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

February 10, 2005

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

February 10, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Rato:

LETTER OF INTENT

AND MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. The Government of the United Republic of Tanzania is implementing a financial and economic programme under a three-year low access arrangement under the Fund's Poverty Reduction and Growth Facility (PRGF). Following discussions we held recently with the Fund staff, on behalf of the Government I hereby transmit the attached Memorandum of Economic and Financial Policies (MEFP), which reviews recent economic developments and progress in the implementation of the 2004/05 programme supported by the PRGF arrangement, and sets out policies the Government intends to pursue during the remainder of the fiscal year.

2. Progress under the 2004/05 programme has been satisfactory. All, except for one quantitative performance criterion and one quantitative benchmark for end September 2004 were observed. The Bank of Tanzania Net International Reserves (NIR) (performance criterion) and Net Domestic Assets (NDA) (benchmark) targets for end-September 2004 were missed on account of more than the projected foreign exchange outflows, driven by higher-than-projected external payments for oil imports and public sector obligations. Also one structural benchmark, namely the issuing of Regulations under the Income Tax Act 2004 was not met in time due to the need to consult with stakeholders, just as was done with the law itself. The regulations were issued in October, 2004. In this regard, we are seeking a waiver of the non-observance of the quantitative performance criterion, and completion of the third review under the PRGF arrangement, and the consequent disbursement of the fourth loan in an amount equivalent to SDR 2.8 million. Due to delays in discussion of the amendments of the Bank of Tanzania Act and the Banking and Financial Institutions Act with the

Zanzibar authorities, we request a modification of the performance criteria for the fifth disbursement under the arrangement, as explained in para. 28 of the MEFP. The fifth disbursement will be subject to the fourth review expected to be completed by end-August 2005, based on the conditions set forth in Tables 1 and 3 of the attached MEFP. Conditions for disbursements during the third year of the arrangement will be determined also at the time of the fourth review.

3. The Government reaffirms its commitment in pursuit of maintenance of macroeconomic stability, including monetary and fiscal policies, as well as structural reforms especially in tax administration, strengthening of the financial sector, and improving governance. The Government believes that the policies and measures described in the attached MEFP are adequate to achieve the objectives of the 2004/05 programme. We will continue to provide the Fund with the required information to assess progress in implementing the programme and will also consult with the Fund on the adoption of any measures that may be appropriate at the initiative of Tanzania or the Fund.

4. The Government of Tanzania intends to make the contents of this letter and those of the attached MEFP available to the public and authorizes its publication on the IMF website, together with Fund staff reports on the third review under the PRGF, once the Executive Board completes the review.

Yours sincerely,

/s/

Basil P. Mramba (MP)

Minister for Finance

Attachment: Memorandum of Economic and Financial Policies.

Memorandum of Economic and Financial Policies for the Balance of 2004/05 and the Medium Term

I Recent Economic Developments and Progress Under the Programme:

1. During 2003/04, the economy recorded satisfactory performance, with 5.6 percent growth during calendar year 2003 despite the severe drought that affected agriculture and energy sectors, and a sharp rise in petroleum prices at the world market. In 2004, agricultural production is expected to recover, on account of improved weather conditions, and there is a noticeable improvement in mining, construction, transportation, communications, manufacturing, trade and tourism activities. Manufacturing for exports, including Export Processing Zones and SMEs continues to pick up. On the basis of the overall performance of the economy during the first three quarters of 2004, the projected real GDP growth of 6.3 percent under the programme in 2004 is achievable.

2. Inflation increased from 4 percent at end June 2003 to 6.5 percent at end June 2004 on account of higher than normal food prices due to drought conditions and higher oil prices, but has since fallen. Based on the newly adopted consumer price index discussed below, the headline inflation reached the highest level of 4.7 percent in April 2004, with annual food inflation peaking at 8.4 percent. However, recovery in food production, owing to favourable weather helped to contain inflationary pressures since then. Headline inflation eased to 4.0 percent in the year to September 2004, with food inflation slowing to 4.6 percent. Developments in non-food (underlying) inflation were largely influenced by changes in prices of fuel and power, which contributed to an increase in non-food prices to 3.2 percent in the year ending September 2004.

3. Consistent with the commitment to publishing reliable statistics in a timely manner, the government has introduced the new series of Consumer Price Index (CPI) whose basket is based on the 2000/01 household budget survey. The change is on account of commodity market prices movements over time and changes in the composition of the basket of goods and services consumed by a typical household

4. The fiscal programme in 2003/04 was also affected by the drought, and a supplementary budget was approved by Parliament in February 2004 partly for the replenishment of food supplies from imports, and to provide support to

TANESCO for generation of the more costly thermo electricity instead of hydro power. Otherwise, budget execution in 2003/04 was better than anticipated. Domestic revenue was 4 percent above budget estimates mainly due to positive performance in income and petroleum taxes' which were 13.7 percent above the collections in 2002/03. Actual expenditure in 2003/04 improved compared to 2002/03, with higher execution on account of frontloading of budget support funds by donors. In this regard, original plans to use Ministries, Departments, and Agencies' (MDAs) expenditure cuts as a source of finance in the Supplementary Budget were not applied to PRS priority sectors due to good revenue performance, better than expected external resources, and further savings in other areas of the budget. In the year to June 2004, net domestic financing resulted in a build up of TShs 44.3 billion in government bank deposits, in contrast to a TShs 106 billion drawdown projected under the programme.

5. Improvement was also recorded in expenditure management and efficiency during 2003/04. Whereas expenditure execution was slow in the first two quarters of 2002/03, it was relatively higher in the first two quarters of 2003/04, reducing the problem of expenditure accumulation in the fourth quarter. This was facilitated by the continued quarterly allocations for PRS priority sectors, frontloading of the majority of budget support funds (received by the end of the second quarter, allowing early cash releases to spending MDAs), and improvements in the understanding of the Procurement Act 2001 by MDAs facilitated by procurement training and experience. The early utilisation of cash releases to MDAs is expected to be further improved following the amendments to the Public Procurement Act, passed by Parliament in November 2004. These include the decentralization of tendering process to MDAs and transforming the Central Tender Board into a Regulatory Authority. But, there are still notable weaknesses in expenditure management, especially with respect to management of cash spending. As a result, in 2003/04 the net accumulation of uncashed government checks was TSh 50 billion (0.4 percent of GDP), with the check float totaling TSh 137 billion (1.2 percent of GDP) at the end of the year.

6. In the first quarter of the current fiscal year, overall budgetary performance was broadly in line with budget estimates. Revenue collections during the first quarter exceeded projections by about 5.5 percent largely due to higher collections from VAT on imports and income taxes. Actual collections during the first quarter reflect a 26 percent nominal growth over the corresponding period last year. The improvement in tax revenue collection comes partly as a result of ongoing reforms of tax policy and administration, reduction of tax exemptions and improvements in customs services and administration. On the other hand, there has been significant improvement in expenditure management and efficiency, both in priority sectors, as well as in other charges of all MDAs. Total recurrent expenditure amounted to TShs 499 billion and was 80 percent of

budget estimates, while the execution of domestically financed spending was at 84 percent. Cumulative net domestic financing of the budget in July – September 2004 was in line with programme ceiling; Government had a build up of deposits of TShs 105 billion, against an adjusted programme target of a TShs 94 billion.

7. Reform of the tax system continues to be on track. The new Income Tax law became effective on 1st July, 2004 and the regulations for its application were effected in October 2004. The regulations provide for, among other things, the limitation of the Minister's authority to grant exemptions to emergencies and subject to prior approval of the Cabinet. The Government is also currently considering recommendations from a recently completed consultancy on the review of other tax laws, including rationalisation of the administration provisions of different tax laws as part of our ring-fencing agenda. Similarly, TRA is implementing second generation reforms promulgated in its Corporate Plan for 2003/04 – 2007/08. Following recommendation of a Fund mission on Customs reform, and assistance from a resident technical assistance team of Customs experts, significant reforms have been initiated in the customs administration. These include the commencement of destination inspection based on risk based examination of entries and establishment of post clearance audit teams. The Large Taxpayers Department, which now serves 200 taxpayers, is also being strengthened through recruitment of staff with the requisite skills and reorganisation on functional basis. Following the changes made in the VAT structure, notably the increase of the threshold for registration, and the repeal of Stamp Duty on receipts, preparations have begun for reorganisation of TRA headquarters and regional offices on functional lines.

8. Implementation of the Public Financial Management Reform Programme (PFMRP) has begun, following the appointment of the Programme Manager and Coordinator, and completion of a memorandum of understanding with the participating donors. This shall be the main vehicle for rolling out the benefits of consolidated accounting and expenditure control to effective budgeting and cash management. As a precautionary measure, an IFMS disaster recovery site has also been implemented. Problems associated with the capturing of project funds persisted during the year 2003/04, and discussions to ensure that development partners channel the resources through the government system are underway. In this regard, the Government continues to urge development partners to adopt general budget support as their preferred instrument for aid delivery. The fiscal years for local and central governments have been harmonised (July to June) with effect from this year in order to improve planning for financing service delivery at the local level.

9. During the fiscal quarter to September 2004, monetary policy stance tightened amidst strong credit growth. Monetary policy implementation during the quarter was challenged by substantial upward pressures on reserve money emanating from high inflows of official donor assistance to the budget, largely unanticipated expenditure float from 2003/04, and low demand for liquidity sterilization instruments at prevailing interest rates. Reflecting active liquidity management by the Bank of Tanzania (BOT), reserve money amounted to TShs 863.6 billion, by end September 2004 and was under the programme ceiling. Broad money supply (M3) grew by 21.7 percent in the year through September 2004, while M2 grew by 20 percent. Currency in circulation increased significantly due to high demand for cash to finance seasonal crop marketing transactions following a relatively good crop harvest in 2004, and bank deposits rose largely on account of a boost in exports proceeds, coupled with foreign inflows and increased credit creation following expansion of economic activities in the country.

10. Credit to the private sector remained strong, reaching an annual growth rate of 47 percent at end June 2004, but slowed to about 34 percent at end September 2004, following repayment of some matured loans. The sustained high level of credit to the private sector is attributed to increased competition in the banking sector; the increase in the number of credit-worthy borrowers; and the ongoing efforts by the Government and the private sector to improve the business environment, including the amendment of the Land Act, 1999 to facilitate the use of land as collateral. The ratio of banks' credit to the private sector improved from 6.1 percent of GDP in June 2003, to 8.6 percent in September 2004, reflecting continued expansion in economic activities in the country.

11. The tightened liquidity management led to more upward pressure on interest rates with the average lending rates rising from 14.2 percent at end June 2004 to 14.9 percent at end September 2004. Likewise time deposit rates rose from an average of 4.3 percent in June 2004 to 4.6 percent in September 2004, in line with the increase in weighted average yields (WAY) of treasury bills. Overall WAY rose from 7.8 percent in June 2004 to 9.6 percent in September 2004. The margin between 1-year lending rate and 12-month deposit rate narrowed from 10.0 percentage points in June 2004 to 9.5 percentage points in September 2004. With the current inflation rate of 4.0 percent registered in September 2004, annual deposit and lending rates were positive in real terms.

12. External sector performance improved during the quarter under review. Balance of payments developments were characterized by modest recovery of traditional exports, strong growth in non-traditional exports, and improvements in

tourism activities. The import bill was lower than expected as the installation of flow meters temporarily disrupted oil imports. As a consequence, the trade account deficit narrowed.

13. A steady inflow of foreign assistance during July –September 2004, coupled with HIPC debt relief, resulted in the increase in official gross reserves to US$ 2,003 million from about US$ 1,878 million at end-June 2004, which is equivalent to about 7.5 months of imports of goods and non-factor services. The nominal exchange rate of the shilling to the U.S. dollar appreciated from TShs 1,107 at end-June 2004 to TShs 1,060 at end-September 2004. This reflected mainly the impact of foreign exchange sales by the Bank to mop up excess liquidity at the time when market conditions reflected an abundant supply of foreign currency in the economy coming from export proceeds, tourism receipts (peak season), and official inflows.

14. During the quarter, the Government continued negotiations with Non-Paris Club bilateral creditors for debt relief on terms comparable to those under the Enhanced HIPC framework. During this quarter, India joined Bulgaria and Kuwait in confirming relief under the HIPC framework, in respect of government –to-government debt, and dialogue is underway with the Abu Dhabi Fund, Libya, and Iran. Contacts with Brazil have not yielded any results yet. To consolidate achievements already recorded in the debt management area, we have carried out a review of the institutional capacity for implementing the National Debt Strategy 2000, and are working with the Eastern and Southern Africa Macroeconomic and Financial Management Institute (MEFMI) to develop an inter-institutional capacity building programme for this purpose.

15. The Government has continued to improve the business environment and consolidate the benefits already obtained from the on-going dialogue with the business community through the Tanzania National Business Council (TNBC) and Investors' Roundtable (IRT). Preparation of the Private Sector Development (PSD) Strategy, incorporating a focus on the SMEs and drawing from several sectoral policy documents, is under way. Implementation on a pilot basis of selected activities under the PSD strategy, commenced in November 2004. Following successful implementation of the pilot phase, the system will be rolled out to other parts of the country. Recognising that business licensing is a regulatory rather than revenue raising instrument, the Government eliminated business licence fees for small businesses and limited it to TShs 20,000 for others The government has also adopted a strategy for business licence reform and a draft law based on the strategy and expected to limit the time to obtain a license to only two days will be presented to Parliament by end-April 2005. Ongoing work include a review of sectoral licensing laws with a view to bringing them in line

with the strategy. Furthermore, preparatory work for the registration of businesses and assets held in the informal sector has been initiated, with the objective of legalising rights over such assets and promote the informal sector's access to credit.

16. The Government continues to implement the Public Service Reform Programme (PSRP) in order to improve public service delivery. This will be achieved through the Government's long-term plan of capacity building as well as implementing a performance-orientated pay reform. In this regard the Selected Accelerated Salary Enhancement (SASE) scheme continues to be implemented in four ministries (Health, Finance, President's Office–Public Service Management, and President's Office – Planning and Privatisation). As part of performance monitoring and evaluation, the Government is implementing a range of performance based instruments including annual plans, performance budgets, service delivery surveys (SDSs) and open performance appraisals.

II The Programme for the remainder of 2004/05 and the Medium Term Outlook.

A. Successes and Challenges of the PRS

17. The Government remains highly committed to poverty reduction. The first PRS has been in operation for three years. The most tangible gains have been in primary education where nine out of ten children of school age are now enrolled in primary schools. A clear policy decision was to get more children into school system and then address the issue of quality through better teacher training, strengthening of school administration, curriculum development and examination systems. A major secondary education development programme was launched in June 2004, to improve the intake of primary school leavers which is currently only 30 percent. In other poverty indicators the picture is mixed. Reducing poverty in rural areas remains the most difficult challenge. The Government recognizes that given that 80 percent of the poor live in the rural areas, growth of the rural economy is critical. Long-term growth lies in economic diversification, better physical infrastructure and transformation of the agricultural sector. These are addressed in the new national strategy for growth and reduction of poverty, as described below.

B. The national strategy for growth and the reduction of poverty (NSGRP) and medium term macroeconomic objectives

18. Following the completion of the implementation period of the first Poverty Reduction Strategy (PRS) and publication of the final PRS Monitoring Report early 2004, a new National Strategy for Growth and Reduction of Poverty (NSGRP) focusing on sustainable economic growth and reduction of income poverty, social wellbeing, and governance, is being prepared and already at an advanced stage. To maintain the national consensus in the fight against poverty, the NSGRP was presented at a National Poverty Policy Week, November 1-4, 2004, and will be discussed at the regions level before being submitted for approval by the Government. In this respect, all government agencies, civil society representatives, non-governmental organisations, development partners and private sector players, contributed their views during the drafting process.

19. The NSGRP focuses on three core areas as instrumental to poverty reduction in the period 2005-10. These are Growth of the Economy and Reduction of Income Poverty; Improvement of Quality of Life and Social Wellbeing; and Governance and Accountability. Key to higher growth and reduced poverty will be continued sound economic management and the improvement of food availability. Quality of life and social wellbeing will benefit from a special focus on equitable access for boys and girls to quality primary and secondary education, and better availability of clean and safe water. Governance and accountability will be addressed through more equitable allocation of resources, the protection of the rights of the poor and of vulnerable groups and the improvement of personal and material security.

C. Fiscal Policy and Public Resource Management

20. During the remainder of the fiscal year and in the medium term, the Government is committed to continue the pursuit of sound macroeconomic policies, including prudent monetary and fiscal policies in a manner consistent with the macroeconomic objectives under the programme, and strengthening implementation capacity of government institutions, particularly at the local government level, and to facilitate and ensure the achievement of both quantitative and structural targets articulated under the programme.

21. Revenue is expected to continue performing as projected for the remainder of the year. We will continue to enhance domestic resource mobilisation through close monitoring of the tax policy reforms and strengthening the tax administration. In view of the recent reforms in the local governments' taxation

area, we will carry out a study and develop a strategy for local government financing. Efforts to modernise the tax administration will continue to be based on the TRA Corporate Plan. As outlined in previous letters, this includes:

(i) Reorganisation of the TRA along functional lines, and strengthening the Large Taxpayer Department (LTD) after the recent doubling of its coverage to 200 taxpayers, including through deepening the integration of systems to make self-assessment fully functional and through the strengthening of the audit function. Moreover, we intend to further expand the coverage of the LTD to 250 companies by end-June 2005;

(ii) Continuing the Treasury Voucher system as the main instrument of administering exemptions. In this connection, we do not intend to grant any new discretionary tax concessions to investors, including through any expansion of the list of strategic investors maintained by the Tanzania Investment Center. In the event any such tax concessions are made, they will be implemented entirely through the Treasury Voucher system. We will also continue publication of details of beneficiaries from the scheme on the Government and Ministry of Finance websites;

(iii) Improving the efficiency of TRA operations through computerisation, improved personnel practices including training, and improved communication with the public.

(iv) Introducing risk management tools in the Customs administration, and reducing the release times by extending the hours of operations of the customs with the simultaneous review of the release bottlenecks of other agencies;

(v) Complete by June 2005 the quality assurance review of the Customs and Excise Department reforms under the TRA's second corporate plan, including an update of the action plan focusing on post-clearance auditing and compliance;

(vi) Improving overall customs revenue controls through the recently introduced destination inspection procedure; enhancing the post-clearance audit and verification unit; transmitting master manifests from arriving vessels directly to customs; and creating an intelligence unit at customs;

(vii) Maintaining surveillance on the handling of petroleum imports, consistent with the taxation at source and introduction of flow meters at the port of entry to eliminate taxation by estimation.

22. The review of the Tanzania Investment Act is ongoing. We intend to submit to Parliament by February 2005 an amendment to the Act to, among other things, limit the applicability of the fiscal stability clause to at most five years. We also intend to revise the Act governing Export Processing Zones (EPZs) consistent with the trade protocol on the EAC customs union. In the meantime, we will maintain our current policies on restricting EPZ licenses to those companies that have access to preferential trade agreements.

23. Improving expenditure management will remain a priority for the year and in the medium term, particularly by improving the linkage between the budget and the NSGRP. The Budget Guidelines and MTEF for 2005/06 – 2007/08 will include an explicit disaggregation of resources allocated for NSGRP and non-NSGRP expenditures, and reflect the shift from sector to outcome focus in the strategy. Expenditure management is also being strengthened by monitoring more closely the expenditure float and building capacity for better projecting of monthly expenditure requirements. Furthermore, the Government will strengthen the transparency and accountability of expenditure management, consistent with the objectives of the poverty reduction strategy, by rolling out the IFMS to eligible Local Government Authorities and recruitment and training of accounting staff and capacity building at the local government level. Furthermore, the process is underway to amend Authorities' Financial Memorandum to reflect the requirements of the Public Finance Act (PFA) and the New Public Procurement Act, 2004. In view of the new Public Procurement Act 2004, we also intend to review the Public Finance Act 2001 and regulations, with the aim of achieving consistency between the law and the reformed current practices, and effect the penalty and surcharge provisions of the Public Finance Act. Also, improved software is being installed and training has started for the extension of IFMS to another 18 Local Authorities in accordance with the revised strategy and plan of the IFMS Implementation and Coordination Committee (IICC). The Public Financial Management Reform Programme will continue to be used as the main instrument for reducing the fiduciary risk of budget support. Also, the new Public Procurement Act, 2004 passed by Parliament in November, 2004 is expected to improve expenditure efficiency by decentralising procurement decisions and establishing the Public Procurement Regulatory Authority.

24. In line with its National Debt Strategy, the Government is committed to not contracting non-concessional external debt, while continuing with negotiations with the remaining Paris Club and non-Paris Club bilateral creditors for comparable debt relief. Priority in this area is being given to improving the capacity for evaluation of borrowing and guarantee applications from MDAs, and consolidation of debt data including contingent liabilities.

D. Monetary policies and financial sector reforms

25. Monetary Policy objectives for the year 2004/05 will continue to be directed towards maintaining low and stable inflation, to ensure macroeconomic stability, through maintenance of the appropriate level of liquidity. Recognizing the challenges of liquidity management against the backdrop of continued high aid flows, the Bank of Tanzania will put in place measures to ensure that the evolving liquidity situation does not re-ignite inflation. The measures will include improving the efficacy of the existing monetary policy instruments, undertaking policy-oriented research to identify appropriate policy responses to challenges of monetary policy, improving liquidity forecasting framework, including a framework for projecting government budgetary flows, and improving the internal forecasting and review procedures of the BOT regarding domestic and foreign exchange market operations. Liquidity management will also be facilitated by the operationalisation of the Tanzania Interbank Settlement System (TISS), which enables all large taxpayers to make payments electronically and directly into the Government accounts at the BOT.

26. Taking into account stronger-than-expected expansion of credit to the private sector and in the absence of inflationary pressures, the monetary programme for 2004/05 is being revised to target a growth of 23.5 percent for M3, compared with 23 percent previously envisaged. In view of the lower-than-projected multiplier, this targeted growth of M3 would be consistent with a growth of reserve money of 28 percent, as compared with 23 percent targeted earlier. Given the absence of inflationary pressures, we believe that this revised monetary programme is consistent with our annual inflation target.

27. During the remainder of 2004/05 and in the medium term, the Government will implement a broad-based second generation financial sector reform based partly on the FSAP recommendations, aimed at optimising financial sector contribution to investment and growth of the economy. To this end, the Inter-Institutional Committee for implementing the recommendations of the Financial Sector Reform Programme (FSRP) has prepared an Implementation Action Plan. This plan was shared with stakeholders. The Inter-Institutional Committee will finalize this document for it to be submitted to government by May 2005 for consideration.

28. The role and operations of the BOT will be critical to the effective reform of the financial sector, and more generally to sustain sound macroeconomic and financial policies. In this respect, the Government is reviewing the Bank of Tanzania Act and the Banking and Financial Institutions Act with a view to modernizing the regulatory framework of the Central Bank. Our reforms in this area are consistent with best practices of SADC harmonisation of the legal and

operational framework for the financial sector in the region. Consistent with these principles, to safeguard the autonomy of the Bank of Tanzania, and further strengthen the effectiveness of its operations, the government will submit to Parliament revisions to the BOT Act that aim at enhancing the Bank's autonomy and its governance structures, as well as the transparency and accountability of its operations. Specifically, the amendments to the Act to be submitted to Parliament will include a strengthening of the Board's role as the BOT's decision-making body, a strengthening of the accountability of the Bank for conduct of monetary policy, and an increase in the number of Deputy Governors. As indicated in our letter of July 22, 2004, it had been intended to submit the amendment to the Bank of Tanzania Act, together with the amendment to the Banking and Financial Institutions Act (discussed in the para. 29 below), to parliament by end-February 2005. However, delays in discussion of the amendments with the Zanzibar authorities have delayed submission of the acts to parliament. The government will submit these amendments to parliament by April 30, 2005.

29. While the current Banking and Financial Institutions Act (BFIA) already covers many important areas for establishing a satisfactory framework for bank supervision, the Government considers it necessary to amend it with a view to clarifying the scope of regulatory and supervisory authority, and providing for the establishment of a prompt corrective action framework. To this end, we will submit by end-April 2005 amendments to Parliament, together with amendments to the BoT Act, that, among others, incorporate into the Act a clear set of objectives for banking operations.

30. The restructuring of the National Microfinance Bank (NMB) is at an advanced stage of implementation. The final bid instructions were issued in January 2005, as envisaged in the program. Furthermore, we expect that the preferred bidder will be selected, approved by government, and announced by end-June 2005. The Government is pursuing the divestiture of the bank as part of its strategy for improving efficiency in the sector.

31. As noted in the MEFP of July 22, 2004, the government has been considering options to further improve the availability of medium-term credit to key sectors of the economy. In addition to its developmental objective, this strategy aims at increasing the economy's absorption capacity. To this end, the government intends to introduce credit guarantee schemes under both a Small and Medium Size Enterprises (SME) guarantee facility and a Development Finance Guarantee Facility (DFGF), and is receiving assistance from the Bretton Woods Institutions for the design of these schemes. We are mindful of the risks of undermining the progress made to date in private financial sector intermediation. However, we believe that the acceleration of structural reforms in the financial

sector, particularly improved commercial dispute resolution, wil ensure that the schemes will become redundant over the medium-term. The government will ensure that they (i) operate on market principles, are appropriately funded from the budget, and protect public resources; (ii) include transparent governance; and (iii) provide for appropriate risk-sharing with commercial banks. With a view to starting the scheme on a prudent basis, we will limit the total volume of new guaranteed credit under the DFGF to TSh 50 billion, (excluding a credit guarantee already agreed).

32. The external sector is expected to continue benefiting from increased exports due to strong performance in the mining and manufacturing sectors, and a pick-up of traditional exports following a good harvest of agricultural crops particularly cotton. On the other hand, high oil prices and increased growth of imports of intermediate and capital goods are expected to slightly widen the trade deficit. The overall reserves position is expected to remain around 7 months of import of goods and non-factor services. The BOT will continue to allow the exchange rate to be market determined and limit their interventions to liquidity management, and smoothing out excessive fluctuations.

33. The Government's strategy for trade liberalization is being implemented mainly within the framework of the East African Community (EAC) and SADC. In this regard, the EAC Customs Union Protocol was ratified by Parliament in November 2004 and preparations for its implementation are underway. The protocol establishes a common external tariff (CET) and substantially reduces non-tariff barriers between the member states, and will come into force after being ratified by the Parliaments of all the three member states.

E. Structural Reforms

34. To facilitate the development of the private sector, the Government will strengthen the Better Regulation Unit (BRU), and implement the Business Environment Strengthening in Tanzania (BEST) programme, and continue dialogue with the private sector players through the Tanzania National Business Council (TNBC) and the Investors' Round Table (IRT). We will also continue with reforms aimed at enhancing productivity and profitability in the agriculture sector in order to attract private investments from both local and foreign investors. The key areas of focus will be: provision of readily available land for large scale agriculture, provision of well-targeted incentives for investments in agricultural technology, completion of the ongoing review of the role of crop boards, reform of local government taxation of agricultural produce, and improvement of the rural infrastructure. Ongoing work on the strategic plan for operationalisation of

the Land Act and Village Land Act is also expected to be finalised before June 2005.

35. In recognition of the employment creation and export potential of the sector, additional resources are being channelled to the agriculture sector to support implementation of the District Agricultural Development Plans (DADPs). For the medium term, the government is examining options for promoting the availability of bank credit to the agricultural sector as a measure to remove an important constraint to rural development and poverty reduction in a manner consistent with the second generation reforms of the financial sector.

36. To further consolidate achievements in the area of governance, the government is preparing a new anti-corruption law, to provide among others, a comprehensive framework for the effective prosecution of incidents of corruption. Drafting of the strategies and action plans is in progress and will be completed for all Local Government Authorities (LGAs) and submitted for final government approval by end-June 2005. In addition, resources have been provided in the current year's budget for the preparation of anti-corruption plans by all Local Government Authorities (LGAs). Furthermore, a new mechanism for complaints and grievances on unethical conduct of civil servants will be put in place before end of 2004.

37. The government is also addressing the issue of efficient and expedient commercial dispute resolution through implementation of the Commercial Dispute Resolution component of BEST. Work plans and budgets for all priority activities have been developed and consultations on management structures are underway with key institutions including the Ministry of Justice and Constitutional Affairs, the Judiciary (Commercial Court Division) and the Law Reform Commission. Actual implementation of reforms will take off during the 2005/2006 financial year in line with procedures for direct exchequer disbursements to the legal sector implementing agencies. Priority activities include reform of the Civil Procedure Code which affects the effectiveness of many other commercial and other legislation.

Table 1. Tanzania: Quantitative Performance Criteria and Benchmarks Under the Poverty Reduction and Growth Facility Arrangement, June 2004 - June 2005

	2004							2005			
	June		September			December		March		June	
	Rev. benchmark	Actual	Performance criteria	Adjusted	Actual	Indicative targets	Rev. estimate	Indicative targets	Performance criteria	Indicative targets	Rev. benchmark
	(In billions of shillings; end of period)										
Net domestic financing of the government of Tanzania (ceiling) 1/ 2/	105	-44	-122	-94	-105	-63	-36	48	48	157	157
Accumulation of budgetary arrears (ceiling; benchmark only)	0	0	0	0	0	0	0	0	0	0	0
Net domestic assets of the Bank of Tanzania (ceiling; benchmark only) 2/	-578	-655	-1,117	-1,089	-838	-1,064	-800	-903	-769	-867	-776
Reserve money (ceiling)	813	800	875	875	864	979	1,000	960	984	1,001	1,028
	(In millions of U.S. dollars, unless otherwise indicated; end of period)										
Net international reserves of the Bank of Tanzania (floor) 3/	1,326	1,385	1,700	1,675	1,501	1,740	1,586	1,642	1,545	1,646	1,589
Accumulation of external payments arrears (ceiling) 4/	0	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	0
Memorandum item:											
Foreign program assistance (grants and loans) 1/	563	543	366	--	341	483	499	558	596	671	709

Source: Tanzanian authorities and IMF staff estimates and projections.

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 July 22, 2004.

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 different from BoT (NDA) in the monetary authority are. adjusted for 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 2004-June 2005

Measure	Date of Implementation	Status
Tax policy and administration		
Develop a plan to introduce a computerized risk-management system aimed at expediting customs clearance primarily through reducing significantly the number of shipments that are physically inspected. 1/	End-December 2004	Observed.
Submit to Parliament an amendment of the Tanzania Investment Act, to limit the applicability of fiscal stability clauses to at most five years. 1/	End-February 2005	Revision of Tanzania Investment Act in progress, subject to discussions with stakeholders.
Financial sector reform		
Issue final bid instructions for the sale of the National Microfinance Bank (NMB). 2/	End-January 2005	Observed.
Submit to Parliament amendments to the Bank of Tanzania Act and the Banking and Financial Institutions Act. 2/	End-April 2005	Revised to end-April due to delays in concluding discussions with stakeholders. Modification of performance criteria requested.
Governance		
Draft anticorruption strategies and action plans to be completed for all Local Government Authorities and submitted for final government approval. 1/	End-June 2005	On track; draft guidelines have been prepared and will be issued to local government authorities following discussions with stakeholders.
Publicizing of the list of companies, individuals, and NGOs that have received tax exemptions each quarter under the Treasury Voucher scheme. 1/	Quarterly	Observed.
Promulgate the implementing regulations for the new Income Tax Act, consistent with para. 26 of the LOI. 1/	End-September 2004	Regulations were made effective as of October 1, 2004.

1/ Structural benchmark.

2/ Performance criterion.

Table 3. Tanzania: Structural Performance Criteria and Benchmarks Under the Poverty Reduction and Growth Facility Arrangement, July 2004-June 2005

Measure	Date of Implementation
Tax policy and administration	
Expand the coverage of the Large Taxpayer Department to 250 taxpayers. 1/	End-June 2005
Complete the quality assurance review of the Customs and Excise Department reforms under the TRA's second corporate plan, including an updating of the action plan focusing on post-clearance auditing and compliance. 1/	End-June 2005
Submit to parliament an amendment of the Tanzania Investment Act, to limit the applicability of fiscal stability clauses to at most five years. 1/	End-February 2005
Financial sector reform	
Government approval and announcement of preferred bidder for National Microfinance Bank (NMB). 2/	End-June 2005
Submit to Parliament amendments to the Bank of Tanzania Act and the Banking and Financial Institutions Act. 2/	End-April 2005 3/
Finalize and submit to government the Financial Sector Reform Implementation Action Plan. 1/	End-May 2005
Governance	
Draft anticorruption strategies and action plans to be completed for all local government authorities and submitted for final government approval. 1/	End-June 2005
Publicizing of the list of companies, individuals, and NGOs that have received tax exemptions each quarter under the Treasury voucher scheme. 1/	Quarterly

1/ Structural benchmark.
2/ Performance criterion.
3/ The authorities have requested a delay from end-February to end-April 2005.