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Tanzania and the IMF

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July 20, 2016

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

June 28, 2016

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.

Letter of Intent

June 28, 2016

Mrs. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Madam Lagarde:

The attached Memorandum of Economic and Financial Policies (MEFP) updates the ones from June 27, 2014, December 18, 2014, June 18, 2015, and December 24, 2015 under the Policy Support Instrument (PSI). It reports on recent economic developments and sets out macroeconomic policies and structural reforms that the Government will pursue in the coming years.

The Government is confident that the policies and measures set forth in the attached Memorandum will deliver the objectives of its program. We stand ready to take further measures that may become appropriate for this purpose and that are in line with the Government's policy objectives.
The Government will consult with the IMF at its own initiative or whenever the Managing Director of the IMF requests such a consultation before the adoption of any such measures or changes to the policies described in the attached Memorandum. The Government will provide the Fund with such information as the Fund may request in connection with the progress made in implementing the economic and financial policies and achieving the objectives of the program.

The Government intends to disseminate this letter, the attached MEFP and the Technical Memorandum of Understanding (TMU), as well as related Fund staff reports, and hereby authorizes the IMF to publish the same after consideration by the Executive Board.

Yours Sincerely,

/s/	/s/
Dr. Philip I. Mpango (MP) MINISTER FOR FINANCE AND PLANNING UNITED REPUBLIC OF TANZANIA	Prof. Benno Ndulu GOVERNOR, BANK OF TANZANIA UNITED REPUBLIC OF TANZANIA

Attachments
Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding on Selected Concepts and Definitions Used in the Monitoring of the Program Supported by the PSI.

Attachment I. Memorandum of Economic and Financial Policies June 28, 2016

I. MACROECONOMIC DEVELOPMENTS AND PROGRAM PERFORMANCE

A. Recent Macroeconomic Developments and Outlook

Output and Prices

1. **Growth.** The economy continued to register strong growth in 2015, estimated at 7 percent. The highest growth rates were recorded in information and communication, public administration, construction, finance and insurance, and transport and storage. Growth was supported by strong export demand for manufactured products and tourism, ample credit to the private sector, and the positive income shock from lower global oil prices. In 2016, real GDP is projected to continue growing by about 7 percent. Growth would remain strong in the medium term, supported by large infrastructure investments in energy and transportation under the new five-year development plan (FYDP II).

2. **Inflation.** Headline inflation remained at single digit throughout 2015, despite the significant exchange rate depreciation in the first half of the year. This performance reflected the tightening of monetary policy in May 2015 and was helped by the general decline in global commodity prices, especially oil prices. Headline inflation averaged 5.6 percent in 2015 and stood at 5.1 percent in April 2016. Core inflation was contained at around 3 percent during the period. Inflation is expected to decrease further in the coming months and remain around the medium term target of 5 percent, helped by continued tight monetary policy, subdued global oil prices, improvement in domestic power and food supply, and stability of the Tanzanian shilling against U.S. dollar.

External Sector Developments

3. **Balance of Payments.** During the first half of 2015/16, the current account deficit narrowed to about US$1.1 billion, compared to about US$2 billion recorded in the corresponding period in 2014/15. The improvement reflected both an increase in exports of goods and services (gold, manufactured goods, transportation, and tourism) and a decline in imports by 12.5 percent (oil products, but also building and construction equipment and food products). The stock of gross official reserves amounted to US$4.1 billion at end-December 2015. The current account is expected to improve further as the momentum of manufactured exports and receipts from tourism and transportation services continue, and the oil import bill remains low on the back of subdued global oil prices and a decline in import volumes due to usage of natural gas in power generation.

Fiscal Performance and Financing in the First Half of 2015/16

4. Fiscal deficit and financing. After a few months of under-performance ahead of the elections, revenue collection picked up starting in December 2015, particularly excises and income tax revenue. The recent developments reflected renewed efforts to fight tax evasion and strengthening of tax administration. As a result, the fiscal outturn in the first half of 2015/16 was broadly in line with the program. In light of financing shortfalls, the execution of discretionary expenditure was slowed, resulting in a cash deficit of 1.7 percent of GDP. Expenditures arrears further accumulated during that period, by about 0.3 percent of GDP on a net basis.

Monetary Policy

5. Monetary policy stance and exchange rate developments. Growth of broader monetary aggregates remained broadly within the program targets, with broad money supply (M3) and credit to the private sector growing at about 19 percent and 25 percent, respectively, for the year ending December 2015, and about 13 percent and 19 percent for the year ending April 2016. The shilling exchange rate experienced high volatility in the last quarter of 2014/15 but stabilized subsequently reflecting the tightening of monetary policy among other factors. Consistent with the objective of improving the conduct of monetary policy, the Bank has increased its focus on the stability of banks' free reserves, as manifested in the active use of reverse repos to prop up liquidity among banks. This has, in turn been mirrored in the stability of interbank cash market rate in the second half of 2015/16.

Financial Sector and Capital Account

6. Financial sector stability. The banking sector has remained sound and stable with levels of capital and liquidity above regulatory requirements. At the end of March 2016, the ratio of core capital to total risk weighted assets and off-balance sheet exposures was 18.0 percent compared with the minimum legal requirement of 10 percent, while the ratio of liquid assets to demand liabilities stood at 36.6 percent which was well above the minimum regulatory limit of 20 percent. The quality of the banking sector's assets deteriorated, as reflected by the increase in the ratio of non-performing loans to gross loans (NPLs) to 8.3 percent from 6.7 percent recorded at the end of March 2015. The majority of banks continue to have low NPLs, i.e., below 5 percent of gross loans. The category with the highest level of NPLs was the agricultural loan sector, followed by trade sector. It remains the BoT's medium-term goal to bring the overall ratio to below the 5 percent level. In response to the increase, the BoT has directed banks with high NPL levels to formulate and implement measures to bring the ratio down, and for large banks in this group to report on a quarterly basis to the central bank on their progress. In addition, banks have been encouraged to increase their use of the existing credit reference system to reduce credit risks going forward.

7. FBME Bank. The bank continues to offer limited services under statutory management of the BoT. A final rule was issued by FinCEN on 25th March 2016, and will take effect on 29th July 2016. Further, liquidation proceedings against the FBME Bank's Cyprus branch are awaiting court approval following withdrawal of its license in December 2015 by the Central Bank of Cyprus. The BoT is finalizing a review of the current state of affairs of FBME Bank in light of these developments with a view of taking appropriate course of action.

8. Financial sector development. Credit reference bureaus are in operation and help reduce information asymmetries between lenders and borrowers, thereby enabling banks to allocate risk efficiently. In a bid to improve the financial sector, the Bank of Tanzania strengthened its supervisory and regulatory role through issuance of new Social Security Investment Guidelines of 2015, the Banking and Financial Institutions (Mortgage Finance) Regulations, 2015, and the Foreign Exchange (Bureau de Change) Regulations, 2015. The legal and regulatory framework for the National Payment Systems was enhanced by operationalizing the National Payment Systems Act 2015 in October 2015 and its accompanying regulations - Licensing and Approval Regulations 2015 and the Electronic Money Issuance Regulations 2015 (licensing of banks and non-banks and electronic money issuers). The new law and regulations are aimed at closing regulatory gaps and strengthening the legal and regulatory framework, while taking on board new developments in the sector.

9. Capital account liberalization. Efforts are underway by the government to lift capital account restrictions and enable participation of the rest of the world. The process of liberalizing capital account transactions was initiated in 2015 by reviewing the relevant regulations and the circular which restricted capital movements. These include the Foreign Exchange Regulations of 2014 and Foreign Exchange Circular of 1998. Draft Regulations which will permit capital and financial account transactions with the rest of the world have been prepared and are currently at an advanced stage of being approved. Draft regulations contain safeguards measures, including prudential rules like minimum holding period for debt flows to ensure orderly conditions in the market. Based on the experience from the partial capital account liberalization to the countries of the East African Community, the new regulations are expected to impose fewer restrictions, particularly with regard to the prescribed holding periods and limits on the share any issuance of government debt that can be held by any category of non-resident. The plan is to have the regulations published in the Government Gazette before end of June 2016.

B. Program Performance

10. Quantitative targets and structural benchmarks. All assessment criteria and quantitative targets for end-2015 were met. The structural benchmark on producing a new medium-term debt management strategy was met and the document was published on the Ministry of Finance and Planning website by end-2015. The technical work to merge the statutory minimum reserve and clearing accounts of commercial banks with the BoT, as well as the necessary changes to the IT system required for that purpose are well-advanced. This is an important step towards implementation of the reserve averaging. The next step is to familiarize banks with the new system before the accounts are merged and required reserve averaging is implemented. The indicative target on average reserve money for end March 2016 was met.

II. THE ECONOMIC PROGRAM FOR THE REMAINDER OF 2015/16 AND FOR 2016/17

11. MKUKUTA II implementation cycle ended in 2015/16, with its unfinished agenda integrated into the FYDP II. There is encouraging progress in some of the indicators. Poverty is becoming more responsive to economic growth, with the poverty rate declining by 6.4 percentage points between 2007 and 2012 (at 28.2 percent). The Human Development Index (HDI) value for Tanzania improved to 0.521 (2014) from 0.466 (2011). Outcomes in health and education improved though at low levels. In health outcomes, for instance, the infant mortality rate declined to 43 deaths per 1000 live births in 2015 from 51 recorded in 2010; the under-five mortality rate declined from 81 deaths per 1000 live births in 2010 to 67 deaths. While the maternal mortality ratio is on the decline, it remains unacceptably still high, at 432 deaths per 100,000 live births recorded in 2012 down from 454 deaths in 2010. Access to education at all levels is also improving, though quality remains a concern. On governance and accountability performance targets, there have been improvements in the areas of public finance management, access to justice, transparency, combating corruption, as well as wider participation at local levels. Challenges remain in many aspects of access to quality social services, nutrition and food, and income securities, as well as rural development including access to affordable energy and roads. These concerns are integrated into the FYDP II agenda as core elements of the transformation process.

12. Economic development priorities. FYDP II, which will also be Tanzania's third poverty reduction strategy, is expected to be completed shortly and will start being implemented in 2016/17. It will focus on economic transformation through industrialization and human development. On the latter, priority will be given to improving social services (education, health, housing, water and sanitation), enhancing income security, and promoting social protection. The industrialization strategy will rely on Tanzania's comparative advantages, particularly its agricultural and mining potential, its large labor force, and its geographic location making it a natural trading and logistics hub for East Africa. The government will play a facilitating role, for instance through the provision of critical infrastructure (e.g., the rehabilitation of the central transportation corridor, the development of the ports of Dar es Salaam and Kigoma, the creation of the new one in Bagamoyo, the provision of abundant and affordable energy) and improving the business environment (including through special economic zones). Costing of the plan, and its inclusion in a medium-term macroeconomic framework closely related to the annual budget process, is still ongoing. It is expected, however, that the financing of the plan will require creating fiscal space through higher revenue mobilization and expenditure streamlining, to avoid excessive recourse to public debt. The use of Public Private Partnerships (PPPs) is also expected to implement some of the large infrastructure projects.

A. Monetary, Exchange Rate, and Financial Sector Policies

13. Monetary policy stance. The money multiplier has increased in recent years, possibly on the back of financial innovations such as mobile money. It is projected to further increase, leading to a relative decline in currency in circulation, replaced by access to the formal financial system. Thus, M3 is projected to grow by 16 percent in the year ending June 2016, giving significant room for growth of credit to the private sector. The Bank will continue pursuing a prudent monetary policy during 2016/17 to keep inflation close to the 5 percent objective, with average reserve money targeted to grow at 12.5 percent. M3 and private sector credit would grow by about 15 percent.

14. Modernizing the monetary policy framework. In an effort to improve the functioning of the market and stability of interbank interest rates, the BoT will further enhance information sharing with commercial banks to help them better manage liquidity. The BoT will also review its collateral framework with a view to expanding the range of eligible collateral needed to access the various central bank facilities by end-July 2016. The review will consider steps that are needed to expand the range of eligible collateral from the current practice of only accepting government securities with a remaining maturity of not more than 6 months. The Lombard window will retain its role in providing emergency liquidity to banks against good collateral at penalty rates. Steps will be taken towards making the Lombard rate more predictable in order to enhance stability of the short-term interest rates. A study will be carried out by end-September 2016 to determine an approach of setting the Lombard rate in a manner that is consistent with the monetary policy stance while ensuring that the facility is not abused (new structural benchmark). The BoT is taking initial steps towards using short-term interest rate for implementation of monetary policy, which is in line with the ongoing initiatives to harmonize monetary policy operations with other EAC member states. It is expected that partial reserve averaging will be implemented by end-June 2016, which will further reduce the volatility of the interbank interest rates.

15. Exchange rate policy. Exchange rates will continue to be market determined, with the BoT participating in the IFEM solely for liquidity management purposes and intervening occasionally to smooth out excessive short-term volatility in the exchange rate. These operations are undertaken while being mindful of ensuring international reserves remain adequate.

16. Financial sector development plans. Recognizing the importance of further financial development in sustaining growth and promoting macroeconomic stability, the government and the BoT are committed to addressing a number of gaps. Sustainable credit growth will require improvements in a number of areas. Information to assess credit risks needs to be made more reliable and widely available, which will contribute to better access to finance and more efficient pricing of loans. The BoT will therefore continue to strengthen monitoring of data submitted to the Credit Reference Databank with the aim of improving relevance and reliability of information shared among lenders. To improve Small and Medium Enterprises'

(SME) access to finance, government is planning to review its SME policy, establish an SME Access to Finance Framework, digitize all transactions of enterprises, explore financing mechanism options for enterprises and establish collateral registration for SMEs. Meanwhile, an internet-based information portal for SMEs was launched on 10th March 2016 to enhance financial literacy and entrepreneurship skills among Micro and Small Medium Enterprises (MSMEs) as well as improve access to financial services and markets. The information is designed to be a one stop center for a wide range of information that small businesses require. To improve access to finance, the government has initiated the drafting of microfinance legislation that will ensure that the microfinance sector is adequately regulated and supervised. The recent success in rolling out a mobile platform that allows users to participate in capital market activities during a recent initial public offering was encouraging. A range of measures will also be considered to foster the development of the government debt market, such as: publishing a quarterly bond auction calendar including tenors (consistent with the overall borrowing plan for the fiscal year); reopening bond series to provide the market with more liquid instruments; and enhancing communication with market participants.

17. Banking supervision framework. The BoT is drafting guidelines to ensure effective implementation of Basel II/III requirements. Efforts are underway to review the existing guidelines on corporate governance for banking institutions, business continuity management in banking institutions, agent banking and physical security measures regulations. In addition, plans are underway to develop guidelines on mergers and acquisitions as well as guidelines on banking holding companies.

B. Fiscal Policies

Budget Implementation in 2015/16 and Budget Plans for 2016/17

18. Budget implementation in 2015/16. The 2015/16 budget was revised in early 2016 to make space for new expenditure priorities in the education sector, additional expenditures on public infrastructure projects, and some expenditures carried over from 2014/15. In addition, external financing shortfalls of about 1 percent of GDP require a downward revision to the expenditure level and a reduction of the overall deficit target to about 3¼ percent of GDP. Tax revenue projections in the revised framework are unchanged, in light of developments in the first 9 months of the fiscal year. Expenditure savings come from delaying non-priority projects and cutting goods and services spending. Parliament’s budget committee was informed in April.

19. Budget plans for 2016/17. The 2016/17 budget will be the first one reflecting fully the new administration’s priorities, as laid out in FYDP II. It will strike a balance between raising public investment to address various development needs and ensuring debt sustainability. The budget thus assumes a higher deficit of around 4.5 percent of GDP. Given the multi-year nature of the planned investments, the fiscal deficit is expected to remain elevated for a few years, before gradually declining to about 3 percent of GDP in the medium term, which is consistent with Tanzania’s commitments towards the East African Monetary Union and maintaining a low risk of debt distress. Creating fiscal space for investment will require ambitious but realistic revenue mobilization efforts. They will include a mix of tax policy and tax administration measures (see below). In addition, nontax revenue is expected to increase significantly: the annual contribution to the budget of 15 percent of revenue will be extended to 10 more parastatals; in addition, following a careful analysis of their financial position, a number of parastatals will make a one-off contribution to the budget on account of retained earnings. Finally, efficiency gains are expected in the collection of various fees. The draft budget is also built on a major shift in expenditure composition to increase the share dedicated to investment. With regard to the latter, the government intends to scale up capital expenditure to 48 percent of total expenditure compared to about 30 percent in 2015/16 budget. Consistent with our new MTDS, budget financing will increasingly rely on project financing from multilateral development banks and export credit agencies, which is more affordable than market terms. Prudent assumptions with regard to donor budget support have been used, in light of the uncertainty in this area; significant amounts of donor project financing are still expected, however. To reduce rollover risks, the government will aim at lengthening the average maturity of domestic debt.

20. Risks and contingency measures. The 2016/17 budget is built on the assumptions of enhanced tax compliance as well as improved tax and non-tax policy. The Government is confident that these measures will lead to much higher revenue mobilization. However, consistent with its commitment to fiscal discipline, the Government intends to start some large projects only after confirmation in the next mid-year budget review of adequate preparation and availability of revenue. This will be the case, in particular, for the standard gauge railway for the central corridor and the renovation of the Dar es Salaam port, whose combined budget allocation in 2016/17 exceeds 1 percent of GDP. Similarly, projects for which external financing has not been mobilized in the course of 2016/17 will be postponed. These measures will ensure that the 2016/17 deficit does not exceed the budget target and limit the risk of expenditure arrears.

Revenue Mobilization

21. Tax policy reforms. Various analyses show that despite some improvements in recent years, Tanzania's tax revenue ratio remains relatively low, even when compared to other low-income countries. As discussed earlier, significant improvements in revenue mobilization will be critical to finance new investments and address the country's development needs in a sustainable way. Closing the revenue gap will require reforms in both tax policy and tax administration. Efforts in the tax policy area have already started with implementation of the new VAT law since July, 2015 which broadened the tax base by removing a number of exemptions. However, more reform needs to be done in this area to bring VAT revenue yield close to the regional average of about 4.5 percent of GDP in the medium term and more than 6.0 percent of GDP in the long term. The Government will prepare a tax policy strategy by end December, 2016, which will among others, explore the scope to further removal of some VAT exemptions, improvement of the VAT refund mechanism, streamlining a number of corporate income tax holidays and exemptions, more regular indexation of specific excise duty rates by the level of inflation, and modernization of mechanism for property taxation. The Government will submit before the Parliament during the 2016/2017 Budget session a proposal to repeal section 145 of the Income Tax Act Cap 332 and substitute it with new provisions that will deal with taxation of extractive industry, including mining and petroleum taxation. The main issues, among others, will be the introduction of ring-fencing clauses which will be applicable in the extractive industry and the introduction of an additional profit tax for the industry.

22. Tax administration reforms. The recent assessment using the Tax Administration Diagnostic Assessment Tool (TADAT) identified a number of weaknesses, in particular in voluntary tax compliance, the integrity of the taxpayer register, the IT system and its oversight, the assessment and management of institutional risks, the processing of taxpayer accounting transactions, audit case selection, the VAT refund process and its financing, and performance monitoring practices. Our priority is to enhance TRA's IT system to improve the integrity of the taxpayer register, which is a precondition for more effective management of compliance. The introduction of the new Tax Administration System (IDRAS) by end-October 2016 (new structural benchmark) will improve the monitoring of timeliness of payments and taxpayer account balances. Finally, risk management will be strengthened, with a focus on auditing practices. Measures will also be taken to strengthen customs management, such as improving the cargo control systems in the port of Dar es Salaam, reducing dwell times through effective risk management, improving the transit management systems, and improving valuation and classification practices.

Fiscal Aspects of Energy

23. Power sector. Recent developments in the power generation mix are expected to have a positive impact on TANESCO's financial situation. Thanks to the replenishment of water reservoirs in recent months and the completion of the gas pipeline and the Kinyerezi I power station, most of the demand is currently met from gas-fired or hydro-electric generation units, whose marginal production cost is below the average tariff. The government has also already transferred this fiscal year close to TSh 200 billion to TANESCO to clear arrears on its electricity bills. The government has also implemented a series of measures that have helped increase TANESCO's financial management and revenue collection including: installation of automatic meter reading to big customers; curbing power ghost vendor machines by changing prepaid meters coding; enforcing penalty and disconnection policy for non-paying customers; and intensifying collection efficiency through increased use of prepaid meters (including for government entities). TANESCO's financial situation, however, remains difficult, and its arrears to suppliers still stood at about US$300 million in April 2016. To address these arrears, the government is considering engaging commercial banks that are willing and ready to pay TANESCO's creditors and convert the amount paid into a long-term loan. Due to TANESCO's limited creditworthiness, it is likely that those banks would require a government guarantee.

Fiscal Aspects of Pensions and Pension Reform.

24. Arrears to pension funds. The Government has revisited its plan of issuance of non-cash special bond for settlement of Pensions Funds debt by extending the timing for issuance. The decision was made to allow the Internal Auditor General to conduct a thorough verification of the total outstanding debts in order to ascertain their authenticity prior to the issuance of the special bonds. The verification has started and the issuance of non-cash special bond is expected by end-December 2016.

25. Pension reform. The actuarial valuation exercise has been completed and discussions with stakeholders on the needed parametric reforms and merging of pensions schemes are ongoing. A special task force has been formed under the Prime Minister's Office to fast-track the merging process.

C. Public Finance and Debt Management

Public finance and debt management

26. Management of domestic expenditure arrears. As of end-December 2015, the stock of verified and unverified expenditure arrears amounted to 2.1 percent of GDP. The settlement of verified expenditure arrears (accumulated up to end-June 2014) has started. These arrears will be fully settled by the end of the fiscal year. The verification of expenditure arrears accumulated since June 2014 is well advanced in a few priority areas (e.g., ministry of works, teachers' remuneration). All arrears accumulated through end-2015 will have been verified by end-June 2016, and their settlement will be implemented with the 2016/17 budget. The budget for 2016/17 emphasizes the priority for accounting officers to clear existing arrears before entering into new commitments. As an immediate priority, commitment and expenditure control against the exchequer releases will be re-established in IFMIS by July 2016. A new public awareness campaign will be launched by end-July 2016 to warn suppliers that orders not generated through IFMIS will not be honored (new structural benchmark). The 2016/17 Budget Speech already made this point.

27. Improving budget credibility and expenditure management. More realistic budgets (both on the revenue and financing side) and tightening of commitment controls will be critical to avoid arrears accumulation and reduce inefficient budget adjustments in the course of the fiscal year. Expenditure and resource mobilization plans will be more closely aligned, with the borrowing plan taking into account the seasonal pattern of revenue and the expected pace of expenditure implementation. Predictability of cash releases has been a source of arrears accumulation, as exchequers could be issued but not be paid due to unanticipated shortage of resources. An expert has been hired to enhance IFMIS with a contract management module that will enable to track multi-year commitments over the life cycle of the budget. This will ensure proper budgeting of the required resources, and further improve the integration of the medium-term expenditure framework into the annual budget process.

28. Public debt management. The approval of the National Debt Management Policy and proposed amendments to the Government Loans, Guarantees and Grants Act Cap. 134 were deferred to incorporate changes in the structure of the Ministry of Finance and Planning. Under the new structure the responsibilities of debt management rest with the Ministry of Finance and Planning. The structure of debt management has remained the same and there are no new responsibilities which have been transferred to the Bank of Tanzania. The Bank of Tanzania remains as an Agent of the Government responsible for issuance of Government Securities. The Policy and Act were prepared with a view to strengthening management of public debt, including providing the legal underpinning for a new debt management department to effectively discharge its responsibilities. The approval of the Policy and Act by Cabinet are now expected by end-July 2016.

Monitoring and Management of the Public Sector

29. The Office of the Treasury Registrar (OTR) will continue preparing and publishing information on each Public Institution and Statutory Corporation's (PISC) revenues, expenditures, profits and losses. An information system is being put in place, which will facilitate quarterly financial reporting by PISCs and consolidation and analysis of that information by OTR. The system is expected to be operational in the coming months, with a first quarterly report by OTR by end-September 2016 (new structural benchmark). In the meantime, PISCs have been directed to open revenue accounts with the BoT, to facilitate monitoring of their operations by OTR. An operating expenditure ceiling of 60 percent of annual gross revenue applies to PISCs that are not receiving Government transfers. For those receiving Government transfers, scrutiny of their budgets will continue. OTR is entering into Performance Contracts with each PISC's Chief Executive Officers and Board Chairpersons. Capacity will continue to be built at OTR to perform all this functions.

D. Other Reforms

30. Improving the business environment in support of economic diversification. Establishing a conducive business environment and investment climate for the private sector to participate competitively and efficiently in economic development has been one of the Government's key agendas. In this regard, the FYDP II underscores the importance of an enabling environment for the establishment and operation of enterprises and set targets that are to be achieved in the next five years. The planned targets and interventions include a reduction in the cost of doing business through legal and regulatory reform, easing registration and license requirements in order to promote both domestic and foreign investors, enforcing property rights and legal instruments, and availability of reliable and affordable energy.

31. Improving governance. The Government of Tanzania recognizes corruption as a serious problem affecting social economic development of the country and therefore a number of initiatives have been taken to deal with this problem. They include the establishment of a National Anti-Corruption Strategy (NACSAP), which focuses on building systems of integrity, accountability and transparency in public institutions. The strategy provides the framework within which public entities are required to initiate concrete measures to address corruption in their areas of jurisdiction. Currently, the Government is preparing NACSAP III which has been designed to strengthen coordination, monitoring and evaluation, devise strong ethics promotion and to have a wider stakeholders' participation in the fight against corruption. The NACSAP will benefit from initiatives underway to enhance discipline in the public service and step up the fight against corruption, including the establishment Corruption and Economic Crimes Division of the High Court.

32. Developing the energy sector. Further commissioning of gas-fired units in the coming years will ensure a sustained reduction of power generation costs. The resolution of TANESCO's arrears and the overall improvement in its financial situation will make it a more credible interlocutor for independent power producers, which will be required to develop production capacity, and on-shore gas providers. This will facilitate the development of on-shore gas resources, which are significant and could play a critical role in the development of energy-intensive industries. The government has resumed discussions with international companies involved in off-shore gas exploration, with a view to providing the conditions allowing them to reach an investment decision.

33. Fostering regional integration. Work is ongoing to implement the single customs territory, with a focus on facilitating trade along the central corridor. Customs systems have been connected, and customs officials from other EAC partner states are already present at the port of Dar es Salaam and able to clear certain goods destined to their countries. Significant progress has been made to reduce non-trade barriers, and efforts in this area will continue. An assessment of the experience with the first phase of implementation of the common market is currently undertaken at the EAC level; its conclusions will inform the next integration phase. Tanzania remains committed to the full implementation of the common market, which is consistent with the objective of making the country a trade and logistics hub for East Africa. Work to harmonize a number of policies and data is also ongoing in the context of the convergence towards EAMU.

34. Improving Statistics. The Government will continue its efforts to improve data quality and dissemination to facilitate economic analysis and policy making. Substantial progress has been made in improving statistics over the past few years, including rebasing their benchmark years and expanding coverage, with assistance from the IMF and donor partners. The Government will soon participate in the Enhanced General Data Dissemination Standard (e-GDDS) initiative to further enhance data dissemination practices. Fiscal data will continue to be improved, including expanding coverage to general government, and moving to GFSM2001/14 standards. The NBS will continue to improve the national accounts data, including deflators, and plan to release expenditure components of quarterly GDP later in 2016.

III. PROGRAM MONITORING

35. Assessment criteria for end-December 2016, and indicative targets for end-September 2016, end-March 2017, and end-June 2017 are set as per Table 1. It is proposed to reschedule to end-December 2016 the two missed structural benchmarks on the clearance of arrears to pension funds, to allow for a new verification of claims by the Internal Auditor General. It is also proposed to modify the assessment criteria for NIR and the overall fiscal deficit for end-June 2016, to reflect the large expected shortfall in external financing. The fifth and sixth reviews under the PSI are expected to take place by December 31, 2016 and June 30, 2017, respectively, on the basis of the assessment criteria and structural benchmarks indicated in Tables 1 and 2, attached.

Table 1. Tanzania: Quantitative Assessment Criteria (AC) and Indicative Targets (IT) Under the Policy Support Instrument, December 2015–June 2017

	Dec. 2015				Mar. 2016				June 2016		Sep. 2016	Dec. 2016	Mar. 2017	June 2017
	AC				IT				AC		IT	AC	IT	IT
	Program	Adjusted Criteria	Actual	Met?	Program	Adjusted Criteria	Actual	Met?	Program	Proposed	Proposed	Proposed	Proposed	Proposed
	(Billions of Tanzania Shillings; end of period, unless otherwise indicated)													
Average reserve money (upper bound) [2]	6,913	6,913	6,862	✓	6,912	6,912	6,533	✓	7,076	7,076	7,418	7,729	7,925	7,958
Average reserve money target [2]	6,845	…	…		6,843	…	…		7,006	7,006	7,345	7,652	7,846	7,879
Average reserve money (lower bound) [2]	6,776	…	…		6,775	…	…		6,936	6,936	7,272	7,576	7,768	7,801
Tax revenues (floor)[1]	5,923	5,923	5,987	✓	8,971	8,971	9,170	✓	12,229	12,229	3,385	7,086	10,672	14,448
Priority social spending (floor; indicative target)[1]	1,400	1,400	1,696	✓	2,100	2,100	2,530	✓	2,800	2,800	790	1,580	2,370	3,160
Accumulation of domestic expenditure arrears (ceiling)[1, 3]	0	0	294	×	0	0	44	×	0	0	0	0	0	0
Fiscal deficit (cumulative, floor) [1, 6, 7]	-1,992	-1,992	-1,788	✓	-2,988	-3,024	-1,883	✓	-3,984	-3,161	-1,219	-2,403	-3,650	-5,027
	(Millions of U.S. dollars; end of period)													
Change in net international reserves of the Bank of Tanzania (floor) [1, 4, 5]	-254	-288	-76	✓	-120	-420	-260	✓	481	16	181	310	439	567
Accumulation of external payment arrears (continuous AC ceiling)[1]	0	0	0	✓	0	0	0	✓	0	0	0	0	0	0
Memorandum items:														
Foreign program assistance (cumulative grants and loans; millions of U.S. dollars)[1]	173	173	140		294	294	172			257	55	160	202	378
o.w. Program grants (millions of U.S. dollars)[1]	24	24	34		54	54	38			73	5	34	50	108
External nonconcessional borrowing (ENCB) disbursements to the budget (millions of U.S. dollars)[1]	79	79	79		432	432	65			533	315	629	944	1,259
Arrears to PSPF on account of the 1999 reform cleared from the beginning of fiscal year 2015/16 (billions of Tanzania shillings)[1]			0				0							
by the government from the beginning of fiscal year 2015/16 (billions of Tanzania shillings)[1]			0				0							

Note: For precise definitions of the aggregates shown and details of the adjustment clauses, see the Technical Memorandum of Understanding (TMU).

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

2 Assessment criteria and indicative targets apply to upper bound only.

3 Starting from June 2016, AC for the end of the fiscal year in June, otherwise IT.

4 Floor will be adjusted downward by the amount in U.S. dollars of any shortfall in foreign program assistance and ENCB financing of the government, up to the equivalent of US$300 million.

5 Starting end-December 2015 the NIR target excludes short-term (less than 1 year) foreign exchange liabilities to residents.

6 The fiscal deficit is measured on a cash basis from the financing side at the current exchange rates and is defined as a sum of (i) net domestic financing (NDF) of the Government; (ii) net external financing and (iii) privatization receipts as defined in the TMU.

7 The deficits in 2015/16 and 2016/17 will be adjusted upward by the amount of arrears to PSPF on account of the 1999 reform and the amount of loans in arrears made by pension funds to government entities (recognized by the government) that were cleared during each fiscal year. The cumulative upward adjustment to the limits on the deficits in 2015/16 and 2016/17 will be capped by the total amount of arrears and loans that are recognized in the strategy to clear arrears to pension funds. The deficit will be increased by any shortfalls in foreign program grants up to a cumulative ceiling of equivalent to US$200 million calculated at the program exchange rate.

Structural Benchmarks Under the Policy Support Instrument, December 2015–June 2016			
Measure	***Macroeconomic rationale***	***Target date***	***Notes***
Public Finance Management/Fiscal Risks			
Settlement of arrears to PSPF on account of 1999 reform	To address fiscal risks	End-March 2016	Not met. To be rescheduled for end-December 2016 to allow for new verification by the Internal Auditor General
Settlement of arrears to pension funds on loans made to government	To address fiscal risks	End-June 2016	Expected to be missed. To be rescheduled for end-December 2016 to allow for new verification by the Internal Auditor General
Launch a new public awareness campaign to warn suppliers that orders not generated through IFMIS will not be honored	To prevent arrears accumulation	End-July 2016	New
Monetary, Financial and Exchange Rate Policies			
Unify the Statutory Minimum Reserve and the clearing accounts that banks maintain at the BoT and implement partial reserve averaging for reserve requirements	To reduce excessive volatilities in short term money market interest rates.	December 31, 2015	Not met. Expected to be implemented by end-June 2016
Produce a study making recommendations on the use of foreign exchange swaps between commercial banks and banks' NOP limit.	To improve liquidity in the foreign exchange market	End-June 2016	Ongoing
Carry out a study to determine an approach of setting the Lombard rate to make it more predictable (in order to enhance stability of the short-term interest rates) while consistent with	To reduce excessive volatilities in short term money market interest rates.	End-September 2016	New

the monetary policy stance and ensuring that the facility is not abused.			
Public Debt Management			
Update the medium-term debt management strategy, and obtain approval by the Minister for Finance	To enhance public debt management	December 31, 2015	Met.
Government to approve the National Debt Management Policy and amendments of the Government Loans, Guarantees and Grants Act	To enhance public debt management	End-March 2016	Not met. Expected to be implemented by end-July 2016
Public sector monitoring			
Office of Treasury Registrar to publish first quarterly report on major Public Institution and Statutory Corporations' revenues, expenditures, and profits and losses	To improve the monitoring of parastatals and transparency	End-September 2016	New
Improve revenue mobilization			
Introduction of a new Tax Administration System (IDRAS)	To improve tax administration	End-October 2016	New

Attachment II. Technical Memorandum of Understanding on Selected Concepts and Definitions Used in the Monitoring of the Program Supported by the PSI

June 28, 2016

I. INTRODUCTION

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

2. The principal data sources are the standardized reporting forms, 1SR and 2SR, as provided by the Bank of Tanzania (BoT) to the IMF, and the government debt tables provided by the Accountant General's office.

3. The program exchange rate is TSh/USD 2,179.60.

II. DEFINITIONS

Net international reserves

4. Net international reserves (NIR) of the BoT are defined as reserve assets of the BoT minus reserve liabilities of the BoT. The change in NIR is calculated as the cumulative change since the beginning of the fiscal year. The BoT's reserve assets, as defined in the IMF BOP manual (5th edition) and elaborated in the reserve template of the IMF's special data dissemination standards (SDDS), include: (i) monetary gold; (ii) holdings of SDRs; (iii) the reserve position at the IMF; (iv) all holdings of foreign exchange; and (v) other liquid and marketable assets readily available to the monetary authorities. Reserve assets exclude assets pledged or otherwise encumbered, including but not limited to assets acquired through short-term currency swaps (maturing in less than one year) and other assets used as collateral or as guarantee for a third party external liability (assets not readily available). The BoT's reserve liabilities include: (i) all foreign exchange liabilities except government's foreign currency deposits of residual maturities more than one year; and (ii) outstanding purchases and loans from the IMF, as recorded in the financial position of Tanzania with the IMF by the Finance Department of the Fund.

5. NIR are monitored in U.S. dollars, and for program monitoring purposes assets and liabilities in currencies other than U.S. dollars shall be converted into dollar equivalent values using the exchange rates as of March 31, 2016 (as recorded in the balance sheet of the BoT).

	US$ per currency unit
British pound	1.4404
Euro	1.1313
Japanese yen	0.0089
Australian dollar	0.7672
Canadian dollar	0.7686
Chinese yuan	0.1544
SDR	1.3988
Swedish Krona	0.1224
Kenyan Shilling	0.0099
South African Rand	0.0669

Reserve money and reserve money band

6. Reserve money is defined as the sum of currency issued by the BoT and the deposits of Other Depository Corporations (ODCs) with the BoT. The reserve money targets are the projected daily averages of March, June, September, and December within a symmetrical one percent band. The upper bound of the band for June and December serves as the assessment criterion and that for March and September, the indicative target.

Fiscal cash deficit of the Government of Tanzania

7. The fiscal cash deficit of the Government (central and local governments only) will be measured on a cash basis from the financing side at the current exchange rates. The deficit is defined as the sum of: (i) net domestic financing (NDF) of the Government; (ii) net external financing and (iii) privatization receipts. Any amounts in foreign currency will be converted into Tanzanian shillings at the exchange rates as of the dates of the transactions.

i. NDF is calculated as the cumulative change since the beginning of the fiscal year in the sum of:

   a. loans and advances to the government by the BoT and holdings of government securities and promissory notes (including liquidity paper issued for monetary policy purposes), minus all government deposits with the BoT, which comprise government deposits as reported in the BoT balance sheet, 1SR (including counterpart deposits in the BoT of liquidity paper issued for monetary policy purposes) and foreign currency-denominated government deposits at the BoT (including the PRBS accounts and the foreign currency deposit account).

   b. all BoT accounts receivable due from the Government of Tanzania that are not included under (i) above;

c. loans and advances to the government by other domestic depository corporations and holdings of government securities and promissory notes, minus all government deposits held with other domestic depository corporations;

d. loans and advances to the government, and holdings of government securities and promissory notes by other public entities (e.g. pension funds) not covered by the central government accounts; and

e. the outstanding stock of domestic debt held outside domestic depository corporations and other public entities, excluding: government debt issued for the recapitalization of the NMB and TIB; debt swaps with COBELMO (Russia) and the government of Bulgaria; mortgage on acquired sisal estates; compensation claims; and debt of parastatal companies assumed by the government.

f. NDF will be measured net of any accumulation of central government claims on the Tanzania Petroleum Development Corporation (TPDC) as a result of the on-lending of an external credit to finance a gas pipeline.

ii. Net external financing is measured on a cumulative basis from the beginning of the fiscal year and is defined as the sum of disbursements minus amortization of budget support loans, project loans, external non-concessional borrowing (ENCB) including project ENCB directly disbursed to project implementers; and any other forms of Government external debt. The term "external debt" will have the meaning set forth in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt (Executive Board's Decision No. 6230-(79/140), as amended by Decision No. 14416-(09/91), effective December 1, 2009). Government external debt is understood to mean a direct, i.e. not contingent, liability to non-residents of the Government of Tanzania.

iii. Privatization receipts consist of net proceeds to the Government of Tanzania in connection with the sale/purchase of financial assets that are not included in NDF and the sale of intangible nonfinancial assets, such as leases and the sale of licenses with duration of 10 years or longer. For the 2015/16 budget, privatization proceeds will exclude TSh 212 billion from the sale of shares in Tanzania Breweries Limited and Tanzania Cigarette Company, which were included in non-tax revenue projections.

Domestic expenditure arrears

8. Domestic expenditure arrears are defined as unpaid claims that are overdue by more than 30 days for goods and services and more than 90 days for contract works as set out in the government's Circular No 9 of 8th December 2014. These will include payments for tax refunds, employee expenses (wages and salaries, staff claims for travel, transfer and other non-salary allowances), utilities, rents, recurrent goods and services, and construction works. Accumulation of domestic expenditure arrears is calculated as a cumulative change in the stock of expenditure arrears at the end of each quarter from the stock at the end of the previous fiscal year (June 30).

External payment arrears

9. External payment 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 and arrears previously accumulated and reported to the Executive Board. The ceiling on external payment arrears is continuous and applies throughout the year.

Priority social spending

10. Priority social spending comprises spending on agricultural inputs, and central government transfers to local governments for health and education.

Tax revenues

11. Tax revenues include import duties, value-added tax, excises, income tax, and other taxes.

Arrears to pension funds

12. Arrears to pension funds include government obligations to the Public Service Pension Fund (PSPF) on pre-1999 reform pension benefits paid on government's behalf and overdue payments on loans made by pension funds to public entities.

Foreign program assistance

13. Foreign program assistance is defined as budget support and basket grants and loans received by the Ministry of Finance and Planning (MoFP) through BoT accounts and accounts at other depository corporations and is calculated as the cumulative sum, since the beginning of the fiscal year, of the receipts from (i) program loans and (ii) program grants. Program assistance does not include nonconcessional external debt.

III. ADJUSTERS

Net international reserves

14. The end-of-quarter quantitative targets for the change in the BoT's net international reserves will be adjusted downward by the amount in U.S. dollars of any shortfalls in (a) foreign program assistance and (b) external nonconcessional borrowing (ENCB) financing of the government budget, up to a limit of US$300 million.

15. The shortfalls will be calculated relative to projections for foreign program assistance shown in the table attached to the applicable Letter of Intent and Memorandum of Economic and Financial Polices of the Government of Tanzania titled "Quantitative Assessment Criteria, and Indicative Targets under the Policy Support Instrument". For purposes of the adjuster, ENCB is measured excluding any non-concessional financing contracted for the gas pipeline.

Fiscal cash deficit

16. The end-of-quarter limits in 2015/16 and 2016/17 will be adjusted upward by the amount of arrears to PSPF on account of the 1999 reform cleared from the beginning of each fiscal year and the amount of loans in arrears made by pension funds to government entities and cleared by the government from the beginning of each fiscal year. The cumulative upward adjustment to the limits on the deficits in 2015/16 and 2016/17 will be capped by the total amount of arrears and loans that are recognized and taken over by the authorities at the end of the verification and reconciliation process.

17. The end-of-quarter limits will be increased by any shortfalls in foreign program grants up to a cumulative ceiling of equivalent to US$200 million calculated at the program exchange rate (para 3).

18. The foreign program grant shortfalls will be calculated relative to projections for foreign grants shown in the table attached to the applicable Letter of Intent and Memorandum of Economic and Financial Polices of the Government of Tanzania titled "Quantitative Assessment Criteria, and Indicative Targets under the Policy Support Instrument".

IV. DATA REPORTING REQUIREMENTS

For purposes of monitoring the program, the Government of Tanzania will provide the data listed in Table 1 below.

Table 1. Summary of Reporting Requirements

Information	Reporting Institution	Frequency	Submission Lag
Issuance of government securities.	BoT	Bi-weekly	1 week
Yields on government securities.	BoT	Bi-weekly	1 week
Daily excess reserves of commercial banks	BoT	Weekly	1 week
Daily data on transactions through IFEM by exchange rate and volume, separating BoT and commercial bank transactions	BoT	Weekly	1 week
Daily data on reserve money and its components	BoT	Daily	1-day
Consumer price index.	NBS	Monthly	2 weeks
The annual national account statistics in current and constant prices.	NBS	Annually	6 months
The quarterly national account statistics in constant prices.	NBS	Quarterly	3 months
Balance sheet of the BoT (1SRF) and the currency composition of official foreign assets and official foreign liabilities.	BoT	Monthly	1 week
Consolidated accounts of other depository corporations and the depository corporations survey (2SRF and the DCS).	BoT	Monthly	4 weeks
Information on foreign currency swaps entered into with residents and non-residents, including amounts, dates on which agreements come into effect and expire, and terms of swaps.	BoT	Monthly	4 weeks
Summary of stock of external debt, external arrears, and committed undisbursed loan balances by creditor.	MoFP	Monthly	2 weeks
External trade developments.	BoT	Monthly	4 weeks
Balance of payments	BoT	Quarterly	4 weeks
Standard off-site bank supervision indicators for other depository corporations.	BoT	Quarterly	6 weeks
Financial Soundness Indicators for other depository corporations.	BoT	Quarterly	6 weeks
Other depository corporation lending by activity.	BoT	Monthly	4 weeks
Commercial banks interest rate structure.	BoT	Monthly	4 weeks

Summary table of: (i) average reserve money; (ii) net domestic financing of the government; (iii) stock of external arrears; (iv) new contracting or guaranteeing of external debt on nonconcessional terms; and (v) net international reserves.[1]	BoT and MoFP	Monthly	4 weeks
Amount of arrears outstanding that are overdue by more than 30 days for goods and services and more than 90 days for contract works as set out in the government's Circular No 9 of 8th December 2014 for all government ministries.	MoFP/AGD	Quarterly	2 months
The flash report on revenues and expenditures.	MoFP/AGD	Monthly	4 weeks
The TRA revenue report	TRA	Monthly	4 weeks
The monthly domestic debt report.[1]	MoFP	Monthly	4 weeks
Monthly report on central government operations.	MoFP	Monthly	6 weeks
Detailed central government account of disbursed budget support grants and loans, and ENCB, and external debt service due and paid.	MoFP	Monthly	4 weeks
Detailed central government account of disbursed donor project support grants and loans.	MoFP	Monthly	4 weeks
Statement on new external loans contracted and guarantees provided by the entities listed in paragraph 14 of the TMU during the period including terms and conditions according to loan agreements.	MoFP	Quarterly	4 weeks
Quarterly report on loans and advances to government by pension funds and other public entities not covered by the central government accounts	MoFP	Quarterly	4 weeks
Report on priority social spending	MoFP	Quarterly	6 weeks

[1]The MoFP and BoT will reconcile data on BoT claims on the government, to ensure that such claims recorded in the BoT balance sheet are the same as those reported by the Accountant General of the MoFP.