International Monetary Fund

Tanzania and the IMF

Press Release:
IMF Executive Board Completes the Second Review Under the Policy Support Instrument for Tanzania
December 21, 2007

Country's Policy Intentions Documents

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

December 7, 2007

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

LETTER OF INTENT

December 7, 2007

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

Dear Mr. Strauss-Kahn:

LETTER OF INTENT AND MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. On behalf of the Government of the United Republic of Tanzania, I hereby transmit the attached Memorandum of Economic and Financial Policies (MEFP), which reviews recent economic developments, progress during the last quarter of 2006/07 in the implementation of the economic and financial programme that we are implementing with support from the Fund through its Policy Support Instrument (PSI), and policies that the Government intends to pursue in the reminder of 2007/08. We also recently had an opportunity to consult with the staff of the IMF on the progress of the programme.

2. The programme remains broadly on track, with all end-June 2007 quantitative performance criteria observed, except for the ceiling on reserve money, which was exceeded by a narrow margin. However, the growth of both extended broad money (M3) and broad money (M2) were contained within targeted levels. The deviation in reserve money was on account of a strong supply of foreign exchange in the market by commercial banks, which frustrated efforts by the Bank of Tanzania to sell foreign exchange as programmed. Since late September 2007, the Bank of Tanzania has increased its foreign exchange sales and reduced its reliance on Government securities for liquidity management. On this basis, we are confident that reserve money growth will be returned to its original target path.

3. Implementation of core reforms continues to yield satisfactory results, especially the public service reforms and in the tax and customs policy and administration areas. The Government is accelerating implementation of the second generation of financial sector reforms, and will continue to undertake improvement of the business environment to promote investment as the prerequisites for accelerated and sustainable growth in a stable macroeconomic environment. In line with MKUKUTA objectives, we intend to maintain the policies towards broad based growth as the sustainable basis of poverty reduction through, among other things, investment in productive infrastructure, and protecting the gains made in the provision of social services.

4. In the context of the PSI framework, we will regularly update the IMF on developments in the economic and financial policies, and provide the data needed for the monitoring of the programme. The Government will also consult regularly with the Fund on any relevant developments at the initiative of the Government, or the Fund.

5. The Government of Tanzania intends to make this letter and the attached MEFP, together with Fund staff reports related to this review under the PSI, available to the public and hereby authorises the IMF to publish the same on its website once the review is completed by the Executive Board.

Yours sincerely,

/s/
Zakia Hamdani Meghji (MP)
MINISTER FOR FINANCE
UNITED REPUBLIC OF TANZANIA

Attachment: Memorandum of Economic and Financial Policies.

ATTACHMENT I

Tanzania: Memorandum of Economic and Financial Policies

I. RECENT MACROECONOMIC DEVELOPMENTS AND PROGRESS UNDER THE PROGRAMME

Introduction

1. During the year to June 2007, Tanzania continued to record good overall macroeconomic performance, benefiting from sustained economic reforms over the last ten years. The second half of the year witnessed a recovery from a slow down in the expansion of economic activity that was recorded in 2006 in the wake of the drought in late 2005 and the high oil prices in the world markets. Particularly strong performance was recorded in the trade and tourism, manufacturing, mining, construction, and communication sectors.

2. In 2006/07, the economy experienced some inflationary pressures emanating mainly from rising prices of fuel and food. The pressure continued in early months of 2007/08, whereby headline inflation rose from 5.9 percent in June 2007 to 9.0 percent in July, 2007 before declining to 7.8 percent in August 2007. The sharp increase of inflation in July 2007 was mainly driven by food inflation which increased from 4.6 percent recorded in the year ended June 2007, to 10.3 percent in the year ended July 2007. Due to reasons such as increased cross border trade in food, a hike in transport costs and high inflation expectations following increases in fuel pump prices in the country, prices of food items this year did not decline as expected between June and July. The increase in food prices is therefore considered to be transitory. As such, inflation is expected to decline further in the coming months following improvements in food supply, and the impact of the recent fuel tax, increase dissipates.

Fiscal policy and public resource management

3. The Government's fiscal programme for 2006/07 (July–June) was implemented successfully, with outcomes in line with programme targets. Despite the energy crisis, domestic revenue exceeded programme estimates by 1.2 percent of GDP and expenditure was contained within programme estimates. [1] Despite a 1.5 percent of GDP shortfall in programme foreign loans and grants, the actual domestic financing of 1.3 percent of GDP was well within programme limits. Domestic revenue collections benefited from better than expected performance of import duties, VAT on local sales, and corporation tax. Excise duties on imports were the main item with a lower than projected performance. Our domestic resource mobilisation

[1] In what follows, ratios to GDP are expressed in terms of the revised GDP series issued by the NBS in September 2007. The revised series is about 10 percent higher in level terms.

effort continues to benefit from robust economic performance and recent policy and administration reforms, including integration of the Tanzania Revenue Authority (TRA) operations and increased use of technology. The overall balance after grants declined by ½ a percentage point of GDP compared with 2005/06.

4. The tax and customs administration reforms progressed well on the basis of TRA's Second Corporate Plan which focuses on improvements in both revenue collection and taxpayer service. Institution-wide reforms in TRA are geared towards certification by the International Standards Organization (ISO), following ISO certification of the Large Taxpayers' Department during 2006/07. The Customs Department programme to roll out ASYCUDA^{++} reached 12 stations by June, 2007 and is expected to be operational at 6 more stations by March, 2008, thus covering largely all import shipments. The integration of ASYCUDA^{++} with the destination inspection system is proceeding smoothly and the integrated processes will be operational in March 2008 as planned, facilitating electronic transfer of data from TISCAN's Classification and Valuation Report (CVR) database to Customs and *vice versa*. We target to have 40% of all non-motor vehicle shipments processed through the Green Channel, 40% through the Yellow (scanner) Channel, and 20% through the Red Channel (physical verification). Customs has developed a risk management strategy and, as part of the next steps, TRA will procure an appropriate software for implementing a National IMPORT Commodity Database (NICD).

5. Despite the drought, increasing international oil prices, and increasing domestic interest payments, Government expenditure was below the programme forecast, closing at 23.6 percent of the GDP for the year mostly due to under-execution of development spending. Foreign financing of the budget was 8.8 percent of the GDP, below the programme target of 12.1 percent. The Government protected essential expenditure for priority social services linked to the achievement of the MDGs, and implemented internal reallocations to respond to critical emerging needs because of the drought and high domestic interest payments. Domestic financing of the budget was 1.3 of GDP, within the adjusted programme target.

6. The Government's focus on promoting transparency and accountability in the management of public resources was sustained. The Government has prepared responses to the observations of the Controller and Auditor General in the 2005/06 audit report, including critical actions to address the issues raised in the NAO report. The Government has also established Audit Committees in all MDAs for effective and sustainable enforcement of financial regulations. It is expected that most of the NAO observations in the 2005/06 report will be adequately addressed at both the central and local Governments' levels following implementation of these measures. Preparation of three-month rolling cash flow plans has been delayed due to technical difficulties in line Ministries, which are being addressed.

7. The now fully staffed and operational Public Procurement Regulatory Authority (PPRA) and the Public Procurement Appeals Authority (PPAA) stepped up implementation of their

mandates during the year, including capacity building for all public institutions and the civil society. The PPRA has issued guidelines for preparation and evaluation of bids; standard bidding documents, and regularly publishes results from its procurement audits in line with its mandate under the Public Procurement Act, 2004. In the context of PFM reforms, strengthening of the procurement oversight institutions, along with the accounting and audit function, continues to receive high priority. Following procurement audits on 20 public procurement entities[2], the PPRA is refining its capacity building programme to address the observed capacity gaps.

Monetary policy

8. Monetary policy implementation during the quarter ending June 2007 was complicated by sizeable inflows of foreign capital in the context of shallow financial markets and high domestic interest rates. In contrast to the programme target of USD 60 million of net sales, the BoT purchased USD 120 million. This called for sales of liquidity papers to the tune of TShs. 320.4 billion compared to the program target of TShs. 29 billion, which contributed to upward pressures on domestic interest rates. Furthermore, there was an apparent shortage of shilling liquidity in commercial banks as reflected by their low participation in the Treasury bills and repo markets particularly in June 2007, and by the higher inter-bank cash market rates. Despite these challenges, the average reserve money closed at TShs. 1,685.2 billion in June 2007, missing the target by only a narrow margin of TShs. 5.2 billion.

9. Broader monetary aggregates moved in line with the monetary policy stance taken by the Bank. Extended broad money supply (M3) grew annually at 20.7 percent compared with 31.6 percent recorded in June 2006, while broad money supply (M2) grew by 20.1 percent compared with 24.5 percent. During the year, both M3 and M2 grew below their respective targets of 24.0 percent and 23.0 percent. Despite the tight monetary policy stance, the Bank facilitated the provision of adequate financial resources to the productive sectors. The annual rate of expansion of credit to the private sector remained strong and in line with the program, reaching 36.4 percent at end June 2007, up from 35.9 percent at end June 2006.

10. During the first quarter of 2007/08, the implementation of monetary policy was further challenged by strong liquidity pressures emanating mainly from donor inflows that came in July 2007 instead of June, and the huge expenditure float from the previous year – all of which were above the respective quarter projections. As a result, the indicative target for average reserve money was missed by a sizeable margin in September.

11. The Joint Cash Management Committee (CMC), with representatives from the Ministry of Finance and the BoT, that was established to develop and supervise implementation of a

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[2] The results of the audits were also published in the local press and on PPRA's website

strategy for improved liquidity management started its assignment in August 2007. The CMC's strategy includes (i) developing a three month rolling Government cash flow forecast; (ii) reducing the level of the expenditure float to the minimum; and (iii) eliminating the large Government deposits in the commercial banks. The Government is also re-assessing its roll over policy in relation to the stock of domestic debt, with a view to reducing the tender size and the frequency of auctions. It is envisaged that, together with the measures planned in the monetary programme, these actions will facilitate a reduction in domestic interest rates.

Financial sector reforms

12. The Government is implementing the second generation financial sector reforms in the context of its Financial Sector Reform Implementation Action Plan (FSIAP). During 2006/07, five consultancy assignments were initiated within the framework of the Second Generation Financial Sector Reforms (SGFSR). These relate to finance leasing, pension sector, mortgage finance, credit information data bank and legal and regulatory framework for credit information bureau. In the area of Lease Finance, a draft finance leasing law has been developed with the assistance of the International Finance Corporation (IFC) and was presented to Parliament in November, 2007. In the area of Pension Sector Reform, a draft legal and regulatory framework for the Pension Sector has been developed and was discussed by stakeholders at a workshop held in Dar es Salaam and the Inter-Institutional Committee on Financial Sector Reform (IIC) in July 2007. Investment Guidelines for pension funds have also been developed with technical assistance from the World Bank. However, the unified legal and regulatory framework and investment guidelines for pension funds were not submitted to Government by end-September 2007 as envisaged pending their harmonization with the amendment to the Social Security Act current under preparation (see para 32). With regard to Mortgage Finance, a draft bill for amending various laws has been developed along with a draft Unit Titles Act.

External sector developments

13. The external sector performance has been positive, although the export sector remains vulnerable to exogenous factors such as climatic conditions and terms of trade shocks. Exports of goods and services have been increasing at an average rate of 20 percent in the past five years. On the other hand, imports have been increasing at an average rate of 21 percent. In 2006/07, a surge in imports is attributed to high oil prices in the world market, and the increased demand of capital goods, as well as intermediate materials in keeping pace with growth momentum of the economy. As a result, during 2006/07, developments in the external sector were highly influenced by the increase in oil prices in the world market and a severe drought at home. A sharp increase in international oil prices, coupled with increased demand for oil for thermal power resulted in a higher import bill, which could not be supported by the modest increase in exports. Consequently, the current account deficit (net of program grants) widened to 14 percent of GDP from 11¼ percent of GDP in 2005/06. Nevertheless, the overall balance of payments

position remained positive on account of continued strong capital inflows in form of program and project assistance, direct foreign investments and debt relief received under the Multilateral Debt Relief Initiative (MDRI). As a result, official foreign exchange reserves increased to US$2.3 billion at the end of June 2007, enough to finance about 4 months of next year's imports. The shilling remained broadly stable in nominal effective terms during 2006/07, following a trend of depreciation in previous years.

14. In 2007/08, the current account deficit is projected to decline modestly, as the anticipated growth in exports will outpace the continued rapid growth of imports driven by demand for new investments particularly in the infrastructure and mining sectors. Export performance will result from expected improved performance in traditional exports assuming good weather continues and improved performance in the services sector especially tourism and transportation will be sustained. It is expected that the current account deficit that is projected at around 13¾ percent of GDP (net of program grants) in 2007/08 will be financed by strong foreign direct investments and increased disbursements in program and project assistance. As a result, the overall balance of payments is anticipated to remain positive, with gross international reserves remaining high at around 2.3 billion by the end of June 2008. The gross international reserves will be enough to cover about 4 months of the next year's import of goods and services.

Private sector development:

15. The Business Registration and Licensing Authority (BRELA) is being modernised, including digitisation of its records and those of related registries, to cope with growing business registration and licensing requirements. A database for land disputes and caseloads has also been established in the Ministry of Lands, Housing, and human Settlements Development, in preparation of a programme for backlog clearance. In line with recent labour law reforms, the Commission for Mediation and Arbitration (CMA) was launched in May, 2007 and eight tripartite sector Wage Boards established. Other activities include the operationalisation of the Commercial Court in Mwanza (northern Tanzania). The different efforts to strengthen the business environment are coordinated through the Business Environment Strengthening (BEST) programme.

Infrastructure

16. Consistent with the draft Medium Term Transportation Infrastructure Investment Plan (TSIP), the budget for implementation of key roads projects has been enhanced, from 2.6 percent of GDP in 2006/07 to 4.1 percent of GDP in 2007/08. Following the enactment of a new Roads Act in April 2007, the Government is exploring options for increasing the resource envelope for this area, including private sector participation. The funding of the Road Fund, established to provide for roads maintenance costs, has been enhanced thorough a 100 percent upward adjustment of the Fuel Levy to ensure sufficient financing of road maintenance. The

concessioning of the railway operations, which became effective in September 2007, is also expected to improve the performance of the transportation sector, thereby addressing one of the most binding constraints to private sector development.

Energy

17. Implementation of TANESCO's Financial Recovery Plan (FRP) continued reasonably well, assisted by the earlier than expected recovery of hydro generation capacity. The experts procured with World Bank support needed more time to finalise their input into TANESCO's tariff application to the regulator, EWURA, leading to a delay in the submission of the application. A decision by the regulator is expected by early 2008. TANESCO is using the private emergence power generators to meet intermittent supply deficits, pending finalisation of procurement of its own 145MW gas fired plants. TANESCO has also signed a TShs 235 billion (about USD 220 million) medium term loan with a syndicate of local financial institutions, as part of the FRP implementation. As the FRP envisages substantial investment in the power infrastructure, the Government is continuing consultations with development partners to secure their support to the investment budget.

18. Further to TANESCO related action, the Government is implementing a broader power sector reform agenda to increase the sector's contribution to the national effort towards growth and reduction of poverty. The main elements of the power sector reforms strategy include establishing an efficient energy production, procurement, transmission, distribution and end-use systems in an environmentally sound and sustainable manner; and ensure availability of reliable and affordable energy supplies. A new Electricity Act to facilitate competition in the generation, transmission and distribution segments, and clarifying the institutional and regulatory arrangements in the sector, was presented to Parliament in November, 2007.

Poverty reduction

19. Tanzania's effort towards reducing poverty and meeting the MDGs is guided by MKUKUTA, the national strategy for growth and reduction of poverty, formulated through very broad consultations, and linked to the National Development Vision 2025. The MKUKUTA Annual Implementation Report (MAIR) was released in November, 2007 showing progress in most areas, even as the measurement of poverty status is hampered by the infrequency of household budget surveys. MKUKUTA areas recording good performance include real GDP growth, domestic revenue collection and related revenue services, improved food self sufficiency, and public expenditure management. As in 2006, the report calls for further refinement of the growth strategy, focusing on areas that might yield quick results, particularly transportation infrastructure, energy, and education.

20. Improvements were also recorded in the education sector, where enrolment ratios for all levels of education system (pre-primary, primary, secondary, and tertiary) improved relative to 2006 levels, and the primary education pass rates reached 80 percent from 22 percent in 2000. The performance in the health indicators continue to depict a mixed picture, with substantial progress recorded in immunization coverage and a declining trend in HIV prevalence; while maternal mortality increased from 529 per thousand live births in 2000 to 578 in 2005 mainly on account of the HIV/AIDS pandemic. The mixed results in relation to the health indicators suggest the diversity of inputs required for improvement in the respective areas. In the year 2006/07 the Commission for Human Rights and Good Governance (CHRGG) received 4,523 new complaints (including 226 from remandees), out of which 3,149 were resolved. While the increase in reported and filed cases is a positive indication of awareness among the people in understanding their rights, the quick out turn of received and resolved cases suggests a significant improvement in the capacity of the Commission.

II. PROGRAMME FOR 2007/08

21. The economic recovery is expected to continue during the remainder of the year, on account of improved weather leading to good agricultural harvest and alleviates recent difficulties with the power supply. Real economic growth is projected at 7.1 percent in 2007 and 7.5 percent in 2008. In addition to the recovery in agricultural production, good performance is expected from the manufacturing and service industries. Food prices are expected to fall further following the harvest, leading to the moderation of inflation to around 6.0 percent by June 2008.

Fiscal programme

22. For 2007/08 the programme projects revenue would reach 16.0 percent of GDP. The substantial increase relative to 2006/07 reflects specific measures, expected to yield about 1 percent of GDP, and continued strengthening of tax administration. Policy measures include indexation of the specific excise duty rates, and adjustment of forestry and hunting fees, as well as the fuel levy and road user charges. Revenue administration measures include the following: the large taxpayers department is further strengthening audits in key areas, including developing specialized expertise in the mining sector, and is making progress on the introduction of electronic filing; the domestic revenue department is tightening procedures for medium taxpayers by establishing specialized units in district offices; and customs processes continue to be improved, in particular to enhance control of fuel products. Collections in the first quarter of the year are in line with this projection. The Government will continue to publish the list of tax exemption beneficiaries each quarter.

23. Total expenditure for 2007/08 is now projected at 27.8 percent of GDP. The wage bill is expected to remain at 5.2 percent of GDP. The Government is still reviewing the recommendations of the Presidential Commission on Public Service Pay as a basis for updating

the Medium Term Pay Policy (MTPP), and is discussing options with the trade unions. In addition to resource constraints for implementing a substantially improved pay package that would ensure improved efficiency of the public service, challenges in formulating a new MTPP include balancing the need for additional staff, especially in frontline services reflecting the MKUKUTA priorities with the need for overall sustainability of the fiscal and macroeconomic frameworks. Domestic interest costs are projected to rise slightly, from 1.0 percent of GDP in 2006/07 to 1.3 percent of GDP in 2007/08, on account of the costs of implementing monetary policy in 2006/07. Development spending is projected to increase to 10 percent of GDP from 6.2 in 2006/07, reflecting increased allocation for the roads sector, execution of MDRI-financed items, and larger project grants.

24. The backbone of the 2007/08 budget is increased domestic revenue and the Government's commitment to refrain from net domestic financing of the budget. To safeguard this objective, implementation of the budget will be based on a prioritised expenditure plan to ensure adequate spending on Government priorities in case of shortfalls in domestic revenue or unexpected spending needs. Shortfalls in programme external financing of up to USD 150 million (about 1 percent of GDP) may be financed domestically.

25. The Government is working to strengthen collection of non-tax revenues and management of natural resources. For this purpose, procurement of a consultant for a study on non-tax revenue, aimed at assessing the revenue potential and adequacy of the administrative framework is underway. In addition, a Government commission is studying the fiscal regime in the mining sector. The results of these studies will be inputs for the 2008/09 budget.

26. Public financial management (PFM) will continue to be focused on strategic resource allocation, and ensuring value for money in budget execution. To this end, the public financial management reform program, which guides our reforms in this area, will be updated by the end of 2007. For the 2008/09 budget, the Government will introduce scenario analysis in three pilot Ministries for the MTEF period covering 2008/09-2010/2011, to strengthen expenditure prioritisation. The Government will also continue consultations with development partners on ways to strengthen the MTEF through improved predictability of medium term external financing. The capacity to carry out value for money audits is being enhanced in the Expenditure Tracking and Monitoring Unit (MoF), the PPRA, and NAO. The Government is also working with East - AFRITAC to establish a framework for tracking budget execution along the MKUKUTA Clusters by achieving greater integration of the Strategic Budget Allocation System (SBAS) and the IFMS. In addition, the Government plans to replace the 1986 GFS economic classification of the budget with the 2001 classification. To this end, we are working with East – AFRITAC to develop the new structure before June, 2008. Regarding cash management, the CMU has introduced a framework and is working with all Ministries to prepare cash plans for the respective Votes, and will start producing the three-month rolling cash flows forecasts by

end-March, 2008. The CMC will finalise the plan to transfer Government deposits in commercial banks to the BOT (structural benchmark) by March, 2008 too.

27. Our medium term fiscal policy will continue to be based on no domestic financing of the budget, increasing revenue mobilisation, and improving effectiveness of public spending. We envisage increasing the share of spending on infrastructure to stimulate faster growth. We are also evaluating implementation modalities of the Constituency Development Fund with a view to ensuring that adequate controls, transparency, and coordination with central and local Government spending plans are in place. We will start work on updating the existing study on tax expenditures aiming at the preparation of a tax expenditure report to accompany budget documentation in the course of 2008/09.

Monetary policy

28. The implementation of monetary policy by the Bank of Tanzania continues to focus on achieving appropriate levels of liquidity in the economy that are consistent with the targeted reduction in the rate of inflation. As inflation is currently running above the target against the background of rising oil prices and high inflationary expectations, the BoT will strengthen its vigilance on liquidity expansion in the economy in order to bring it back on track. This will require curbing the annual growth rate of reserve money to 20 percent by end-June 2008. Correspondingly, the average stock of extended broad money (M3) is projected to grow by about 21 percent during the year.

29. In the context of using foreign exchange sales for liquidity management, exchange rate policy will remain flexible, with intervention limited to promoting orderly market conditions. In a bid to bring reserve money back on track for the remainder of the year, the BoT will step up its foreign exchange sales in the inter-bank market for sterilization purposes and conduct repurchase agreements more frequently to fine tune reserve money positions. This move will proportionally lessen liquidity management burden on Treasury bills and ease pressure on interest rates. Furthermore, to mitigate the impact of high and volatile interest rates on private sector credit, the BoT will reduce tender sizes in future auctions, broaden the direct participation of small and medium investors in the Treasury bills market, move to a biweekly schedule for the T-bill auction (by January, 2008), and develop benchmark maturities. These two measures combined will help achieve significantly lower interest rates.

30. The Bank of Tanzania will also inform market players and the general public – on a monthly basis of the objectives and rationale of its monetary policy stance for a given month. The objective of this move, which will start from December 2007, is to enhance the predictability of the Bank's monetary policy stance and promote orderly financial markets. In addition, the BoT intends to hold quarterly press conferences to inform the public on economic developments.

31. With the large aid inflows envisaged in the medium term, monetary policy will remain focused on reining inflation, particularly from a domestic demand perspective. The Bank will continue to use an appropriate mix of instruments at its disposal. Greater coordination between fiscal and monetary policies would be critical to facilitate effective absorption of donor funds without causing upward pressures on domestic interest rates; exchange rate of the shilling or on domestic consumer prices. To this end, the activities of the joint Cash Management Committee will be strengthened and sustained so as to facilitate effective management of liquidity in the economy.

32. The monetary policy stance of the Bank of Tanzania in the remainder of the year and in the medium term will continue to support a strong growth of credit to the private sector in line with envisaged broad based growth of the economy and poverty reduction initiatives. Increased competition among banks and measures being taken under the ongoing second generation financial sector reform aim to enhance the flow of credit to private businesses including small and medium enterprises (SMEs). Operational guidelines for the envisaged Development Finance Guarantee Facility have already been developed and approved by the Ministry of Finance although no funding has been provided in the budget during 2007/08. The facility is however expected to be operational once funding has been made available. With regard to monitoring of other guarantee schemes which are operational, namely Export Credit Guarantee and Small and Medium Enterprise schemes, the Bank of Tanzania in collaboration with Participating Financial Institutions continues to monitor all guaranteed projects both offsite and onsite with monthly reports being submitted to the Ministry of Finance. We will continue to adhere to our commitments on the size and governance of the medium-term credit and credit guarantee initiatives to ensure transparency and limit undue fiscal risks. Specifically, we will ensure that all credit facilitation and guarantee facilities are subject to an annual independent operational audit to verify that the funds are being used for the purposes intended and that proper governance procedures have been followed.

Financial sector reform and financial stability

33. In the context of implementation of the second generation of financial sector reforms, we will proceed expeditiously with the completion of the amendments to the Land Act and the new Condominium Law currently under preparation, which are critical steps in addressing key bottlenecks to the provision of medium-term credit. To strengthen the regulatory framework for non-bank financial institutions, especially the rapidly growing pension funds, we will proceed over the coming months to finalize the harmonization of the amendment of the Social Security Act with the unified legal and regulatory framework for pension funds with the objective to submit the legislation to Parliament by end-February 2008 (structural benchmark). This would allow the BoT to assume the role of the regulator and supervisor of financial aspects of pension funds until a new independent regulator is put in place under the unified legal and regulatory

framework. Furthermore, to gear prudential supervision toward overseeing a fast-growing and diversifying financial system, we intend to strengthen risk-based supervision by introducing by end-2007 a framework for quarterly stress-testing of banks.

Governance

34. The Government's programme for improving governance is guided by the PFM reforms and the second National Anti-Corruption Strategy Action Plan (NACSAP II). In conjunction with development partners, the Government is finalising a revised PFMRP Strategic Plan outlining the future of PFM reforms to support the Ministry of Finance, the National Audit Office (Union Government), and the National Audit Office in Zanzibar more oriented towards providing services to the MDAs and the general public without losing essential controls over use of public resources and ensuring value for money. Implementation of the NACSAP II launched in December 2006 and a new Anti-Corruption law enacted in April 2007 will be given further impetus with a strengthening of the Prevention and Combating of Corruption Bureau (PCCB). With the support of development partners, the Government is also scaling up its efforts to implement its comprehensive Legal Sector Reform Programme (LSRP).

35. The special audit of the EPA account at the BOT was completed in late November, 2007. When finalized, the findings of the audit will be made publicly available and we will prepare a decisive follow-up plan as required, in which case, the Government remains committed to the expeditious adoption and implementation of appropriate remedial measures.

Statistics

36. The Government will continue to strengthen its statistical base with the objective of subscribing to the Special Data Dissemination Standard (SDDS) as soon as possible. The recent introduction of new national accounts statistics will be followed by the development of quarterly GDP estimates. The National Bureau of Statistics (NBS) also plans to provide more information on methodology and supporting data for the new national accounts and for the consumer price index on its web site in the coming months. A new household budget survey is expected to be completed by mid-2008. Once the results are available, the NBS intends to rebase its consumer price statistics, for which it will request assistance from AFRITAC. The Bank of Tanzania is working to improve private debt and portfolio flows statistics in the financial account of the balance of payments.

Conclusion

37. Implementation of the economic and financial programme approved by the Executive Board of the Fund is progressing well, with substantial progress being noted in the fiscal and

some poverty reduction areas. A combined effect of high liquidity, low food production, and a poor appetite for foreign exchange among commercial banks led to higher than programmed growth in reserve money and inflation. The Government is implementing measures to address this, as part of the programme to be monitored by the Fund.

38. The programme to be implemented by the Government during the remainder of 2007/08 will be monitored by the quantitative assessment criteria and indicative targets set forth in ***Table 1*** annexed hereto**,** and the structural assessment criterion and benchmarks shown in ***Tables 2 and 3***. The programme seeks to promote high and sustainable growth as a basis for more rapid poverty reduction. This primary objective will be pursued on the basis of sustained macroeconomic stability, enhanced public resource mobilisation, efficiency in public spending, increasing the contribution of the financial sector to economic growth, and continuously improving the business climate to increase investment. The Government is confident that the development partners, including the Fund, will maintain and increase their support through financing and policy advice, especially in view of the large investment requirements in communication infrastructure, energy, water, and education.

MINISTRY OF FINANCE
DAR ES SALAAM, TANZANIA
DECEMBER, 2007

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

	2007							2008			
	June			September		December		March		June	
	Assessment Criteria	Adjusted	Actual	Indicative Targets	Preliminary	Assessment Criteria	Revised	Indicative Targets	Revised	Assessment Criteria	Revised
	(Billions of Tanzania shillings; end of period, unless otherwise indicated)										
Net domestic financing of the government of Tanzania (cumulative, ceiling) [1, 2]	67	314	237	-230	-705	-300	-300	-90	-90	0	0
Accumulation of budgetary arrears (ceiling; indicative target only)	0	0	0	0	0	0	0	0	0	0	0
Average reserve money (upper bound) [3]	1,680	1,680	1,685	1,793	1,836	1,934	1,934	1,975	1,975	2,033	2,042
Average reserve money target [3]	1,664	1,664	---	1,775	---	1,915	1,915	1,956	1,956	2,013	2,022
Average reserve money (lower bound) [3]	1,647	1,647	---	1,757	---	1,896	1,896	1,936	1,936	1,993	2,002
	(Millions of U.S. dollars; end of period)										
Net international reserves of the Bank of Tanzania (floor) [4]	1,754	1,559	2,194	1,881	2,807	1,899	2,367	1,765	2,212	1,683	2,036
Accumulation of external payments arrears (ceiling) [5]	0	0	0	0	0	0	0	0	0	0	0
Contracting or guaranteeing of external debt on nonconcessional terms (ceiling) [5]	0	0	0	0	0	0	0	0	0	0	0
Memorandum item:											
Foreign program assistance (cumulative grants and loans) [1]	932	---	737	502	768	774	824	818	883	943	997

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 November 20, 2006.

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

[2] To be adjusted upward by up to US$150 million for the Tanzania shilling equivalent of a shortfall in foreign program assistance from the amounts shown in the memorandum item.

[3] Assessment criteria and indicative targets apply to upper bound only.

[4] Floors are set US$200 million below projected levels. Floor will be adjusted downward for any shortfall in foreign program assistance from the amounts shown in the memorandum item.

[5] Continuous assessment criterion under the PSI; excludes arrears on debt-service payments pending the conclusion of debt-rescheduling agreements.

Table 2. Tanzania: Structural Assessment Criterion and Benchmarks Under the Policy Support Instrument, July 2007 - December 2007

Measure	Target Date of Implementation	Status
Fiscal		
Cash Management Unit in the Accountant General's Department and Cash Management Committee, including both MoF and BoT staff, to produce updated Government's three month rolling cash flow forecast and liquidity management plan at the end of each quarter.	Continuous	CMU and CMC established, but 3-month cash flow is delayed
Customs and Excise Department to develop a risk management strategy/plan, with a detailed timetable, to strengthen risk management and selectivity principles.	End-September 2007	Completed
Financial Sector		
Inter-agency committee on financial sector reform will submit to Government a proposed unified legal and regulatory framework and investment guidelines for pension funds.	End-September 2007	Delayed pending harmonization with Social Security Act
Governance		
Complete the special audit of the NBC-EPA debt in accordance with the agreed terms of reference.	End-October 2007	Audit report submitted to the authorities in November
Energy		
Submit to the regulator a request for an aggregate electricity tariff increase based on full cost recovery (including all current operations, system maintenance, depreciation, and commercial financing costs), consistent with paras. 54-56 of the MEFP attached to the authorities LOI of November 20, 2006. 1/	End-July 2007	Submitted in mid-October

1/ Assessment criterion

Table 3. Tanzania: Structural Benchmarks Under the Policy Support Instrument, January 2008 - June 2008

Measure	Target Date of Implementation
Fiscal	
Cash Management Unit in the Accountant General's Department and Cash Management Committee, including both MoF and BoT staff, to produce updated Government's three month rolling cash flow forecast and liquidity management plan at the end of each quarter.	Continuous
Complete the integration of the Customs and Excise Department and TISCAN's import clearance processes.	End-March 2008
Adopt a plan to transfer government deposits in commercial banks to the BOT.	End-March 2008
Financial Sector	
Submit to Parliament amendments for harmonizing the regulatory framework for pension funds to allow the BoT to assume the role of the regulator and supervisor of financial aspects of pension funds.	End-February 2008
Establish the credit reference databank and its operating guidelines.	End-June 2008

ATTACHMENT II

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

December 2007

Introduction

1. The purpose of this Technical Memorandum of Understanding (TMU) is to describe concepts and definitions that are being used in the monitoring of the quantitative assessment criteria and indicative targets under the Tanzania's PSI-supported program.

Net international reserves

2. Net international reserves (NIR) of the Bank of Tanzania (BoT) are defined as reserve assets minus reserve liabilities. The BoT's reserve assets include (i) monetary gold; (ii) holdings of SDRs; (iii) the reserve position at the IMF; (iv) holdings of foreign exchange, including the Tanzanian government's Poverty Reduction Budget Support (PRBS) and all of its foreign currency deposits at the BoT, and (v) other liquid and marketable assets readily available to the monetary authorities. Reserve assets exclude assets pledged or otherwise encumbered, including but not limited to assets used as collateral or guaranteed for a third-party external liability (assets not readily available). The BoT's reserve liabilities include (i) all short-term foreign exchange liabilities to nonresidents, and (ii) all liabilities to the IMF. Reserve liabilities exclude medium and long-term foreign liabilities.

Reserve money and reserve money band

3. Reserve money is defined as the sum of currency issued by the BoT, including the vault cash of commercial banks, and the deposits of the commercial banks with the BoT. The reserve money targets are the projected daily averages of December 2007, March 2008, and June 2008, within a symmetrical one percent band. The upper bound of the band serves as the assessment criterion or indicative target.

Net domestic financing of the Government of Tanzania

4. Net domestic financing of the Government of Tanzania (NDF) includes financing of the budget of the central (union) government of Tanzania ("government") by the banking system (BoT and commercial banks) and the nonbank public. NDF is calculated as the cumulative change since the beginning of the fiscal year in the sum of (i) loans and advances to the government by the BoT (including paper issued by the BoT for monetary policy purposes) minus all government deposits with the BoT (including funds from paper issued by the BoT for monetary policy purposes); (ii) loans and advances to the government by the commercial banks minus all government deposits held with the banks; and (iii) the outstanding stock of domestic debt to nonbanks excluding: government debt issued for the

recapitalization of the NMB and TIB; debt swaps with COMELCO (Russia) and the government of Bulgaria; mortgage on acquired sisal estates; compensation claims; and debt of parastatal companies assumed by the government.

Government deposits

5. Government deposits at the BoT include government deposits as reported in the BoT balance sheet, and foreign currency-denominated government deposits at the BoT, including the PRBS account and the foreign currency deposit account.

External payments arrears

6. External payments arrears consist of the total amount of external debt service obligations (interest and principal) of the government and the BoT that have not been paid at the time they are due, excluding arrears on external debt service obligations pending the conclusion of debt-rescheduling arrangements.

Contracting or guaranteeing of external debt on nonconcessional terms

7. The term "debt" will have the meaning set forth in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 (Decision No. 12274-(00/85)). Government debt is outstanding debt owed or guaranteed by the Government of Tanzania or the Bank of Tanzania.

8. Government debt is considered nonconcessional if the grant element is lower than 35 percent, calculated using discount rates based on Organization for Economic Cooperation and Development (OECD) commercial interest reference rates (CIRR), adjusted as appropriate for different maturities. This assessment criterion applies not only to debt as defined in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 (Decision No. 12274-(00/85)), but also to commitments contracted or guaranteed for which value has not been received.

Budgetary arrears

9. Budgetary arrears are defined as new arrears accumulated during the fiscal year on wages, domestic interest, and goods and services.

Foreign program assistance

10. Foreign program assistance is defined as grants and loans received by the Ministry of Finance through BoT accounts and commercial banks and is calculated as the cumulative sum, since the beginning of the fiscal year, of the receipts from (i) program loans and (ii) program grants.

Program exchange rate

11. The program exchange rate is set at the end-September 2007 exchange rate (T Sh 1230 per U.S. dollar).

Adjusters

Net international reserves

12. The quantitative targets for the BoT's net international reserves will be adjusted downward by the amount in U.S. dollars of any shortfall in foreign program assistance, up to a limit of US$150 million, relative to projections shown in the Quantitative Assessment Criteria and Indicative Targets Table attached to the applicable Letter of Intent and Memorandum of Economic and Financial Polices of the Government of Tanzania.

Net domestic financing

13. The quantitative limits on the net domestic financing of the Government of Tanzania will be adjusted upward for any shortfall in foreign program assistance in U.S. dollars, up to a limit of US$150 million, converted into Tanzania shillings at the program exchange rate.

Data reporting requirements

For purposes of monitoring the program, the government of Tanzania will provide the data listed below.

14. The following tables related reporting on the developments in relation to the program's assessment criteria and indicative targets to be provided quarterly:

Table of Quantitative Assessment Criteria and Indicative Targets.
Table of Structural Assessment Criteria and Benchmarks.

15. Other data to be provided monthly, quarterly, or other frequency of compilation:

The balance sheet of the BoT.
The consolidated balance sheet of the commercial banks.
The monetary survey.
Commercial banks domestic lending by borrowing sectors.
Commercial banks interest rate structure.
The flash report on revenues and expenditures.
The TRA revenue report.
The Monthly Domestic Debt Report.
Monthly report on Central Government Operations.
The external cash flow statement, including details on payments of interest and principal on government external debt.
Program grants and loans.
Exports and Imports.
Balance of payments.

The published consumer price index report of the National Bureau of Statistics (NBS).
The annual national accounts statistics in constant and current prices as prepared by the NBS.