)	-244.9	-292.6	-312.1	-127.6	-380.3	-120.4	-280.2	-154.0	-402.3	-357.0	-399.1
M3	2,047.7	2,166.5	2,205.9	2,330.6	2,297.1	2,475.3	2,475.3	2,480.0	2,480.0	2,539.9	2,627.2
Foreign currency deposits	540.3	564.2	647.1	588.0	647.6	673.2	691.2	738.0	702.0	707.6	734.4
M2	1,507.4	1,602.3	1,558.8	1,742.5	1,649.5	1,802.1	1,784.1	1,742.0	1,778.0	1,832.2	1,892.8
Currency in circulation	495.4	490.8	473.7	543.3	504.9	590.4	590.4	591.5	580.3	605.8	570.1
Deposits (in Tanzania shillings)	1,011.9	1,111.5	1,085.1	1,199.3	1,144.6	1,211.8	1,193.7	1,150.6	1,197.7	1,226.5	1,322.7
Memorandum items:											
M3 growth (12-month percent change)	25.1	20.5	22.7	20.7	19.0	20.9	20.9	18.8	18.8	17.2	19.1
Foreign currency deposits (12-month percent change)	34.0	21.5	39.4	23.0	35.5	24.6	27.9	26.1	19.9	25.4	13.5
M2 growth (12-month percent change)	22.2	20.2	16.9	19.9	13.5	19.6	18.4	16.0	18.4	14.4	21.4
Credit to nongovernment sector (12-month percent change)	41.1	24.6	36.6	20.6	39.9	22.2	42.5	22.9	39.9	25.7	32.2
Reserve money (12-month percent change)	19.1	20.9	11.6	-4.0	-13.6	18.7	18.7	24.4	24.4	19.5	27.0
Currency/M3 (in percent)	24.2	22.7	21.5	23.3	22.0	23.9	23.9	23.9	23.4	23.9	21.7
Reserve money multiplier (M3/reserves)	2.9	3.1	3.4	3.1	3.3	3.0	3.0	3.1	3.1	3.1	3.2
Velocity of money (M3; average) 2/	4.9	4.8	4.8	...	...	...	...	...	...	...	...
Velocity of money (M3; end-period)	4.4	4.4	4.3	...	...	...	...	...	...	...	...
Net foreign currency position (DMBs; in foreign currency)	160.2	222.1	175.1	191.9	165.7	99.4	107.6	39.4	97.6	2.4	2.3

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

1/ Changed December and March projections largely reflect new information on the timing of donor assistance.

2/ Percentage changes of June 2003 program figures refer to the estimated outcome for June 2003, reported in the Country Report No. 03/238.

Table 7. Tanzania: Balance of Payments, 2001/02-2007/08
(In millions of U.S. dollars, unless otherwise indicated)

	2001/02	2002/03	2003/04	2003/04	2004/05	2005/06	2006/07	2007/08
	Act.	Act.	Prog			Proj.		
Current account	-454.8	-239.7	-606.9	-619.4	-513.9	-514.1	-515.3	-507.5
Trade balance	-737.9	-649.6	-957.8	-999.0	-963.8	-966.3	-934.3	-950.2
Exports, f.o.b.	816.1	1,010.1	1,169.7	1,141.3	1,262.7	1,375.9	1,470.1	1,585.4
Traditional	194.3	223.7	244.6	258.2	264.1	289.2	314.7	340.2
Nontraditional	621.8	786.4	925.1	883.1	998.7	1,086.8	1,155.3	1,245.2
Imports, f.o.b.	-1,554.0	-1,659.7	-2,127.5	-2,140.3	-2,226.5	-2,342.2	-2,404.3	-2,535.6
Services (net)	-23.0	-52.9	-174.1	-150.0	-126.7	-126.2	-131.8	-139.2
Income (net)	-71.5	-32.5	-29.5	-44.5	-36.4	-32.9	-72.9	-70.7
<i>Of which:</i> interest payments due	-113.5	-73.5	-90.2	-101.7	-81.5	-67.1	-65.4	-62.4
<i>Of which:</i> interest on public debt	-88.9	-62.2	-74.6	-86.7	-66.6	-56.1	-57.5	-56.2
<i>Of which:</i> interest on central govt. debt	-69.9	-43.5	-61.7	-73.6	-59.5	-50.5	-51.8	-50.5
Current transfers (net)	377.6	495.3	554.5	574.1	612.9	611.3	623.7	652.5
<i>Of which:</i> official transfers	407.9	488.3	550.1	572.0	613.5	651.3	663.7	692.5
<i>Of which:</i> program grants	184.6	290.3	335.5	353.5	390.4	408.9	428.8	449.4
<i>Of which:</i> HIPC Initiative relief grants	64.0	68.6	73.9	78.0	79.7	96.2	86.0	92.0
Capital account	322.5	294.5	307.8	306.2	289.3	298.3	304.9	306.8
<i>Of which:</i> project grants 4/	294.3	264.4	268.9	268.9	254.3	263.3	269.9	271.8
Financial account	98.8	356.2	449.7	477.2	421.4	414.2	431.2	450.8
Direct investment	283.8	244.1	254.0	254.0	266.7	280.0	294.1	301.2
Portfolio investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment	-185.0	112.1	195.7	223.2	154.7	134.1	137.1	149.6
<i>Of which:</i> government scheduled amortization	-208.2	-108.7	-121.3	-114.6	-110.7	-112.7	-109.6	-109.6
<i>Of which:</i> central government amortization (actual)	-59.8	-100.1	-107.0	-97.7	-105.9	-101.4	-98.6	-98.6
Errors and omissions	6.5	29.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-27.0	440.2	150.6	164.0	196.8	198.3	220.7	250.1
Financing	27.0	-440.2	-150.6	-164.0	-196.8	-198.3	-220.7	-250.1
BoT reserve assets (increase, -)	-231.5	-458.0	-147.5	-160.9	-156.0	-145.1	-161.5	-192.3
Use of Fund credit	48.6	4.6	-3.1	-3.1	-40.8	-53.2	-59.2	-57.7
Exceptional financing	209.9	13.2	0.0	0.0	0.0	0.0	0.0	0.0
Change in arrears (increase +) 1/	111.7	13.2	0.0	0.0	0.0	0.0	0.0	0.0
Debt rescheduled	98.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Gross official reserves (BoT)	1,212.7	1,670.4	1,818.7	1,831.3	1,987.3	2,132.5	2,294.0	2,486.3
In months of imports of goods and services (next year)	6.0	6.7	7.0	7.0	7.3	7.6	7.8	7.7
Current account deficit (as percent of GDP)								
Excluding official current transfers	-8.9	-7.7	-11.7	-12.2	-10.4	-9.4	-8.8	-8.3
Including official current transfers	-4.8	-2.5	-6.1	-6.3	-4.7	-4.3	-4.0	-3.6
World oil price (U.S.dollar/barrel) 2/	24.6	25.7	25.0	25.0	23.5	22.8	21.8	21.5
Aid dependency 3/ 4/	9.5	10.7	10.1	12.8	11.3	10.5	9.9	9.5
Direct foreign investment (as percentage of GDP) 5/	3.0	2.6	2.6	2.6	2.5	2.3	2.3	2.2
GDP	9,378	9,557	9,956	9,809	10,869	11,984	12,917	13,949

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

1/ Arrears are on non-Paris Club official and commercial debt, which is subject to rescheduling.

2/ Oil price is average of spot prices for U.K. Brent, Dubai, and West Texas Intermediate.

3/ Program and project assistance (BOP definition) as percentage of GDP.

4/ Project assistance series revised in 2001/02.

5/ Decline in foreign direct investment ratio in 2001/02 is partly due to data coverage issues.

Table 8. Tanzania: Disbursements of Program Assistance, 2002/03- 2003/04 1/
(In millions of U.S. dollars)

	2002/03				2003/04								FY 2003/04	
	Sep.	Dec.	March	June	Sep.		Dec.	March		June		Prog.	Rev.	
	Act.	Act.	Act.	Act.	Prog.	Act.	Prog.	Rev.	Prog.	Rev.				
Grants	35.2	122.3	42.4	90.3	141.7	159.5	77.3	106.9	67.8	52.1	48.6	35.0	335.5	353.5
Multilateral	0.0	0.0	0.0	42.8	32.0	32.0	0.0	29.1	29.1	0.0	0.0	0.0	61.1	61.1
EU PRBS grants 2/	0.0	0.0	0.0	42.8	0.0	0.0	0.0	29.1	29.1	0.0	0.0	0.0	29.1	29.1
EU grants for arrears' clearance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
World Bank	0.0	0.0	0.0	0.0	32.0	32.0	0.0	0.0	0.0	0.0	0.0	0.0	32.0	32.0
Bilateral	35.2	122.3	42.4	47.5	109.7	127.5	77.3	77.8	38.7	52.1	48.6	35.0	274.3	292.4
PRBS 2/	14.7	101.5	27.3	7.1	98.8	101.1	55.7	65.9	8.9	8.9	0.0	0.0	163.4	175.9
Sweden	12.8	0.0	0.0	0.0	12.1	13.1	0.0	0.0	0.0	0.0	0.0	0.0	12.1	13.1
Netherlands	0.2	15.2	0.0	0.0	0.0	0.1	15.5	23.8	0.0	0.0	0.0	0.0	15.5	23.9
Ireland	0.0	5.9	8.3	0.0	0.0	0.0	0.0	0.0	8.9	8.9	0.0	0.0	8.9	8.9
United Kingdom	0.0	54.7	16.1	0.0	64.7	66.9	30.7	30.7	0.0	0.0	0.0	0.0	95.4	97.6
Norway	0.0	13.7	0.0	0.0	8.2	10.6	5.5	2.7	0.0	0.0	0.0	0.0	13.7	13.3
Finland	1.7	0.0	0.0	0.0	1.6	1.8	0.0	0.0	0.0	0.0	0.0	0.0	1.6	1.8
Denmark	0.0	11.0	0.0	0.0	5.5	6.2	4.0	4.0	0.0	0.0	0.0	0.0	9.5	10.2
Switzerland	0.0	0.0	0.0	6.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Germany	0.0	0.0	0.0	0.0	4.7	0.0	0.0	4.7	0.0	0.0	0.0	0.0	4.7	4.7
Japan	0.0	1.0	2.9	0.0	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4
Canada	0.0	0.0	0.0	1.0	2.0	2.1	0.0	0.0	0.0	0.0	0.0	0.0	2.0	2.1
Sectoral baskets	20.5	20.8	15.1	40.4	10.9	26.3	21.7	11.9	29.8	43.2	48.6	35.0	110.9	116.5
Belgium	0.0	0.0	0.0	0.0	0.0	4.3	0.0	0.0	3.8	0.0	0.0	0.0	3.8	4.3
Canada	0.3	0.3	7.4	0.0	0.6	0.0	0.6	0.0	13.6	10.0	0.0	4.7	14.7	14.7
Denmark	3.8	0.0	2.9	0.0	5.3	4.3	0.0	0.9	4.1	4.2	0.0	0.0	9.4	9.4
EU	0.0	0.0	0.0	14.0	0.0	0.0	0.0	0.0	0.0	10.0	17.6	7.6	17.6	17.6
Finland	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.5	0.0	0.5	2.0	0.0	2.0	2.0
Ireland	1.9	3.6	0.0	1.2	1.6	2.4	3.0	2.5	0.0	1.5	1.4	1.6	7.9	7.9
Netherlands	4.1	10.0	0.0	17.2	3.2	9.4	7.7	2.1	0.0	9.9	15.5	10.0	26.4	31.3
Norway	0.0	3.4	3.4	0.0	0.0	3.5	4.8	2.1	4.8	3.4	0.0	0.7	9.6	9.6
Sweden	0.0	0.0	0.0	6.3	0.0	0.0	0.0	0.3	0.0	0.0	10.2	9.9	10.2	10.2
Switzerland	0.0	2.0	0.5	0.0	0.0	1.8	3.7	0.0	0.0	1.4	0.0	0.5	3.7	3.7
United Kingdom	10.2	0.0	0.0	1.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.4	2.4	0.0	0.0	2.4	2.4
Germany	0.2	1.5	0.9	0.0	0.3	0.7	1.9	2.6	1.1	0.0	0.0	0.0	3.3	3.3
Loans	2.4	0.0	45.1	98.3	125.0	104.0	0.0	53.6	54.6	51.9	0.0	0.0	179.6	209.6
Multilateral	2.4	0.0	45.1	98.3	125.0	104.0	0.0	53.6	54.6	51.9	0.0	0.0	179.6	209.6
World Bank 3/	2.4	0.0	45.1	98.3	100.0	104.0	0.0	0.0	54.6	51.9	0.0	0.0	154.6	155.9
African Development Bank	0.0	0.0	0.0	0.0	25.0	0.0	0.0	53.6	0.0	0.0	0.0	0.0	25.0	53.6
Bilateral	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total program assistance	37.6	122.3	87.5	188.7	266.7	263.5	77.3	160.6	122.4	104.1	48.6	35.0	515.1	563.1
Cumulative from beginning of fiscal year	37.6	160.0	247.4	436.1	266.7	263.5	344.0	424.0	466.5	528.1	515.1	563.1	...	...

Sources: Tanzanian authorities; and donors.

1/ Fiscal years run from July to June.

2/ Poverty reduction budget support.

3/ Including loan baskets.

Table 9. Tanzania: Status of HIPC Initiative Agreements by Creditor

	Debt Relief in Nominal Terms (Millions of U.S. dollars)	Agreement to Provide Relief Beyond HIPC?	Comments
Multilateral creditors			
IMF	120	n.a.	Provided grants through PRGF-HIPC Trust Fund. Average of 48 percent of debt-service payments.
AfDB/AfDF	190.7	n.a.	Debt service reduction of 80 percent annually until debt relief is delivered.
IDA/IBRD	1,157.1	n.a.	Debt-service relief of 69.1 percent and 63.6 percent on debts outstanding at end-June 1999 and 2001, respectively.
IFAD	24.5	n.a.	Reduction of 100 percent of debt -service due
BADEA	14.7	n.a.	Concessional rescheduling of the debt and reduced interest rate.
OPEC	9.8	n.a.	Concessional loan and restructuring of existing debt.
NDF	3.2	n.a.	Contribution to HIPC Initiative Trust Fund , to pay 100 percent debt service.
EADB	0.6	n.a.	Reduced interest rate and extension of repayment period.
EU	37.9	n.a.	Provided grants at the completion point to pay off outstanding loans.
Paris Club creditors			
Austria	31.3	Yes	Bilateral agreement for PC VII was signed on May 7, 2002.
Belgium	74.3	No	Bilateral agreement for PC VII was signed on November 29, 2002.
Brazil	0.0	Pending	Reminder letter to submit draft agreement for PC VII sent June 2, 2003. Awaiting reply.
Canada	31.1	No	Bilateral agreement for PC VII was signed on October 16, 2002.
France	89.9	Yes	Bilateral agreement for PC VII was signed on March 6, 2003.
Germany	56.2	Yes	Bilateral agreement for PC VII was signed on April 29, 2003.
Italy	132.0	Yes	Bilateral agreement for PC VII was signed on May 7, 2002.
Japan	0.0	Pending	Awaiting agreement on PC VI and VII.
Norway	11.1	Yes	Bilateral agreement for PC VII was signed on December 5, 2002.
Netherlands	99.1	Yes	Bilateral agreement for PC VII was signed on March 17, 2002.
Russia	69.6	No	Bilateral agreement for PC VII was signed on July 18, 2003.
United Kingdom	129.2	Yes	Letter dated July 4, 2002 indicating amount of relief under PC VII.
United States	21.3	Yes	Bilateral agreement for PC VII was signed on July 4, 2002.
Non-Paris Club bilateral creditors			
Algeria	0	No	Request letter for debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Angola	0	No	Request letter for debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Bulgaria	0	No	Tanzanian delegation is conducting active negotiations.
China	37.7	n.a.	15 interest-free loans maturing December 31, 1999 cancelled.
Czech Republic	0	No	The debt has been assigned to Lazard.
Egypt	0	No	Request letter for debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Hungary	0	No	Request letter for debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Iran	0	No	Tanzanian delegation is currently conducting active negotiations.
Iraq	0	No	Request letter for debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Kuwait	n.a.	n.a.	Signed bilateral agreement on March 8, 2003. Rescheduled 9 pre-cutoff-date loans on concessional terms.
Libya	0	No	Tanzanian delegation is conducting active negotiations.
Romania	0	No	Request letter for debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
United Arab Emirate	0	No	Request letter for debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Yugoslavia	0	No	Request letter for debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Zambia	0	No	Request letter for debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Zimbabwe	0	No	Diminimus clause

Source: Bank of Tanzania.

Table 10. Tanzania: External Debt Indicators, 2001/02–2011/12 1/
After bilateral relief beyond the enhanced HIPC Initiative

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
	(In percent)										
Debt Indicators at the HIPC Completion Point 2/											
NPV of debt-to-GDP ratio	14.2	14.7	14.8	14.8	14.9	15.1	15.1	15.1	15.0	14.9	14.9
NPV of debt-to-exports ratio 3/ 4/	105.2	112.1	115.6	117.0	117.3	117.5	116.8	116.2	115.2	114.3	114.4
NPV of debt-to-revenue ratio 5/	126.5	125.2	124.4	123.4	120.7	118.7	116.8	113.5	110.5	106.5	103.9
Debt-service-to-export ratio 6/	6.4	5.7	6.2	6.9	6.4	5.7	5.6	5.3	5.6	5.6	4.9
Debt service-to-revenue ratio 5/	8.0	6.6	7.1	7.9	7.1	6.3	6.0	5.6	5.8	5.6	4.8
Updated Debt Indicators 7/											
NPV of debt-to-GDP ratio	14.8	15.7	16.4	16.2	15.6	15.8	15.6	16.3	14.7	14.3	14.2
NPV of debt-to-exports ratio 3/ 4/	98.3	97.0	96.4	94.5	93.0	94.7	95.2	93.8	91.2	89.2	89.9
NPV of debt-to-revenue ratio 5/	122.3	124.5	124.1	118.4	109.3	106.3	104.6	107.1	97.0	94.3	93.3
Debt-service-to-export ratio 6/	6.0	4.8	5.2	5.9	5.5	5.0	5.0	4.5	4.9	4.9	4.4
Debt service-to-revenue ratio 5/	8.0	6.9	7.4	8.0	6.9	6.0	5.8	5.6	5.6	5.5	4.7
Memorandum items:											
	(In millions of U.S. dollars)										
NPV of debt after bilateral debt relief beyond enhanced HIPC Initiative assistance	1,386	1,500	1,628	1,763	1,871	2,041	2,183	2,318	2,437	2,555	2,724
Debt service after bilateral relief beyond enhanced HIPC Initiative assistance	90	83	97	119	119	115	122	122	140	149	139
GDP	9,378	9,557	9,956	10,869	11,984	12,917	13,949	14,206	16,533	17,829	19,217
Exports of goods and services	1,495	1,716	1,853	2,029	2,155	2,285	2,439	2,689	2,883	3,027	3,178
Exports of goods and services (3-year mvg. avg.)	1,411	1,547	1,688	1,866	2,012	2,156	2,293	2,471	2,670	2,866	3,029
Government revenue	1,134	1,205	1,312	1,489	1,712	1,920	2,087	2,165	2,513	2,710	2,921
Projected disbursements of new loans	...	314	352	385	275	418	365	348	350	354	443

Sources: Tanzanian authorities; and IMF staff estimates.

1/ All debt indicators refer to public and publicly guaranteed debt and are defined after rescheduling, unless otherwise indicated. All years on July-June basis.

2/ Estimated in November 2001 based on end-June 2001 debt data.

3/ Based on a three-year average of exports (e.g., export average over 1999/00-2001/02 for NPV of debt-to-exports ratio in 2001/02).

4/ Assuming full delivery of HIPC Initiative assistance at end-June 2001.

5/ Revenue is defined as central government revenue, excluding grants.

6/ Based on current year exports.

7/ Estimated in Jan. 2004 based on completion point debt data, new disbursements and other macroeconomic developments.

February 9, 2004

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Köhler,

1. Tanzania completed its first three year programme supported by the IMF under the Poverty Reduction and Growth Facility (PRGF) in June 2003. During the sixth and final review the Government requested for a new, but low access PRGF arrangement which was approved by the Executive Board in July 2003. Hence this letter acknowledges the approval and requests the conclusion of the first review under the new arrangement. The letter also outlines the progress in implementing the programme since July 2003 as well as the Government's policy intentions and targets for the remainder of the fiscal year 2003/04 (July-June) and the medium term. The third disbursement under the PRGF is subject to a review expected to be completed by August 2004.

I RECENT ECONOMIC PERFORMANCE AND POLICY IMPLEMENTATION

A. Macroeconomic Developments

2. Tanzania's macroeconomic performance in 2003 continues to be in line with projections, with real GDP growth expected at 5.5 percent. In spite of shortfalls in rain which adversely affected agricultural production in certain regions and led to localized food shortages, agriculture is projected to grow at 3.5 percent in real terms. On a year-on-year basis, inflation slightly increased slightly, from 4.4 percent in September 2002 to 4.5 percent in September 2003, on account of higher food prices, while non-food inflation continued to decline. Gross official reserves of the Bank of Tanzania (BoT) stayed well above seven months of imports of goods and services.

B. Performance Under the Programme

3. All quantitative performance criteria and benchmarks for September 2003 were observed (Table 1). The structural performance criteria and benchmarks

(Table 2) through December 2003 have been met, except for the submission to Parliament of a new income tax act, and the licensing of one company for an EPZ that is not exclusively oriented to the AGOA and EBA markets. The new income tax law has been widely discussed by all stakeholders which was the reason for the delay in its submission to Parliament, and has been submitted to Parliament in February 2004; we request a waiver for the non-observance of the performance criterion. The collection of income tax based on self assessment in the Large Taxpayers Department is dependent on the implementation of the new income tax act. Three companies have been licensed for Export Processing Zones, two of which are geared towards the AGOA markets, and one takes advantage of preferential trade agreements for SADC. Furthermore, to curtail tax exemptions no new companies have been added to the list of Strategic Investors maintained by the Tanzania Investment Center. A bill for amendments to the Land Act was submitted to Parliament for first reading in the November 2003 session. The list of companies, NGOs and public officials exempted from paying taxes and the exempted amounts given under the Treasury Voucher Scheme for the first quarter of 2003/04 was published in November 2003. Following a broad-based consultative process, a substantially simplified business licensing system has been adopted by the Government and will be tested in Dar es Salaam beginning March 2004. It is planned to be subsequently expanded to other parts of the country. A review of prudential regulations by the Bank of Tanzania was completed in December 2003, and resulted in increased flexibility in the implementation of some provisions to facilitate further lending, pending comprehensive revision of the Banking and Financial Institutions Act.

C. Fiscal Developments

4. Government revenue remained consistently above estimates during the fiscal year ended June 2003. Tax areas which showed strong revenue performance for fiscal year 2002/03 were VAT on domestic goods and income tax, but a negative growth was registered over the last year in taxes on petroleum imports. Total expenditure for the fiscal year 2002/03 was TSh 1,989.5 billion, 6 percent below the budget estimate of TSh. 2,106 billion. There was a significant catch up in the utilization of budget allocations by Ministries, Departments and Agencies (MDAs) towards the end of the fiscal year. Year-on-year, actual expenditure during June 2002–June 2003, increased by 31 percent.

5. The Government introduced new revenue measures in the fiscal year 2003/04 aimed at curbing tax evasion, reducing distortions, eliminating nuisance taxes, particularly at the local government level, and increasing voluntary compliance, and streamlining incentives in the tax system, notably through rationalization and

realignment of taxes. Specific revenue enhancing measures which have been taken in the 2003/04 budget include the following:

- A set of comprehensive administrative measures to reduce smuggling and tax evasion on petroleum products
- Inclusion of religious NGOs into the Treasury Voucher system beginning October 2003, following the successful implementation of the scheme for non-religious NGOs and Civil servants since January 2003.

In addition, the following tax changes were made aimed at increasing efficiency and production :

- Removal of impediments in fisheries sub-sector and problems of smuggling of fish by reducing the withholding tax on sale of fish from 2 percent to 1 percent.
- Abolition of nuisance taxes (levies and fees) at local government level, so as to encourage development activities. Only those levies and fees which can be collected efficiently without causing economic distortions and undermining the national policy of reducing poverty have been retained.

6. In addition, the Government adopted the second Corporate Plan for 2003/04-2007/08 for the TRA. This is the driving force behind the objective of ensuring that TRA becomes an efficient and effective modern tax administration, which promotes voluntary tax compliance by providing high quality customer service with fairness and integrity. The Corporate Plan has been operational since July 2003, and focuses on: (i) adopting self assessment of income tax liabilities for account cases; (ii) integrating existing tax-based departments in a functional organizational structure aiming at improving efficiency to medium and small tax payers and reducing their compliance costs, (iii) significantly strengthening the Large Taxpayers Department (LTD), and (iv) streamlining the collection of VAT by raising the VAT threshold.

7. Following a year of robust revenue growth, the first quarter revenue collections were slightly above the quarterly target. Tax areas, which showed strong revenue performance in the first quarter, were VAT, excise and import taxes on petroleum, reflecting in large part the recently implemented administrative measures to limit smuggling of fuel, and corporate income tax. Total expenditure for the fiscal quarter was TSh 506 billion, 12 percent below the budget estimate. This underperformance is due to lower than anticipated foreign interest payments, slow implementation of development projects, and recurrent expenditures in the non-priority sectors. As before, priority sectors have continued to receive their full quarterly allocations in line with their respective cash flow requirements. The net

domestic financing (NDF) position of the Government at the end of September 2003 registered a net accumulation of bank deposits of TSh 220 billion, reflecting the front-loading of the programme budget support by the development partners in the fiscal year 2003/04.

D. Progress in Public Financial Management Reform

8. The Government has continued its efforts of securing effective and sustainable financial management arrangements that support an equitable delivery of public services. Such support is intended to reduce and minimize resource leakages as well as strengthening accountability of public funds. The Government has prepared and finalized a new Accounting Procedures Manual for use concomitantly with the Public Finance Act 2001 and its Regulations. This manual has been circulated to and used by all MDAs as evidenced by its use in the preparation of Final Accounts for 2002/2003.

9. The IFMS continues to be the main source of report generation for the Government's budgetary operations and will remain so for the foreseeable future. Utility commitments in the IFMS have continued to be done by the Treasury on behalf of MDAs. So far, tracking studies have shown that in general MDAs are liquidating the bills they receive except for situations where there are disputes as to the amount to be paid. In fiscal year 2003/04, the Government has specified poverty reducing expenditure with GFS codes for effective monitoring of performance through IFMS, which applies to central Government expenditures as well as local Government subventions in PRS priority sectors. The actual expenditure outturn for priority sectors based on these codes is included in the first quarter Budget Execution Report for 2003/04, and will facilitate better analysis of expenditure at item level.

E. Monetary and Financial Sector Developments

10. Monetary policy during 2003 was appreciably tightened with broad money growth decelerating to 19 percent at end-September 2003 from a peak of 25 percent end-December 2002. The adoption of base money as a performance criterion under the new PRGF arrangement has reinforced coordination between domestic liquidity management and foreign exchange management. Thus, during July-September 2003 domestic liquidity management and foreign exchange management have complemented each other, and BoT has been a net seller in the foreign exchange market. Meanwhile, credit to the private sector, in domestic currency, continued to increase, fueled in part by large corporations, which switched from borrowing in foreign currency to domestic currency. The shift is related to hedging against exchange rate risk and increased credit availability stemming from increased competition among banks.

11. Reserve money at end-September 2003 remained below the programme target by TSh 76 billion, following mopping-up of liquidity by the BoT through open market operations and net sales of foreign exchange as well as continued enforcement at end-September of the requirement to transfer on a weekly basis tax revenues deposited in the TRA's accounts with commercial banks to the Government account at the BoT. This action resulted in a temporary liquidity squeeze among some banks. Banks' liquidity situation improved substantially in October 2003, as a result of a drawdown of government deposits and open-market operations by the BoT, and resulted in a drop of interbank lending rates from a peak of 11 percent in September to 8-9 percent. Furthermore, commercial banks have now significantly advanced in preparations for the signing of a master repo agreement, which will facilitate interbank operations and allow the redistribution of liquidity across the banking system. Following the tightening of liquidity at end September, both M3 and M2 growth remained below projections.

G. Public Debt Management

12. Public debt developments were broadly on track. Domestic debt market developments continued to be favourable with the yield curve, which spans from 35-day Treasury bills to 10-year Treasury bonds, continuing to serve as a reference rate for lending and deposit rates in the market. The Government continues with its endeavour to convert unsecuritised debt into marketable securities and to streamline the domestic debt maturity profile. With a view to strengthening the legal and institutional framework underpinning debt contraction, a new institutional structure was put in place to implement the Government Loans, Guarantees, and Grants Act 2003, including a national debt management committee. Furthermore, regulations under the act have been gazetted. The Government has also completed a study on the parastatals' contingent liabilities component of domestic debt.

13. As regards external debt, the Government has signed bilateral agreements with all Paris Club creditors except Brazil and Japan. The Government is actively following up (negotiating) with these countries and hopes to soon conclude agreements. The creditors, through the Paris Club Secretariat, have extended the deadline for bilateral agreements to June 30, 2004. The Government continues to appeal to Non-Paris Club official and commercial creditors to extend debt relief on terms comparable to those under the enhanced HIPC framework. Partial debt relief has been provided by China and India and negotiations are ongoing for further relief. The Government continues to strive for debt relief on Paris Club comparable terms and appreciates any assistance the IMF and the World Bank can provide in encouraging participation of the non-Paris Club creditors in the debt relief initiative.

H. External Sector

14. The first quarter outturn of the current account evolved broadly as envisaged with a slightly less favorable balance. The trade balance widened slightly compared to previous projections, as oil imports showed stronger growth than expected. Tourism receipts were up from previous estimates. Taking account of lower debt service payments and lower-than-programmed foreign exchange sales by the BoT, there was an increase in gross international reserves of US\$252 million to \$1,922.4 million by the end of September 2003, exceeding the programme projections by \$145 million.

15. The nominal exchange rate has remained broadly stable since June 2003 at about 1,050 T Shillings per dollar, representing a depreciation in real effective terms of about 1.5 percent, and hence extending the depreciating trend of the last three years. The Government of Tanzania has maintained a freely floating exchange rate, limiting interventions exclusively to smooth wide fluctuations and/or for the purpose of liquidity management.

I. Other Structural Reforms

16. The parastatal sector reform programme has continued to focus on restructuring and privatisation of parastatals in order to improve efficiency by reducing unnecessary running costs to the Government. A ten year lease agreement was signed in February 2003 to concession out DAWASA to a local company, City Water Services Ltd. DAWASA is now in the process of finalizing the subsidiary loan agreement with the Government.

17. Delays experienced in the privatization of the National Microfinance Bank (NMB) are on account of concerns expressed by Members of Parliament and the public. However, Parliament approved on November 14, 2003 a repeal of the NMB 1997 Act to pave the way for sale of 49 percent share to a consortium of strategic investors and 21 percent for Tanzanians, while the Government retains the remaining shares for future sale to the public. In addition, we are continuing to address the problems of the bank and to provide assistance whenever required so as to promote the interests of rural areas and smallholder enterprises.

18. Substantial progress has been made in the area of private sector development (PSD). As noted above, following a broad-based consultative process, a simplified process for business licensing has been adopted, and will be tested in a pilot project to be launched shortly. Moreover, a PSD strategy document has been finalized and is being reviewed by stakeholders. Its major elements include the creation of an enabling business environment; the development of financial and non-financial services strategies; and the establishment of a supportive institutional

infrastructure. The Small and Medium Enterprises (SME) policy was launched in August 2003 and is being implemented in collaboration with stakeholders. In addition, all labour laws have been reviewed by representatives from the Government and the business community. The labour policy is currently being prepared for approval, while the revised Labour Act has been presented for first reading to Parliament in the November 2003 session.

19. Consistent with the Poverty Reduction Strategy, the Government has continued to make progress in the promotion of good governance, including the implementation of the National Anti-Corruption Strategy and Action Plans (NACSAP) of ministries, independent departments and agencies. In this regard, quarterly reports on the implementation of NACSAP continue to be published.

20. The implementation of the EPZ Act began in May 2003 following the finalization of governing regulations. Through November 2003, two zones in Dar es Salaam have become operational and three companies, which are expected to export 100 percent of their output have been licensed, although the law allows a maximum share of 30 percent of the production to be sold in the domestic market. Two of the licensed companies are exclusively AGOA market oriented, while the third will export electronics to SADC countries, benefiting from the SADC tariff arrangement. With a view to protecting the tax base, the policy of licensing only new investors as EPZ operators has been strictly observed in line with approved eligibility criteria. Moreover, security provisions for the EPZ's through appropriate fencing and adequate inspections have been enforced by the customs administration.

II. POLICIES FOR FISCAL YEAR 2003/04 AND THE MEDIUM TERM

A. POVERTY REDUCTION STRATEGY

21. Tanzania continues to implement its Poverty Reduction Strategy (PRS). The third PRS progress report is currently being prepared following a participative process with stakeholders during a poverty policy week in October 2003. The report will include the poverty status of the country, progress reports of policy implementation by the priority sectors, as well as progress in mainstreaming cross cutting issues such as HIV/AIDS, environment and gender. Cognizant of the fact that the first PRS cycle has come to an end, the Government has decided to embark on a comprehensive review of the Strategy. The overall purpose of the review is to update the current PRS by making it more comprehensive and pro-poor, and attain progress in harmonizing the poverty-reduction strategy (PRS), public expenditure review (PER), and the budget cycle. The review will involve wide consultation with

all stakeholders, including grassroots levels, and is anticipated to be completed by the first half of fiscal year 2004/05.

22. For more efficient implementation of the PRS, the Government recognizes the need for improving data collection, collation and analysis. Hence, capacity for this has been strengthened in the President's Office - Regional Administration and Local Government. More specialized personnel have been recruited and a computer network has been established to ensure better communication with regions and local government. In addition, the Millennium Development Goals (MDGs) have been integrated into the poverty monitoring framework through the revision of the PRS poverty indicators

23. Progress in agricultural development include the following: subsequent to the approval by Parliament of amendments of various laws to promote microfinance in February 2003, a special task force has been commissioned to finalise regulations which are expected to be gazetted by June 2004; monitorable benchmarks for assessing the effectiveness of the coordination mechanism for the implementation of the Agricultural Sector Development Programme have been prepared and are being reviewed on a regular basis; work is being carried out on the marketing of agricultural outputs through institutional and impact evaluation of the four Crop Boards in Tanzania in order to limit their functions to regulatory activities; and efforts to promote access to markets and agricultural trade are being taken forward through the development of proposals to strengthen the institutional arrangements for district road maintenance and rehabilitation.

B. Macroeconomic framework

24. Macroeconomic stability has continued to be successfully maintained. However, due to the effect of the drought on agricultural output, a cautious estimate for GDP growth will be maintained at 5.5 percent for 2003. The projection for 2004 is 6.3 percent, thereafter growing to 7.0 percent by 2006. The drought and shortage of food are expected to cause inflation to rise to 5 percent by end-June 2004 (1 percentage point higher than expected in July 2003). However, after stabilization of food prices, inflation is expected to be maintained at 4 percent during 2004/05 to 2006/07, which is consistent with the average inflation rate of our major trading partners. The exchange rate will continue to be freely floating, with the Bank of Tanzania intervening only to smooth wide fluctuations and for the purpose of liquidity management.

C. Fiscal Policy and Budgetary Reform

25. Fiscal policy for 2003/04 focuses on enhanced domestic revenue mobilization efforts and efficient expenditure management through sound cash budgeting and

early allocation of resources to MDAs for recurrent as well as development expenditure.

26. On the revenue side, it is projected that notwithstanding the overperformance in the first quarter, revenues for the remainder of the year will be in line with the programme estimates. Thus, revenue is now expected to reach 13.2 percent of GDP for 2003/04. Expenditures are expected to evolve in line with the programme estimates except that a number of expenditure needs have emerged in a few areas not anticipated in the 2003/04 budget. These include provisions for procurement of a government airplane, supplementary payments to the pension fund and transfers to the TANESCO (as noted below), and possibly a modest replenishment of the food reserve, the latter two being on account of the drought, as well as outlays for voter register and transfers to local governments to compensate for the abolition of certain local government taxes.. A supplementary budget will be presented to Parliament in February 2004 to cover these outlays. Taking account of interest and amortization payments, and allowing for a likely shortfall in recorded foreign financed project support, the overall deficit before and after grants would be 10.5 and 4 percent of GDP respectively, compared with the programme estimates of 9.3 and 3.1 percent of GDP. Domestic financing would be TSh 82.7 billion, some TSh 40 billion higher than originally anticipated. Uncertainties with respect to some expenditures, particularly those related to the drought, will require close monitoring of this figure throughout the year.

27. Following a lengthy consideration, we have commenced procurement of a new government airplane to replace the 28 year old presidential plane. The cost of the replacement is about TSh 48 billion, which will be reduced by subsequent sale of the old plane. The airplane procurement process was followed in accordance with the public procurement regulations and the full cost of the payments for the plane will be subject to all regular Parliamentary procedures through its inclusion in the supplementary budget. Purchase of the plane will not adversely affect the level of expenditure budgeted for priority sectors.

28. It is the government's intention to improve the operational efficiency of TANESCO and discontinue the persistent budget transfers to this parastatal. Since a private company took over TANESCO's management, there has been great improvement in financial and operating performance. However, owing to severe drought, which limits the operation of hydro capacity, and high oil prices, which increase the cost of thermal capacity, additional budget support is necessary to avoid the adverse impact of the electricity shortage.

29. In early 2004, key senior government officials of relevant ministries and agencies and the World Bank will hold high-level consultations to discuss power sector issues to be addressed in the short term as well as a strategy for the longer

term that will serve Tanzania's needs while significantly reducing the fiscal burden. These will include the financial restructuring of the sector, improving TANESCO's operating efficiency, treatment of capacity charges to providers, the structure of tariffs, and rationalization of future investments. Following these consultations, Government, with assistance from the World Bank and key development partners, will define a short-term action plan and develop the overarching power sector strategy.

30. In response to stakeholders' demands to extend the consultation process, we were unable to submit the draft income tax bill to Parliament for the November session, as originally intended. However, the bill was submitted to Parliament in February 2004, with final approval expected in April 2004, and the law becoming effective July 1, 2004. This revised procedure will allow more time for consultation with stakeholders, and provide Parliament with adequate time for consideration. The draft income tax bill is based on the principle of self-assessment, and addresses a number of sources of revenue leakages. The government wishes to limit, instead of eliminating as initially intended, the discretionary powers of the Minister of Finance to grant tax exemptions so as to respond to emergencies and special circumstances that could not be addressed in a timely manner by the widely spaced sessions of Parliament. The discretionary powers of the Minister of Finance to grant tax exemptions, under all new tax Acts, will be subject to prior Cabinet approval.

31. In other areas of the tax reform, we are proceeding as intended. The following specific measures will be undertaken:

- i) In order to further rationalize the exemptions regime, the government intends to carry out a number of measures. First, during fiscal year 2003/04 the government will revoke all government notices granting tax exemptions issued prior to 1997, and incorporate the remaining exemptions in the relevant tax laws. Exemptions granted under any intergovernmental agreement will be retained, but such agreements will be registered with the Ministry of Finance. We intend to engage with those donors who favour abolition of special tax relief provided to contractors under their projects to discuss possibilities for improving the current exemption practices. Second, in the context of the ongoing comprehensive review of tax laws, we will submit to Parliament amendments to the Customs Tariff Act, Excise Ordinance, and Stamp Duty Tax Act limiting discretionary powers to grant exemptions from import, excise, and stamp duties. Third, we will continue to ensure that any new discretionary exemptions from indirect taxes are implemented through the Treasury Voucher Scheme and published within two months of the end of each quarter. Fourth, to prepare for further tightening of the tax exemption regime, the Government will request from our development partners assistance commissioning of a social impact analysis study of removing some

VAT exemptions to be considered in the 2004/05 budget and initiate preparations for modification to the mining law to ensure that fiscal terms of mining agreements (apart from the royalty regime) are established exclusively in the tax laws.

- ii) The Tanzania Revenue Authority (TRA) will continue implementation of its second corporate plan for the period of 2003/04 – 2007/08 with a view to modernizing its organization and operations, and improving its effectiveness. In particular TRA will continue preparations for implementation of an integrated structure for domestic revenue administration during 2004/05. TRA also plans to implement by June 2004 a function-based Large Taxpayers Department (LTD) that integrates VAT and income tax administration and that is adequately resourced (in terms of management and trained auditors that are suitably accommodated and equipped) and complete a transfer of an additional 100 large taxpayers to the LTD. An integrated computer system for administration of income tax and VAT will also be piloted in the LTD. TRA has also begun to integrate all district offices.
- iii) We will work on devising a customs reforms strategy to benefit from the arrival of DFID-funded technical advisors. We have requested assistance from the IMF on articulating an overview of the customs reforms strategy.
- iv) To simplify our tax system and to improve administrative efficiency, we will revise the VAT threshold by June 2004 with a view to reducing significantly the number of taxpayers covered and abolish the remaining stamp duty on receipts. Concurrently with these reforms, we will revise the presumptive tax rates to compensate for the revenue loss from reducing the register of VAT payers.
- v) In the context of EAC cooperation we will also pursue harmonization of investment incentive regimes.

Public Expenditure Management

32. Budget execution is expected to improve due to frontloading of programme support funds, which has facilitated allocations for recurrent and development expenditures early on in the fiscal year. In addition, spending is expected not to accumulate in the fourth quarter due to gradual improvement in the understanding of procurement procedures which has been an obstacle to efficient execution of the budget in the years 2001/02 and 2002/03. Furthermore, problems in the Procurement Act of 2001 are in the process of being identified and amendments are to be proposed. Intensive training has been initiated at MDAs and at the Central

Tender Board. Other improvements to the central procurement process include proposals to change the Central Tender Board to a Public Procurement Regulatory Authority, which are expected to be tabled in Parliament before June 2004. The Authority is expected to be established in July 2004.

33. In order to better inform expenditure policy management, another expenditure tracking, particularly for priority sectors is to be undertaken this fiscal year. A tracking study is to be conducted for the education sector in order to investigate the accountability of the systems used to channel funds to Councils for the intended poverty reducing purposes. This is expected to highlight whether other priority sectors' systems for channeling funds are also efficient. In a concerted initiative to increase accountability, the Government has also prepared and issued a final draft of an Auditing Procedures Manual. The draft has been circulated to stakeholders for their comments and views. It is intended that training and workshop sessions will be undertaken in the near future in order to sensitize awareness and instill knowledge of the accounting procedures manual and the recently issued auditing procedures manual to stakeholders in MDAs.

34. The Government has moved to ensure that major reforms currently underway are streamlined and work in tandem. To this end key implementation strategies under the PFMRP now in progress have been linked explicitly to PRSP strategies.

35. The Government will continue to centrally monitor the settlement of utility bills by MDAs with a view to ensuring that there is a minimum number of disputes and that there is no accumulation of utility arrears. To further improve tracking and monitoring of the payments of utility bills received by MDAs, the quarterly reports on the utility payments would include information on the proportion of the non-disputed bills outstanding for more than three months. To improve recording of foreign financed development projects in the IFMS, the MDA's accounting officers are required by the Accountant General to submit information on the foreign financed development projects' implementation on a quarterly basis. The government's finances would benefit from moving towards a more comprehensive in-year cash management system. In 2003/04, we will review the current cash management practices with a view to building on the improvements already made in extending the list of sectors receiving disbursements on a quarterly basis.

36. The Government also remains committed to public sector pay reform and is currently reviewing the viability of the Selected Accelerated Salary Enhancement scheme for possible reinstatement across government in July 2004 in order to promote work incentives in the civil service.

D. Monetary Policy and Financial Sector Reform

37. Monetary policy objectives will continue to be directed towards maintaining low and stable inflation, while ensuring consistency with the broad macroeconomic policy framework of the Government. The BoT will continue to manage liquidity in the economy through appropriate use of open market operations and foreign exchange interventions. To improve liquidity management, the BoT intends to strengthen its capacity to forecast bank liquidity on a daily basis by, amongst other things, developing a framework to improve projections of government operations. Moreover, recent developments in the financial markets include the advancement of plans for the signing of a master repurchase agreement. Furthermore, a Lombard facility is expected to be introduced at the BoT by end-March 2004, which will improve liquidity management in the banking system.

38. The monetary programme for 2003/04 has set reserve money targets of Tsh 826 billion at end – December 2003, Tsh 808 billion at end-March 2004 and Tsh 813 billion at end June 2004. The targets for net domestic assets and net international reserves of the Bank of Tanzania for end-December 2003 and end-March 2004 are TSh -731 billion and \$1,480 million, and TSh -703 billion and \$1,438 million, respectively. Also the programme targets for net domestic assets and net international reserves of the BoT for the quarter ending June 2004 are TSh -599 billion and \$1,346 million, respectively. Reserve money at end – March 2004 will be monitored as performance criterion under the programme, while NDA will be a benchmark. Broad money (M3) is projected to increase to TSh 2,475.3 billion at end-December 2003 and to TSh 2,627 billion at end June 2004, or by 20.9 percent at end-December 2003 and 19.1 percent at end-June 2004, respectively. Given the recent increase in the demand for money, daily liquidity tracking will be strengthened within the reserve money framework while avoiding market distortions. To this end, the Bank of Tanzania will continue to conduct timely and targeted sterilization operations with treasury bills and liquidity paper, supplemented by foreign exchange market operations.

39. As noted below the Government is following through with the implementation of the FSAP recommendations after consultations with the staff of the IMF and the World Bank. The FSAP indicated that Tanzania has achieved significant improvements in a number of aspects of the financial system, including high penetration of new banks; reduction in interest rate spreads, which induced new lending; and a pick-up in private sector credit. Furthermore, these developments are underpinned by strong banking soundness indicators, including a declining trend in nonperforming loans. However, the FSAP also identified some areas that need to be substantially strengthened, in particular, the management of systemic liquidity and improvement in access to bank credit. To these ends, the government has developed a comprehensive reform agenda to address weaknesses in the financial

sector. As the envisaged reforms cut across a number of institutions, by end-March 2004, the government will establish the Financial Sector Reform Committee, chaired by the Governor of the Bank of Tanzania (BoT), and including representatives of relevant MDAs to ensure effective coordination and implementation of the measures.

40. The BoT has initiated a review of a broad range of prudential regulations, including those identified in the FSAP, such as the excessive collateral requirements for large loans and aggregate large borrower limits, with a view to improving access to bank credit. Moreover, reflecting substantial developments in the financial system over the last five years and to further strengthen the independence of the central bank, the Bank of Tanzania has requested technical assistance from the Fund to assist in the preparation of possible revisions and amendments to the Bank of Tanzania Act (1995) and the Banking and Financial Institutions Act (1991). Other key measures in the financial sector include the following: (a) stimulating the development of secondary market, including further analysis and design of operational guidelines for debt management, securities operations, mainly long-term government securities; (b) improving the retail payments system infrastructure; (c) initiating a review of pensions, unit trusts, and leasing, including regulatory framework; (d) strengthening capital and securities markets, (e) strengthening insurance supervision, (f) strengthening microfinance, including supervision and regulation of MFIs; (g) restructuring and/or privatizing the People's Bank of Zanzibar, the Tanzania Investment Bank and the Tanzania Postal Bank; and (h) strengthening commercial courts.

41. To remove the remaining structural and institutional impediments in the development of the financial sector, measures will be taken to improve the land registry, and enhance the capacity of the judiciary, including the commercial courts, through the employment and training of more judges, with a view to keeping the average case resolution for the commercial courts to below six months. Consistent with the programme, structural performance criterion, amendments to the Land Act were submitted to Parliament, and passed the First Reading. We expect Parliamentary approval procedures to be completed in February 2004. Following Parliamentary approval of the Land Act Amendment, the Government will accelerate the necessary land surveys and issue land titles to lease holders with a view to enabling commercialization of land leases and their collateralization for bank loans. Government will also initiate, with the support of the De Soto Foundation and the Norwegian government, a program to assist small landholders and traders to participate in the formal economy. This program will be piloted in several urban areas during the financial year 2004/05.

E. Other Structural Reforms

42. The Government will continue to ensure adequate provision of resources for implementation of the NACSAP. The Government is working on revision, with stakeholders, the code of conduct for all public servants. A mechanism for complaints and grievances will be subsequently put in place to deal with unethical conduct. The anti-corruption action plans for all Local Government Authorities (LGA's) are being developed following which the Government will ensure effective implementation of the plans.

43. Following Parliamentary approval of the privatization law for the NMB, the government will prepare an investment information memorandum by March 2004, and subsequently invite expressions of interest.

F. External Sector Issues

44. The Government's efforts to strengthen the external position in the medium term will focus on reversing the sharp decline in traditional exports of the late 1990's, increasing agro-industry and manufactured exports, and in attracting foreign direct investment and other nondebt-creating financial flows. For 2003/04, external developments are expected to evolve broadly as envisaged. The current account deficit is expected to be 6.3 percent of GDP compared to 6.1 percent projected in the programme. The trade deficit is expected to widen relative to previous projections, however, the updated estimates for service receipts envisage an upturn in tourism receipts as first quarter numbers indicate no adverse impact, as earlier feared, from events in the Middle East. Updated projections of total programme and project aid flows show an increase of about \$59 million from the program estimate. These higher inflows, partly offset by a widened current account deficit are expected to result in an accumulation of net international reserves of \$167.3 million, about \$17 million higher than previously anticipated.

45. The recently established Export Credit Guarantee Scheme (ECGS) will continue to be strengthened in order to sustain rural incomes and increase exports. In addition to the ECGS which is aimed at development of high value agricultural exports and manufactured products, the Government has established a small pilot scheme to guarantee commercial bank credit for small and medium-sized enterprises (SMEs). Policy and guidelines for the scheme are currently being prepared. Supply side constraints for SMEs which limit the opportunity to play a significant role in the African Growth Opportunities Act (AGOA) of the USA and Everything But Arms (EBA) of the EU are being addressed through supportive institutional infrastructure. Capacity building to strengthen the competitiveness of Tanzanian products, especially non-traditional ones is being addressed. It is also

expected that the implementation of EPZs, targeted exclusively to exporting firms with proven markets, will support the development of manufactured exports.

46. In order to enhance efficiency and export performance, we are continuing to pursue trade liberalization, mainly within the framework of the East African Community (EAC) and continued implementation of the SADC tariff reduction programme. In February 2004, the Presidents of Kenya, Tanzania, and Uganda are expected to sign a protocol for the establishment of the EAC customs union. This includes the adoption of a common external tariff with three bands of 0, 10, and 25 percent, compared with our previous four-band regime (0, 10, 15, and 25). In addition, the protocol substantially reduces non-tariff barriers between the three countries, albeit retaining some restrictions including additional customs duties on some sensitive goods. Preliminary analysis indicates that the average tariff rate will decline from the current level since the tariff on most goods previously rated at 15 percent will be reduced to 10 percent. Looking forward, the government is fully committed to a deeper reduction in the maximum CET. The protocol provides for a reduction to 20 percent in 5 years. Recognizing the efficiency gains from a low CET, Tanzania is ready to agree to further reductions in the maximum rate that are also acceptable to our EAC partners. As the Government continues to implement the tariff reduction, there are also ongoing efforts to eliminate non-tariff barriers.

47. Government recognizes that by establishing more supportive legislative and institutional infrastructure, and a low tax regime, special incentives to attract investment may no longer be necessary. In this context, efforts are under way with Fund technical assistance to harmonize taxes and avoid harmful practices within the East African Community, including through the development of a code of conduct on investment incentives and company income taxation. Also, efforts are being made to address specific administrative and infrastructure constraints that impact on the competitiveness of Tanzanian processed products. In the interim, the incentives provided under the EPZ Act will be offered only for gemstone processing and manufacturing firms that are substantially export oriented (a minimum of 70 percent of output to be exported) and whose products are geared to markets with preferential trade access such as AGOA, EBA, and SADC. With the exception of a zone in North Tanzania currently planned for processing and exporting of Tanzanite and other gemstones, additional zones will be developed only after we gain sufficient experience with the performance of EPZs and assess their impact.

H. Concluding Remarks

48. The new three – year low access PRGF arrangement continues to be a valuable monitoring framework for economic and financial policy progress in Tanzania. The conclusion of this PRGF review enables the Government to confirm progress in sound economic management to all stakeholders.

49. The Government of Tanzania will continue to provide the Fund with such information as the Fund requests in connection with Tanzania's progress in implementing economic and financial policies and achieving the objectives of the programme. Tanzania will also consult with the Managing Director of the Fund on the adoption of any measures that may be appropriate, at the initiative of Tanzania or whenever the Managing Director requests such consultation. Moreover, after the period of the arrangement and while Tanzania has outstanding financial obligations arising from loans under the arrangement, Tanzania will continue to consult with the Fund from time to time at the initiative of the Government or whenever the Managing Director requests consultation on Tanzania's economic and financial policies.

Sincerely,

/s/

Basil P. Mramba (MP)

MINISTER FOR FINANCE

Attachments: Tables 1-3

Table 1. Tanzania: Quantitative Performance Criteria and Benchmarks Under the Poverty Reduction and Growth Facility Arrangement, June 2003 - June 2004

	2003											2004			
	June		September			December		March		June					
	Estimate	Actual	Performance Criteria	Adjusted	Actual	Benchmarks	Rev. Benchmark	Indicative Benchmark	Performance Criteria	Benchmarks	Rev. Benchmark				
(In billions of shillings; end of period)															
Net domestic financing of the government of Tanzania (ceiling) 1/ 2/	-14	-36	-150	-146	-183	-145	-267	-32	-118	43	83				
Accumulation of budgetary arrears (ceiling; benchmark only)	0	0	0		0	0	0	0	0	0	0				
Net domestic assets of the Bank of Tanzania (ceiling; benchmark only) 2/	-557	-592	-584	-580	-799	-534	-731	-579	-703	-584	-599				
Reserve money (ceiling)	693	640	764		688	826	826	808	808	828	813				
(In millions of U.S. dollars, unless otherwise indicated; end of period)															
Net international reserves of the Bank of Tanzania (floor) 3/	1,196	1,179	1,287	1,284	1,415	1,298	1,480	1,324	1,438	1,346	1,346				
Accumulation of external payments arrears (ceiling) 4/	0	0	0		0	0	0	0	0	0	0				
Contracting or guaranteeing of external debt on nonconcessional terms (ceiling)	0	0	0		0	0	0	0	0	0	0				
Memorandum item:															
Foreign program assistance (grants and loans) 1/	464	436	267		264	344	424	467	528	515	563				

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 -- 2003]

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

2/ To be adjusted upward for the Tanzania shilling equivalent of any shortfall in foreign program assistance from the amounts shown in the memorandum item. Figures are not consistent with NDA (BOT) in Table 5 of the staff report, as they are adjusted with the program exchange rate.

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

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

Table 2. Tanzania: Structural Performance Criteria and Benchmarks Under the Poverty Reduction and Growth Facility Arrangement, July 2003-June 2004

Measure	Date of Implementation	Status
Tax policy and administration		
Submission to Parliament of the new income tax law, to become effective January 1, 2004 consistent with paragraph 24 of the letter of intent of July 10, 2003. ^{1/}	October 2003	Not observed.
Large Taxpayer Department to introduce collection of income tax based on self-assessment. ^{2/}	January 1, 2004	Pending.
Revision of the value-added tax (VAT) threshold to substantially reduce the number of VAT taxpayers, and revision of the threshold for the presumptive tax accordingly. ^{2/}	June 2004	Ongoing.
To curtail tax exemptions, no new companies will be added to the list of strategic investors maintained by the Tanzania Investment Center, and no companies will be licensed for the export processing zone, other than as specified in paragraph 24 of the letter of intent of July 10, 2003. ^{2/}	Continuous	Partly observed. One company was licensed that does not export to AGOA or EBA markets.
Financial sector reform		
Submission to parliament of amendments to the Land Act, as outlined in paragraph 31 of the Letter of Intent of July 10, 2003. ^{1/}	October 2003	Observed.
Review of prudential regulations, as indicated in paragraph 32 of the letter of intent of July 10, 2003. ^{2/}	Dec. 2003	Observed.
Improve environment for investment		
Adoption of an action plan to reform and simplify the business licensing system. ^{2/}	Dec. 2003	Observed.
Governance		
Publicizing of the list of companies, individuals, and NGO's that have received tax exemptions each quarter, as specified in paragraph 42 of the letter of intent of July 10, 2003. ^{1/}	Quarterly	Observed. All exemptions given under the Treasury voucher scheme published on the government website.

^{1/} Performance criterion.

^{2/} Structural benchmark.

Table 3. Tanzania: Prior Action, Structural Performance Criteria and Benchmarks Under the Poverty Reduction and Growth Facility Arrangement, December 2003-June 2004

Measure	Date of Implementation
Tax policy and administration	
Submission to Parliament of a new income tax act, consistent with paragraph 30 of the Letter of Intent.	Prior action
Final consideration by Parliament of the new Income Tax Act, consistent with paragraph 30 of the Letter of Intent. ^{1/}	April 2004
Implementation of a function-based Large Taxpayers Department that integrates VAT and income tax administration, and completion of transfer of an additional 100 large taxpayers to the LTD. ^{2/}	June 2004
Announcement of revision of the value-added tax (VAT) threshold to reduce the number of VAT taxpayers, together with the abolition of remaining stamp duties on receipts, and revision of the threshold for the presumptive tax accordingly. ^{1/}	June 2004
To curtail tax exemptions, no new companies will be added to the list of strategic investors maintained by the Tanzania Investment Center, and no companies will be licensed for the export processing zone, other than as specified in paragraph 47 of this letter of intent. ^{2/}	Continuous
Financial sector reform	
Establishment of an interagency, interministerial financial sector reform committee to oversee FSAP reform agenda. ^{1/}	March 2004
Introduction of short-term collateralized lombard facility ^{2/}	March 2004
Governance	
Publicizing of the list of companies, individuals, and NGO's that have received tax exemptions each quarter, as specified in paragraph 31 of this letter of intent ^{2/}	Quarterly

1/ Performance criterion.

2/ Structural benchmark.

Tanzania: Relations with the Fund
(As of December 31, 2003)

I. Membership Status: Joined 09/10/62; Article VIII					
II. General Resources Account:					
			<u>SDR million</u>	<u>% Quota</u>	
Quota			198.90	100.00	
Fund holdings of currency			188.90	94.97	
Reserve position in Fund			10.00	5.03	
III. SDR Department:					
			<u>SDR million</u>	<u>% Allocation</u>	
Net cumulative allocation			31.37	100.00	
Holdings			0.34	1.08	
IV. Outstanding Purchases and Loans:					
			<u>SDR million</u>	<u>% Quota</u>	
Poverty Reduction and Growth Facility			294.25	147.94	
V. Financial Arrangements:					
	<u>Approval</u>	<u>Expiration</u>	<u>Amount</u>	<u>Amount</u>	
<u>Type</u>	<u>date</u>	<u>date</u>	<u>approved</u>	<u>drawn (SDR</u>	
			<u>(SDR million)</u>	<u>million)</u>	
PRGF	08/16/2003	08/15/2006	19.60	2.80	
PRGF	04/04/2000	08/15/2003	135.00	135.00	
PRGF	11/08/1996	02/07/2000	181.59	181.59	
VI. Projected Obligations to Fund (without HIPC assistance)					
(SDR million; based on existing use of resources and present holdings of SDRs):					
		Forthcoming			
		<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
		<u>2008</u>			
Principal		27.50	38.32	46.32	46.61
Charges/interest		1.90	1.73	1.52	1.28
Total		29.41	40.05	47.84	47.88
		43.95			
Projected Obligations to Fund (with Board-approved HIPC assistance)					
(SDR million; based on existing use of resources and present holdings of SDRs):					
		Forthcoming			
		<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
		<u>2008</u>			
Principal		17.36	31.40	40.43	39.32
Charges/interest		1.91	1.73	1.52	1.28
Total		19.26	33.13	41.96	40.60
		39.54			

VII. Implementation of HIPC Initiative:

	<u>Enhanced framework</u>
Commitment of HIPC assistance	
Decision point date	Apr 2000
Assistance committed (NPV terms) ²²	end-June 1999
Total assistance (US\$ million)	2,026.00
<i>Of which:</i> Fund assistance (SDR million)	88.95
Completion point date	11/21/01
Delivery of Fund assistance (SDR million)	
Amount disbursed	
Interim assistance	88.95
Completion point balance	26.68
Additional disbursement of interest income ²³	62.27
Amount applied against member's obligations (cumulative)	55.30

VIII. Safeguards Assessments:

The safeguards assessment of the Bank of Tanzania (BoT), which was completed on December 5, 2003, found that, while the bank had a relatively strong internal control environment, some vulnerabilities existed, notably in the external audit and financial reporting areas. In order to mitigate these vulnerabilities, staff recommended that the BoT should (i) contract annual external audits that are conducted in accordance with International Standards on Auditing; (ii) adopt International Accounting Standards as the financial reporting framework; (iii) establish a formal process of reconciling accounting data to the program data reported to the Fund; (iv) publish the full audited financial statements on a timely basis, within five months of the financial year's end; and (v) adopt an audit charter for the internal audit function to strengthen audit methodologies and procedures.

IX. Exchange Arrangements:

The currency of Tanzania is the Tanzania shilling. The official exchange rate is market determined on the basis of the interbank foreign exchange market. The middle rate in terms

²² Net present value (NPV) terms at the decision point under the enhanced framework.

²³ Under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC) Initiative, an additional disbursement is made at the completion point corresponding to interest income earned on amounts committed but not disbursed during the interim period, calculated using the average return (during the interim period) on the investment of resources held by, or for, the benefit of the PRGF-HIPC Trust.

of the U.S. dollar, the intervention currency, was T Sh 1,073.6 per U.S. dollar as of January 14, 2004. The exchange system is free of restrictions on the making of payments and transfers for current international transactions.

X. Article IV Consultation:

The last Article IV consultation was concluded on November 18, 2002 (EBS/02/187).

XI. Technical Assistance, 2000–2003:

Departments	Timing	Form	Purpose
Fiscal Affairs	October 2000	Mission	Public expenditure management
	March 2001	Mission	Fiscal decentralization
	May 2001	Short-term consultant	Translation of government accounts and operationalization to the standard classifications
	October 2001	Mission	Report on Observance of Standards and Codes (ROSC) fiscal transparency module and preparation of an assessment and action plan for tracking poverty-reducing expenditure
	2001–02	Long-term consultant	Strengthening of fiscal analysis at the Ministry of Finance
	October 2002	Mission	Tax administration
	2002 – 03	Long-term consultant	Public expenditure management
	Mar. – May 2003	Peripatetic advisor	Tax administration
	April 2003	Mission	Inspection and tripartite review
	June – Sep. 2003	Long-term consultant	Public expenditure management
	Sep. – Oct. 2003	Peripatetic advisor	Tax administration
	Oct. 2003	Mission	Tax administration
Legal	Oct. 2002 – Jan 2003	Mission	Income tax law
Monetary and Financial Systems	March 2001	Mission	Monetary policy operations
	2003-04	Long-term consultant	Banking supervision and regulation
	Feb. 2003	Mission	FSAP premission
	June 2003	Mission	Payments systems workshop
Statistics	October 2000	Multitopic mission	Macroeconomic statistics
	May 2002	Mission	Balance of payments statistics
	2002 – 03	Long-term consultant	Multisector statistics
	June 2003	Mission	Government finance statistics course

XII. Resident Representative:

Mr. Ali Abdi has been the Senior Resident Representative since October 2001.

Tanzania: Relations with the World Bank Group

Partnership in Tanzania's development strategy

The government of Tanzania's development strategy is set forth in its poverty reduction strategy paper (PRSP) and further refined in the first and second progress reports, which were endorsed by the Bank's Board on November 27, 2001 and May 29, 2003, respectively. The PRSP focuses on three main areas of outcomes. The first is a reduction in the breadth and depth of income poverty. The outcome targets include a reduction in basic needs poverty and food poverty, with a particular focus on rural areas, where poverty is most prevalent. The second area is that of improving the quality of life and social well-being. More specifically, this entails improving human capabilities, enhancing longevity and survival, and social well-being (social inclusion and personal security), improving nutrition, and containing extreme vulnerability (mainly through safety nets). The third broad area is an environment conducive to development that can be sustained. The environment encompasses macroeconomic stability and good governance.

The IMF is supporting Tanzania's poverty reduction efforts in the context of the three-year arrangement under the Poverty Reduction and Growth Facility (PRGF). Among external partners, the Fund takes the lead in the policy dialogue with the government on macroeconomic policies, including overall fiscal and monetary policy. Under the PRGF arrangement, in addition to macroeconomic targets, the Fund has agreed with the authorities structural performance criteria relating to reforms in the areas of tax policy and administration, public debt management, financial transparency and good governance, trade policy, and financial sector development. As outlined more fully below, the Bank's support is complementing the Fund's through a focus on sectoral reforms in the context of projects and analytic work and the Poverty Reduction Support Credit (PRSC1) covering the areas of economic governance, business environment, and rural development.

Bank Group strategy

The current Country Assistance Strategy (CAS) for Tanzania was approved by the Bank's Board on June 15, 2000. To ensure alignment with the new PRSP, which the government intends to complete by the end of 2004, the next CAS will be presented to the Board in early 2005. The focus of the current CAS is on higher economic growth, poverty reduction, and institutional reforms to improve governance. It conforms with the government's main strategy of adherence to macroeconomic stability, increased private sector participation in the economy, a renewed emphasis on rural development, and an improved delivery of social services. It also supports the government's desire to enter into new relationships with its development partners, based on the phased switching from projects to programs for more effective and efficient use of aid resources.

The Bank is providing support for the implementation of the PRS through a Poverty Reduction Support Credit and Grant (PRSC), which was approved by the Bank's Board on May 29, 2003. The operation has been prepared in close collaboration with eleven other donors, who provide financial assistance through the Poverty Reduction Budget Support (PRBS) facility, using a joint performance assessment framework and a common review process. The focus of the PRSC/PRBS is on scaling up pro-poor growth, especially through a focus on rural development and improvements in the business environment. In addition, the PRSC/PRBS also supports the strengthening of public expenditure management and public service delivery, especially in the priority sectors for poverty reduction, and the operationalization of an appropriate monitoring and evaluation system to enhance the accountability for results and outcomes of sectoral programs.

IDA also provides adjustment lending through PSAC1 and implementation has been satisfactory. Four out of the five tranches of the credit have already been released. The closing date of PSAC1 has been extended to May 31, 2004 to allow the government to finalize and approve a strategy for the divestiture of the National Insurance Company, the main outstanding condition for the release of the last tranche (US\$40 million). The implementation of policy reforms agreed upon under PSAC1 and the PRSC is supported by a series of technical assistance and investment projects. These include project support to improve tax administration, to reform the public sector, and to develop the financial sector, including rural finance and microfinance.

In the social sectors, the Bank has approved an adjustment lending operation in support of primary education (US\$150 million). The objectives of the program include improving education quality, expanding school access, and increasing school retention at the primary level. Bank support in this area has already facilitated a significant increase in primary school enrollment. The Bank contributes to the health sector multidonor "basket fund," which supports reforms of the sector and provides funding for nonwage expenditures. A multisectoral HIV/AIDS project supports Tanzania's efforts to reduce HIV transmission and mitigate the adverse consequences of AIDS. In the water sector, a project that will support technical, commercial, and financial rehabilitation of the water supply and sanitation services in Dar es Salaam was approved by the Bank's Board on May 27, 2003.

In the agriculture sector, the Bank supports policy reforms through analytical work and the policy dialogue under the PRSC. The Bank also provides support to strengthen research and extension services. A Participatory Agricultural Development and Empowerment project credit was approved by the Bank's Board on May 27, 2003 to support investments in appropriate technologies to reduce soil fertility decline.

Efforts to improve Tanzania's infrastructure are supported through projects in the road and railway sectors, as well as an urban rehabilitation project. In the power sector, the Bank has helped the government implement the Power Sector Restructuring Program. The Bank has encouraged the government to develop the domestic gas market and to generate lower-cost power through the Songo Songo Gas Development and Power Generation project.

The IFC's portfolio includes investments in agriculture, agro-processing, banking and financial services, and tourism in the amount of US\$37 million. Over the next three years, potential investments in the magnitude of US\$20–30 million in private infrastructure and financial institutions, and to provide financing and capacity-building support to small and medium-sized Tanzanian enterprises are expected. MIGA's current exposure in Tanzania includes four guarantees in the infrastructure, telecommunications, and mining sectors totaling US\$175 million gross and US\$70 million net exposure.

Tanzania joined the World Bank Group in 1962. Beginning with an IDA credit for education in 1963, a total of 128 credits and 27 loans, totaling US\$4.67 billion (US\$4 billion from IDA) have been provided to Tanzania. Total disbursements amounted to US\$3.8 billion as of November 30, 2003 (some US\$3,449 million from IDA and US\$355 million from the IBRD). Currently, the portfolio comprises 25 active projects, with commitments of US\$1.5 billion in all major sectors. As of November 30, 2003, the undisbursed balance for the portfolio stood at US\$682 million.

Bank-Fund collaboration in specific areas

The IMF and World Bank staffs maintain a close collaborative relationship in supporting the government's structural reforms. As part of its overall assistance to Tanzania—through lending, country analytic work, and technical assistance—the Bank supports policy reforms in the following areas in collaboration with the Fund:

- **Public expenditure management.** Improvements in public expenditure management have been one of the top priorities of the Tanzanian government since 1995. The Bank, the Fund, and other donors have worked closely to provide the government the needed support for institutional and policy reforms. While the Fund is leading the dialogue on fiscal policy, the Bank is focusing on strategic resource allocation and operational efficiency of public expenditures. In the area of overall fiscal policy, the reduction of domestically financed deficits has resulted in sustained macroeconomic stability over the past five years. To enhance strategic resource allocation and operational efficiency, the Bank is supporting a government-led, participatory public expenditure review/medium-term expenditure framework (MTEF) process that has supported the strengthening and opening up of the budget process as well as the allocation of resources to pro-poor priority areas. In addition to process, support and analytical work in this area, the Bank is also supporting policy reforms through the PSAC and PRSC. Another area of Bank involvement is the fiscal decentralization process, where, in addition to ongoing analytical work, project support is planned to start in 2004. The Bank and Fund collaborate closely to support institutional budget and expenditure management reforms. A recent Country Financial Assessment Analysis (CFAA), carried out in a collaboration of the Bank, other donors, and the government, an IMF Report on the Observance of Standards and Codes (ROSC), and a joint Bank/IMF assessment of capacity to track poverty-reducing expenditure have all noted the improvements in public financial management and fiduciary systems in recent years. The Bank also prepared a Country

Procurement Assessment Report, which provides an agenda for strengthening procurement systems in Tanzania.

- **Tax policy and administration reform.** A relatively small and stagnant domestic revenue effort is a severe constraint on Tanzania's efforts to improve public service provision and to fully finance the implementation of the poverty reduction strategy. The Bank and the Fund have over the past few years expended significant effort to enhance the domestic revenue effort. While the Fund has taken the lead in reforms and adjustments of tax policy, the Bank has taken the lead in reforms to strengthen tax administration.
- **Financial sector reforms.** Tanzania has been engaged in far-reaching reforms of the financial sector. The Bank and the Fund have been working closely to support these policy reforms. In addition to its contribution to the policy dialogue, the Bank has provided significant technical assistance for financial sector reforms. This includes two financial institution development projects that support, respectively, the withdrawal of the government from banking and nonbanking financial institutions and the strengthening of financial sector supervision. Successful outcomes of these reforms include the privatization of Tanzania's largest bank and the entry of a fairly large number of international banks into the Tanzanian market. Other areas of Bank involvement include the reform of the capital and securities authority, reform of pension systems, and liberalization of capital accounts. Through a separate project, the Bank supports the development of rural and microfinance services. A joint Bank/Fund Financial Sector Assessment was completed in June 2003.
- **Public service reform and improved service delivery.** In recent years, the government of Tanzania, with support from the Bank and other donors, has launched a number of major initiatives to improve performance and to foster greater accountability, transparency, and integrity in the public sector. These include (i) the Public Service Reform Program, (PSRP), (ii) the Local Government Reform Program, (iii) the Public Finance Management Reform Program, (iv) the National Anti-Corruption Strategy and Action Plans for Tanzania, (v) the National Framework on Good Governance, delineating a comprehensive approach to improve governance, (vi) the establishment of a Good Governance Coordination Unit (GGCU) in the President's Office, and (vii) the launch of the Legal Sector Reform Program. Among these reforms, the PSRP plays a central role since its objective is to improve the accountability, transparency, and resource management of service delivery. The program is closely linked with other major reforms in public finance and decentralization. The PSRP aims at transforming the public service into a service that has the capacity, systems, and culture for client orientation and continuous improvement. Cooperation between the Bank and the Fund covers those areas where public sector reform has a direct impact on fiscal stability and public sector financial management.
- **Trade reforms.** The Bank and the Fund are working closely to assist Tanzania in establishing a pro-growth trade framework. While the Fund is focusing on reforms of the

tariff regime, the Bank is focusing on trade expansion through its regional trade facilitation project. The Bank is also involved at the regional level in the dialogue on trade reforms in the context of the East African Community.

A. TANZANIA: Financial Relations with the World Bank Group

Statement of Loans and Credits
 (As of November 30, 2003;
 in millions of U.S. dollars)

	IBRD	IDA	IDA GRANT	TOTAL
Original Principal	361.03	4,210.37	102.00	4,673.40
Cancellations	5.47	231.58	0.00	237.06
Disbursed	355.55	3,497.52	34.67	3,837.50
Undisbursed	0.00	610.95	71.49	682.44
Repaid	353.03	311.25	0.00	664.29
Due	2.42	3,368.35	0.00	3,370.77
Exchange adjustment	0.44	0.00	0.00	0.44
Borrower's obligation:	2,865.00	3,368.35	0.00	3,371.21
Sold third party:	0.09	6.20	0.00	6.29
Repaid third party:	0.09	6.20	0.00	6.29
Due third party:	0.00	0.00	0.00	0.00

Statement by the IMF Staff Representative on Tanzania
February 25, 2004

This statement describes developments since the staff report was issued on February 11, 2004. These developments do not change the thrust of the staff appraisal.

The Tanzanian authorities submitted in early February 2004 the new income tax act to Parliament for a first reading, which was a **prior action** for this review. They confirmed that the act will be considered for approval by parliament in April 2004. In February 2004, parliament also approved amendments to the Land Act that had been agreed with stakeholders, including financial institutions.

Preliminary data made available since the staff report was issued indicate that economic and financial developments remained in line with the program. Year-on-year inflation at end-January 2004 stood at 4.7 percent. Reserve and broad money growth remained below the end-December 2003 projections by about 5 percent, largely on account of tight liquidity management by the Bank of Tanzania, while credit to the private sector continued its strong growth. The estimated budget outturn through the first half of FY 2003/04 was in line with the program, as revenue and expenditures have evolved broadly as anticipated.

The nominal exchange rate of the shilling to the US Dollar depreciated to about TSh 1109 (from TSh 1063 at end-December 2003), reflecting higher imports, notably food imports to address growing shortages.

Heavy reliance on expensive thermo-power as a result of drought-related water shortages in the hydro-electric system could increase the demand for transfers from the budget by the electricity utility TANESCO. The authorities are in close consultation with the World Bank with a view to developing an emergency action plan for managing the financial implications of the drought for the energy sector, as well as designing a medium-term reform strategy. It is the authorities' intention to address these issues and the regularization of past indebtedness in the context of the 2004/05 budget.

The signing of a trade protocol establishing a customs union in the East African Community (EAC) planned for mid-February has been postponed to early March.



Press Release No. 04/37
FOR IMMEDIATE RELEASE
February 25, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes First Review Under Tanzania's PRGF Arrangement and Approves US\$4.2 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Tanzania's performance under a SDR 19.6 million (about US\$29.3 million) Poverty Reduction and Growth Facility (PRGF) arrangement (see [Press Release No. 03/127](#)). The completion of this review enables the release of a further SDR 2.8 (about US\$4.2 million), which will bring the total amount drawn under the arrangement to SDR 5.6 million (about US\$8.3 million).

In completing the review, the Board waived the nonobservance of the performance criterion related to the submission to parliament of the new income tax law, which was delayed to February 2004.

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year period on principal payments.

Following the Executive Board's discussion on Tanzania's economic performance, Agustín Carstens, Deputy Managing Director and Acting Chair, made the following statement:

"The Tanzanian authorities deserve credit for maintaining macroeconomic stability and making substantial progress with structural reforms, which have paved the way for a steady but modest increase in real per capita income combined with low inflation. Reflecting its good track record in the implementation of its reform program, Tanzania has received steady financial support and technical assistance from the donor community. In particular, debt relief under the enhanced HIPC Initiative has helped Tanzania to undertake higher social sector spending and maintain debt sustainability.

"Despite these achievements, poverty remains widespread, especially in rural areas, and economic development has been uneven across the country. Thus, the authorities are committed

to sustained economic reform efforts in order to make further progress toward the growth and poverty reduction objectives articulated in the PRSP. The strengthening of the business environment and of agricultural performance, as well as measures to manage the macroeconomic impact of high aid flows, will be key elements of these reforms.

“Enhancing revenue mobilization and containing aid dependence will be critical to enhance the robustness of macroeconomic stability. To this end, the authorities plan to achieve a comprehensive reform of tax policy and tax administration. The forthcoming adoption of a new Income Tax Bill and the Tanzania Revenue Authority (TRA)’s implementation of a new three-year corporate plan will be crucial measures in this direction. Furthermore, rationalizing the tax regime for mining companies, while imposing strict controls on tax exemptions, will be important steps to contain revenue leakages. Maintaining a sound fiscal position and debt sustainability will also require firm control over nonpriority expenditure and prudent debt management policies.

“Continued reform in the financial sector, consistent with the recommendations of the recent Financial Sector Assessment Program (FSAP), will be crucial to improve access to bank lending and strengthen the financial sector’s contribution to higher economic growth. The newly passed amendments to the Land Act are expected to facilitate bank lending by permitting the use of land as collateral. The privatization of the National Microfinance Bank will also help to broaden access to financial services.

“The authorities recognize the seriousness of the rising fiscal pressures emanating from growing subsidies for the energy sector. They intend to take swift action by formulating and implementing a short-term action plan and a medium-term reform strategy, which will aim at providing reliable power supply, while reducing the electricity utility’s dependence on fiscal subsidies. In this context, the authorities intend to hold high level consultations with the World Bank in the near future.

“The authorities are committed to pursuing closer regional integration and further trade liberalization, mainly in the framework of the East African Community (EAC). As part of these efforts, the authorities are encouraged to work with EAC partner states to further reduce tariffs and remove non-tariff barriers.

“Finally, the authorities have underlined their commitment to the full implementation of their updated national anti-corruption strategy and action plan for 2003–2005, which will be a crucial step for strengthening governance and boosting business confidence,” Mr. Carstens said.