

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
<b>Tax policy and administration</b>		
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. <sup>1/</sup>	October 2003	Not observed.
Large Taxpayer Department to introduce collection of income tax based on self-assessment. <sup>2/</sup>	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. <sup>2/</sup>	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. <sup>2/</sup>	Continuous	Partly observed. One company was licensed that does not export to AGOA or EBA markets.
<b>Financial sector reform</b>		
Submission to parliament of amendments to the Land Act, as outlined in paragraph 31 of the Letter of Intent of July 10, 2003. <sup>1/</sup>	October 2003	Observed.
Review of prudential regulations, as indicated in paragraph 32 of the letter of intent of July 10, 2003. <sup>2/</sup>	Dec. 2003	Observed.
<b>Improve environment for investment</b>		
Adoption of an action plan to reform and simplify the business licensing system. <sup>2/</sup>	Dec. 2003	Observed.
<b>Governance</b>		
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. <sup>1/</sup>	Quarterly	Observed. All exemptions given under the Treasury voucher scheme published on the government website.

<sup>1/</sup> Performance criterion.

<sup>2/</sup> 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
<b>Tax policy and administration</b>	
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. <sup>1/</sup>	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. <sup>2/</sup>	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. <sup>1/</sup>	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. <sup>2/</sup>	Continuous
<b>Financial sector reform</b>	
Establishment of an interagency, interministerial financial sector reform committee to oversee FSAP reform agenda. <sup>1/</sup>	March 2004
Introduction of short-term collateralized lombard facility <sup>2/</sup>	March 2004
<b>Governance</b>	
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 <sup>2/</sup>	Quarterly

1/ Performance criterion.

2/ Structural benchmark.