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Tanzania: Sixth Review Under the Poverty Reduction and Growth Facility and Requests for Waiver of a Performance Criterion and for a New Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Press Release on the Executive Board Discussion for Tanzania; and Statement by the Executive Director for Tanzania

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

- the staff report for the sixth review under the Poverty Reduction and Growth Facility and requests for a waiver of performance criterion and for a new three-year arrangement under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on **June 6, 2003,** with the officials of Tanzania on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on July 14, 2003**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a press release summarizing the **views of the Executive Board as expressed during its July 28, 2003 discussion** of the staff report that completed the review.

- a statement by the Executive Director for Tanzania

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

Letter of Intent sent to the IMF by the authorities of Tanzania*
Technical Memorandum of Understanding of by the authorities of Tanzania*
Financial System Stability Assessment

*May also be included in Staff Report

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

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TANZANIA

Sixth Review Under the Poverty Reduction and Growth Facility and Requests for Waiver of a Performance Criterion and for a New Three-Year Arrangement Under the Poverty Reduction and Growth Facility

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

Approved by Anupam Basu and Michael T. Hadjimichael

July 14, 2003

- In the last three years, Tanzania has made further substantial progress in establishing macroeconomic stability and deepening structural reform. Although considerable progress has been achieved, growth performance has been inadequate to significantly reduce poverty, which remains pervasive, especially in the rural areas. Because much of the outstanding reform agenda, including revenue mobilization and financial sector reform, falls within the Fund's core area of expertise, and as the Fund's assessment of macroeconomic performance is an important signaling element for disbursements of assistance by other donors, the authorities are seeking a new PRGF arrangement in support of the objectives outlined in the PRSP. However, reflecting Tanzania's improved external position, and to highlight the authorities' progress toward an exit from the PRGF, access under the proposed arrangement would be only 10 percent of quota (Table 1).

- Discussions for the sixth review and a proposed new PRGF arrangement were held in Dar es Salaam during April 22-May 6 and May 28-June 6, 2003 by a staff team comprising Mr. Sharer (head), Mr. Treichel, Mr. Tjirongo (all AFR), Mr. Pivovarsky (FAD), and Mr. Tiffin (PDR). Mr. Abdi (Senior Resident Representative) assisted the mission. The mission was received by President Mkapa and met with the Minister for Finance (Mr. Mramba), the Governor of the Bank of Tanzania (Mr. Ballali), and senior officials from these and other government departments. The mission also met with representatives of the business, the diplomatic and donor communities, and of nongovernmental organizations.

- Completion of the sixth and final review under the current PRGF arrangement will entitle Tanzania to a disbursement of SDR 15 million. The government's letter of intent (LOI) relating to this review, and the request for a new PRGF arrangement, is presented in Appendix I; it contains a request for the waiver of a performance criterion. Section I of the staff report discusses performance under the current PRGF arrangement. Section II presents the medium-term program to be supported by the proposed PRGF arrangement, and the contribution of the PRGF to both the objectives of the PRSP and the sources of growth underlying the strategy. Appendices contain summaries of Tanzania's relations with the Fund (including safeguards assessments) and the World Bank Group, as well as a discussion of statistical issues and social indicators.

- President Mkapa was re-elected in October 2000; the next presidential elections are scheduled for 2005. In January 2003, the British government issued a warning of a terrorist threat to Zanzibar.

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Executive Summary

- **Under IMF-supported programs, Tanzania has achieved considerable macroeconomic and structural adjustment since the mid-1990s.** Real GDP growth averaged 4.6 percent during 1996–2002 against 2.7 percent during 1990–95; at the same time, inflation fell to below 5 percent from about 30 percent. Fiscal imbalances have been reduced, expenditures reoriented to the social sectors and the external position substantially strengthened. Moreover, Tanzania reached the completion point under the HIPC Initiative in 2001. Nevertheless, poverty remains pervasive, particularly in the rural areas.

- **Performance under the current PRGF arrangement has been favorable.** All quantitative performance criteria and benchmarks through end-March 2003 were observed, and substantial progress was made in implementing structural reforms, albeit some with delay. Real GDP growth rose 6.2 percent, slightly above target, and inflation remains at about 4 percent.

- **The new PRGF-supported program for 2003–06 aims to contain inflation at about 4 percent and raise real GDP growth further, to above 6 percent.** Growth will be underpinned by substantial investments in physical infrastructure as outlined in the PRSP. The current account deficit is projected to decline steadily, given robust growth in exports and a modest increase in imports.

- **To facilitate these objectives Tanzania will pursue a three-pronged strategy, aimed at mobilizing revenue, further liberalizing the trade regime, and improving the economy's supply response by removing key impediments to growth and generally improving the investment environment.** Thus, the reform agenda focuses on key areas within the core mandate of the Fund, notably steadily increasing the revenue to GDP ratio in order to bolster macroeconomic performance and reduce reliance on foreign aid, and improving the effectiveness of the financial system to improve economic efficiency and attract investment.

- **In support of the program's medium-term revenue target, the authorities are taking a range of measures to bolster tax administration substantially,** including adoption of a new medium-term corporate plan for the Tanzania Revenue Authority, and of a new income tax law that closes loopholes and moves to self-assessment; a refocusing of management and administrative resources that will facilitate a broadening of coverage of large taxpayers; a revamp of the administration of VAT and presumptive taxation, and actions to broaden the tax base through curtailing exemptions.

- **The reform of the financial sector** will build on the work of the recent joint Fund-Bank FSAP mission and the earlier report prepared by a joint ICM-AFR mission.

I. Recent Economic Developments and Performance Under the Program

A. Recent Economic Developments

1. **Macroeconomic developments in 2002 were generally favorable (Tables 2 & 3).** Real GDP grew by about 6.2 percent, slightly above the program target, on account of the strong performance of the agricultural, mining, and construction sectors. Annual inflation declined to 4.4 percent at end-2002 (from 4.9 percent in 2001) and 4.3 percent in May 2003. Nonfood price inflation, however, has risen since mid-2002, reaching 9.6 percent in January 2003 before declining to 5.4 percent by May 2003, reflecting mainly the pass-through of utility price increases by parastatals and higher fuel prices.

2. **Fiscal developments in 2002/03 (July–June) were characterized by better-than-projected revenue performance and shortfalls in expenditure (Tables 4 & 5).** Revenue is estimated to have exceeded the program target by 0.2 percent of GDP on account of buoyant collections of income taxes. Total expenditure is expected to remain below projections by about 1.8 percent of GDP, owing to delays in the disbursement of donor funds and problems with the recording of foreign grant-financed development expenditure.[1] The overall deficit, before grants, was below the budget by about 2 percent of GDP. Thus, the government is estimated to have improved its position with the banking system by 0.2 percent of GDP, compared with the programmed net borrowing of 0.6 percent of GDP.

3. **Monetary developments in 2002 were marked by rapid growth in bank deposits (mainly foreign currency), larger-than-envisaged increases in private sector credit, and declining interest rates.** Notwithstanding a robust growth in private sector credit, the increase in deposits significantly exceeded the demand for bank lending, resulting in a buildup in excess liquidity in the banking system. Consequently, the Bank of Tanzania (BoT) stepped up the absorption of liquidity in the last two months of the year, and, as a result, banks' excess reserves declined to a more normal level by year's end (Table 6).[2] The 12-month growth rate of broad money (M3) was, however, 25 percent at end-2002 and 19.6 percent at end-March 2003, against the program targets of 21 percent and 16 percent, respectively (Table 7). The increase in broad money is attributed to changes in the money multiplier, related, in turn, to a higher-than-anticipated demand for deposits due to the opening of new bank branches and changes in bank technology. As banks' excess reserves fell, yields on 91-day treasury bills rose from 2.5 percent in September 2002 to 4.4 percent in

[1] Although coverage has improved considerably, many grant-financed projects are not channeled through the exchequer system; hence, grant-financed development expenditure continue to be understated.

[2] The reduction in excess liquidity was facilitated by increased sales of liquidity paper following BoT's securitization of a non-interest-bearing government stock in 2002.

December 2002 and 5.4 percent in May 2003. Moreover, the spread between deposit and lending rates narrowed, reflecting the growing competition in the banking sector.

4. **Tanzania's overall balance of payments position strengthened in 2002/2003,**[3] owing to larger inflows of donor assistance, as well as the impact of debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative, (Tables 8 & 9). However, the current account deficit, excluding official transfers, widened slightly. There was a strong increase in nontraditional exports, mainly gold, combined with a moderate improvement in traditional exports, reversing a declining trend. Imports also rose significantly in 2002/03, reflecting the investment cycle of the mining sector and a return to trend following lower than normal imports in 2002. Additionally, service imports increased because of a rise in telecommunications-related payments.

5. **Reflecting continued strong inflows of donor assistance, gross official reserves rose from 5.9 to 6.8 months of import cover** (Table 8). The overall balance of payments improved sharply, showing a surplus of $418 million. As for the exchange rate, over the 12 months to May 2003, the Tanzania shilling depreciated, in real effective terms by 17.7 percent. Staff estimates of the equilibrium real exchange rate suggest that, at end-2001 the currency was overvalued by 9–12 percent (see Selected Issues paper SM/02/342), which suggests that the current exchange rate, in real terms, is broadly in line with its equilibrium value.

6. **The authorities have made further progress in implementing reforms in the public enterprise sector.** At end-2002, a concession for the Dar es Salaam Water and Sewerage Authority (DAWASA) was granted to a British-German consortium. Meanwhile, the financial position and managerial capacity of the Tanzania Electricity Supply Company (TANESCO) have continued to improve, following the introduction of a new management team in mid-2002. The sale of 49 percent of Air Tanzania to South African Airways was completed in November 2002. However, the privatization of the National Microfinance Bank (NMB) was put on hold on account of opposition to the envisaged modalities by the parliamentary committee in February 2003.

7. **Efforts to intensify the dialogue with the business community have continued with the second meeting of the Investors' Roundtable (IRT) in May.** The IRT reviewed progress in the areas noted by the July 2002 inaugural meeting, notably the reforms of the Land Act, local government taxation, and efforts aimed at generally improving Tanzania's investment climate. While recognizing the government's commitment, participants noted that little tangible progress had been made, and urged actions to enhance the effectiveness of working groups established at the inaugural meeting. It is planned to establish a steering committee prior to the next IRT meeting, scheduled for November 2003.

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[3] To facilitate program design and monitoring, and to align external developments with the budget, the balance of payments is being presented on a fiscal-year basis.

8. **All quantitative performance criteria and benchmarks for end-December 2002 and end-March 2003 were observed and all structural performance criteria and benchmarks were implemented, albeit some with delay** (Appendix I, Tables 1 and 2). The structural performance criterion regarding submission to parliament of the amendments to the Loans, Guarantees, and Grants Act (an end-February performance criterion) was implemented in March 2003, and the authorities are requesting a waiver. Regarding other elements of the structural reform agenda, while consolidated accounts of local governments have been published since December 2002, individual accounts are yet to be finalized subject to the clarification of some inconsistencies and the preparation of a harmonized framework for budget preparation. The second report on the implementation of ministerial anti-corruption plans was published in March 2003, later than expected due to capacity limitations in the Good Governance Coordination Unit. The harmonization of the treatment of loan loss provisions by banks for prudential requirements and taxation purposes is expected to be achieved in the context of the new income tax law (see below).

B. Objectives and Achievements Under PRGF-Supported Programs

9. **Tanzania's first poverty reduction strategy paper (PRSP) was endorsed by the Boards of the Bank and the Fund as a basis for continued support in November 2000,** and the first annual progress report was completed in November 2001. The second annual progress report was submitted to the Fund and Bank in March 2003, and endorsed by the Bank's Board on May 29, 2003. The main objectives of the PRSP are to achieve high and equitable growth by maintaining sound macroeconomic policies and implementing reforms to raise factor productivity and promote market efficiency.

10. **In line with the PRSP, the main objectives of past Fund-supported programs were to deepen macroeconomic stability and structural reform, with a view to boosting growth and accelerating poverty reduction**. Structural reforms focused on strengthening tax administration and policy; improving expenditure management; restructuring the financial sector; liberalizing the trade regime; strengthening governance and the transparency of budget execution; and improving the business environment. Key achievements include the following:

- **Major progress in macroeconomic performance**—real growth over 1996–2002 averaged 4.6 percent, compared with 2.7 percent during 1990-95. An analysis of the sources of growth suggests that this stemmed largely from improvements in total factor productivity—reflecting the effect of structural reforms, particularly the liberalization of agricultural production and marketing (Box 1).

- **Inflation has been brought down from 30 percent during 1990-95 to single digits since 1999**. Over the same period, broad money growth has been reduced from an average of over 35 percent to 15 percent, aided by financial sector reform and sharply curtailed government recourse to domestic financing.

- **Tanzania reached the completion point under the HIPC Initiative in 2001, which has been critical in achieving debt sustainability.** Moreover, debt management was strengthened by the adoption of a national debt strategy, and amendments to the Loans, Guarantees, and Grants Act vesting authority to raise loans and issue guarantees on behalf of the government solely with the Minister of Finance.

- **Tanzania has successfully established the PRSP and the medium-term expenditure framework (MTEF) as instruments of policy formulation and monitoring.**[4] The quality of poverty analysis has been helped by the household budget survey completed in 2002, which assessed poverty in terms of food poverty, and a broader concept of basic needs. Furthermore, an integrated labor force survey and a poverty and human development report were recently prepared. Participatory meetings with stakeholders have been taking place regularly to review progress in reforms, as well as to assess the annual expenditure reviews.

- **Budgetary allocations to priority and investment expenditures have increased**. An expenditure-tracking study, conducted in 2001, showed that Tanzania fared well against comparator countries regarding the transparency and accountability of expenditures. The publication of quarterly budget execution reports since November 2001 has also enhanced transparency.[5]

- **The size of the civil service has been reduced from 330,000 in the mid-1990s to 264,000 at present.** This downsizing has contained the wage bill and facilitated larger allocations to priority expenditures.

- **The maximum tariff rate was reduced from 30 percent in 1998/99 to 25 percent in 1999/2000, while the number of tariffs was streamlined from six to four.** Consequently, Tanzania's rating on the Fund's trade restrictiveness index declined from 7 in 1996 to 5 in 2002 (on a 10-point scale, with 10 being the most restrictive).

- **Substantial progress in privatization has been made**; about two-thirds of all state-owned enterprises had been privatized by end-2002, contributing to economic efficiency and fiscal consolidation.

C. Key Areas for Further Reform

11. **Despite substantial structural measures implemented in the fiscal area, domestic revenue remained markedly below the average for sub-Saharan Africa, averaging 12.6 percent of GDP during 1996-2002.** Over the same period, Tanzania made little

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[4] See paras. 8-9 of the LOI.

[5] See paras. 6-7 of the LOI.

progress in reducing aid dependency, underscoring the fragility of the country's macroeconomic stability.

12. **Success in reducing poverty is still elusive, especially in the rural areas**. Some 36 percent of Tanzanians are below the basic needs poverty line and 19 percent below the food poverty line. While this shows some improvement since 1991, a statistically significant decline in poverty has occurred only in Dar es Salaam, underscoring the need to foster agricultural and rural sector development.

13. **Financial intermediation is low, with total commercial bank credit accounting for only 6 percent of GDP.** Commercial banks find it difficult to serve small and widely dispersed customers, who in turn are deterred by high transaction costs, accessibility, and conditions for borrowing. Poor physical infrastructure makes payments and deposit services costly for the rural areas and neither banks nor microfinance institutions have made significant headway in finding cost-effective ways of lending to these areas.

14. **To enhance the role of the private sector in the growth process, decisive steps need to be taken to address corruption and create an enabling environment for private investment.** Despite establishing an institutional infrastructure to promote good governance, perceptions of corruption in the public sector continue to be deeply entrenched. Tanzania's poor rating on the Transparency International index underscores the pervasiveness of governance problems, which negatively affect the business environment. It will also be important to address other impediments to investment, including simplifying business licensing requirements, streamlining local government taxation, improving access to bank lending, and strengthening the legal and physical infrastructure.

II. The Program for 2003/04–2005/06

15. **The achievements during the previous two programs have bolstered the authorities' determination to continue the implementation of macroeconomic and structural reforms in the context of a new IMF-supported arrangement**. The staff considers that such an arrangement is warranted, in that a significant part of the outstanding reform agenda falls within the Fund's core area of responsibilities, and donors will continue to rely on the Fund to indicate whether Tanzania's macroeconomic performance and implementation of related reforms is satisfactory.

16. **The policy discussions of the proposed PRGF-supported program focused on a three-pronged strategy** aimed at (i) mobilizing revenue, in order to strengthen domestic savings and reduce aid dependency; (ii) continuing trade liberalization in order to enhance efficiency and strengthen the tradables sector; and (iii) improving the economy's supply response by removing impediments to growth, including measures to improve the efficiency of the financial sector and promote private sector development. At the same time, it was recognized that structural impediments needed to be addressed to ensure that aid is used to support growth, while the risk of Dutch disease, which has been avoided so far, is minimized.

A. PRSP Priorities

17. In the PRSP progress report, the government reaffirms its commitment to reducing poverty and reaching the Millennium Development Goals (MDGs). The authorities are integrating these objectives into the PRSP process, including through the ongoing public expenditure reviews and MTEF. The PRSP Progress Report recognizes that to reduce aid dependency and enhance priority sector outlays, efforts at mobilizing revenue will have to be reinforced. It furthermore notes the importance of improving the business climate. The new PRGF-supported program supports these goals and the authorities' efforts to consolidate macroeconomic stabilization (Box 2).

B. Medium-Term Macroeconomic Framework and Strategy

18. **Tanzania's medium-term macroeconomic framework** aims at stabilizing inflation at about 4 percent and achieving real GDP growth of above 6 percent during 2003-06.[6] The current account deficit, after rising in 2003/04, is projected to decline steadily, as substantially improved exports are not expected to be fully offset by the envisaged rising levels of consumption and private investment-related imports. The net present value (NPV) of external debt is expected to remain steady in relation to GDP.

19. **Macroeconomic projections are based on an analysis of the sources of growth, which foresee a substantial improvement in factor productivity.** The PRSP progress report discusses the strategy to promote broad-based growth. Two crucial elements for attaining this strategy will be improving access to foreign private capital (Box 3) and addressing the economic effects of HIV/AIDS (Box 4).

20. **Improving the efficiency of the agricultural sector, which accounts for almost half of GDP, will be critical to achieving the program goals.** To this end, the implementation of the Agricultural Development Program, adopted in 2001, is expected to increase agricultural production through support for research and extension services, improved infrastructure, and measures to promote private sector participation. The Rural Development Strategy also aims to promote pro-poor growth by commercializing smallholder agriculture, increasing access to services for the poor (education, health, and financial services), reducing risks and vulnerability to climatic threats through improved crop forecasting and monitoring, and strengthening implementation of local government reforms. All these measures should help improve agricultural production and rural incomes.[7]

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[6] Poor rainfall in the early part of the 2003/04 crop year raised concerns about agricultural output. However, the subsequent return of favorable weather lessened the potential adverse impact. Thus, economic growth is projected at 5.5 percent for 2003.

[7] See paras. 19 and 39 of the LOI.

C. Fiscal Policies for 2003/04 and Beyond

21. **Key challenges in the fiscal area include the need to enhance revenue while increasing allocations to priority sectors and strengthening expenditure management and the tracking of poverty-related expenditure.** The medium-term fiscal program targets a rise in the revenue-to-GDP ratio rising from 12.5 percent of GDP in 2002/03 to 13.1 percent of GDP in 2003/04 and to 14.9 percent by 2006/07. This would facilitate a further substantial increase in priority sector spending. As a result, the overall deficit (after grants) would rise modestly to 3.1 percent of GDP in 2003/04 and thereafter decline to about 2.2 percent of GDP in 2006/07. Taking account of the projected higher level of foreign financing, domestic financing would be limited to about 0.5 percent of GDP throughout the period, significantly less than previously envisaged.

22. **In support of the program's medium-term revenue target, the authorities are taking a range of measures aimed at modernizing tax policy and administration (para. 24 of the LOI).** Main elements are (i) the adoption of a new corporate plan for the Tanzania Revenue Authority (TRA), which lays the groundwork for the comprehensive reform and reorganization of the tax administration, including, particularly, the operations of the Large Taxpayer Department (LTD); (ii) approval of a new income tax law, which closes numerous loopholes in income taxation; (iii) revamping of the administration of VAT and presumptive taxation; and (iv) actions to broaden the tax base by curtailing exemptions. Furthermore, the 2003/04 budget includes substantive measures to curb smuggling.

23. **Key elements of the new corporate plan for the TRA adopted by the government at the end of June** are (i) integration of the tax administration along functional lines, starting with the LTD; (ii) redirection of administrative resources toward the LTD, thereby enabling it to progressively widen its coverage;[8] (iii) increasing the VAT threshold, and (iv) simplification of the small taxpayer administration by streamlining the presumptive tax, widening its coverage to include those no longer required to pay the VAT, and eliminating the stamp duty, which is widely viewed as a nuisance tax.

24. **The new income tax law announced in the budget speech is based on the principle of self-assessment and is expected to contribute to higher revenue by including a broader range of capital gains and abolishing the full expensing of capital investments.** Self-assessment should free up administrative resources currently employed in verifying the numerical accuracy of submitted records and could also be conducive to better compliance over time. The law, which will become effective as of January 1, 2004, also withdraws the Minister's power to grant exemptions on a discretionary basis. Envisaged amendments to customs and excise tax law, furthermore, foresee that new exemptions can be granted only through parliament. In addition, the government will revoke all government

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[8] The strengthening of the LTD is supported by the development of an integrated information system and measures to improve training and auditing capacity.

notices related to exemptions issued before 1997 and replace them with new notices that place quantitative or time restrictions on these exemptions. An amendment to the VAT Act was introduced in April 2003 exempting government-financed infrastructure projects from VAT in order to permit full utilization of the fuel levy revenues for road construction. While the staff agreed that this measure will have no net revenue implications, it expressed concern that it is contrary to the stated objectives of the tax reform and may undermine the integrity of the VAT system.

25. **In response to the staff's concerns about revenue leakages from the newly created export processing zones (EPZs), the authorities agreed to license only companies that can verify they already have access to markets covered under the preferential trade arrangements—the U.S. African Growth and Opportunity Act (AGOA) and the Everything But Arms (EBA) initiative of the European Union (EU)—and will produce almost exclusively for these markets**. Given that there are currently no such companies operating in Tanzania, this policy should ensure that only companies newly entering Tanzania will benefit from tax privileges offered by the EPZs. The authorities will also undertake, with Fund technical assistance, a comparative study of the benefits from tax incentives in EPZs in the region.

26. **The 2003/04 budget targets an increase in the revenue-to-GDP ratio to 13.1 percent of GDP from the 12.5 percent recorded in 2002/03**. The 2003/04 budget, presented to the parliament on June 12, 2003, is broadly consistent with the agreed program. In addition to the improvements in tax administration noted above, the increase reflects the expansion of the treasury voucher scheme to religious NGOs, the buoyancy of the nonagricultural sectors of the economy; strong PAYE collections; the continuing shift of donor funding from tax-exempt projects to budget support; and an expected significant increase in imports. In addition, the budget includes substantive measures to tighten collections of duties and excises on petroleum, which is expected to yield 0.2 percent of GDP in 2003/04. These measures, which aim at curbing abuse and corruption, are not expected to have any adverse impact on poverty. Staff discussed with the authorities the possibility of removing exemptions on agricultural inputs and fertilizers, but agreed with the authorities that plans for such measures should only be finalized after their impact on the rural population had been assessed in the context of a Poverty and Social Impact Analysis (PSIA).

27. **Expenditures in 2003/04 are expected to grow by about 3 percentage points of GDP, compared with the 2002/03 expected outturn.**[9] The increase reflects higher recurrent and development expenditures, including increased priority sector outlays.[10] The government

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[9] Excluding the expenditure carryover of 0.8 percent of GDP in 2002/03.

[10] Priority sector expenditures are expected to rise by 1.3 percent of GDP compared with the 2002/03 outturn, which is expected to be in line with the 2002/03 budget due to the continued practice of quarterly releases to priority sectors. Their share in total expenditures is expected to increase from 46 to 51 percent. As for development expenditures in priority sectors, a

(continued)

intends to pursue the civil service pay reform, including by refining pay structures. Development expenditures are expected to rise by 1 percent of GDP, mainly reflecting higher outlays on infrastructure. To facilitate the execution of expenditures, while maintaining appropriate controls, procurement regulations will continue to be streamlined.[11] Noting the expected shortfall in expenditures, the staff suggested the authorities use the program adjustor for shortfalls in foreign aid in order to protect priority social outlays. The authorities agreed, but also indicated their wish to proceed cautiously in the light of often uncertain aid inflows.

28. **In line with the objectives of the Assessment and Action Plan (AAP) for tracking poverty-reducing expenditures, the 2003/04 budget foresees a range of measures to further improve expenditure management and enhance transparency.** All local government budgets are expected to be prepared according to the IMF's government finance statistics (GFS) classification system; and local government accounts will be consolidated in a standardized format. An expenditure-tracking study will be conducted. Furthermore, following the identification of budgetary codes for priority expenditures within the 2003/04 budget guidelines, reports on poverty-reducing expenditure, based on the integrated financial management system (IFMS), will be incorporated in the quarterly budget execution reports.

29. **To lay the groundwork for greater fiscal decentralization, the authorities are planning measures aimed at further harmonization of fiscal policies at the central and local levels.** Budget guidelines for local authorities are being aligned with those for the central government and fiscal years are being harmonized. During 2003/04, the government is planning to abolish a number of local taxes in line with the recently issued guidelines for the harmonization of taxes, levies, and licenses.

D. Monetary Policy and Financial Sector Reforms

30. **As a consequence of large, not fully sterilized donor inflows and the lack of suitable lending opportunities, monetary growth since 1999 has consistently exceeded targeted levels, although its effect on inflation has been muted by larger-than-expected increases in the demand for money.** The staff noted that, given the projected aid inflows in 2003/04, the BoT will need to mop up excess liquidity through a combination of sales of foreign exchange and of liquidity paper, and urged the authorities to reinforce the control of reserve money. The BoT indicated that it had been reluctant to sell foreign exchange out of concern that this could erode external competitiveness by placing upward pressure on the exchange rate. It furthermore noted that in 2002/03 open market operations had been

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correct assessment of the fiscal outturn may only be possible following the completion of the end-of-year survey of grant-funded donor projects by the Accountant General.

[11] The government noted that the planned purchase of an aircraft for senior government officials will follow transparent procurement procedures, and that financing will be on concessional terms (see LOI paragraph 29).

facilitated by the large-scale securitization of government stock—an action that was no longer anticipated to be possible in the coming fiscal year. Despite this situation, the BoT agreed that, subject to the need to meet the net foreign reserves target, foreign exchange intervention would be used for the purpose of liquidity management, taking into account the seasonality in the foreign exchange market. Thus the sterilization plan will involve co-ordination between both sales of foreign exchange and the issuance of liquidity paper. The authorities concurred with the staff's proposal to monitor reserve money as a performance criterion since this would underscore the focus of the BoT's policy framework on achieving the inflation target. They cautioned, however, that meeting quarterly reserve money targets would present a challenge given the unpredictability and volatility of reserve money. In this context, they underlined their intention to improve liquidity forecasting.

31. **Premised on the above policies, the monetary program for 2003/04 envisages a decline in velocity and a constant reserve money multiplier, resulting in broad money growth of 21 percent and 17 percent at end-December 2003 and end-June 2004, respectively.** Taking into account the continued strengthening of the fiscal position and the maintenance of gross reserves of about seven months of imports, growth in private sector credit is programmed to remain above 24 percent during the period. This reflects strong demand stemming from robust growth, lines of credit established by corporate clients who had previously borrowed abroad, and recent trends by some banks to grant credit for small scale construction activity against salaries. Velocity, measured as the ratio of GDP to the average stock of broad money, is expected to decline to 4.4 at end-2003 from 4.9 at end-2002, in line with a similar decline of velocity in 2002. The sustained low level of inflation despite the more rapid than programmed growth in broad money suggests a structural change in the demand for money.

32. **The staff agreed with the authorities that the Financial Sector Assessment Program (FSAP) in May 2003 should serve as a basis for further reforms in the financial sector (key findings are summarized in Box 5).** The stock of commercial bank credit to the private sector, at about 6 percent of GDP, is low even by regional standards. The government is taking a number of measures to foster financial intermediation and broaden access to banking services. In particular, the BoT will review restrictive prudential regulations that emphasize security-based lending (requiring that loans above 5 percent of the bank's core capital be collateralized at 125 percent) as against a cash-flow approach and sound credit management. The amendments to the Land Act, scheduled to be submitted to parliament in October 2003, will facilitate the use of land as collateral for bank lending, especially mortgage financing. Efforts currently under way to foster the development and supervision of microfinance will greatly broaden the range of financial services. Moreover, the expected privatization of the NMB will strengthen microfinance and deepen financial intermediation.

33. **With respect to the export credit guarantee scheme established by the BoT in July 2002, the authorities plan to undertake a feasibility study in 2003 with a view to transforming the transitory arrangement into a full-fledged independent institution.** The scheme, with an initial capital stock of T Sh 6.5 billion, has issued a pre-shipment credit

guarantee cover to commercial banks in favor of various exporters amounting to about T Sh 4.7 billion. The staff urged the authorities to include in the accompanying regulations measures to ensure that the scheme did not result in open-ended financial obligations to the government and does not weaken credit assessment by financial institutions.

34. **The authorities are intensifying their efforts to enhance the development of capital markets.**[12] In early 2003, the Dar es Salaam Stock Exchange was opened to foreign investors. There are, furthermore, plans to develop the regulatory and institutional framework to permit cross listing with other regional stock markets, as recommended by the recent FSAP mission.

E. Other Structural Reforms, Governance Issues, and Capacity Building

35. **The government is committed to continuing the privatization of public enterprises.**[13] The concessionaire for DAWASA is expected to begin operations shortly. Reforms of TANESCO under the guidance of a management team from the private sector have improved performance, but the reliability of electricity supply remains a significant problem. Following the failure to privatize the railway company (TRC) owing to the absence of interested buyers, the authorities are planning to readvertise the company. Prospects for the divestiture of the telecommunications company have improved following the appointment of a mediator to resolve the protracted dispute between the government and foreign investors over payments due under the purchase agreement.

36. **The government is broadening its efforts to improve governance, although the prosecution of individuals accused of corruption has thus far been limited.**[14] Quarterly reports on the implementation of the national anticorruption strategy and ministerial action plans continue to be published, and an updated anticorruption strategy for 2003-05 is being prepared, that includes an assessment of human and financial resource requirements. In 2002, a Commission of Human Rights and Good Governance was established, which will investigate the conduct of officials and institutions, as well as direct complaints by citizens to appropriate government institutions. Of more than 2,500 individuals, however, for whom investigations were officially opened, only 25 court cases have been concluded.

37. **A range of measures aimed at strengthening fiscal transparency and limiting rent-seeking behavior is being adopted.** To enhance the transparency of exemptions currently in place, the government will publish from September 2003 a list of companies,

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[12] Recommendations made by the recent ICM/AFR mission to enhance Tanzania's access to private capital are summarized in Box 3.

[13] See paras. 36–37 of the LOI.

[14] The program's policies in this area are described in paras. 42–43 of the LOI.

individuals, and NGOs that have received tax exemptions each quarter. In addition, the measures to constrain tax exemptions noted above will improve governance.

38. **The lack of human resources and skills was identified by the IRT conference as one of the key impediments to doing business in Tanzania.** Both public and private institutions face acute shortages of skilled management. Under the new program, the government is determined to make effective use of technical assistance, including through AFRITAC, to follow-up on program policies to enhance revenue mobilization and strengthen the financial sector, and also to facilitate longer-term capacity building.

39. **In addition to the above measures, the authorities are taking further steps to improve the investment climate.** A development policy for small and medium-sized enterprises (SMEs), which focuses on creation of an enabling environment, including establishment of a supportive institutional framework, is expected to be ready by November 2003. Also, the government plans to submit to parliament amendments to the Labor Act by October 2003, and to adopt by December 2003 an action plan to reform and simplify the business licensing system.

F. External Outlook and Capacity to Repay the Fund

40. **The program anticipates a further increase in donor assistance in 2003/04, which will be largely sustained over the medium term.** Consequently, imports are expected to increase substantially in 2003/04, reflecting higher aid-financed development spending, as well as further mining-related capital goods imports, higher cereal imports, and the authorities' anti-smuggling efforts. As a result, the current account deficit, excluding transfers, is expected to worsen during 2003/04 to about 11.7 percent of GDP. Thereafter, however, it is projected to narrow steadily to 8.9 percent of GDP by 2007/08. The volume of traditional exports is expected to recover, with annual average growth of over 6 percent from 2003/04 to 2007/08. The robust growth in nontraditional exports, notably mining, is also expected to continue over the medium term. Medium-term projections for foreign direct investment (FDI) are based on 2001/02 data which have not yet been revised upwards pending the completion of a FDI survey for those years. As a result, FDI is projected to decline as a percentage of GDP, while rising in dollar terms. (A survey for 1999 and 2000 demonstrated that inflows of FDI had been significantly underestimated.) Receipts from tourism are conservatively projected to remain modest over the next few years, reflecting the current global security concerns. Overall, the balance of payments should continue to improve with foreign reserves rising steadily from 6.8 months of imports in 2002/03 to 7.6 months by 2007/08.

41. **There are downside risks to the external sector outlook outlined above. The robust growth in exports is predicated on continued structural reform and an expected recovery in world markets.** However, the medium-term trajectory of imports is associated closely with the projected path of net foreign aid. Should foreign assistance fall short of projections, the growth rate of imports would also fall, muting any impact on the balance of payments. As for trade liberalization, in June 2003 the member states of the East African

Community agreed on a three-band common external tariff (CET) of 0, 10 and 25 percent. The protocol for the EAC Customs Union is scheduled for signature in November 2003. The overall impact on trade liberalization is not yet clear. While the CET is a simplification of Tanzania's current structure (0, 10, 15, 25), the tariff bands for specific goods have yet to be determined. The staff will follow up on this issue.

42. **Tanzania's external debt remains at a sustainable level, given the significant debt relief received under the enhanced HIPC Initiative (Table 11).**[15] Based on disbursements since the completion point, the NPV of debt-to-exports ratio at end-2002/03 is lower than the 150 percent target under the HIPC Initiative (Table 10) and should remain so over the medium term.[16] However, there have been significant delays in signing bilateral Paris Club agreements with Russia, Japan, and Brazil. Having extended the bilateral deadline from February 28, 2003 to June 30, 2003 the authorities have asked the Paris Club for a further extension to end-December 2003. The authorities are also continuing efforts to reach comparable agreements with non-Paris Club bilateral and commercial creditors. To underscore their commitment in this regard, they have placed $5 million into a special earmarked account and made further provisions in the budget for amounts that would be payable to these creditors in the event of reaching agreements. However, the response so far from these creditors has been disappointing. The authorities have requested the assistance of the Fund and the World Bank in encouraging the participation of non-Paris Club creditors in the HIPC Initiative.

43. **The staff discussed the state of negotiations between the authorities and Russia concerning reportedly overdue debt payments.** The authorities have stated that they have written to the Russian authorities and have also asked the Paris Club Secretariat for guidance regarding the amounts in question. The authorities also stressed that they are firmly committed to fulfilling their debt obligations, and that they are actively seeking to resolve this matter as quickly as possible.

44. **Tanzania will need to continue to manage its external debt prudently and rely exclusively on external grants or long-term loans on highly concessional terms.** Gross payments to the Fund in 2003/04 will total SDR 22.9 million, equivalent to 1.6 percent of the projected exports of goods and nonfactor services. Given the projected improvements in its macroeconomic policies, Tanzania should not have difficulty discharging its future obligations to the Fund in a timely manner.

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[15] For a detailed analysis of debt sustainability see Selected Issues Paper (SM/02/342).

[16] For ease of comparison, projections in Table 10 retain the same assumptions for interest rates and discount factors as those underlying the debt sustainability analysis in the HIPC Initiative completion point document.

G. Statistical Issues

45. While the economic and financial statistics have improved in recent years and are adequate for program-monitoring, several areas need strengthening, as highlighted by the recent data ROSC mission (October 2002), which assessed data dissemination practices against the GDDS. Tanzania has participated in the GDDS since July 2001 and meets recommendations for coverage, periodicity, and timeliness of core statistics. Participation in the GDDS has provided impetus for a number of institutional reforms, including the establishment of the National Bureau of Statistics as a government agency and the passage of the Statistics Act 2002. The country is working to meet the more rigorous requirement for subscription to the SDDS. The staff encouraged the authorities to improve its (i) national accounts by implementing the 1993 *System of National Accounts* (*SNA*), establishing new benchmarks and base year, and including Zanzibar in the national accounts; (ii) price data by starting the compilation and dissemination of price statistics for the full Tanzanian territory; (iii) government finance statistics by compiling data on local government operations consistent with international standards, reconciling data inconsistencies with the national accounts, monetary and financial statistics, and the balance of payments, and developing government finance statistics in Zanzibar in a form that can be consolidated with those of the mainland; and initiating a migration path to the 2001 *Government Finance Statistics Manual*; (iv) monetary and financial statistics by including all depository corporations in the coverage of the depository corporations survey; and (v) balance of payments by addressing the deficiencies in the legal mandate for compiling balance of payments statistics and bringing the methodology for debt arrears and reserve assets in accordance with the IMF's *Balance of Payments Manual* (fifth edition).

III. Program Monitoring

46. The program will be monitored through the quantitative and structural and performance criteria and benchmarks specified in Tables 1 and 2 of Appendix I. Quantitative performance criteria have been set for end-September 2003 and end-March 2004. Structural benchmarks have been established for specific dates through June 2004, and a continuous performance criterion on the avoidance of external payments arrears has also been set. Program implementation will be assessed during a first review.

IV. Staff Appraisal

47. Under the expiring PRGF arrangement, Tanzania made major progress in establishing macroeconomic stability and deepening structural reform. In response to sound macroeconomic policies, growth performance has improved substantially, and, since the mid-1990s, there has been a steady, albeit modest, increase in per capita income. At the same time, inflation has declined to single digits. Tanzania's good record of policy formulation and implementation enabled it to reach the decision point under the HIPC Initiative in 2000 and the completion point in 2001. Debt relief under this initiative has been critical in achieving debt sustainability and has also facilitated higher social sector outlays. Substantial progress

has also been made with the privatization program, including the divestiture of some large strategic enterprises.

48. Notwithstanding these achievements, poverty has remained pervasive, particularly in the rural areas. This partly reflects slow progress in implementing the agricultural and rural sector development programs, as well as the continued shortcomings in the business environment, which have inhibited higher investment. The latest PRSP progress report outlines a range of measures in the areas of education, health, road construction, and agriculture, which—supported by Tanzania's development partners—should help in translating Tanzania's macroeconomic achievements into the alleviation of poverty.

49. The PRGF arrangement supports the objectives of Tanzania's PRSP by enhancing the robustness and sustainability of macroeconomic stability, and by addressing key impediments to higher growth in the context of a three-pronged strategy consisting of (i) greater revenue mobilization, to boost domestic savings and safeguard against adverse effects of a possible decline in foreign aid; (ii) structural reforms, to improve the domestic supply response, in particular financial sector reforms and efforts to attract foreign direct investment; and (iii) trade liberalization, to improve the availability of imports. The implementation of this strategy should not only help in accelerating Tanzania's growth performance, but also facilitate the effective use of larger aid flows by improving absorptive capacity and mitigating possible Dutch disease effects.

50. The medium-term strategy for the reform of tax administration and tax policy developed by the authorities establishes a sound and comprehensive basis to accomplish the targeted revenue increases. The projected improvements in revenue mobilization over the medium term are ambitious, although the revenue effort would still remain low by regional standards. The three-year corporate plan adopted recently by the Tanzania Revenue Authority articulates a detailed program for the modernization of the tax administration by integrating tax departments along functional lines and substantially strengthening the Large Taxpayer Department, as well as improving the efficiency of VAT collections. The new income tax law, which is due to become effective January 1, 2004, streamlines revenue collections by closing existing loopholes and tightening fiscal incentives available to investors. While these plans for the reform and modernization of Tanzania's tax administration are conducive to substantially larger revenue collections, their implementation will be challenging in view of capacity constraints and possible resistance from vested interests within the Tanzanian tax administration. To ensure the success of the envisaged reforms, it is therefore essential that they be fully supported at the highest political level. It is essential that they be complemented by vigorous efforts to combat smuggling and evasion, as envisaged.

51. While larger revenue collections will mitigate the expansion of liquidity emanating from larger aid inflows, the Bank of Tanzania will have to take forceful measures to control monetary expansion, and will need to monitor developments closely and intervene in the foreign exchange and domestic money markets in a flexible and pragmatic manner in order to preempt inflationary pressures and possible upward pressure on the exchange rate. In this

regard, the staff welcomes the Bank of Tanzania's commitment to liquidity control in line with its monetary targets as well as the focus on reserve money as the key monitoring tool. The staff believes the current level of the exchange rate to be broadly appropriate. The authorities should continue to limit interventions in the foreign exchange market to smoothen short-term fluctuations.

52. Notwithstanding improvements in recent years, Tanzania's business climate is not yet conducive to attracting investment at the rate that would be needed to materially reduce unemployment and poverty. The chief concerns expressed in the context of the Investors' Roundtable include taxation, business licensing requirements, structural impediments to bank lending, governance, and infrastructure. The commitments included in the authorities' letter of intent foresee a number of measures that would address these concerns, including the planned amendment of the Land Act, the reform of local government taxation, the streamlining of business licensing requirements, and the regular publication of the names of companies, NGOs and individuals exempt from taxes. The full implementation of these measures could significantly improve Tanzania's standing as an investment location and boost growth in areas such as tourism and manufacturing, which could benefit to a significant extent from higher foreign direct investment. The authorities are, therefore, urged to move expeditiously in all of these areas. Reaching agreement on modifications to the Land Act will be particularly important given the delays that have occurred, and the staff urges the authorities to redouble their efforts at forging a consensus among the stakeholders on the amendments to the Land Act. Moreover, the staff urges the authorities to develop a medium-term plan of action for financial sector reform, taking account of the recommendations from the FSAP mission and from the report of the ICM-AFR mission, that will enhance efficiency, help attract foreign investment, strengthen capacity, and generally support the programs' objectives. The staff also urges the authorities to intensify their anti-corruption efforts as an essential element of improving governance and strengthening the investment environment.

53. The staff recommends that the Executive Board grant a waiver for the nonobservance of the structural performance criterion on the submission to parliament of amendments to the Loans, Guarantees, and Grants Act, since the authorities took appropriate corrective action by submitting these amendments shortly after the target date in the program. Based on the commitments made in the attached letter of intent, the staff recommends completion of the sixth review under the current PRGF arrangement and approval of the authorities' request for a new three-year PRGF arrangement.

Box 1. Tanzania: Sources of Growth

A growth-accounting framework based on the standard Cobb-Douglas production function was used for the analysis $Y=AK^{\alpha}L^{1-\alpha}$, where Y is real GDP, A is total factor productivity (TFP), K is physical capital, L is labor, and α is the elasticity of output with respect to the capital input. The series for capital stock was constructed using the perpetual inventory accumulation framework, with the authorities' data on real investment for the past and staff projections for the future, and assuming a constant depreciation rate of 6 percent and a capital-output ratio of 2.0 in 1980.[1/]

Employment was substituted for L as past production is attributable to employment rather than the total labor force. The Tanzania Integrated Labor Force Survey of 2000/01 reports the employment-to-population ratio as 76 percent for that year. As a time series for the yearly changes in employment levels was unavailable, the population growth rate (with some adjustments) was used as a proxy. The growth-accounting framework was applied to actual data (through 2001) to compute the Solow residual (interpreted as TFP). Solow residuals for the past were filtered (using the Hodrick-Prescott filter), following standard methodology, to capture the basic trend and to remove exogenous shocks.

Tanzania: Sources of Economic Growth (In percent)

	1981-85	1986-90	1991-96	1990-2002	2003-07
Real GDP growth	1.0	5.7	2.3	4.6	6.3
Factor accumulation [1/]	2.5	5.2	2,0	2.8	4.2
Solow residual (TFP) [2/]	-1.5	0.5	0.3	1.8	2.1
Investment-GDP ratio	16.2	17.7	23.1	18.6	22.1

Sources: Tanzanian authorities; and staff estimates and projections.

[1/] Accumulation of labor and capital, using factor shares of 0.74 and 0.26, respectively.
[2/] Residual from the growth-accounting exercise.

[1/] The figures are close to the standard figures used for similar studies on African economies. The impact of slight changes in depreciation rate and capital-output ratio on the final result is minimal.

Box 2. Tanzania: The PRGF-Supported Program and Poverty Reduction

The new PRGF arrangement is expected to support the authorities' poverty reduction efforts by (i) deepening macroeconomic stability and attracting private investment, and (ii) strengthening expenditure policy and management.

Macroeconomic stability and investment

Sustained macroeconomic stability is an essential prerequisite for growth and private investment, and, hence, poverty reduction. Tanzania's progress in this area is undermined by the low revenue-to-GDP ratio, which makes the country vulnerable to a decline in foreign aid. Under the new PRGF arrangement, fiscal revenue is projected to increase significantly to 14.9 percent of GDP by 2006/07 as a result of measures aimed at modernizing tax administration and tax policy. Macroeconomic stability and growth will also be strengthened by measures to attract private investment through improvements to the business environment.

Expenditure policy and management

The medium-term fiscal framework foresees a further substantial increase in priority expenditure, in particular in the areas of agriculture, education, and health. Expenditure management will benefit from the implementation of a set of measures to improve the tracking of poverty-related expenditure along the lines of the Assessment and Action Plan (AAP). In this context, following the identification of uniform budgetary codes for priority expenditure in the budget guidelines for the 2003/04 budget, reports on poverty-reducing expenditure, based on the integrated financial management system (IFMS), are planned to be incorporated in the quarterly budget execution report.

Box 3. Tanzania: Improving Access to Foreign Private Capital[1]

Although since 1995 Tanzania has made significant progress in carrying out a critical mass of macroeconomic and structural reforms that have facilitated economic stability and sustained growth, a number of impediments limit the potential to attract both foreign direct investment (FDI) and portfolio investment. Enhancing Tanzania's access to foreign private capital flows is key to supplementing domestic savings to spur investment-led growth and help build a dynamic private sector.

FDI in Tanzania increased substantially in recent years (from US$50 million in 1991 to US$327 million in 2001). It is, however, concentrated in the mining sector and has had limited effect on employment creation. Banking has also attracted foreign private capital following the liberalization of the banking services in 1995—presently, the five largest banks are foreign owned. Investors listed political stability and sustained macroeconomic and structural reforms as the main factors for choosing Tanzania as an investment destination. Privatization of state-owned enterprises has also boosted FDI inflows in recent years. Portfolio investment has been limited, mainly owing to the ban on foreign portfolio investment in securities issued and traded in the Dar es Salaam Stock Exchange (DSE). Despite this, foreigners have equity shareholdings in the form of strategic ownership in a number of listed companies. The authorities opened the DSE to foreign participation in early 2003. Owing to the increased liquidity of local banks, bank financing from abroad has diminished in importance. However, a number of impediments (such as lack of acceptable collateral, lack of information on creditworthiness of borrowers, antiquated laws that impede the liquidation process in the case of default, and ineffective enforcement of legal contracts) still limit the access of significant sectors of the economy to bank financing.

Key recommendations

With respect to foreign direct investment, the authorities should

- revise the Investment Act to help clarify and harmonize the regulatory framework for FDI;
- clarify and harmonize the regulatory framework, including by further streamlining business licensing requirements, and improving the transparency and predictability of the tax regime;
- facilitate and expedite access to land leases for commercial use; and
- expand access to international markets, including by pursuing regional trade agreements and regional cooperation in other areas with the East African Community (EAC) and Southern African Development Community (SADC) partners.

In the area of portfolio investment, the authorities are encouraged to

- simplify the process and reduce the cost of listing, and also strengthen accounting and financial reporting practices and procedures to help more companies in Tanzania qualify for listing on the DSE;
- encourage the development of private pension funds and unit trusts to help bridge the gap between the lack of institutional investors and surplus domestic capital; and
- take a regional approach to capital market development as a member of the EAC and the SADC, that will, among other things, permit cross listings from companies based in EAC partner countries Kenya and Uganda.

Bank financing measures that the authorities should take include the following:

- revise the Land Act to enable private individuals to use land as collateral for bank borrowing;
- set up a credit reference bureau—ideally, using a company that already has strong links in the subregion;
- improve the efficiency of the commercial court; and
- develop a financial leasing subsector to help extend medium to long-term financing to underbanked sectors of the economy, particularly the small and medium-sized enterprises.

[1]Based on a pilot study on access to foreign private capital carried out by the International Capital Markets, African, and Policy Development and Review Departments of the Fund.

Box 4. Economic Effects of HIV/AIDS in Tanzania

Background. Since the first cases of HIV/AIDS were diagnosed in 1983, the pandemic has expanded unabated. In 2002, estimates of Tanzanians living with HIV/AIDS ranged from 1.8 to 2.2 million, suggesting a prevalence rate above 12 percent—compared with the rates for Kenya (15 percent), Uganda (5 percent) and Zambia (22.5 percent). Since 1999, AIDS has been the leading cause of death among young adults—accounting for 43 percent of total deaths in 2002—and is expected to peak at 59 percent in 2020. The most vulnerable groups, mainly children and women, have the highest infection rate (9.3 percent in women, compared with 5.8 percent in men). The high mortality rate among young adults has led to an increase in the number of orphans (estimated at 2 million in 2002). The sharp increase in this has put strains on the traditional care system, in which relatives willingly take in the children of their deceased relatives. Teenage-headed households, which are the most food insecure, are now on the rise. Moreover, orphans are more likely to drop out of school to join the ranks of street children, who often turn to petty crime and prostitution—which perpetuates the cycle of HIV infection.

At the sectoral level. Labor shortage due to illness and death is the most discernible effect of HIV/AIDS. The pandemic has disproportional effects on different sectors. Enterprises—mainly in the manufacturing, mining and financial sectors—that rely on highly skilled labor face the greatest risk. The mining sector relies on a core of highly skilled personnel. In the manufacturing sector, efforts to attract foreign investment have been undermined, as investors weigh the costs of HIV/AIDS. The high level of HIV/AIDS could also have a significant impact on the growth potential of the tourism sector. In the agricultural sector, the combined effects of the loss of adult labor and the increase in the number of orphan-headed households are expected to reduce both the scale of production and productivity. The decline in rural household income could worsen the poverty situation. The rising mortality owing to AIDS among teachers also threatens the supply of educators. The pressure to increase health and welfare expenditure will imply significant retrenchment in budgetary allocations for poverty reduction and infrastructure development, and will adversely affect the supply of human capital. In the civil service, where workers have extensive benefit programs, personnel emolument costs will increase with rising mortality and morbidity due to AIDS.

At the macroeconomic level. Tanzania's medium-term growth prospects are good, but these prospects are threatened by the impact of HIV/AIDS. Using the classic Solow growth model, simulations based on Tanzania's demographic and macroeconomic data demonstrate that, without effective policy action, AIDS may reduce GDP in 2010 by 15 percent in relation to a counterfactual no-AIDS scenario.

The government response to the crisis focused on enhancing health care for individuals infected with HIV/AIDS, coordinated by the Ministry of Health, and conducting decentralized multisectoral awareness campaign. These efforts have not proved particularly effective. The messages were general and not targeted to the most vulnerable groups, and, although HIV/AIDS was featured in the public expenditure reviews, the implementation of identified activities was hampered by a lack of resources. In 1999, President Mkapa declared the pandemic a national disaster, and, in April 2002, the Tanzania Commission for AIDS was created to coordinate the implementation of the HIV/AIDS policy. Furthermore, an HIV/AIDS multisector conference was held in December 2002. These efforts are expected to reenergize the ongoing efforts, including reviewing the national HIV/AIDS policy and the strategic framework guiding all participants.

Box 5. Key Findings of Tanzania's Financial System Assessment Program (FSAP)[1]

The banking system is small, but sound—deposits and the level of credit to private sector account for 14 percent of GDP and 6 percent of GDP, respectively. The capital adequacy ratio is in excess of 20 percent and there is moderate dollarization. Seven large banks account for 75 percent of the total assets of the banking system; four are subsidiaries of international banks, and a South African bank has acquired the largest domestic bank. The poor credit culture, difficult and slow enforcement of creditor rights, lack of suitable collateral, and absence of conditions for effective cash-flow-based lending hamper financial intermediation.

Banking stability issues. The results of the stress tests (credit risk, interest rate risk, exchange rate risk, and the risk of a decline in interest spreads) suggest that the financial system is generally resilient to shocks. Relatively low lending activity limits the extent of credit risk. The concentration of lending is a cause for concern, but it does not appear to pose an immediate risk. The regulatory limits on foreign exchange exposures, as well as the cautious approach of banks to foreign currency lending lessen the consequences of even a large movement of the exchange rate, taking account of the likely indirect effects on the credit quality of loans in foreign currency. Similarly, banks would be able to endure a significant reduction of interest spreads. **The only major risk area identified by the stress tests is the interest rate risk**—two large banks have significant holdings of government bonds that expose them to considerable interest rate risk.

The framework of banking supervision is generally adequate, when assessed against the Basel Core Principles. Some of the bank regulations may, however, be too constraining. Although no crisis is in immediate prospect, **contingency planning** needs to be developed now. The bank privatization process also needs to be completed. One large and two small banks remain under government ownership. In addition, issues relating to the one insolvent bank owned by the government of Zanzibar also need resolution.

Monetary management. To enhance the effective sterilization of the impact of foreign inflows on the liquidity position of the banking system, the BoT should develop a **sterilization plan**, comprising a suitable combination of foreign exchange sales and net treasury bill issuance. To complement the sterilization plan, the BoT would also need to strengthen its monetary policy framework, and develop financial markets and market infrastructure.

Enhancing the scope of financial intermediation. The small stock of outstanding credit has provoked calls for **more proactive direct policies,** such as the establishment at the behest of government of specialized institutions to expand credit to underserved sectors, or on longer terms. The fragility of the recovery of financial sector confidence in Tanzania would argue for extreme caution in such direct innovations. Just as the private sector is beginning to emerge from its shell, the aggressive below-cost provision of financial services by a government-sponsored agency would be sure to halt or postpone what would likely be more sustainable market innovations.

There appear to be significant barriers to bank lending on account of the weak legal and information infrastructures on which the banks and other financial institutions can build. For instance, the comparative absence of longer-term credit is often noted and blamed on the Land Act of 1999, which may have shifted the balance of protection away from the lender to the borrower. There has been continuous pressure from the banks for extensive changes in this law to allow them to secure lending on landed property with greater assurance. It is unlikely that much expansion of longer-term finance can be expected without some amendments to the land law, though such amendments will not be a panacea. Other legal and regulatory reforms that could help remove barriers to such lending technologies as leasing need to be put in place. The development of the information infrastructure should include the establishment of a credit registry.

The availability of long-term resources for future investment in securitized medium- and long-term bank loans and corporate bonds, as well as in equities, is a source of strength for the system, which will only come to full fruition when the banks have identified suitably bankable medium-term loan opportunities. Notwithstanding recent improvements, the legal framework for **microfinance** needs further strengthening to take into account the broad diversity of entities involved in microfinance and to allow for a simple yet effective approach to their regulation and supervision.

1/ Based on the FSSA report, being issued to the Board in conjunction with this report.

Box 6. Tanzania: Structural Conditionality

Coverage of structural conditionality in the new program

The structural performance criteria and benchmarks proposed as conditionality for the second disbursement under the PRGF arrangement (LOI, Table 4) support the macroeconomic objectives of the program by underscoring the government's intention to improve

- **tax policy and administration** by submitting to parliament a new income tax law, to become effective January 1, 2004; moving income tax collection by the Large Taxpayer Department to a self-assessment basis; revising the VAT threshold to reduce the number of VAT taxpayers and revising the threshold for the presumptive tax accordingly; and curtailing tax exemptions;

- **financial sector reform** by submitting to parliament amendments to the Land Act; and reviewing current prudential requirements;

- **the investment environment** by adopting an action plan to reform and simplify the business licensing system; and

- **governance** by publicizing each quarter the list of companies, individuals, and NGOs that have received tax exemptions.

Status of structural conditionality under the existing PRGF-supported program

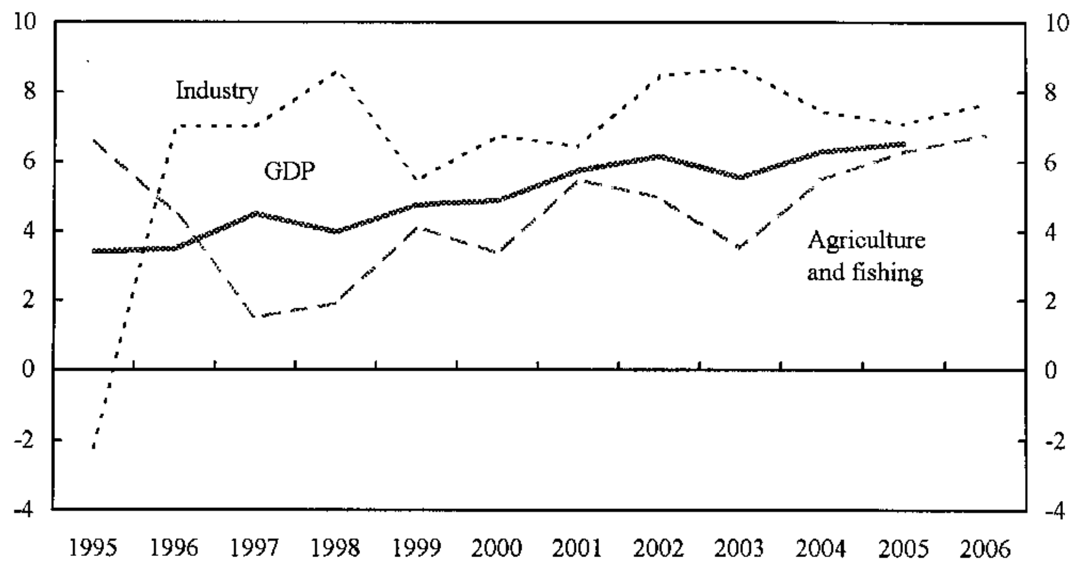
The structural performance criteria and benchmarks applicable to the seventh disbursement focused on broadly the same areas. The end-February 2003 performance criterion relating to the submission to parliament of amendments to the Loans, Guarantees, and Grants Act was not observed on time, but the authorities took appropriate corrective action in March 2003 by submitting the amendments to parliament; the authorities are requesting a waiver. The other performance criterion relating to the identification of budgetary codes for priority expenditures and their application in the budget guidelines for 2003/04 was observed. All the structural benchmarks were observed: (i) the adoption of a centralized motor vehicle registration system; (ii) introduction of a treasury voucher system for administering the indirect tax exemption applying to non-religious NGOs and to imports of motor vehicles by eligible public servants; (iii) issuance of guidelines to local councils for the harmonization of taxes, levies, and licenses; (iv) requirement for spending agencies (MDAs) to submit to the Office of the Accountant General quarterly reports on their utility bills and amounts paid, starting with a report for the first quarter of 2002/03; (v) identification of budgetary codes for priority expenditures and apply them in the budget guidelines for 2003/04; (vi) establishment of a National Debt Management Committee under the National Debt Strategy; and (vii) submission to parliament of the draft law establishing the legal, regulatory, and supervisory framework for microfinance operations.

Structural areas covered by World Bank lending and conditionality

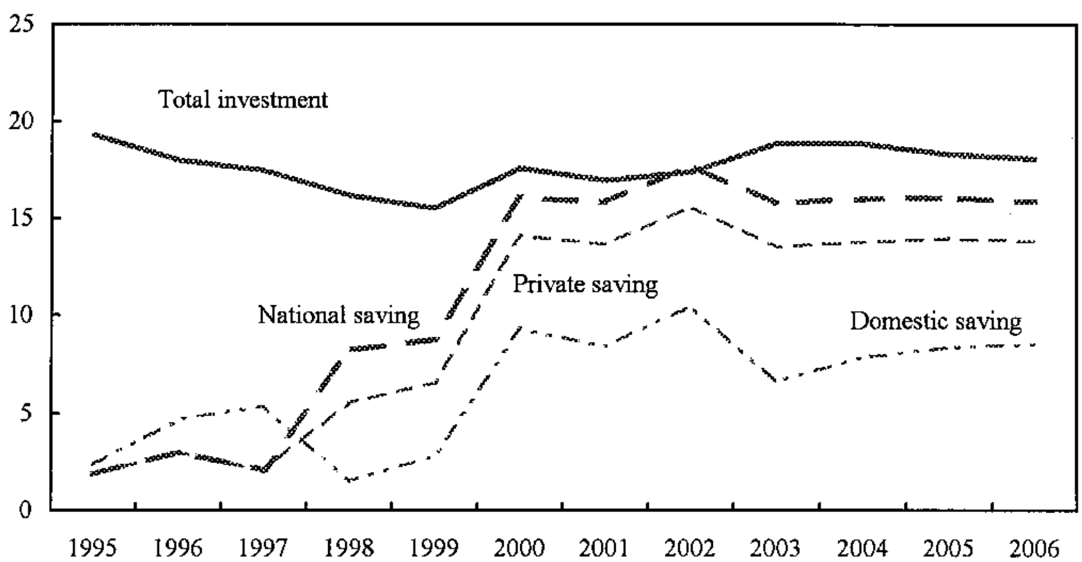
In May 2003, IDA approved a US$132 million Poverty Reduction Support Credit (PRSC) that would build on recent reforms undertaken by Tanzania and support the implementation of the Poverty Reduction Strategy (PRS). The first PRSC would focus on private sector development and public sector management to complete and deepen the reform agenda defined under the Programmatic Structural Adjustment Credit (PSAC) and lay the groundwork for attacking income poverty more aggressively. A single tranche of US$132 million would likely be made available in July 2003. It is anticipated that over the next two years, there will be two further single-tranche PRSCs (each up to US$150 million, equivalent) in fiscal-year (FY) 04 and FY 05 to support the implementation of the PRS. Conditionality under this credit is linked to measures relating to the implementation of the PRS, institutional reforms, debt, and financial management.

Figure 1. Tanzania: GDP, Savings and Investment, 1995-2006

Real GDP
(Annual percentage change)



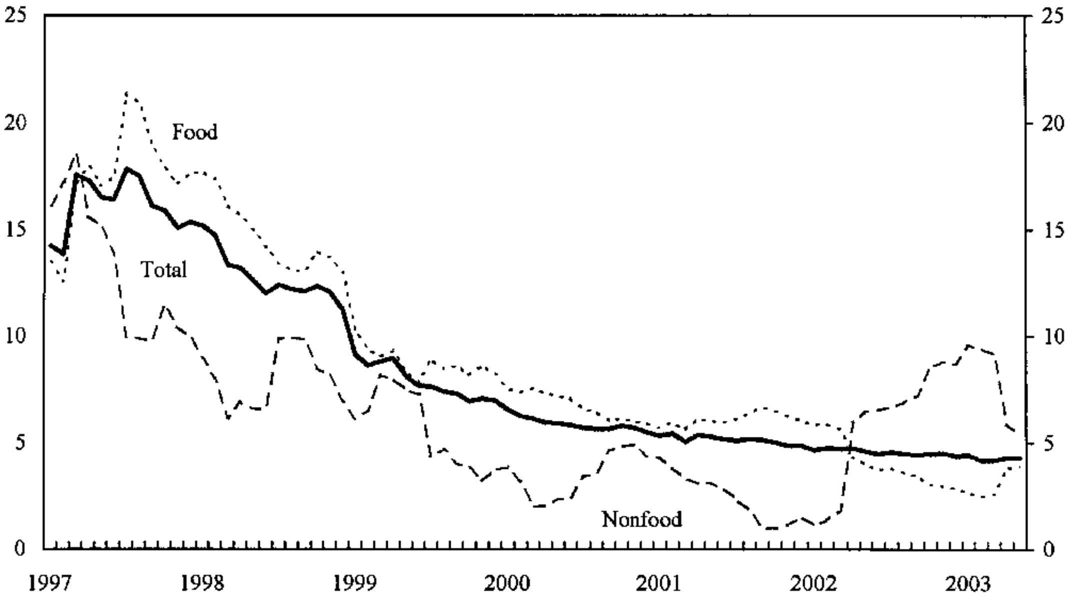
Total Savings and Investment
(In percent of GDP)



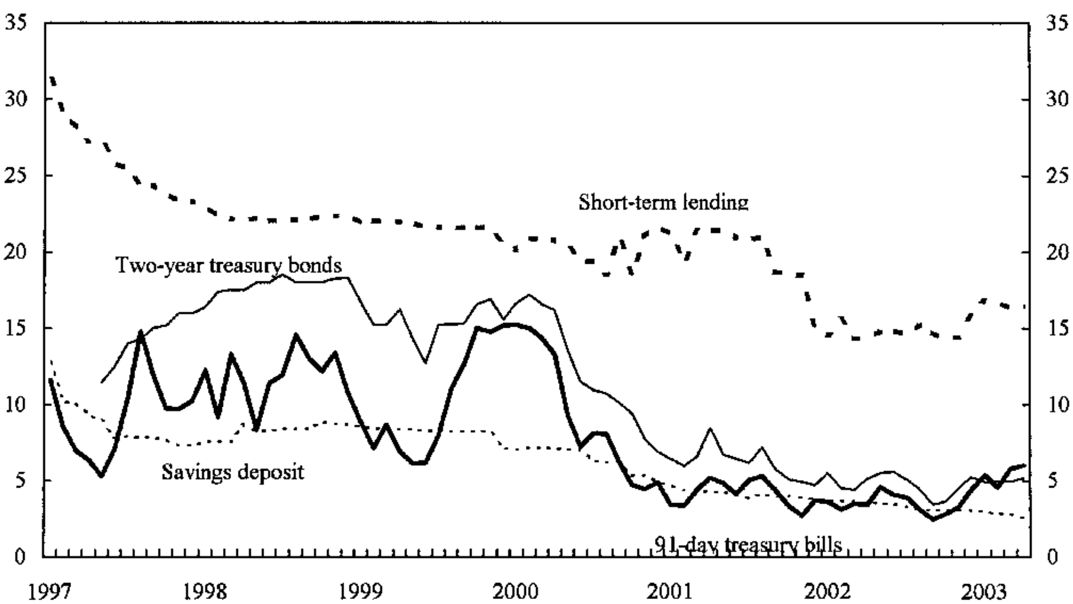
Sources: Tanzanian authorities; IMF staff estimates and projections.

Figure 2. Tanzania: Prices and Interest Rates, January 1997- April 2003 1/
(In percent)

Consumer Price Index, January 1997-May 2003
(12-month change in percent)



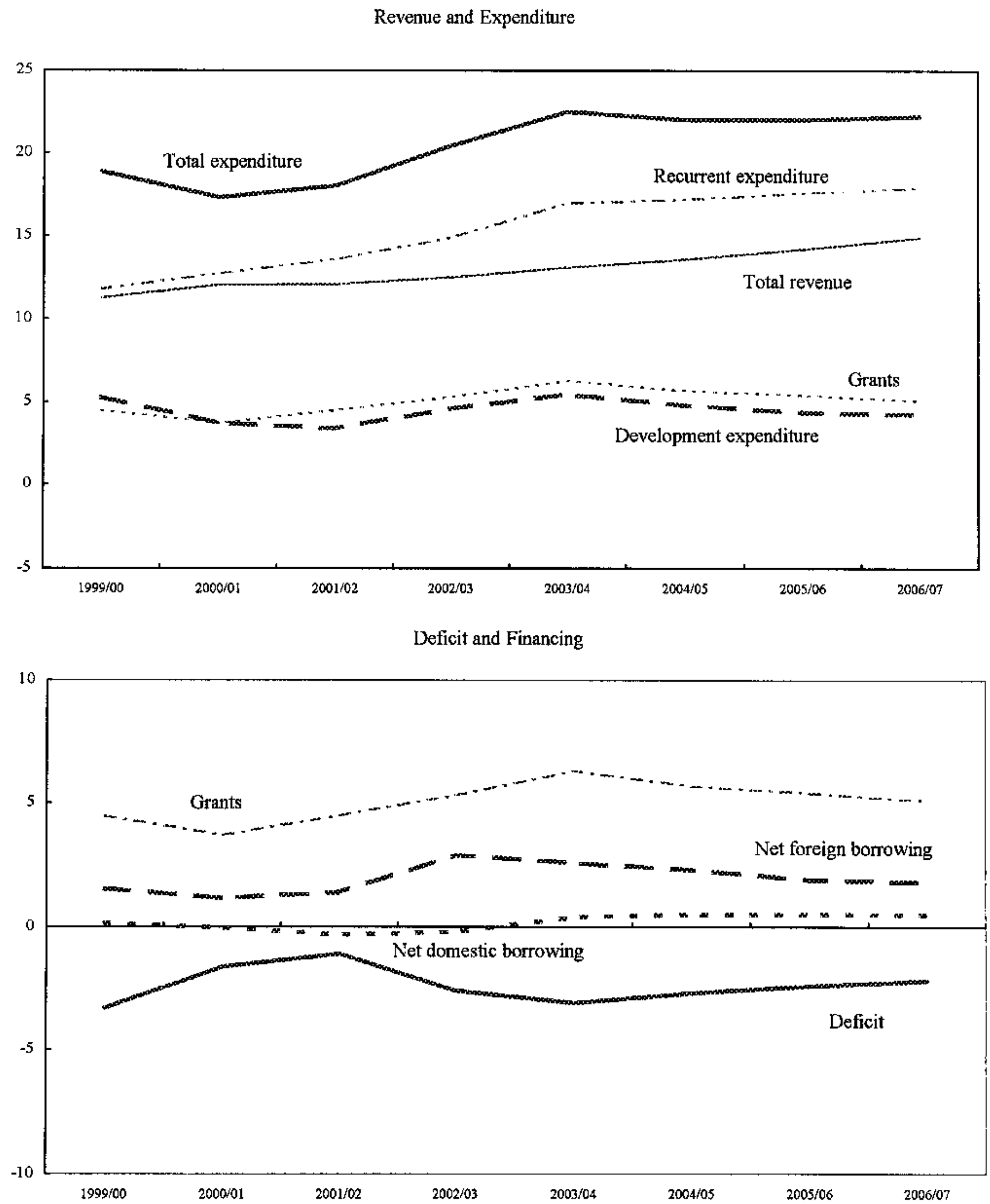
Interest Rates, January 1997-May 2003
(In percent)



Source: Tanzanian authorities.

1/ Consumer Price Index calculated as the 12-month change in percent.

Figure 3. Tanzania: Central Government Finances, 1999/00-2006/07 1/
(In percent of GDP)

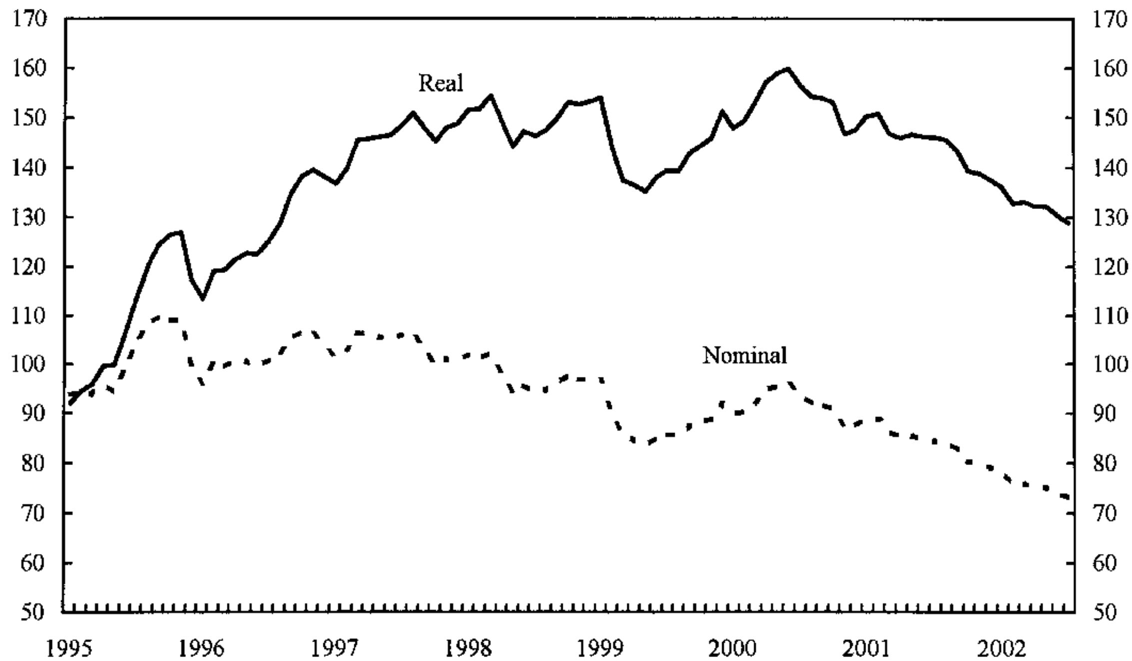


Sources: Tanzanian Ministry of Finance; IMF staff projections.

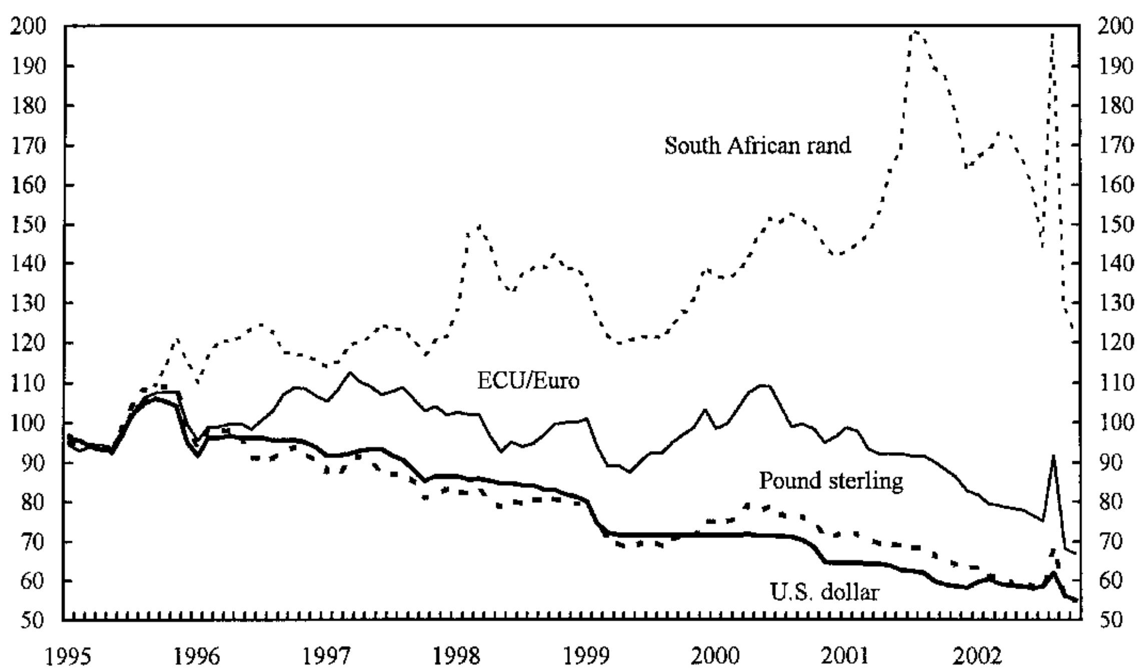
1/ Fiscal year runs from July to June.

Figure 4. Tanzania: Exchange Rates, January 1997-March 2003
(1995=100; foreign currency per Tanzanian shilling)

Real Effective Exchange Rates



Bilateral Real Effective Exchange Rates



Sources: Tanzanian authorities; IMF, Information Notice System.

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

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

Source: Fund staff.

Table 2. Tanzania: Selected Economic and Financial Indicators, 2000-04

	2000	2001	2002 Prog.	2002 Actual	2003 Proj.	2004 Proj.
	(Annual percentage change, unless otherwise indicated)					
National income and prices						
Nominal GDP (billions of Tanzania shillings)	7,267	8,186	9,039	9,068	10,030	11,156
Real GDP growth	4.9	5.7	5.9	6.2	5.5	6.3
Real GDP per capita	2.2	3.4	3.8	4.2	3.5	4.0
Consumer prices (period average)	5.9	5.2	4.6	4.6	5.0	5.0
Consumer prices (end of period)	5.5	4.9	4.5	4.4	6.1	4.0
External sector 1/						
Exports, f.o.b. (in U.S. dollars)	714.5	816.1	880.2	953.0	1,169.7	1,278.5
Imports, c.i.f. (in U.S. dollars)	-1,581.2	-1,685.3	-1,828.9	-1,873.8	-2,335.3	-2,426.7
Export volume	26.4	15.0	3.8	10.1	10.0	7.9
Import volume	5.4	2.6	5.6	10.1	14.6	4.3
Terms of trade	-4.7	-0.5	4.1	2.3	2.7	3.3
Nominal effective exchange rate (end of period)	-1.0	-12.3	...	-17.2	...	...
Real effective exchange rate (depreciation -)	1.6	-9.5	...	-20.3	...	...
Public finance 1/						
Revenue (excluding grants)	20.3	12.2	12.4	14.5	16.6	14.7
Total expenditure	3.5	16.3	35.4	25.2	22.3	8.4
Current expenditure	22.2	18.7	29.4	21.8	26.4	12.0
Development expenditure and net lending	-20.5	1.8	101.1	52.0	31.0	-3.1
Money and credit 1/						
Broad money	21.7	17.0	13.0	22.1	20.5	17.2
Net foreign assets	57.6	44.9	32.5	31.4	49.9	9.7
Net domestic assets	-3.0	-14.1	10.5	4.4	-49.1	69.9
Credit to government 2/	21.8	-54.6	-55.5	-105.1	300.9	-136.8
Credit to nongovernment sector	12.1	20.7	27.0	27.4	24.6	24.5
Velocity of money (GDP/M3; average)	6.0	5.4	5.3	4.9	4.4	4.5
Treasury bill interest rate (in percent; end of period) 3/	9.0	8.6	...	4.6	...	...
	(In percent of GDP, unless otherwise indicated)					
Public finance 1/						
Revenue (excluding grants)	12.0	12.1	12.3	12.5	13.1	13.6
Total grants	3.7	4.5	5.7	5.3	6.3	5.7
Expenditure	17.3	18.0	22.2	20.4	22.5	22.0
Overall balance (including grants)	-1.6	-1.1	-4.2	-2.6	-3.1	-2.7
Domestic financing 4/	0.0	-0.3	0.7	-0.2	0.4	0.5
Savings and investment						
Resource gap	-7.5	-7.4	-8.1	-6.4	-11.3	-10.4
Investment	17.6	17.0	17.4	18.2	19.4	18.8
Government	4.4	3.5	4.0	4.8	5.7	5.1
Nongovernment	13.2	13.5	13.4	13.4	13.8	13.8
Gross domestic savings	10.1	9.6	9.3	11.8	8.2	8.4
External sector, public debt, and debt service 1/						
Current account balance (excluding official transfers)	-9.4	-8.9	-9.1	-9.3	-11.7	-10.5
Current account balance (including official transfers)	-4.4	-4.8	-4.4	-4.0	-6.1	-5.2
External debt service due (before debt relief; in percent of exports of goods and nonfactor services) 5/	-28.3	-21.6	-16.0	-14.6	-12.9	-11.3
	(In millions of U.S. dollars, unless otherwise indicated)					
Balance of Payments 1/						
Current acount balance (excluding grants; deficit -)	-866.8	-832.4	-885.6	-885.0	-1,161.5	-1,145.0
Overall balance of payments (deficit -)	-7.8	28.1	234.1	418.3	150.6	185.6
Gross official reserves	982.9	1,212.7	1,492.4	1,671.2	1,818.7	1,963.5
In months of imports of goods and nonfactor services	5.3	5.9	7.3	6.8	7.0	7.2

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

1/ Fiscal years (July-June), beginning in the year indicated in the column header.
2/ Including new debt issued for the recapitalization of banks.
3/ Weighted-average yield of 91-, 182-, and 364-day treasury bills.
4/ Excluding new debt issued to recapitalize government-owned banks.
5/ For 2002/03 onward, debt service due is net of expected HIPC relief from bilateral and commercial creditors.

Table 3. Tanzania: National Accounts, 2000-06

	Shares (2000; in percent)	2000	2001	2002 Est.	2003	2004	2005	2006
					Projections			
				(In units as indicated)				
Overall GDP								
Nominal (in billions of Tanzania shillings)		7,267	8,186	9,068	10,030	11,163	12,320	13,573
Real (percentage change)		4.9	5.7	6.2	5.5	6.3	6.5	7.0
Deflator (percentage change)		7.0	6.1	4.2	5.0	5.0	3.8	3.1
			(Annual percentage change in real terms, unless otherwise indicated)					
Sectoral components of GDP								
Agriculture	48.2	3.4	5.5	5.0	3.5	5.5	6.3	6.8
Industry	16.1	6.7	6.4	8.5	8.7	7.4	7.1	7.7
Mining	2.3	13.9	13.5	15.0	13.0	9.0	9.0	9.0
Manufacturing	8.3	4.8	5.0	8.0	8.0	8.0	7.0	7.0
Electricity and water	1.7	5.9	3.0	3.1	6.4	6.0	6.0	6.0
Construction	3.8	7.0	6.6	8.1	8.5	6.7	6.8	8.2
Services	35.4	7.8	6.8	6.8	6.3	6.7	6.5	6.8
Trade, hotels, and restaurants	16.4	6.5	6.7	7.0	6.0	7.2	7.0	7.0
Transport and communications	5.4	6.1	6.3	6.4	6.5	6.3	6.3	6.3
Financial and business services	5.9	4.0	2.3	4.7	5.9	6.3	6.3	6.3
Public administration and other services	7.7	7.9	5.3	6.4	10.4	4.4	4.1	6.6
Demand components of GDP								
Consumption		-1.8	5.3	3.6	9.7	6.5	6.4	7.0
Government		15.9	16.8	13.8	24.9	13.4	9.5	10.2
Private sector		-3.5	4.0	2.2	7.5	5.3	5.8	6.4
Investment		7.5	5.8	6.7	14.0	6.0	3.5	5.6
Government		-0.2	-15.4	21.8	32.6	6.3	-4.0	1.7
Private sector		10.4	13.1	2.9	8.3	5.9	6.4	6.9
Foreign balance 1/		6.2	-0.3	1.5	-6.6	-1.5	-0.7	-1.3
Exports		17.1	17.5	0.9	1.2	5.6	6.3	5.8
Imports		-8.1	9.1	-3.3	19.3	6.3	4.5	5.8
					(In percent of GDP)			
National saving and investment								
Government								
Saving		2.0	2.2	2.2	2.2	2.3	2.1	2.1
Investment		4.4	3.5	4.0	5.1	5.1	4.6	4.4
Balance		-2.4	-1.3	-1.9	-2.9	-2.8	-2.5	-2.3
Nongovernment sectors								
Saving		14.1	13.7	15.6	13.6	13.8	14.0	13.8
Investment		13.2	13.5	13.4	13.8	13.8	13.7	13.7
Balance		0.9	0.2	2.2	-0.2	0.0	0.2	0.1
All sectors								
Saving		16.1	15.9	17.7	15.8	16.0	16.1	15.9
Of which : domestic saving		9.3	8.4	10.5	6.6	7.9	8.4	8.5
Investment		17.6	17.0	17.4	18.9	18.9	18.4	18.1
Foreign savings (-) 2/		-1.5	-1.1	0.3	-3.1	-2.8	-2.3	-2.2
Consumption		90.7	91.6	89.5	93.4	92.1	91.6	91.5
Public		10.6	11.7	12.5	14.8	15.8	16.3	16.8
Private		80.1	79.9	77.1	78.6	76.3	75.4	74.7

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

1/ Figures represent the contribution of the change in the foreign balance to real GDP growth.
2/ External current account, including grants (interest payments on a cash basis).

Table 4. Tanzania: Central Government Operations, 2001/02-2006/07 1/
(In billions of Tanzania shillings)

	2001/02	2002/03		2003/04		2004/05	2005/06	2006/07
		Prog.	Proj.	Prog.	Proj.	Proj.	Proj.	Proj.
Total revenue	1,042.9	1,172.3	1,194.7	1,312.6	1,393.0	1,598.4	1,841.5	2,128.9
Tax revenue	938.5	1,066.9	1,088.6	1,198.7	1,275.2	1,464.0	1,688.3	1,954.3
Import duties	88.9	109.4	103.4	103.2	123.4	135.7	149.3	164.2
Value added tax (VAT)	352.3	394.3	410.0	465.2	471.9	557.8	648.5	763.0
Excises	177.6	203.9	186.9	230.4	221.2	258.3	289.8	335.4
Income taxes	228.4	240.9	276.7	269.8	321.9	363.0	436.3	509.4
Other taxes	91.3	118.3	111.6	130.1	136.8	149.3	164.6	182.3
Nontax revenue	104.5	105.4	106.0	113.8	117.8	134.3	153.2	174.6
Total expenditure	1,556.0	2,106.2	1,948.8	2,196.1	2,383.3	2,582.4	2,847.9	3,181.9
Recurrent expenditure	1,171.4	1,520.4	1,426.6	1,717.5	1,803.4	2,020.6	2,273.7	2,566.2
Wages and salaries	342.0	411.5	411.5	480.3	464.1	539.7	633.5	730.3
Interest payments	121.1	131.6	114.5	123.9	149.4	145.3	139.1	144.6
Domestic	64.6	57.4	48.9	54.6	71.9	68.2	75.0	82.5
Foreign	56.5	74.2	65.7	69.3	77.6	77.1	64.2	62.1
Goods and services and transfers	708.3	977.3	900.6	1,113.3	1,189.9	1,335.7	1,501.0	1,691.3
Clearance of domestic arrears	59.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development expenditure	291.3	585.9	442.7	478.5	579.9	561.7	574.2	615.8
Domestically financed	50.2	95.7	95.7	105.0	140.1	144.3	153.0	191.2
Foreign financed	241.1	490.2	347.1	373.5	439.8	417.4	421.3	424.6
Expenditure carryover	34.1	0.0	79.4	0.0	0.0	0.0	0.0	0.0
Unallocated revenue (+)/expenditure (-) 2/	33.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, before grants	-479.5	-933.9	-754.1	-883.5	-990.2	-984.0	-1,006.4	-1,053.0
Grants	385.2	541.2	505.9	517.3	666.0	672.4	701.9	735.7
Program (including basket grants) 3/	183.0	267.4	305.6	233.1	362.3	383.4	403.5	424.2
Project	140.2	198.5	148.9	213.2	223.9	206.0	213.3	218.6
HIPC grant relief	62.0	75.3	51.4	70.9	79.8	83.1	85.1	92.9
Overall balance, after grants	-94.3	-392.7	-248.2	-366.2	-324.3	-311.6	-304.6	-317.3
Financing	94.3	392.7	248.2	366.2	324.3	311.6	304.6	317.3
Foreign (net)	118.5	316.0	272.7	150.6	279.0	266.2	250.5	256.4
Foreign loans	187.4	443.0	358.6	285.6	408.9	390.4	372.2	374.8
Program (including basket loans) 3/	86.5	151.3	160.4	125.2	193.0	179.0	164.2	168.8
Project	100.9	291.7	198.2	160.4	215.9	211.5	208.0	206.0
Amortization	-68.9	-127.0	-86.0	-135.0	-129.9	-124.2	-121.7	-118.4
Domestic (net)	-22.6	63.7	-14.4	210.6	42.7	60.3	69.1	75.9
Bank financing	-59.2	54.7	-23.4	210.6	42.7	60.3	69.1	75.9
Nonbank financing	36.6	9.0	9.0	0.0	0.0	0.0	0.0	0.0
Amortization of parastatal debt	-1.6	-10.0	-10.0	-15.0	-14.4	-15.0	-15.0	-15.0
Privatization proceeds	0.0	18.0	0.0	20.0	17.0	0.0	0.0	0.0
Memorandum items:								
Primary balance (excluding grants and foreign-financed development expenditure)	-117.3	-312.1	-292.5	-386.1	-401.0	-421.3	-446.0	-483.9
Expenditure on defense and national service	118.6	145.0	...	155.1	...	...	...	...

Table 4. Tanzania: Central Government Operations, 2001/02-2006/07 1/ (concluded)

	2001/02	2002/03		2003/04		2004/05	2005/06	2006/07
		Prog.	Proj.	Prog.	Proj.	Proj.	Proj.	Proj.
	(In percent of GDP)							
Total revenue	12.1	12.3	12.5	12.6	13.1	13.6	14.2	14.9
Tax revenue	10.9	11.2	11.4	11.5	12.0	12.5	13.1	13.6
Import duties	1.0	1.2	1.1	1.0	1.2	1.2	1.2	1.1
VAT	4.1	4.2	4.3	4.5	4.5	4.8	5.0	5.3
Excises	2.1	2.1	2.0	2.2	2.1	2.2	2.2	2.3
Income taxes	2.6	2.5	2.9	2.6	3.0	3.1	3.4	3.6
Other taxes	1.1	1.2	1.2	1.2	1.3	1.3	1.3	1.3
Nontax revenue	1.2	1.1	1.1	1.1	1.1	1.1	1.2	1.2
Total expenditure	18.0	22.2	20.4	21.1	22.5	22.0	22.0	22.2
Recurrent expenditure	13.6	16.0	14.9	16.4	17.0	17.2	17.6	17.9
Wages and salaries	4.0	4.3	4.3	4.6	4.4	4.6	4.9	5.1
Interest payments	1.4	1.4	1.2	1.2	1.4	1.2	1.1	1.0
Domestic	0.7	0.6	0.5	0.5	0.7	0.6	0.6	0.6
Foreign	0.7	0.8	0.7	0.7	0.7	0.7	0.5	0.4
Goods and services and transfers	8.2	10.3	9.4	10.7	11.2	11.4	11.6	11.8
Clearance of domestic arrears	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development expenditure	3.4	6.2	4.6	4.6	5.5	4.8	4.4	4.3
Domestically financed	0.6	1.0	1.0	1.0	1.3	1.2	1.2	1.3
Foreign financed	2.8	5.2	3.6	3.7	4.2	3.6	3.3	3.0
Expenditure carryover	0.4	0.0	0.8	0.0	0.0	0.0	0.0	0.0
Unallocated revenue (+)/expenditure (-) 2/	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, before grants	-5.6	-9.8	-7.9	-8.5	-9.3	-8.4	-7.8	-7.4
Grants	4.5	5.7	5.3	4.9	6.3	5.7	5.4	5.1
Program (including basket grants) 3/	2.1	2.8	3.2	2.2	3.4	3.3	3.1	3.0
Project	1.6	2.1	1.6	2.0	2.1	1.8	1.6	1.5
HIPC grant relief	0.7	0.8	0.5	0.7	0.8	0.7	0.7	0.6
Overall balance, after grants	-1.1	-4.1	-2.6	-3.6	-3.1	-2.7	-2.4	-2.2
Financing	1.1	4.1	2.6	3.6	3.1	2.7	2.4	2.2
Foreign (net)	1.4	3.3	2.9	1.5	2.6	2.3	1.9	1.8
Foreign loans	2.2	4.7	3.8	2.8	3.9	3.3	2.9	2.6
Program (including basket loans) 3/	1.0	1.6	1.7	1.2	1.8	1.5	1.3	1.2
Project	1.2	3.1	2.1	1.6	2.0	1.8	1.6	1.4
Amortization	-0.8	-1.3	-0.9	-1.3	-1.2	-1.1	-0.9	-0.8
Domestic (net)	-0.3	0.7	-0.2	2.0	0.4	0.5	0.5	0.5
Bank financing	-0.7	0.6	-0.2	2.0	0.4	0.5	0.5	0.5
Nonbank financing	0.4	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Amortization of parastatal debt	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Privatization proceeds	0.0	0.2	0.0	0.2	0.2	0.0	0.0	0.0
Memorandum items:								
Primary balance (excluding grants and foreign-financed development expenditure)	-1.4	-3.3	-3.1	-3.7	-3.8	-3.6	-3.4	-3.4
Priority sector spending	8.8	10.2	...	9.7	11.9	...	...	...
Expenditure on defense and national service	1.4	1.5	...	1.5	...	...	...	...
Nominal GDP (market prices, billions of Tanzania shillings)	8,627	9,494	9,549	10,441	10,594	11,733	12,929	14,320
Foreign grants and loans (net)	5.8	9.0	8.2	6.4	8.9	8.0	7.4	6.9

Sources: Ministry of Finance; and Fund staff projections.

1/ Fiscal years run from July to June.
2/ Statistical discrepancy between fiscal and monetary data.
3/ Basket funds are sector-specific accounts established by the government for channeling donor support to fund specific activities in different sectors.

Table 5. Tanzania: Central Government Expenditure on Priority Sectors, 2001/02 - 2003/04 1/

(In billions of Tanzania shillings, unless otherwise indicated)

	2001/02	2002/03		2003/04
		Prog.	Rev. Prog.	Proj.
Total expenditure in priority sectors	761.9	893.2	966.2	1,219.9
(in percent of GDP)	8.8	9.6	10.2	11.5
(in percent of total expenditure)	52.1	48.2	45.9	51.2
Education	344.9	373.8	414.8	480.6
Health	142.1	157.1	172.3	231.2
Water	32.5	50.3	58.5	81.5
Agriculture (research and extension)	31.9	57.4	62.6	118.7
Lands	8.1	9.2	21.2	6.0
Roads	179.6	219.9	208.4	249.6
Judiciary	18.8	21.5	23.8	32.2
TACAIDS 2/	4.0	4.2	4.5	4.3
Recurrent expenditure in priority sectors	497.6	550.5	681.6	808.3
(in percent of GDP)	5.8	5.9	7.2	7.6
(in percent of total recurrent expenditure)	42.5	38.0	44.8	44.8
Education	282.1	318.0	400.0	453.9
Health	90.9	97.7	128.6	170.7
Water	15.5	15.9	16.9	17.4
Agriculture (research and extension)	17.2	17.5	34.2	47.6
Lands	7.4	8.1	4.8	5.4
Roads	65.7	72.8	73.6	84.3
Judiciary	14.8	16.3	18.9	24.8
TACAIDS 2/	4.0	4.2	4.5	4.3
Development expenditure in priority sectors	264.2	358.4	284.6	411.6
(in percent of GDP)	3.1	3.9	3.0	3.9
(in percent of total development expenditure)	90.7	88.7	48.6	71.0
Education	62.8	55.8	14.8	26.8
Health	51.2	59.4	43.7	60.5
Water	17.0	34.3	41.6	64.1
Agriculture (research and extension)	14.7	39.9	28.4	71.1
Lands	0.7	1.1	16.4	0.6
Roads	113.9	147.1	134.8	165.3
Judiciary	4.0	5.2	4.9	7.4
TACAIDS 2/	0.0	15.7	0.0	15.8
Memorandum items:				
Total expenditure 3/	1,462.8	1,852.6	2,106.2	2,383.3
Recurrent expenditure	1,171.4	1,448.5	1,520.4	1,803.4
Development expenditure	291.3	404.1	585.9	579.9
HIPC Initiative debt relief	116.8	121.8	123.0	79.8
(in percent of GDP)	1.4	1.3	1.3	0.8
GDP (market prices)	8,627	9,262	9,494	10,594

Source: Ministry of Finance.

1/ Fiscal year runs from July to June.

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

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

Table 6. Tanzania: Summary Accounts of the Bank of Tanzania, December 2001 - June 2004
(In billions of Tanzania shillings, unless otherwise indicated; end of period)

	2001	2002		2003						2004	
	Dec.	June	Dec.	Mar.		Jun.		Sep.	Dec.	Mar.	Jun.
	Act.	Act.	Act.	Prog.	Act.	Prog.	Est.	Proj.	Proj.	Proj.	Proj.
Net foreign assets	650.7	700.7	991.3	1,049.9	1,048.8	1,023.7	1,285.1	1,386.7	1,399.2	1,427.3	1,452.2
Net international reserves	692.6	742.6	1,033.2	1,091.8	1,090.7	1,065.6	1,327.0	1,428.5	1,441.1	1,469.1	1,494.0
(in millions of U.S. dollars)	755.9	784.2	1,057.9	1,110.3	1,058.7	1,075.3	1,195.5	1,287.0	1,298.3	1,323.6	1,346.0
Medium- and long-term foreign liabilities	-41.9	-41.9	-41.8	-41.9	-41.8	-41.9	-41.8	-41.8	-41.8	-41.8	-41.8
Net domestic assets	-66.3	-127.6	-295.6	-383.5	-399.3	-331.1	-592.4	-623.0	-573.1	-619.0	-624.2
Overall credit to government (net)	-170.7	-245.7	-325.2	-400.7	-344.2	-332.7	-407.1	-437.7	-387.8	-465.4	-438.9
Credit to government (net, excl. liquidity paper)	-37.8	-47.1	-80.3	-35.7	-55.3	9.2	-114.5	-307.8	-265.0	-276.1	-77.4
Liquidity paper (sterilized treasury bills)	-133.0	-198.6	-244.9	-365.0	-288.9	-342.0	-292.6	-129.9	-122.8	-189.3	-361.4
Credit to banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other items net (asset +)	104.4	118.1	29.5	17.2	-55.1	1.7	-185.3	-185.3	-185.3	-153.6	-185.3
Reserve money	584.4	573.1	695.7	666.4	649.6	692.7	692.7	763.7	826.1	808.3	828.0
Currency outside banks	411.6	429.4	495.4	465.6	447.9	491.9	490.8	543.3	590.4	591.5	605.8
Bank reserves	172.7	143.7	200.3	200.9	201.7	200.8	202.0	220.5	235.8	216.8	222.2
Currency in banks	44.6	37.1	51.2	40.0	54.7	40.0	53.2	53.5	53.7	55.6	56.1
Deposits	128.2	106.6	149.1	160.9	147.0	160.8	148.8	167.0	182.0	161.2	166.1
Required reserves (calculated) 1/	100.2	118.3	129.6	135.9	136.6	135.8	141.0	152.0	161.6	161.0	165.3
Excess reserves (calculated)	27.9	-11.7	19.4	25.0	10.4	25.0	7.8	15.0	20.4	0.2	0.7

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

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

Table 7. Tanzania: Monetary Survey, December 2001 - June 2004
(In billions of Tanzania shillings, unless otherwise indicated; end of period)

	2001	2002		2003						2004	
	Dec.	June	Dec.	Mar.		Jun.		Sep.		Mar.	Jun.
	Act.	Act.	Act.	Prog.	Act.	Prog.	Est.	Proj.	Proj.	Proj.	Proj.
Net foreign assets	1,173.6	1,263.8	1,527.7	1,539.4	1,665.5	1,517.0	1,894.7	1,996.3	2,025.4	2,053.5	2,078.3
Net domestic assets	463.1	534.1	520.0	484.8	422.1	532.6	271.7	184.7	223.5	398.6	461.5
Domestic credit	500.1	474.3	579.3	581.3	582.1	655.5	569.3	482.3	521.1	664.4	759.1
Credit to government (net)	95.6	-7.8	8.6	2.0	-16.0	46.9	-31.2	-176.9	-176.1	-70.7	11.5
Credit to nongovernment sector	404.5	482.0	570.7	579.3	598.1	608.6	600.5	659.1	697.1	735.2	747.6
Other items net (asset: +)	-37.0	59.8	-59.3	-96.6	-160.0	-122.9	-297.6	-297.6	-297.6	-265.8	-297.6
Of which: discrepancy between BoT and deposit money banks (DMBs)	4.6	-10.2	-5.2	0.0	7.4	0.0	0.0	0.0	0.0	0.0	0.0
M3	1,636.7	1,797.9	2,047.7	2,024.1	2,087.6	2,049.6	2,166.5	2,330.6	2,475.3	2,480.0	2,539.9
Foreign currency deposits	403.1	464.4	540.3	529.7	585.4	538.7	564.2	588.0	691.8	758.4	727.3
M2	1,233.7	1,333.5	1,507.4	1,494.4	1,502.2	1,510.9	1,602.3	1,742.5	1,783.5	1,721.6	1,812.6
Currency in circulation	411.6	429.4	495.4	465.6	447.9	491.9	490.8	543.3	590.4	591.5	605.8
Deposits (in Tanzania shillings)	822.0	904.1	1,011.9	1,028.9	1,054.3	1,019.0	1,111.5	1,199.3	1,193.2	1,130.2	1,206.8
Memorandum items:											
M3 growth (12-month percent change)	17.1	22.1	25.1	16.0	19.6	14.0	20.5	20.7	20.9	18.8	17.2
Foreign currency deposits (12-month percent change) 1/	32.6	24.2	34.0	11.0	22.7	16.0	21.5	23.0	28.0	29.5	28.9
M2 growth (12-month percent change)	12.8	21.3	22.2	17.9	18.5	13.3	20.2	19.9	18.3	14.6	13.1
Credit to nongovernment sector (12-month percent change)	18.8	27.4	41.1	31.1	35.3	26.2	24.6	20.6	22.2	22.9	24.5
Reserve money (12-month percent change)	5.0	13.1	19.1	21.1	18.0	20.9	20.9	-4.0	18.7	24.4	19.5
Currency/M3 (in percent)	25.2	23.9	24.2	23.0	21.5	24.0	22.7	23.3	23.9	23.9	23.9
Reserve money multiplier (M3/reserves)	2.8	3.1	2.9	3.0	3.2	3.0	3.1	3.1	3.0	3.1	3.1
Velocity of money (M3; average) 2/	5.4	5.3	4.9	...	...	4.9	4.8	...	4.4	...	4.5
Velocity of money (M3; end period)	5.0	4.8	4.4	...	...	4.6	4.4	...	4.1	...	4.2
Net foreign currency position (DMBs; in foreign currency)	265.8	265.1	160.2	119.0	196.8	140.7	236.3	206.7	151.2	96.6	192.7

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

1/ The growth in foreign currency reflects largely the depreciation of the Tanzanian shilling as well as the slow demand for credit denominated in foreign currency.

2/ The sharp increase in broad money at end-2002 distorts the trend in average velocity in 2002 and 2003. However, end-period velocity is less volatile and shows only a marginal decline, consistent with a gradual improvement in banking services, especially in the rural areas. Velocity for June is based on fiscal-year GDP.

Table 8. Tanzania: Balance of Payments, 2000/1-2007/8
(In millions of U.S. dollars, unless otherwise indicated)

	2000/2001	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
	Act.	Act.	Est.			Proj.		
Current account								
Including current official transfers	-407.2	-454.8	-376.3	-606.9	-562.6	-551.7	-586.5	-553.5
Excluding current official transfers	-866.8	-832.4	-885.0	-1,161.5	-1,145.0	-1,165.1	-1,229.1	-1,224.9
Goods and services	-766.5	-760.9	-843.6	-1,131.9	-1,130.7	-1,155.3	-1,225.4	-1,227.0
Trade account	-724.4	-737.9	-754.5	-957.8	-932.1	-937.3	-979.8	-955.9
Exports, f.o.b.	714.5	816.1	953.0	1,169.7	1,278.5	1,381.9	1,482.3	1,600.2
Traditional	261.0	194.3	216.4	244.6	270.5	296.4	322.9	349.2
Nontraditional	453.5	621.8	736.6	925.1	1,008.1	1,085.5	1,159.3	1,251.0
Imports, f.o.b	-1,438.9	-1,554.0	-1,707.5	-2,127.5	-2,210.6	-2,319.2	-2,462.1	-2,556.0
Services (net)	-42.1	-23.0	-89.1	-174.1	-198.6	-218.0	-245.7	-271.1
Credit	652.6	654.9	658.1	665.6	697.4	734.1	771.0	799.5
Debit	-694.7	-677.9	-747.2	-839.7	-896.0	-952.1	-1,016.6	-1,070.6
Income (net)	-100.3	-71.5	-41.4	-29.5	-14.3	-9.8	-3.6	2.1
Credit	46.3	66.0	79.9	84.4	84.7	85.7	86.9	90.5
Debit	-146.6	-137.5	-121.3	-113.9	-99.0	-95.5	-90.5	-88.4
Of which: interest payments due	-118.9	-113.5	-98.0	-90.2	-75.0	-70.9	-65.4	-62.4
Of which: govt. payments due	-109.0	-88.9	-82.2	-74.6	-60.4	-59.4	-57.5	-56.2
Current transfers (net)	459.6	377.6	508.7	554.5	582.4	613.4	642.5	671.3
Of which: official transfers (credit)	445.1	407.9	499.6	550.1	575.8	599.3	628.5	656.3
Of which: Program grants	181.2	184.6	301.5	335.5	355.0	373.6	392.8	412.5
HIPC Initiative relief grants	57.4	64.0	68.6	73.9	76.9	78.8	86.0	92.0
Capital account	398.4	322.5	308.4	307.8	292.6	304.4	311.9	315.3
Of which: project grants	380.6	294.3	266.5	268.9	254.3	263.3	269.9	271.8
Financial account	312.0	98.8	397.7	449.7	455.6	463.2	482.8	488.0
Direct investment	395.3	283.8	244.1	254.0	261.7	280.1	294.1	301.2
Portfolio investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment	-83.3	-185.0	153.6	195.7	193.9	183.2	188.7	186.8
Assets	-69.8	-59.4	9.0	8.4	0.0	0.0	0.0	0.0
Of which: Banks	-69.8	-59.4	9.0	8.4	0.0	0.0	0.0	0.0
Liabilities	-13.5	-125.6	144.7	187.3	193.9	183.2	188.7	186.8
Loans	-65.2	-138.8	123.1	186.2	184.5	167.5	175.0	179.6
Government drawings	314.3	191.3	322.0	378.1	361.5	344.5	346.9	351.2
Of which: Project Loans	261.2	99.2	159.5	198.5	195.8	192.6	190.7	189.7
Program Loans	53.1	92.2	162.5	179.6	165.7	152.0	156.3	161.5
Government repayments	-326.8	-274.0	-126.7	-121.3	-109.6	-112.7	-109.6	-123.1
Of which: scheduled amortization	-256.1	-208.2	-126.7	-121.3	-109.6	-112.7	-109.6	-123.1
Banks	1.1	-0.3	-1.3	-0.9	0.0	0.0	0.0	0.0
Other sectors' drawings	3.4	12.4	24.0	28.7	19.1	5.0	5.0	5.5
Other sectors' repayments	-57.2	-68.2	-95.0	-98.5	-86.5	-69.4	-67.4	-54.0
Trade credit	12.8	13.1	14.9	11.1	9.4	15.6	13.8	7.2
Currency and deposits	38.9	0.1	6.7	-10.0	0.0	0.0	0.0	0.0
Errors and omissions	-311.0	61.6	88.6	0.0	0.0	0.0	0.0	0.0
Overall balance	-7.8	28.1	418.3	150.6	185.6	215.9	208.1	249.8
Financing	7.8	-28.1	-418.3	-150.6	-185.6	-215.9	-208.1	-249.8
BoT reserve assets (increase, -)	-233.2	-231.5	-456.8	-147.5	-144.8	-162.7	-149.0	-192.0
Use of Fund credit	28.3	26.0	4.6	-3.1	-40.8	-53.2	-59.2	-57.7
Exceptional financing	212.7	177.4	33.9	0.0	0.0	0.0	0.0	0.0
Change in arrears (increase +) 1/	142.0	111.7	33.9	0.0	0.0	0.0	0.0	0.0
Debt rescheduled	70.7	65.7	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Gross official reserves (BoT)	982.9	1,212.7	1,671.2	1,818.7	1,963.5	2,126.3	2,275.3	2,467.3
In months of imports of goods and services	5.3	5.9	6.8	7.0	7.2	7.3	7.5	7.6
Current account deficit (as percent of GDP)								
Excluding official current transfers	-9.4	-8.9	-9.3	-11.7	-10.5	-9.7	-9.4	-8.5
Including official current transfers	-4.4	-4.8	-4.0	-6.1	-5.2	-4.6	-4.5	-3.9
World Oil Price (U.S. $/barrel) 2/	26.3	24.6	25.7	25.0	22.8	21.5	21.0	21.0
Net aid flows (as percent of GDP) 3/	10.7	8.5	9.6	10.1	9.4	8.6	8.2	7.7
Foreign direct investment (as percent of GDP) 4/	4.3	3.0	2.6	2.6	2.4	2.3	2.2	2.1
GDP	9,211	9,378	9,498	9,956	10,863	11,971	13,098	14,368

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

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

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

3/ Net aid flows are defined as grants plus concessional foreign borrowing minus actual debt-service payments. From 2003/04, actual payments are equal to scheduled payments.

4/ Significant decline in foreign direct investment ratio in 2001/02 is partly due to data coverage issues.

Table 9. Tanzania: Disbursements of Program Assistance, 2002/03- 2003/04 1/
(In millions of U.S. dollars)

	2002/03							2003/04				2002/03	2003/04
	Proj. Sep	Act. Sep	Proj. Dec	Act. Dec	Proj. Mar	Act Mar	Proj. Jun	Proj. Sep	Proj. Dec	Proj. Mar	Proj. Jun	Est. FY	Proj. FY
				157.5									
Grants	**20.2**	**35.2**	**155.2**	**122.3**	**62.9**	**47.2**	**96.8**	**141.7**	**77.3**	**67.8**	**48.6**	**301.5**	**335.5**
Multilateral	0.0	0.0	36.4	0.0	0.0	0.0	41.8	32.0	0.0	29.1	0.0	41.8	61.1
EU PRBS grants 2/	0.0	0.0	36.4	0.0	0.0	0.0	41.8	0.0	0.0	29.1	0.0	41.8	29.1
EU grants for arrears' clearance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
World Bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	32.0	0.0	0.0	0.0	0.0	32.0
Bilateral	20.2	35.2	118.8	122.3	62.9	47.2	55.0	109.7	77.3	38.7	48.6	259.7	274.3
PRBS 2/	14.5	14.7	94.0	101.5	21.5	27.3	7.6	98.8	55.7	8.9	0.0	151.0	163.4
Sweden	12.8	12.8	0.0	0.0	0.0	0.0	0.0	12.1	0.0	0.0	0.0	12.8	12.1
Netherlands	0.0	0.2	14.9	15.2	0.0	0.0	0.0	0.0	15.5	0.0	0.0	15.3	15.5
Ireland	0.0	0.0	6.0	5.9	0.0	8.3	0.0	0.0	0.0	8.9	0.0	14.2	8.9
United Kingdom	0.0	0.0	54.3	54.7	15.5	16.1	1.6	64.7	30.7	0.0	0.0	72.3	95.4
Norway	0.0	0.0	6.0	13.7	5.0	0.0	0.0	8.2	5.5	0.0	0.0	13.7	13.7
Finland	1.7	1.7	0.0	0.0	0.0	0.0	0.0	1.6	0.0	0.0	0.0	1.7	1.6
Denmark	0.0	0.0	10.0	11.0	0.0	0.0	0.0	5.5	4.0	0.0	0.0	11.0	9.5
Switzerland	0.0	0.0	0.0	0.0	0.0	0.0	5.0	0.0	0.0	0.0	0.0	5.0	0.0
Germany					0.0	0.0	0.0	4.7	0.0	0.0	0.0	0.0	4.7
Japan	0.0	0.0	1.0	1.0	1.0	2.9	0.0	0.0	0.0	0.0	0.0	4.0	0.0
Canada	0.0	0.0	1.8	0.0	0.0	0.0	1.0	2.0	0.0	0.0	0.0	1.0	2.0
Sectoral baskets	5.7	20.5	24.8	20.8	41.4	19.9	47.4	10.9	21.7	29.8	48.6	108.7	110.9
Belgium	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.8	0.0	0.0	3.8
Canada	0.0	0.3	0.0	0.3	0.0	7.4	0.0	0.6	0.6	13.6	0.0	8.0	14.7
Denmark	0.0	3.8	0.8	0.0	0.8	2.9	0.0	5.3	0.0	4.1	0.0	6.7	9.4
EU	0.0	0.0	0.0	0.0	12.4	0.0	13.3	0.0	0.0	0.0	17.6	13.3	17.6
Finland	0.0	0.0	0.8	0.0	0.0	0.0	1.0	0.0	0.0	0.0	2.0	1.0	2.0
Ireland	0.0	1.9	2.5	3.6	2.2	0.0	4.1	1.6	3.0	0.0	3.4	9.6	7.9
Netherlands	4.1	4.1	10.0	10.0	20.0	0.0	20.0	3.2	7.7	0.0	15.5	34.1	26.4
Norway	0.0	0.0	3.0	3.4	0.0	3.4	0.0	0.0	4.8	4.8	0.0	6.8	9.6
Sweden	0.0	0.0	2.6	0.0	0.0	0.0	9.0	0.0	0.0	0.0	10.2	9.0	10.2
Switzerland	1.6	0.0	0.0	2.0	0.9	0.0	0.0	0.0	3.7	0.0	0.0	2.0	3.7
United Kingdom	0.0	10.2	5.2	0.0	5.2	5.3	0.0	0.0	0.0	0.0	0.0	15.5	0.0
Others										2.4		0.0	2.4
Germany	0.0	0.2	0.0	1.5	0.0	0.9	0.0	0.3	1.9	1.1	0.0	2.6	3.3
Loans	0.0	2.4	80.0	0.0	25.0	45.1	115.0	125.0	0.0	54.6	0.0	162.5	179.6
Multilateral	0.0	2.4	80.0	0.0	25.0	45.1	115.0	125.0	0.0	54.6	0.0	162.5	179.6
World Bank	0.0	2.4	80.0	0.0	0.0	45.1	90.0	100.0	0.0	54.6	0.0	137.5	154.6
African Devlopment Bank	0.0	0.0	0.0	0.0	25.0	0.0	25.0	25.0	0.0	0.0	0.0	25.0	25.0
Bilateral	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total program assistance	**20.2**	**37.6**	**235.2**	**122.3**	**87.9**	**92.3**	**211.8**	**266.7**	**77.3**	**122.4**	**48.6**	**464.0**	**515.1**
Cumulative from beginning of fiscal year	20.2	37.6	255.4	160.0	343.3	252.2	464.0	266.7	344.0	466.5	515.1	...	...

Sources: Tanzanian authorities; and donors.

1/ Fiscal years run from July to June.

2/ Poverty reduction budget support.

Table 10. Tanzania: External Debt Indicators, 2001/02–2011/12 1/

After bilateral relief beyond the enhanced HIPC Initiative

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
	(In percent)										
Debt Indicators at the HIPC Completion Point 2/											
NPV of debt-to-GDP ratio	14.2	14.7	14.8	14.8	14.9	15.1	15.1	15.1	15.0	14.9	14.9
NPV of debt-to-exports ratio 3/ 4/	105.2	112.1	115.6	117.0	117.3	117.5	116.8	116.2	115.2	114.3	114.4
NPV of debt-to-revenue ratio 5/	126.5	125.2	124.4	123.4	120.7	118.7	116.8	113.5	110.5	106.5	103.9
Debt-service-to-export ratio 6/	6.4	5.7	6.2	6.9	6.4	5.7	5.6	5.3	5.6	5.6	4.9
Debt service-to-revenue ratio 5/	8.0	6.6	7.1	7.9	7.1	6.3	6.0	5.6	5.8	5.6	4.8
Updated Debt Indicators 7/											
NPV of debt-to-GDP ratio	14.8	16.2	16.9	16.5	16.1	15.8	15.5	15.5	15.4	15.3	15.3
NPV of debt-to-exports ratio 3/ 4/	100.9	101.7	101.3	99.2	97.8	98.7	98.7	98.8	98.1	97.4	97.3
NPV of debt-to-revenue ratio 5/	121.8	133.1	142.0	139.3	127.5	118.7	110.8	108.7	108.0	107.2	107.2
Debt-service-to-export ratio 6/	6.1	5.2	5.3	6.1	5.7	5.2	5.1	4.8	5.2	5.2	4.6
Debt service-to-revenue ratio 5/	7.9	7.3	8.4	9.3	7.9	6.6	6.1	5.6	6.1	6.1	5.4
Debt Indicators from the Authorities' DSA 8/											
NPV of debt-to-GDP ratio	19.4	21.4	22.3	22.0	21.7	21.4	21.3	21.6	21.9	22.2	22.6
NPV of debt-to-exports ratio	132.5	134.8	133.6	132.6	131.8	133.8	135.7	137.6	139.3	141.2	143.7
NPV of debt-to-revenue ratio	159.8	176.5	187.3	186.1	171.7	160.9	152.4	151.4	153.4	155.5	158.3
Memorandum items:	(In millions of U.S. dollars)										
NPV of debt after bilateral debt relief beyond enhanced HIPC Initiative assistance	1,386	1,512	1,659	1,790	1,926	2,074	2,214	2,361	2,498	2,642	2,813
Debt service after bilateral relief beyond enhanced HIPC Initiative assistance	90	83	98	119	120	116	122	122	141	151	142
GDP	9,378	9,351	9,809	10,864	11,971	13,140	14,292	15,221	16,211	17,264	18,387
Exports of goods and services	1,471	1,609	1,835	1,967	2,103	2,236	2,389	2,544	2,710	2,886	3,073
Exports of goods and services (3-year mvg. avg.)	1,373	1,487	1,638	1,804	1,968	2,102	2,243	2,390	2,548	2,713	2,890
Government revenue	1,138	1,136	1,169	1,285	1,510	1,748	1,997	2,172	2,314	2,464	2,624
Projected disbursements of new loans	...	348	408	369	352	347	358	378	398	420	443
NPV of debt after enhanced HIPC Initiative assistance (from Bank of Tanzania)	1,820	2,004	2,189	2,392	2,594	2,812	3,043	3,289	3,549	3,831	4,153
Projected disbursements of new loans (from BoT)	...	514	509	558	572	594	616	642	669	698	729

Sources: Tanzanian authorities; and IMF staff estimates.

1/ All debt indicators refer to public and publicly guaranteed debt and are defined after rescheduling, unless otherwise indicated. All years on July-June basis.
2/ Estimated in November 2001 based on end-June 2001 debt data.
3/ Based on a three-year average of exports (e.g., export average over 1999/00-2001/02 for NPV of debt-to-exports ratio in 2001/02).
4/ Assuming full delivery of HIPC Initiative assistance at end-June 2001.
5/ Revenue is defined as central government revenue, excluding grants.
6/ Based on current year exports.
7/ Estimated in June 2003 based on completion point debt data, new disbursements in 2002 and other macroeconomic developments in 2002.
8/ The Bank of Tanzania carried out a debt sustainability analysis based on end-June 2002 debt data. These indicators are from the baseline scenario which assume full delivery of enhanced HIPC Initiative assistance. It also assumes a higher level of projected new borrowing.

Table 11. Tanzania: Status of HIPC Agreements by Creditor

	Nominal Debt Relief US$ millions	Agreement to Provide Bilateral Relief beyond HIPC	Comments
Multilateral	**1,558.5**		
IDA/IBRD	1,157.1	n/a	Debt-service relief of 69.1 percent annually for 20 years on debts outstanding at end-June 1999 (average reduction of 63.6 percent on debts outstanding at end-June 2001).
IMF	120.0	n/a	Debt-service reduction through grants provided from PRGF-HIPC Trust Fund. Average of 48 percent of debt service payments on current IMF obligations.
AfDB/AfDF	190.7	n/a	Debt service reduction by 80 percent annually until debt relief is delivered.
IFAD	24.5	n/a	Reduction of 100 percent of debt service due.
EU/EIB	37.9	n/a	Grants provided at the complition point to pay off outstanding loans.
Nordic Development Fund	3.2	n/a	Contribution to HIPC initative trust fund , to pay 100 percent of debt service.
OPEC Fund	9.8	n/a	Concessional loan and restructuring of existing debt.
BADEA	14.7	n/a	Concessional rescheduling of debt and reduced interest rate.
East African Development Bank	0.6	n/a	Reduced interest rate and extension of repayment period.
Paris Club Bilateral Creditors	**675.5**		
Austria	31.3	Yes	Bilateral agreement for PC VII signed May 7, 2002.
Belgium	74.3	No	Bilateral agreement for PC VII signed November29, 2002.
Brazil	-	Pending	On June 2, 2003, the authorities sent Brazil a reminder to submit a draft agreement for PC VII. Awaiting reply.
Canada	31.1	No	Bilateral agreement for PC VII signed October 16, 2002.
France	89.9	Yes	Bilateral agreement for PC VII signed March 6, 2003.
Germany	56.2	Yes	Bilateral agreement for PC VII signed April 29, 2003.
Italy	132.0	Yes	Bilateral agreement for PC VII signed May 7, 2002.
Japan	-	Pending	Awaiting final agreement on PC VI. Agreement on PC VII will follow shortly thereafter.
Netherlands	99.1	Yes	Bilateral agreement for PC VII signed March 17, 2002.
Norway	11.1	Yes	Bilateral agreement for PC VII signed December 5, 2002.
Russia	-	Pending	Agreement on PC VII delayed by dispute concerning $40 m debt swap (under PC V).
United Kingdom	129.2	Yes	No bilateral agreement needed. Debt cancelled through letter to Tanzania authorities.
United States	21.3	Yes	Bilateral agreement for PC VII signed July 4, 2002.
Non-Paris Club Bilateral Creditors	**37.7**		
Algeria	-	No	Letter requesting debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Angola	-	No	Letter requesting debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Bulgaria	-	No	Letter requesting debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
China	37.7	No	15 interest-free loans maturing Dec 31, 1999 cancelled.
Czech Republic	-	No	Debt assigned to Lazard.
Egypt	-	No	Letter requesting debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Hungary	-	No	Letter requesting debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Iran	-	No	Letter requesting debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Iraq	-	No	Letter requesting debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Kuwait	-	No	Indicated willingness to participate in HIPC Initiative. Rescheduled 9 pre-CD loans on concessional terms March 8, 2003.
Libya	-	No	Letter requesting debt relief under PC VII terms sent August 5, 2002. Libyan authorities have replied that they are not part of the PC, and so are not bound by PC terms.
Pakistan	-	No	Letter requesting debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Poland	-	No	Letter requesting debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Romania	-	No	Letter requesting debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
United Arab Emirates	-	No	Letter requesting debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Yugoslavia	-	No	Letter requesting debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Zambia	-	No	Letter requesting debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Zimbabwe	-	No	Letter requesting debt relief under PC VII terms sent April 17, 2002. Awaiting reply.

Source: Bank of Tanzania.

July 10, 2003

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

Dear Mr. Köhler,

1. Tanzania continues to implement its programme for poverty reduction with the support of the IMF through a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) extending to June 2003. The fifth review under the arrangement was concluded by the Executive Board of the IMF in November 2002. This letter requests completion of the sixth and final review under the current PRGF arrangement. In addition, the Government requests for a low access PRGF arrangement with the IMF. To this end, this letter discusses progress in implementing the programme since mid-2002 and sets out the Government's policy intentions for the medium term and targets for the fiscal year 2003/04 (July-June). The first disbursement under the requested PRGF arrangement is subject to a review expected to be completed by December 2003.

I RECENT ECONOMIC PERFORMANCE AND POLICY IMPLEMENTATION

A. Macroeconomic Developments

2. Tanzania's macroeconomic performance continued to improve in 2002, accompanied by a strong economic expansion. The GDP growth rate rose from 5.7 percent in 2001 to 6.2 percent in 2002, despite the continued worsening in the terms of trade and a slowdown in tourism related to the current adverse global security situation affecting travel. Growth in 2002 stemmed from relatively strong performances in agriculture, mining, manufacturing, as well as wholesale and retail trade. The 12-month rate of inflation declined further, from 4.5 percent in June 2002 to 4.3 percent in April 2003. Gross official reserves of the Bank of Tanzania (BoT) stayed well above six months of imports of goods and services.

B. Performance Under the Program

3. The quantitative benchmarks and performance criteria on central government revenue and the net domestic financing of the central government were met by

wide margins. All other quantitative performance criteria and benchmarks for end-December 2002 were also observed (Table 1). The following structural performance criteria and benchmarks were observed (Table 2): i) Introducing a treasury voucher system for administering the tax exemptions applying to non-religious NGOs and to imports of motor vehicles by eligible public servants; ii) Issuance of guidelines to local councils for the harmonization of taxes, levies and licenses; iii) Requiring spending agencies to submit to the Accountant General quarterly reports on their utility bills and amounts paid, starting with a report for the first quarter of 2002/03; iv) The identification of budgetary codes for priority expenditures and applying them in the budget guidelines for 2003/04; v) Establishing the National Debt Management Committee under the National Debt Strategy; and vi) Submission to parliament of the draft law establishing the legal, regulatory, and supervisory framework for microfinance operations. The structural performance criterion on submission to Parliament of amendments to the Loans, Guarantees and Grants Act by February 2003 was delayed, and we request a waiver for the non-observance of this performance criterion. However, the bill has subsequently been passed by Parliament in April 2003. The implementation of the centralized motor vehicle registration system was also delayed owing to litigation by a vendor; however, the system started functioning in May 2003.

C. Fiscal Developments

4. Government revenue has remained consistently above estimates during the first three quarters of the fiscal year 2002/03, and has grown by 18 percent over the same period last year. The most notable features are the strong revenue performance of VAT on domestic goods and income tax, while a negative growth was registered over the last year in taxes on petroleum imports. This strong revenue growth is due to a combination of policy changes; administration improvements; and expansion of the economy.

5. Total expenditure for the three quarters ending March 2003 was Tsh. 1226 billion, or 77 percent of estimates. This underperformance is due to delays in programme loan disbursements which reduced the resource envelope; slow execution of discretionary expenditure; and delays in procurement. Notwithstanding the shortfall in foreign financing, priority sectors have continued to receive their full quarterly allocations in line with their respective cash flow requirements. In addition, full budgetary allocations were provided for the Population Census and HIV/AIDS priority interventions via TACAIDS. The net domestic financing (NDF) position of the Government at the end of March 2003 registered a net borrowing of Tsh 28.4 billion.

D. Progress in Public Financial Management Reform

6. The Government has continued with efforts to establish effective and sustainable financial management arrangements to support the equitable delivery of public services, to minimize resource leakages, and to strengthen accountability. In this regard, the Government has revised the Public Financial Management Reform Programme (PFMRP) taking forward relevant Country Financial Accountability Assessment (CFAA) and Report on Observance of Standards and Codes (ROSC) recommendations as well as recent developments, including the new Public Finance and Public Procurement Acts. The Government is continuing to work on the remaining seven benchmarks emanating from the priority expenditure tracking study that was conducted as part of the PRSP/HIPC process and we are confident that they will all be met in the ensuing two years. The Integrated Financial Management System (IFMS) has continued to be the main source of report generation for the Government's budgetary operations. In order to increase transparency, reports relating to budget execution and public debts in addition to being published in the local media are also posted on the national website. The Government will continue holding Public Expenditure Reviews in order to take on board views and opinions of the general public and other stakeholders.

7. Utility commitments in the IFMS have continued to be effected on behalf of Ministries, Departments and Government Agencies (MDAs). On a quarterly basis, utility reports showing amounts paid against amounts billed and committed are produced. This allows for tracking and monitoring the payment of utility bills received by MDA's to utility entities. So far, reports indicate that MDAs are paying their bills consistent with bills they receive.

E. Implementation of the Poverty Reduction Strategy

8. Tanzania continues to implement its Poverty Reduction Strategy (PRS). The second annual PRS progress report which outlines the implementation of the PRS, was finalized and published in March 2003. It was prepared on the basis of participatory discussions including a wide range of stakeholders during both the Poverty Policy Week in September 2002 and the Consultative Group meeting held in Dar es Salaam in December 2002. It has also incorporated comments from the World Bank and IMF staff.

9. The annual PRS progress report 2002 draws on the Poverty and Human Development Report (PHDR). This presents information on the implementation of various aspects of the PRS and was also discussed during the Poverty Policy Week in September 2002. It included major findings from the Household Budget Survey (HBS) and the Integrated Labour Force Survey (ILFS), both of which have been

published as separate reports. The Participatory Poverty Assessment (PPA) programme was launched in 2002 as part of the poverty monitoring framework. The field work was conducted during April-June 2002 and the report is currently being finalized. The PPA has focused on vulnerability, an area which was identified to have an information gap in the original PRSP. In an effort to advance the Poverty Monitoring System (PMS), a set of existing poverty monitoring indicators of social well-being identified in the Poverty Monitoring Master Plan are being developed further based on data availability, data quality and relevance to poverty.

F. Monetary and Financial Sector Developments

10. During the first three quarters of 2002/03, developments in monetary aggregates remained encouraging. The actual outturn on net domestic assets, and net international reserves met the requirements of the PRGF performance criteria. The stock of reserve money at end March 2003 was below the PRGF target for the quarter ending March 2003 of Tsh. 666.4 billion by Tsh. 16.8 billion, reflecting concerted efforts by the Bank of Tanzania to contain liquidity during the period. However, broad money supply, M2 grew by 18.5 percent and was above the programme target of 17.9 percent, while M3 grew by 19.6 percent against the programme target of 16.0 percent. The increases in M2 and M3 were due to changes in the money multiplier, caused by higher than projected growth in deposits, largely attributed to opening of new bank branches by commercial banks in areas that previously did not have banking services. Other reasons for the rapid growth in deposits include the realization of privatization proceeds of about TZS 20 billion, introduction of automatic teller machines (ATMs) by commercial banks, plus the issuance of new bank notes by the Bank of Tanzania. The depreciation of the shilling revalued upwards foreign currency deposits in terms of Tanzania shillings on the balance sheets of banks and in the monetary survey.

11. Given the unanticipated nature and unusual sources of liquidity creation since the beginning of 2002/03 fiscal year, the ordinary instruments available to the Bank of Tanzania were not adequate to mop up the excess liquidity. As liquidity build up continued, alternative means of bringing down the rate of monetary expansion had to be sought. As a first step, the government agreed with the Bank of Tanzania to securitize Tsh 40 billion of a hitherto dormant government stock held by the Bank of Tanzania. This has already been converted into long-term treasury bonds. Furthermore, Tsh 80 billion was also securitized in the form of 35, 182 and 364-day treasury bills, and is currently being replaced by long term bonds. The process has however, taken longer than projected following unanticipated low demand in the Treasury bond market, brought about by investment diversification by major institutional investors, particularly the pension funds which have recently increased their investments in real estate business.

12. During the review period, commercial banks' weighted average lending and deposits rates exhibited a downward trend and the margin between average deposit and lending rates narrowed from 12.6 percentage points in June 2002 to 11.7 percentage points in March 2003. The overall lending rates declined from 16.4 percent in June 2002 to 15.0 percent in March 2003, while the average deposit rate fell from 3.8 percent to 3.3 percent. The downward trend of deposits rates reflected developments in the T-bills market. The average savings deposit rate fell from 3.5 percent to 2.8 percent and the average time deposit rate decreased from 4.0 percent to 3.7 percent in the same period. Considering the inflation rate of 4.2 percent for March 2003, deposit rates were negative in real terms, except for the 6-month, 12-month and 24-month time deposits, which were positive in real terms at 4.2 percent, 5.8 percent and 4.4 percent, respectively. The prevailing wide spread between deposit and lending rates coupled with negative real interest rates on some deposits stems from structural as well as institutional impediments that still remain in the economy. Many of these impediments will be addressed in the course of 2003/04.

G. Public Debt Management

13. Public debt developments were broadly on track. Domestic debt market developments continued to be favourable. This was encouraged by the successful floatation at the stock exchange of the 5-year Treasury bond in February 2002, the launching of a 7-year fixed rate Treasury bond in August 2002 and 10-year bond in October 2002. These new bonds are part of the ongoing efforts to convert unsecuritized debt into marketable securities.

14. As regards external debt, there has been some progress in concluding bilateral agreements under Paris Club VII. To date, agreements have been signed with Austria, the United States, Canada, Belgium, France, Netherlands, Norway, Germany and Italy. The United Kingdom has notified the Government of Tanzania that it is providing total debt cancellation and that there is therefore no need for a bilateral agreement. Recognizing the genuine difficulties faced by the Government in expediting the process, the creditors, through the Paris Club Secretariat, have agreed to extend the deadline for bilateral agreements to June 30, 2003.

15. The Government has been consistently appealing to the Non-Paris Club official and commercial creditors to extend debt relief on terms comparable to those under the enhanced HIPC framework, but there has been little progress. So far, only Kuwait has provided debt relief under the HIPC framework. China and India have offered debt relief by canceling some of the debts but not on terms comparable to the PC. In addition, some dialogue has been initiated with Libya, but no commitment has been made yet. Also, discussions are going on with the

Government of Russia with regard to claims of moratorium interest under PCVI bilateral agreements. We have written to the Paris Club Secretariat to ask for clarification of the issues involved. To underscore its strong commitment to reaching agreement with these creditors, the Government has recently established a foreign currency escrow account managed by the Bank of Tanzania into which it has deposited US dollar 5 million, equivalent to 12.5 percent of the estimated debt service due to these creditors after application of the enhanced HIPC debt relief terms. In this regard, the government would appreciate the assistance of the Fund and the Bank in encouraging participation of the non-Paris Club creditors in the debt relief initiative.

H. External Sector

16. During 2001/02, the external current account deficit improved to 8.9 percent of GDP (excluding current official transfers) from 9.4 percent of GDP a year earlier. Non-traditional exports, gold in particular, performed well during most of 2001/02. However, traditional exports recorded their worst performance in recent years mainly due to falling export prices in the world market for coffee, cotton and cashew nuts. Imports increased by 8.0 percent largely on account of an increase in the imports of capital and intermediate goods. However, there was significant decrease in imports of consumer goods, in particular, foodstuffs owing to favourable weather conditions. There has also been a decline in official grants during the year under review compared to 2000/01 levels. Gross external official reserves rose to USD 1546.1 million at the end of March 2003, equivalent to 7.5 months of 2002/03 imports of goods and non-factor services.

II POLICY DIRECTION FOR THE MEDIUM TERM

17. Over the medium term, we anticipate growth to accelerate to 6-7 percent, while containing inflation at an average of 4 percent. Given Tanzania's population growth, such real growth rate would support an annual increase in per capita income of about 3 percent. We project the current account deficit to decline slightly, as substantially higher exports of goods and services are mostly offset by higher imports reflecting increased consumption and private investment.

18. Our growth projections are underpinned by an increase in both private and public investment over the average of 2000–02, as public investments favorably impact the business environment and support higher private investment. To accomplish this rise in investment, we will implement a range of measures to remove impediments to investment. Our efforts in this direction will be assisted by the dialogue with investors in the context of the Investors' Roundtable. We will also seek to continue with trade liberalization to enhance competitiveness.

19. Given the preponderance of agriculture in Tanzania's economy and the fact that little progress has been made in reducing poverty in the rural areas, improvements in the agricultural sector will be critical in strengthening our growth performance and achieving the objectives for poverty reduction under our PRSP. With our development partners, we are implementing the Agricultural Sector Development Program and the Rural Development Program which centers on the support of policy efforts at the district and field levels by strengthening access to financing and marketing. Engines of growth will furthermore be the services and industrial sectors, notably tourism and manufacturing, which are expected to grow more strongly in response to our efforts at improving the business climate. Furthermore, we expect utility services to improve once DAWASA and TANESCO are privatized, as anticipated, while growth in the mining sector will remain buoyant.

20. We recognize that the effective use of higher aid flows in support of these objectives may be constrained by limited absorption capacity and the potential upward pressure on the exchange rate from additional aid flows. To address these risks, we will redouble our efforts at improving absorption capacity by strengthening institutional capacity, particularly in the public service, removing bottlenecks in the infrastructure, and improving governance.

III. POLICIES FOR FISCAL YEAR 2003/04

A. POVERTY REDUCTION STRATEGY

21. Tanzania remains committed to the Development Vision 2025 goal of reducing poverty. The National Poverty Eradication Strategy (NPES) 1997, the Poverty Reduction Strategy Paper (PRSP) 2000 as well as the first two annual progress reports, and the Zanzibar Poverty Reduction Plan 2002 form the framework within which to achieve this goal. In the coming fiscal year, the Government will strive to achieve the targets set in the annual PRS progress reports which center around the maintenance of macroeconomic stability, structural reforms, the promotion of pro-poor growth and the creation of employment. The third annual progress report will contain valuable information drawn from the Population and Housing Census (September 2002), and from an Agriculture Survey to be conducted in 2003. The former will measure poverty indicators more directly and at a highly disaggregated level, providing key information that will make the PRS more responsive to specific local problems. The latter will provide better understandings of the linkages between agriculture, the main economic activity, and poverty, and will thereby help to better inform the implementation of the PRS, the Rural Development Strategy and the Agriculture Sector Development Strategy. Beginning with the fiscal year 2003/04 poverty reducing expenditure will be specified with GFS codes for effective monitoring of performance. They will apply for central

government expenditures as well as for local government subventions in PRS sectors.

22. To promote more efficient implementation of the PRS, the Government intends to approve, by March 2004, an updated action plan for strengthening and sustaining capacity of the Secretariat in the Vice President's Office (VPO), as well as in the President's Office – Regional Administration and Local Government (PO-RALG) coordination and monitoring unit, in order to improve the ability to collect, collate and analyse administrative data. Furthermore, under the PRS Action plan, the Millenium Development Goals will be integrated into the Poverty Monitoring framework by November 2003.

B. Macroeconomic framework

23. The overarching focus of policies in 2003/04 will be towards consolidating and maintaining macroeconomic stability and strengthening domestic resource mobilization and the external sector, whilst implementing key sectoral strategies, as outlined in the PRS. In the absence of exogenous shocks, the real GDP was earlier projected to grow by 6.3 percent in 2003, rising to 7.4 percent by the year 2006. However, there has been a drought in some parts of the country in the early part of 2003, which could significantly affect agricultural output and thus lower growth prospects. Moreover, global security concerns will likely have an adverse effect on tourism. Thus for purposes of the program, GDP growth for 2003 is cautiously estimated at 5.5 percent. Monetary policy will be geared towards reducing the inflation rate to about 4 percent by end-June 2004, after rising to 6 percent at end-2003 because of the impact of drought on food prices. Thereafter, the inflation rate is projected to decline to below 4 percent, consistent with the average inflation rate in our major trading partners. The exchange rate is freely floating, with the Bank of Tanzania intervening only to smoothen wide fluctuations and for the purpose of liquidity management.

C. Fiscal Policy and Budgetary Reform

24. The current revenue to GDP ratio is inadequate for meeting the current salaries and other current expenditures of the Government. This is a source of great concern, as the low revenue yield makes the budget dependent on donor inflows. This situation calls for a sustained revenue mobilization effort in order to improve revenue collections and hence enhance the government's ability to finance budgetary operations. In this context, the focus of 2003/04 fiscal policy is to raise the revenue yield, measured by the ratio of revenue to GDP, to above 13 percent. Efforts will be directed towards reviewing the taxation system so as to rationalize tax policy and simplify tax administration, curbing tax evasion, and reducing tax exemptions. The government aims to implement key recommendations from the

IMF report on priorities and strategies for revenue administration reforms, the Public Expenditure Review study on tax policy and administration and the government commissioned study on estimation of potential revenue gaps for Tanzania in order to raise the revenue yield. In the tax area, in particular, the Government's objectives will include significantly increasing the effectiveness of TRA operations by (i) adopting self-assessment of income tax liabilities; (ii) integrating existing tax-based departments in a functional organization structure; (iii) strengthening compliance management of large taxpayers through implementation of the above reforms in the Large Taxpayer Department by January 1, 2004 (structural benchmark); and (iv) simplifying VAT administration. Specific measures include:

i. In the sphere of income taxation, the Government intends to submit to Parliament by end-October a new income tax act which is to become effective on January 1, 2004. The Act is based on the principle of self-assessment, brings the legislation in line with the current economic and business environment, and removes all discretionary powers to grant tax exemptions. We will also propose to parliament the abolition of the stamp duties on receipts, with the new income tax law. The new income tax law will include a new presumptive tax with adjusted rates to offset the loss of revenue from abolishment of the stamp duty on receipts. These measures will simplify tax administration and improve tax collection by removing complexities of the current income tax act;

ii. In order to rationalize the exemptions regime, the Government intends to carry out a number of measures. Firstly, the Government is mindful that prior to 1997 certain government notices relating to tax exemptions were issued that were either too generous or difficult to administer. In order to rectify this situation, the government will during the fiscal year 2003/04 revoke all government notices relating to tax exemptions issued prior to 1997. These government notices will be replaced by new ones that would either place a quantitative restriction on exempted goods or place a time bar on the tax exemption. This move will tighten the current exemptions regime. Secondly, in the context of its ongoing comprehensive review of tax laws which is expected to be completed during the fiscal year, the government will submit to Parliament amendments to the Customs Tariff Act, Excise Ordinance, and Stamp Duty Tax Act removing all discretionary power to grant exemptions from import, excise, and stamp duties and vest the authority with parliament. Thirdly, to improve control of exemptions in the medium term, in 2003/04 the voucher system will be extended to administer tax exemptions to religious NGO's;

iii. The Tanzania Revenue Authority (TRA) has prepared the second corporate plan for the 2003/04 – 2007/08 period with a view to modernizing its organization and operations, and improving its effectiveness. In particular, the government will endorse the corporate plan by end-June 2003 and will mandate its implementation. Also, the TRA will re-engineer its business processes and develop an integrated computer system. These measures will be implemented in the Large Taxpayer department before implementing them across the organization. In addition, steps will be taken to increase the number of taxpayers registered with the Large Taxpayers Unit;

iv. To simplify our tax system and to improve administrative efficiency, we will revise the VAT threshold by June 2004 with a view to reducing the number of taxpayers covered and revise presumptive tax rates to compensate for the revenue loss.

v. In view of the recent unsatisfactory performance of petroleum taxes, the Government is taking measures effective July 2003, that would make the petroleum sector less susceptible to evasion and improve compliance.

vi. The setting up of Export Processing Zones (EPZ) is intended mainly to boost employment as well as diversify exports, in particular in view of the opportunities presented by AGOA exports to the US and EBA exports to the EU. The Government is also mindful of the importance of avoiding revenue leakages. Therefore, we will license only companies which can verify that they already have access to the AGOA and EBA exports, and will produce exclusively for these markets. Moreover, we will amend the regulations to strengthen the rules and procedures to avoid tax leakages. We will also undertake, with Fund technical assistance, a comparative study of the benefits from tax incentives from EPZs in the region. In addition, no new companies will be added to the list of Strategic Investors maintained by the Tanzania Investment Center.

vii. The government has decided to operationalise in 2003/04 the Joint Finance Commission between the Union Government of Tanzania and the Revolutionary Government of Zanzibar. This Commission will aim at strengthening budgetary coordination.

25. According to the budget projection for 2003/04, total expenditure has been provisionally forecast at 22.5 percent of GDP in 2003/04 representing an increase of 2.0 percentage points from the previous year. The government intends to pursue the civil service pay reform and in this context the civil service wage bill has been forecast to increase by an average of 13 percent in 2003/04. The increase is planned to cover new recruitment, refinement of pay structures as well as pay rises. In addition, the number of staff at lower grades will be reduced.

26. Priority expenditures in 2003/04 will be enhanced in line with the PRS and all priority sectors and items will continue to be protected while critical allocations for services like utilities will continue to be ring-fenced. The specific requirements to attain the poverty outcome targets of the Poverty Monitoring System, particularly in the social sectors of health and education will be met. In order to increase transparency and improve tracking of priority expenditures, the budget for 2003/04 will specifically include a table showing poverty-reducing items. Efforts are also ongoing to introduce functional classification and the adoption of GFS uniform codes. Starting 2003/04, the quarterly Budget Execution Reports will incorporate reports on poverty-reducing expenditures based on IFMS.

27. Total foreign project expenditures is forecast at 4.2 percent of GDP, above the budget level in 2002/03. Budget support grants are expected to increase from 3.2 percent of GDP in 2002/03 to 3.4 percent in 2003/04. Taking account of the revenue and expenditure estimates above, bank financing of the government during 2003/04 will be limited to TSh 42.7 billion.

28. The large number of local government taxes and licenses has been identified as a significant impediment to investment. A strategy for harmonisation of local government taxes and levies was developed in April 2002 and the relevant guidelines were issued to local authorities in December 2002. The government intends to continue to implement these guidelines during 2003/04 so as to address the concerns of stakeholders voiced during discussions between the private sector and the government. To this end, the Government has identified taxes to be abolished, particularly those which are considered to be nuisance and those which undermine the Government's efforts to fight poverty.

29. The Government has continued applying Financial Management of Public Funds consistent with the requirements of the Public Finance and Public Procurement Act (2001). However, the regulations in these acts are being reviewed in order to reduce unnecessary bottlenecks and allow for an unencumbered procurement process, while maintaining internal controls. In 2003/04, the government intends to procure an aircraft and will ensure that procurement procedures are followed in accordance with the Public Procurement Regulations. Any associated financing would be on concessional terms, consistent with the program. Off-budget payments for the purchase of the air traffic control system have been regularized by presenting a supplementary warrant to the Parliament. Furthermore, key reforms will be made in the context of the implementation of the revised Public Financial Management Reform Programme, which will be continued in the coming fiscal year. These reforms will include the consolidation of improvements within IFMS so as to ensure that no budgetary arrears accumulate.

D. Monetary Policy and Financial Sector Reform

30. The Bank of Tanzania will continue to monitor closely domestic as well as international economic developments in order to take appropriate monetary policy measures to ensure continued macroeconomic and financial stability and the maintenance of external competitiveness. The monetary program for 2003/04 targets reserve money of Tsh 764 billion at end – September 2003, Tsh 826.1 billion at end-December 2003 and Tsh 808 billion at end March 2004. The targets for net domestic assets and net international reserves of the Bank of Tanzania for end-September 2003 and end March 2004 are Tsh -584 billion and USD 1,287 million, and TZS -579 billion and USD 1,324 million, respectively. Reserve money and NIR for end – September 2003 and end – March 2004 will be monitored as performance criteria under the program, while NDA will be a benchmark. Broad money (M3) is projected to increase to Tsh 2475.3 billion at end-December 2003 and to TZS 2539.9 billion at end June 2004, or by 20.9 percent et end – December 2003 and 17.2 percent at end-June 2004, respectively. Liquidity management will be targeted towards ensuring that growth in monetary aggregates is consistent with the program targets. In particular, monetary policy will be geared to ensure that the expected increase in inflation related to the food shortage would be temporary and to be largely reversed before the end of the fiscal year 2003/04. The main focus of monetary policy will be to control the increase in excess liquidity expected to emanate mainly from the projected large increase in foreign inflows. In this regard, the Bank in collaboration with the Government will increase the supply of long-term instruments in the market in order to augment substantially the supply of instruments to mop up excess liquidity. In view of the recent increase in the demand for money, we have operationalized the daily liquidity forecasting framework to strengthen reserve money management. To this end, the Bank of Tanzania will conduct timely and targeted sterilization operations with treasury bills (liquidity paper) and other instruments. Open market operations will remain the main monetary policy instrument, supplemented by foreign exchange market interventions.

31. To remove the remaining impediments in the development of the financial sector, amendments to the Land Act, which continues to hamper the use of land as collateral will be presented to Parliament in October 2003 (structural performance criterion). In the meantime, the proposed draft amendments will be reviewed jointly by the Ministry of Lands, the Attorney General Chambers, the Bank of Tanzania and the Tanzania Bankers Association to ensure that they are consistent with the Government's objective of increasing access to bank credit by a much wider range of borrowers in the population in order to promote a high rate of growth of the economy needed to accelerate poverty reduction. Other policy measures in this area will aim at improving the land registry, and enhancing the capacity of the judiciary, including the commercial court, through the employment and training of more judges, with a view to keeping the average case resolution for the commercial court

to below six months. The Government is also considering other avenues for promoting property rights. The Bank of Tanzania will endeavour to ensure that the credit information bureau is established in line with the framework that the Bank of Tanzania has already prepared. The Ministry of Lands will be provided with the necessary financial and technical support to computerize and improve the land registry. Given the sharp drop in traditional exports, the Export Credit Guarantee Scheme will continue to be strengthened in order to sustain rural incomes and increase exports.

32. The Bank of Tanzania intends to strengthen the regulatory and supervisory framework for micro-finance institutions and to generally strengthen the overall supervision of the financial sector in order to enhance the stability of the financial system. Efforts are underway to introduce a more diverse range of products, including putting in place an enabling environment, which will facilitate the provision of long-term finance to the productive sector. The Bank of Tanzania will by December 2003 review relevant prudential regulations and legislation with a view to relaxing some of the credit limits, such as the requirement to raise the collateral equivalent to 125 percent of the loan amount and the aggregate ceiling for large loan exposures as a ratio of the bank's core capital. The Bank of Tanzania will pay due regard to the work of the recent IMF Mission regarding Tanzania's future prospects for accessing foreign private capital and of the report of the FSAP mission.

33. To preserve the soundness of the financial system, in March 2003, the Bank of Tanzania took over the management of the Delphis Bank following the poor financial performance of the bank and the inability of its shareholders to inject additional capital to cover losses incurred in its operations. While under the administration of the Bank of Tanzania, all the bank's operations have been proscribed. Discussions are underway for new shareholders to capitalize the bank and re-open it under new management. At the same time, the Government is implementing a comprehensive restructuring plan to address the long-standing problems of the People's Bank of Zanzibar. To strengthen the capital base of the banking system, the Bank of Tanzania has adopted a phased increase in the minimum paid up capital of commercial banks. The Government is cognizant of the need to strengthen measures against anti-money laundering and financing of terrorism. To this end, Tanzania is implementing the recommendations of the financial task force under the East and Southern African Anti-Money Laundering Group.

E. Debt Sustainability

34. The Government has started implementing the key recommendations of the recently approved National Debt Strategy. The improved procedures will be formalized by gazetting the recently approved amendments of the Government Loans, Guarantees and Grants Act, 1974. In light of a large stock of parastatal debt, the Government has initiated a study with the aim of getting a clearer understanding of the maturity profile of these contingent liabilities, as well as suggesting ways to fund repayment of the same when need arises. The study was commenced in February 2003 and is expected to be completed by the end of December 2003.

F. Other Structural Reforms

35. The parastatal sector reform programme continues to make substantial progress. The divestiture of Air Tanzania Corporation was concluded during December 2002 while DAWASA was concessioned out to private operators in February 2003. The focus over the medium term will remain on privatization of large utilities, including TANESCO, the Tanzania Railways Corporation, and the Tanzania Harbours Authority. Pursuant to the government's policy of privatizing public enterprises the budget for 2003/04 will provide for the possible cost of retrenchments for enterprises subject to privatization in 2003/04, in line with the government's policy to provide only statutory benefits. The Government will also ensure that following privatization, adequate regulatory frameworks will be established so as to protect consumer welfare. In this vein, the regulatory agency for the water and electricity sectors (EWURA) will begin operations in July 2003.

36. There have been delays in the privatization of the National Microfinance Bank (NMB) on account of concerns expressed by unions and parliamentarians. Nevertheless, the government is committed to improve the efficiency of the financial system and to promote the interests of rural areas and smallholders by addressing expeditiously the problems of the bank, including the need for government subsidies. Accordingly, the government will adopt a revised strategy for dealing with the NMB by mid-July, and expects that by the latter half of 2004 the NMB will be privately owned and managed to enable it to contribute to improving microfinance in Tanzania.

37. In the area of private sector development, it is recognised that Small and Medium Enterprises (SME) play a crucial role in employment creation and income generation in Tanzania. The Government is committed to the SME development policy, which was adopted in February 2003 and is expected to be ready for implementation by November 2003. The strategies for implementing the policy in the medium term focus on three main areas, namely the creation of an enabling business environment; the development of financial and non-financial services

strategies; and the establishment of a supportive institutional infrastructure. Consultations with the private sector will be promoted and Government aims to ensure representation of SME relevant issues on the agenda of the Tanzania National Business Council.

38. In view of promoting the business environment, a better regulatory unit for the Business Environment Strengthening for Tanzania (BEST) programme will be operationalised through provision of adequate staffing and resources. In addition, by December 2003, we will adopt an action plan to reform and simplify the business licensing system after further consultation with stakeholders and prepare a related position paper. Furthermore, a new labour policy and revised Labour Act has been prepared in consultation with stakeholders and will be submitted to parliament by October 2003.

39. A key reform in the area of rural development will be to prepare and issue a prioritized strategic plan and a corresponding program to strengthen the administrative capacity for implementation of the Land Act and Village Land Act. Other reforms include: the enforcement of the microfinance legislation and regulations; preparation of monitorable benchmarks for assessing the effectiveness of coordination mechanism for the implementation of the Agricultural Sector Development Program; review of the role and funding of crop boards to limit their functions to regulatory activities; and to develop proposals to strengthen the institutional arrangements for district road maintenance and rehabilitation.

40. In an effort to improve public sector performance, during the next fiscal year, the government intends to enhance pay in line with the approved budget for 2003/04. In addition, we will amend the local government service regulations to be in line with the Public Service Act by November 2003.

41. Transparency of budget execution, centrally as well as locally, will continue to be maintained by the publication of quarterly budget execution reports by the Government (on the national website) and the LGAs (which submit their reports to PO-RALG which then consolidates the information). Furthermore, an expenditure tracking survey is due to be completed in the next fiscal year under the Public Expenditure Review.

42. Consistent with the Poverty Reduction Strategy, the Government has continued to make progress in the promotion of good governance, including the implementation of the National Anti-Corruption Strategy and Action Plans (NACSAP) of ministries, independent departments and agencies. In this regard the second quarterly report on the implementation of NACSAP was published in March 2003. In order to address coordination and implementation of the National Anti-Corruption Strategy and Action Plan (NACSAP) 2003-2005, a report assessing the necessary

human and financial resources will be finalized by November 2003, which will subsequently guide the provision of these resources to the implementing institution. In addition, the revised code of conduct will be made available for public servants, and a mechanism for complaints and grievances will be subsequently put in place to deal with unethical conduct. For the 2003/04 budget, the anti-corruption action plans for all LGAs will be included, following which the Government will ensure effective implementation of the plans. Beginning this fiscal year, the government will publicize within two months of the end of each quarter the name and exemption amount for companies, NGO's, and individuals that have received exemptions during the quarter (structural performance criterion).

43. Various other reform programmes in the area of good governance are ongoing, progress of which have been presented in 2002 PRS progress report. To provide a solid basis for these reforms the commission of Human Rights and Good Governance has been established and is now fully operational. The establishment of this commission is a milestone in ensuring administrative justice which is greatly expected to contribute towards the promotion of good governance in the country.

G. External Sector Issues

44. The improvements in the external accounts in recent years were a result of large inflows of external assistance and growth in mining exports and tourism receipts. The government's efforts to strengthen the external accounts in the medium term will focus on reversing the sharp decline in traditional exports, increasing agro-industry and manufactured exports, and in attracting foreign direct investment and other nondebt- creating financial flows. The 46.2 percent decline in the earnings from traditional exports over the past three calendar years reflects not only the sharp decline in agricultural commodity prices in world markets, but also stagnant volumes of key exports. The government is facilitating efficient marketing of output, through the recently established export credit guarantee facility, and will encourage the development of high value agricultural exports and manufactured products. In this context, the government understands that there is a supply side constraint which limits the opportunity to play a significant role in the African Growth Opportunities Act (AGOA) of the USA and Everything But Arms (EBA) of the EU. Government recognises that by establishing a supportive institutional infrastructure, small- and medium-size enterprises can contribute substantially by providing competitive products to sell under AGOA. We have also initiated a capacity building process to strengthen the competitiveness of Tanzanian products, especially non-traditional ones. It is also expected that the implementation of EPZs, targeted exclusively to exporting firms, will support the development of manufactured exports.

45. Export competitiveness will be enhanced by a further reduction in import tariffs and removal of non-tariff barriers over the medium term. Institutionally, such trade liberalization must occur mainly within the framework of the East African Community (EAC).In June 2003 member states of the EAC agreed to adopt a common external tariff with three bands (0, 10 and 25 percent). The Customs Union Protocol of the EAC is expected to be signed in November 2003. There are also ongoing efforts to eliminate all non-tariff barriers within the EAC and SADC. The government is committed to phasing out the suspended duties imposed on a short list of imported commodities and will review the time frame in the context of the EAC trade protocol negotiations and enactment of antidumping legislation. To promote inflows of private capital through liberalization of portfolio investment, the government has revised the regulations of the Dar es Salaam Stock Exchange to allow foreign participation. The Bank of Tanzania, in collaboration with the Capital Market and Securities Authority, established modalities to guide foreign investors' dealings and has developed institutional arrangements for monitoring private capital flows, as well as instituting appropriate regulations that will provide the necessary safeguards.

46. The external current account deficit, before grants, estimated at 11.8 percent of GDP in 2003/04 is projected at 10.5 percent in 2004/05 and 9.6 percent in 2005/06. Exports of goods and services are projected to grow by an annual average of 9.3 percent, over the three years, as traditional exports and tourism receipts recover slowly, and mining exports continue their good performance. Imports are projected to grow on average by 10.3 percent over the three years, with a sharp increase in 2003/04 on account of anticipated large food imports related to the prevalent drought, and a rise in investments and capital imports. The external financing requirement of US$ 1.1 billion per year over the three years is expected to be covered by external assistance in the form of grants, concessional loans and debt relief. In order to maintain external debt at sustainable level, the government will not contract or guarantee external debt on nonconcessional terms, and will not accumulate external payments arrears.

H. Concluding Remarks

47. Significant progress has been made in the sphere of fiscal, monetary and structural issues in the context of the current PRGF which is due to end after completion of the sixth review. Even though the Bank of Tanzania foreign exchange reserves are now adequate to meet the requirements of the foreign exchange markets, significant risks remain. In this context, the Government of Tanzania considers the continuation of IMF engagement through a three – year low access PRGF arrangement to be valuable for continued economic progress. We would therefore like to request this arrangement beginning in fiscal year 2003/04 and we

intend to continue consultation with the Fund on Tanzania's economic and financial policies in accordance with such an arrangement.

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

Sincerely,

Basil Pesambili Mramba (MP)
Minister for Finance

Attachments: Tables 1-4

Table 1. Tanzania: Quantitative Performance Criteria and Benchmarks Under the Poverty Reduction and Growth Facility (PRGF) Arrangement, December 2002 - June 2003

	2002			2003			
	December			March			June
	Performance Criteria						Indicative
	Prog.	Adjusted	Actual	Benchmarks	Adjusted	Actual	Benchmarks
	(In billions of Tanzania shillings; end of period)						
Net domestic financing of the government of Tanzania (ceiling) 1/ 2/ 3/	0	58	7	16	133	28	64
Central government recurrent revenue (floor, benchmark only) 1/	559		595	862		902	1.172
Extrabudgetary expenditure (ceiling, benchmark only) 1/	0		0	0		0	0
Accumulation of budgetary arrears (ceiling, benchmark only) 1/	0		0	0		0	0
Net domestic assets (NDA) of the Bank of Tanzania (ceiling) 2/ 4/ 5/	-328	-222	-289	-384	-232	-383	-331
Reserve money (ceiling, benchmark only) 4/	707		696	666		650	693
	(In millions of U.S. dollars, unless otherwise indicated)						
Net international reserves of the Bank of Tanzania (floor) 6/	1,020	894	1,058	1,020		1.059	1.020
Accumulation of external payments arrears (ceiling) 7/	0		0	0		0	0
Contracting or guaranteeing of external debt on nonconcessional terms (ceiling) 1/	0		0	0		0	0
Memorandum items:							
Foreign program assistance (grants and loans) 1/	268		160	406		252	429
Programmed debt-service payments (in billions of Tanzania shillings) 1/	126		78	179		144	259

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 August 31, 2001, subject to the addition of the adjustment clause laid out in footnote 3 below.

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

2/ To be adjusted upward for the Tanzania shilling equivalent of any shortfall in foreign program assistance from the amounts shown in the memorandum item.

3/ To be adjusted downward/upward to the extent that total debt-service payments (interest on foreign and domestic debt and amortization of foreign debt), fall short of/ exceed the amount shown in the memorandum item.

4/ To be adjusted downward to the extent that eligible bank reserves fall short of 10 percent of commercial bank deposits.

5/ Note that NDA is adjusted for the program exchange rate, so it may not directly correspond to the NDA in the monetary table.

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

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

Table 2. Tanzania: Structural Performance Criteria and Benchmarks Under the Poverty Reduction and Growth Facility Arrangement, November 2002 – March 2003

Measure	Date of Implementation (End of period)	Implementation Status
Tax policy and administration		
Adopt centralized motor vehicle registration system.	December 2002	Observed
Introduce a treasury voucher system for administering the indirect tax exemption applying to nonreligious NGOs and to imports of motor vehicles by eligible public servants.	January 2003	Observed
Issue guidelines to local councils for the harmonization of taxes, levies, and licenses.	January 2003	Observed
Expenditure management		
Require spending agencies (MDAs) to submit to the Accountant General quarterly reports on their utility bills and amounts paid, starting with a report for the first quarter of 2002/03.	November 2002	Observed
Identify the budgetary codes for priority expenditures and apply them in the budget guidelines for 2003/04 **(performance criterion).**	February 2003	Observed
Public debt management		
Submit to parliament amendments to the Loans, Guarantees and Grants Act **(performance criterion).**	February 2003	Delayed. Observed in March 2003
Establish National Debt Management Committee under the National Debt Strategy.	February 2003	Observed
Financial sector reform		
Submit to parliament the draft law establishing the legal, regulatory, and supervisory framework for microfinance operations.	February 2003	Observed

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

	2003			2004	
	June Estimate	September Performance Criteria	December Benchmarks	March Indicative Benchmarks	June Benchmarks
	(In billions of Tanzania shillings; end of period)				
Net domestic financing of the government of Tanzania (ceiling) 1/ 2/	-14	-150	-145	-32	43
Accumulation of budgetary arrears (ceiling; benchmark only)	0	0	0	0	0
Net domestic assets of the Bank of Tanzania (ceiling; benchmark only) 2/	-557	-584	-534	-579	-584
Reserve money (ceiling)	693	764	826	808	828
	(In millions of U.S. dollars, unless otherwise indicated; end of period)				
Net international reserves of the Bank of Tanzania (floor) 3/	1,196	1,287	1,298	1,324	1,346
Accumulation of external payments arrears (ceiling) 4/	0	0	0	0	0
Contracting or guaranteeing of external debt on nonconcessional terms (ceiling)	0	0	0	0	0
Memorandum item:					
Foreign program assistance (grants and loans) 1/	464	267	344	467	515

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 June [] 2003.

1/ Cumulative from the beginning of the fiscal year (July 1).
2/ To be adjusted upward for the Tanzania shilling equivalent of any shortfall in foreign program assistance from the amounts shown in the memorandum item.
3/ To be adjusted downward for any shortfall in foreign program assistance from the amounts shown in the memorandum item.
4/ Continuous performance criterion; excludes arrears on debt-service payments pending the conclusion of debt-rescheduling agreements.

Table 4. Tanzania: Prior Action, Structural Performance Criteria, and Benchmarks Under the Poverty Reduction and Growth Facility Arrangement, July 2003-June 2004

Measure	Date of Implementation
Tax policy and administration	
Adoption by the Tanzania Revenue Authority (TRA) board of corporate plan, as outlined in paragraph 24 of the letter of intent	Prior action
Submission to parliament of the new income tax law, to become effective January 1, 2004 consistent with paragraph 24 of the letter of intent[1/]	October 2003
Large Taxpayer Department to introduce collection of income tax based on self-assessment[2/]	January 1, 2004
Revision of the value-added tax (VAT) threshold to substantially reduce the number of VAT taxpayers, and revision of the threshold for the presumptive tax accordingly[2/]	June 2004
To curtail tax exemptions, no new companies will be added to the list of strategic investors maintained by the Tanzania Investment Center, and no companies will be licensed for the export processing zone, other than as specified in paragraph 24 of the letter of intent[2/]	Continuous
Financial sector reform	
Submission to parliament of amendments to the Land Act, as outlined in paragraph 31 of the letter of intent[1/]	October 2003
Review of prudential regulations, as indicated in paragraph 32 of the letter of intent[2/]	December 2003
Improve environment for investment	
Adoption of an action plan to reform and simplify the business licensing system[2/]	December 2003
Governance	
Publicizing of the list of companies, individuals, and NGOs that have received tax exemptions each quarter, as specified in paragraph 42 of the letter of intent[1/]	Quarterly

[1/] Performance criterion.
[2/] Structural benchmark.

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

July 10, 2003

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 performance criteria and benchmarks under the Poverty Reduction and Growth Facility (PRGF)-supported program, as laid out in Table 3 of the government's letter of intent of July 10, 2003 to which this TMU is attached.

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; 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.

Net domestic assets and reserve money

3. Net domestic assets (NDA) of the BoT are defined as the BoT's reserve money **minus** its net foreign assets (NFA). Reserve money is defined as the sum of currency issued by the BoT and the deposits of the commercial banks with the BoT. Net foreign assets (NFA) of the BoT consist of its NIR, net other foreign assets, and its medium- and long-term foreign liabilities. For purposes of deriving NDA from reserve money and NFA, the latter are converted into Tanzania shillings at the program exchange rate.

Net domestic financing of the government of Tanzania

4. Net domestic financing of the Government of Tanzania (NDF) includes financing by the banking system (BoT and commercial banks) and the nonbank public of the budget of the central (union) government of Tanzania. 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 (excluding liquidity paper issued by the BOT for monetary policy purposes) minus all government deposits with the BoT; (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 NBC and the NMB, and debt of parastatal companies assumed by the government.

External payments arrears

5. 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

6. 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 (but does not include debt of any political subdivision or government-owned entity with separate legal personality that is not otherwise owed or guaranteed by the Government of Tanzania).

7. 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 rates (CIRR), adjusted as appropriate for different maturities. This performance 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

8. New budgetary arrears are defined as arrears accumulated during the fiscal year on wages, domestic interest, and goods and services.

Foreign program assistance

9. Foreign program assistance is defined as grants and loans received by the Ministry of Finance through BoT accounts 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.

Adjusters

10. The quantitative targets for the BoT's net international reserves will be adjusted downward for any shortfall in foreign program assistance.

11. The quantitative limits on the BoT's net domestic assets will be adjusted upward for any shortfall in foreign program assistance converted into Tanzania shillings at the average quarterly exchange rate.

12. The quantitative limits on net domestic financing of the Government of Tanzania will be adjusted upward for any shortfall in foreign program assistance converted into Tanzania shillings at the average quarterly exchange rate.

DATA REPORTING REQUIREMENTS

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

13. Reporting of developments in relation to the program's benchmarks and performance criteria to be provided monthly:

Table of Quantitative Performance Criteria and Benchmarks (Table 3).

Table with the Structural Benchmarks and Performance Criteria (Table 4). The column of this table, labeled "Status," will be updated on a monthly basis with a view to monitor progress with the structural benchmarks and performance criteria.

Table on priority sector expenditure targets and performance.

14. 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.
Exports and Imports.
Balance of payments:

The published consumer price index report of the National Bureau of Statistics (NBS).

The quarterly and annual national accounts statistics in constant and current prices as prepared by the NBS.

Tanzania: Relations with the Fund
(As of April 30, 2003)

I. Membership Status: Joined 09/10/62; Article VIII

		SDR million	% Quota
II.	**General Resources Account:**	SDR million	% Quota
	Quota	198.90	100.00
	Fund holdings of currency	188.90	94.97
	Reserve position in Fund	10.00	5.03
III.	**SDR Department:**	SDR million	% Allocation
	Net cumulative allocation	31.37	100.00
	Holdings	0.32	1.02
IV.	**Outstanding Purchases and Loans:**	SDR million	% Quota
	Poverty Reduction and Growth Facility (PRGF)	293.88	147.75

V. Financial Arrangements:

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
PRGF	04/04/2000	06/30/2003	135.00	120.00
PRGF	11/08/1996	02/07/2000	181.59	181.59
ESAF	07/29/1991	07/28/1994	181.90	85.60

VI. Projected Obligations to Fund (without HIPC assistance)
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	17.42	27.50	38.32	46.32	46.61
Charges/interest	1.85	1.87	1.70	1.49	1.25
Total	19.27	29.38	40.02	47.80	47.85

Projected Obligations to Fund (with Board-approved HIPC assistance)
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	5.58	19.84	31.40	40.43	41.49
Charges/interest	1.85	1.87	1.70	1.49	1.25
Total	7.42	21.71	33.10	41.92	42.74

VII. Implementation of HIPC Initiative:

	Enhanced framework
Commitment of HIPC assistance	
Decision point date	3/31/2000
Assistance committed (NPV terms)[17]	end-June 1999
Total assistance (US$ million)	2,026.00
Of which: Fund assistance (SDR million)	88.95
Completion point date	11/21/01
Delivery of Fund assistance (SDR million)	
Amount disbursed	96.40
Interim assistance	26.68
Completion point[18]	69.72
Amount applied against member's obligations (cumulative)	35.93

VIII. Safeguards Assessments:

Under the Fund's safeguards assessment policy, the Bank of Tanzania (BoT) was subject to the transitional procedures with respect to the PRGF arrangement that was approved on April 4, 2000. The transitional procedures required a review of only the BoT's external audit mechanism. The assessment, completed on April 3, 2001, concluded that the BoT's current external audit mechanism was not adequate in specific respects. Recommendations were reported to the Executive Board in EBS/02/56 (3/29/02). Under a new PRGF-supported program, the BoT would be subject to a full safeguards assessment in accordance with the Fund's policy on safeguards. This assessment is under way.

IX. Exchange Arrangements:

The currency of Tanzania is the Tanzania shilling. The official exchange rate is determined on the basis of the rate established in the interbank market for foreign exchange. The middle rate in terms of the U.S. dollar, the intervention currency, was T Sh 1,038.0 per U.S. dollar as of April 30, 2003. The exchange system is free of restrictions on the making of payments and transfers for current international transactions. The exchange rate is floating independently.

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[17] Net present value (NPV) terms at the decision point under the enhanced framework.

[18] Under the enhanced HIPC Initiative, the nominal amount of assistance disbursed will include an additional amount corresponding to interest on amounts committed but not disbursed during the interim period, calculated using the average return (during the interim period) on the investment of resources held by, or for, the benefit of the PRGF-HIPC Trust.

X. Article IV Consultation:

The most recent Article IV consultation was concluded on November 18, 2002 (EBS/02/187; 11/4/02)).

XI. Technical Assistance, 1999–2003:

Departments	Timing	Form	Purpose
Fiscal Affairs	1998–99	Long-term consultant	Expenditure management
	October 1999	Mission	New duty drawback system
	October 2000	Mission	Public expenditure management
	March 2001	Mission	Fiscal decentralization
	May 2001	Short-term consultant	Translation of government accounts and operationalization to the standard classifications
	October 2001	Mission	Conduct the Report on Observance of Standards and Codes (ROSC) fiscal transparency module and preparation of an assessment and action plan for the ability to track poverty-reducing expenditure
	2001–02	Long-term consultant	Strengthening of macroeconomic fiscal analysis at the Ministry of Finance
	October 2002	Mission	Tax administration
	2002 – 03	Long-term consultant	Tax administration
	2002 – 03	Long-term consultant	Public expenditure management
	Mar. – May 2003	Mission	Tax administration
	April 2003	Mission	Inspection and tripartite review
	April 2003	Mission	Public expenditure management
	June – Sep. 2003	Long-term consultant	Public expenditure management
IMF Institute	March 1999	Mission	Financial programming and policy courses
Monetary and Financial Systems	Since October 1998	Long-term consultant	Financial system reform
	Since November 1998	Regional advisor	Payments systems
	June–July 1999	Mission	Capital account liberalization
	March 2001	Mission	Monetary policy operations
	2003-04	Long-term consultant	Banking supervision and regulation
	Feb. 2003	Mission	Financial Sector Assessment Program (FSAP) pre-mission
	June 2003	Mission	Payments systems workshop
Statistics	October 2000	Multitopic mission	Macroeconomic statistics
	May 2002	Mission	Balance of payments statistics
	2002 – 03	Long-term consultant	Multisector statistics
	June 2003	Mission	Government finance statistics course

XII. Resident Representative:

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

Tanzania : Relations with the World Bank Group
(As of June 6, 2003)

Partnership in Tanzania's development strategy

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

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

Bank Group strategy

The current Country Assistance Strategy (CAS) for Tanzania was approved by the Bank's Board on June 15, 2000. The next CAS will be presented to the Board by the end of 2003. The focus of the current CAS is on higher economic growth, poverty reduction, and institutional reforms to improve governance. It conforms with the government's main strategy of adherence to macroeconomic stability, increased private sector participation in the economy, a renewed emphasis on rural development, and an improved delivery of social services. It also supports the government's desire to enter into new relationships with its development partners, based on the phased switching from projects to programs for more effective and efficient use of aid resources.

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

IDA also provides adjustment lending through PSAC 1 and implementation has been satisfactory. Four out of the five tranches of the credit have already been released. Government has requested an extension of the closing date of the credit till December 31, 2003 to finalize and approve a strategy for the divestiture of the National Insurance Company –the main outstanding condition for the release of the last tranche. The implementation of policy reforms agreed upon under PSAC1 and PRSC is supported by a series of technical assistance and investment projects. These include project support to improve tax administration, to reform the public sector, and to develop the financial sector, including rural finance, and microfinance.

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

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

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

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

Tanzania joined the World Bank Group in 1962. Beginning with an IDA credit for education in 1963, a total of 124 credits and 27 loans, totaling US$4.35 billion (US$4 billion from IDA) have been provided to Tanzania. Total disbursements amounted to US$3.5 billion as of June 6, 2003 (some US$3,198 million from IDA and US$355 million from IBRD). Currently, the portfolio comprises 23 active projects with commitments of US$1.5 billion in all major sectors. As of June 6, 2003, the undisbursed balance for the portfolio stood at US$909 million.

Bank-Fund collaboration in specific areas

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

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

Tax policy and administration reform. A relatively small and stagnant domestic revenue effort is a severe constraint on Tanzania's efforts to improve public service provision and to fully finance the implementation of the poverty reduction strategy. The Bank and the Fund have over the past few years made significant efforts to enhance the domestic revenue collection. While the Fund has taken the lead in reforms and adjustments of tax policy, the Bank has taken the lead in reforms to strengthen tax administration.

Financial sector reforms. Tanzania has been engaged in far-reaching reforms of the financial sector. The Bank and the Fund have been working closely to support these policy reforms. In addition to its contribution to the policy dialogue, the Bank has provided significant technical assistance for financial sector reforms. This includes two financial institution development projects that support, respectively, the withdrawal of the government from banking and nonbanking financial institutions and the strengthening of financial sector supervision. Successful outcomes of these reforms include the privatization of Tanzania's largest bank and the entry of a fairly large number of international banks into the Tanzanian market. Other areas of Bank involvement include the reform of the capital and securities authority, the reform of pension systems, and the liberalization of capital accounts. Through a separate project, the Bank supports the development of rural and microfinance services. A joint Bank/Fund Financial Sector Assessment is being prepared.

Public service reform and improved service delivery. In recent years, the government of Tanzania, with support from the Bank and other donors, has launched a number of major initiatives to improve performance and to foster greater accountability, transparency, and integrity in the public sector. These include (i) the Public Service Reform Program (PSRP) (ii) the Local Government Reform Program, (iii) the Public Finance Management Reform Program, (iv) the National Anti-Corruption Strategy and Action Plans for Tanzania, (v) the National Framework on Good Governance, delineating a comprehensive approach to improve governance, (vi) the establishment of a Good Governance Coordination Unit (GGCU) in the President's Office, and (vii) the launch of the Legal Sector Reform Program. Among these reforms, the PSRP plays a central role since its objective is to improve the accountability, transparency, and resource management of service delivery. The program is closely linked with other major reforms in public finance and decentralization. The PSRP aims at transforming the public service into a service that has the capacity, systems, and culture for client orientation and continuous improvement. Cooperation between the Bank and the Fund covers those areas where public sector reform has a direct impact on fiscal stability and public sector financial management.

Trade reforms. The Bank and the Fund are working closely to assist Tanzania in establishing a pro-growth trade framework. While the Fund is focusing on reforms of the tariff regime, the Bank is focusing on trade expansion through its regional trade facilitation project. The Bank is also involved at the regional level in the dialogue on trade reforms in the context of the East African Community.

Tanzania : Financial Relations with the World Bank Group

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

	IBRD	IDA	TOTAL
Original Principal:	361.03	3,991.91	4,352.94
Cancellations:	5.48	229.36	234.83
Disbursed:	355.55	3,198.62	3,554.17
Undisbursed:	0.00	661.82	661.82
Repaid:	351.69	277.90	629.59
Due:	3.77	2,979.68	2,983.45
Exchange Adjustment:	0.44	0.00	0.44
Borrower's Obligation:	4.21	2,979.68	2,983.89
Sold 3rd Party:	0.09	6.20	6.29
Repaid 3rd Party:	0.09	6.20	6.29
Due 3rd Party:	0.00	0.00	0.00

Tanzania: Statistical Issues

Tanzania's statistical infrastructure and economic database remain weak. Tanzania has received considerable technical assistance to alleviate these difficulties, and progress has been made in some areas. The authorities are fully cooperative in providing available data to the Fund in a timely manner. Tanzania has very few statistical publications and no fully articulated publication policy. The authorities are committed to improving the production and dissemination of macroeconomic and sociodemographic statistics in the framework of the General Data Dissemination System (GDDS). Tanzania is a participant in the GDDS, and its metadata were posted on the Data Standards Bulletin Board (DSBB) in July 2001. In October 2000, a GDDS multisector statistics mission conducted a detailed assessment of Tanzania's statistical systems and used the framework of the GDDS to provide guidance on statistical practices and development in the areas of national accounts, price, foreign trade, balance of payments, fiscal, monetary, and sociodemographic data. A mission to prepare the data module for a Report on the Observance of Standards and Codes (ROSC) was recently completed (October 8-23, 2002).

National accounts

National accounts data are prepared by the National Bureau of Statistics (NBS) on the basis of data collected by its regional offices and by other government entities. The national accounts data provide a basis for assessing movements in output, although many weaknesses remain, particularly with respect to data sources for the breakdown by expenditure category, deficiencies in external sector data, and the paucity of indicators to extrapolate benchmark production levels. These deficiencies impede the accurate estimation of the savings-investment relationship. The recent revision of the data for crops and the new household budget survey are expected to improve the quality of the national accounts.

Prices

Monthly consumer price data are collected by the NBS from 20 cities and regional centers. Since mid-May 1996, data have been reported within three weeks after the end of the month. The authorities intend to update the consumer price index weights (food currently has a 71.2 percent weight) on the basis of the recent household budget survey data, and to expand the producer price index series.

Government finance statistics

Although monthly data on central government revenue, expenditure, and financing are provided to the Fund on a timely basis, concepts in use differ from the international standards in the treatment of lending minus repayments, and transfer payments. Despite improvements in the recording of government transactions, discrepancies remain between revenue and expenditure data, on the one hand, and financing data, on the other. This seems to be related to the different sources used for these data. There appears to be a different coverage of the central government sector in the fiscal and monetary data. Following the creation by the Ministry of Finance, with donor assistance, of a database of donor-funded projects in

2001/02 (July-June), the amount of foreign-financed projects reported by and channeled through the budget has increased significantly. No information is yet provided on the financial position of local governments, although the authorities stated that there were plans to produce these reports.

The government has recently completed the computerization of its accounting system for budgetary units, which the authorities indicate would allow resumption of reporting in the *Government Finance Statistics (GFS) Yearbook*. However, the computerized accounting system does not provide details of the nature of development expenditure and has not yet been extended to cover the extrabudgetary units.

Monetary statistics

The GDDS multisector mission (October 11–24, 2000) determined that the quality of monetary statistics was compromised by various methodological problems, in particular the arbitrary application of the residency criterion by commercial banks, the exclusion of rural banks and nonbank deposit-taking institutions from the coverage, the inadequate subdivision of the resident sector data owing to the misclassification of certain accounting data in monetary aggregates, the lack of a separate identification of restricted deposits of closed banks and nonperforming loans of the banking system, the nontransparent treatment of repurchase agreements, the inadequate sectorization of various accounts in the bank reporting system, the erroneous coverage of international reserves, the lack of market-based valuations of foreign securities, and, finally, the treatment of accrued interest in a highly aggregated manner.

To address these problems, the mission recommended that the Bank of Tanzania (BoT) (i) instruct commercial banks to classify accounts according to the client's properly determined residency status and use; (ii) extend the coverage of monetary statistics to all depository corporations; (iii) revise the bank report forms to allow for a more detailed scheme for sectorizing resident sector data; (iv) reclassify misclassified accounting data to facilitate an accurate construction of monetary aggregates; (v) establish a separate identification of restricted deposits of closed banks and nonperforming assets of the banking system to ensure that the resulting deposit and credit aggregates were meaningful for macroeconomic analysis; (vi) treat repurchase agreements with commercial banks as a new financial instrument for providing or taking loans; (vii) modify the bank reporting system to emphasize appropriate sectoral distinctions between various accounts; and (viii) redefine the coverage of international reserves to include only liquid foreign assets and a market-based value of gold assets. Based on these recommendations, the mission prepared an action plan. The authorities intend to seek technical assistance to implement some of these recommendations. A follow-up mission in monetary and financial statistics is envisaged that will review the implementation of these recommendations and assist the authorities with the development of a wider financial survey covering activities of all deposit-taking financial institutions.

Balance of payments statistics

Foreign trade data are prepared by staff missions on the basis of customs data from the BoT. The foreign trade data are compiled by the Tanzania Revenue Authority, based on customs records. A recent balance of payments statistics mission (May 8-21, 2002) found that there continued to be a significant unrecording of trade. Information on invisible transactions is sparse. Tourism revenue is estimated on the basis of data records of the foreign international exchange transactions reporting system (ITRS) at present. However, the authorities have made strong progress in improving the data for travel credits by gathering data from travel surveys and they plan to use the survey-based data as the data source beginning in 2003.

Information on official grant and loan receipts is prepared by the staff on the basis of contact with official agencies. The data on current and capital transfers (grants) are estimates, based in part on data provided by the Ministry of Finance and in part on United Nations Development Program (UNDP) projections. However, the coverage, periodicity, and disaggregation of the data are inadequate and efforts are under way to achieve a complete coverage of data on grants disbursed.

Data on private capital flows are very poor at present. Some information on private banking sector flows can be derived from the monetary survey; other private capital flows are not adequately captured through the ITRS records and thus are reflected only in the category "errors and omissions." However, the authorities have made commendable progress in collecting information, for the first time conducting a survey in 2000 of private capital flows and stocks, particularly foreign direct investment transactions covering direct investment income, equity capital transactions—including the noncash acquisition of equity—and intercompany loans. The authorities have also updated the registry of enterprises with foreign equity capital. The 1999 data obtained from the 2000 survey of private capital flows, which show significantly higher levels of inward direct investment than indicated in the ITRS records, will be incorporated into the balance of payments statistics beginning in late 2003.

Data on the gross and net official reserves of the BoT are provided monthly with a short lag and more frequently on request. Similarly, data on foreign assets and liabilities of the banking system are provided with relatively short lags.

Significant progress was made in improving the quality of external debt data as a result of the reconciliation exercise undertaken in connection with the HIPC Initiative. At present, multilateral and bilateral Paris Club debts have been fully reconciled. These two categories of debts account for 80 percent of Tanzania's total external debt. However, little progress has been made in reconciling the rest of the debt owed to non-Paris Club bilateral and commercial creditors. Information on external debt not guaranteed by the public, mostly private sector debt, is also limited and not captured in a timely manner.

Tanzania: Core Statistical Indicators
(As of May 28, 2003)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports[1]	Current Account Balance	Overall Government Balance[2]	GDP/ GNP	External Debt/ Debt Service
Date of latest observation	6/03/03	5/28/03	5/28/03	5/28/03	4/30/03	5/28/03	April 2003	April 2003	2002	April 2003	2002	March 2003
Date received	6/16/03	6/04/03	6/04/03	6/04/03	5/19/03	6/16/03	6/16/03	6/16/03	May 2003	5/28/03	6/12/02	5/28/03
Frequency of data [3]	D	M	M	M	M	M	M	M	A	M	A	A
Frequency of reporting [3]	D	M	M	M	M	M	M	M	A	M	A	A
Source of data [4]	A	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting [5]	E	E	E	E	E	C	C	C	C	C	M	C
Confidentiality [6]	C	D	D	D	C	C	C	C	C	D	C	C
Frequency of publication [3]	D	M	M	M	M	M	M	M	A	M	A	A

1/ Based on Bank of Tanzania data.
2/ Contains only partial information on the development budget.
3/ Codes for frequency of data, frequency of reporting, and frequency of publication are the following: **D**-daily; **W**-weekly; **M**-monthly; **Q**-quarterly; **A**-annually; and **O**-other.
4/ Code for source of data is **A**-direct reporting by central bank, Ministry of Finance, or other official agency.
5/ Codes for mode of reporting are the following: **C**-cable or facsimile; **E**-electronic data transfer; and **M**-mail.
6/ Codes for confidentiality are the following: **C**-for unrestricted use; and **D**-embargoed for a specified period and thereafter for unrestricted use.

Tanzania: Social Indicators

	Latest Single Year			Same Region/Income Group	
	1970-75	1980-85	1995-02	Sub-Saharan Africa	Low income
Population					
Total population, midyear (millions)	15.9	21.8	33.7	658.9	2,459.8
Growth rate (annual average percent for period)	3.0	3.2	2.6	2.6	2.0
Urban population (percent of population)	10.1	17.6	27.8	34.4	31.9
Total fertility rate (births per woman)	6.8	6.5	5.3	5.2	3.6
Poverty					
(Percent of population)	...	...	35.0	...	...
Urban head count index	...	...	23.5	...	...
Rural head count index	...	...	38.6	...	...
Income/consumption distribution					
GNI per capita (U.S. dollars)	...	...	270	470	410
Consumer price index (1995=100)	1	8	181	133	140
Food price index (1995=100)	...	10	2,125	...	...
Income/consumption distribution	—				
Gini index	...	...	...	...	...
Lowest quintile (percent of income or consumption)	...	...	...	...	...
Highest quintile (percent of income or consumption)	...	...	...	...	...
Social indicators					
Public expenditure					
Health (percent of GDP)	...	...	1.3	2.4	1.2
Education (percent of GDP)	...	...	2.1	3.6	3.4
Social security and welfare (percent of GDP)	...	...	...	...	...
Net primary school enrollment rate					
(percent of age group)					
Total	...	56	48	...	...
Male	...	55	47	...	...
Female	...	56	49	...	...
Access to an improved water source					
(percent of population)					
Total	...	...	54	55	76
Urban	...	...	80	82	88
Rural	...	...	42	41	70
Immunization rate					
(percent under 12 months)					
Measles	...	...	...	53	57
DPT	...	...	...	46	57
Child malnutrition (percent under 5 years)	...	...	29	...	...
Life expectancy at birth					
(years)					
Total	48	51	44	47	59
Male	46	49	44	46	58
Female	50	53	45	47	60
Mortality					
Infant (per 1,000 live births)	118	108	93	91	76
Under 5 (per 1,000 live births)	218	176	149	162	115
Adult (15-59)					
Male (per 1,000 population)	513	451	562	504	294
Female (per 1,000 population)	419	370	521	459	261
Maternal (per 100,000 live births)	...	...	1,100	...	...
Births attended by skilled health staff (percent)	...	58	35	...	...

Source: World Bank, *World Development Indicators*, 2002 . Available on CD-ROM.

Note: Net enrollment ratios exceeding 100 percent indicate discrepancies between the estimates of school-age population and reported enrollment data.

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FOR IMMEDIATE RELEASE
July 28, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Sixth and Final Review Under Tanzania's PRGF Arrangement and Approves US$21 Million Disbursement; IMF Also Approves a New Three Year, US$27 Million PRGF Arrangement

The Executive Board of the International Monetary Fund (IMF) completed the sixth and final review of Tanzania's economic performance under the Poverty Reduction and Growth Facility (PRGF) arrangement (see Press Release No. 00/25). As a result, Tanzania will be able to draw the equivalent to SDR 15 million (about US$21 million) under the arrangement immediately, which will bring the total amount drawn under the arrangement to the equivalent to SDR 135 million (about US$189 million).

In completing the review, the Executive Board granted a waiver for the non-observance of the end-February 2003 structural performance criterion on the submission to parliament of the amendments of the Loans, Guarantees, and Grants Act and reviewed the second annual progress report of Tanzania's Poverty Reduction Strategy Paper (PRSP) and considered it a sound basis for IMF concessional assistance.

The Executive Board also approved a new three-year PRGF arrangement in an amount equivalent to SDR 19.6 million (US$27 million). The arrangement will be effective on August 16, 2003 and the first disbursement equivalent to SDR 2.8 million (US$4 million) will be available on that date.

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

After the Executive Board's discussion on Tanzania, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, stated:

"The Tanzanian authorities are to be commended for their strong implementation of sound macroeconomic policies and structural reform under the Tanzania's three-year program launched in 2000. These policies have substantially boosted Tanzania's economic growth, raised average per capita incomes, and reduced inflation. Moreover, the authorities' policy record has helped Tanzania obtain debt relief under the enhanced HIPC Initiative, thus allowing the country to reach debt sustainability and support higher social sector spending. The external sector is strong, with steady foreign assistance and direct investment supporting privatization and economic diversification.

"Nevertheless, the persistence of poverty in Tanzania, especially in the rural areas, is cause for concern. The range of measures outlined in the latest PRSP progress report in education, health, road construction, and agriculture, should, when implemented with the expected strong support from Tanzania's development partners, go a long way in helping the authorities to tackle poverty.

"The authorities are embarking on a further three-year program, which will emphasize higher revenue mobilization through reforms of tax administration and tax policies. These reforms will be crucial for enhancing the robustness of the macroeconomic stability, and for sustaining priority-sector spending over the medium term.

"Tanzania is also taking welcome steps to improve the business climate. Measures are planned to address investor concerns, including with respect to local government taxation, business licensing, impediments to bank lending, and infrastructure. Along with continued progress with the privatization program, as well as intensified efforts to fight corruption and enhance governance, full implementation of these measures should significantly improve Tanzania's standing as an investment destination.

"The Fund urges the non-Paris Club creditors that have not yet done so to provide their share of debt relief under the HIPC Initiative on terms comparable to those given by the Paris Club. It calls on Tanzania and its creditors to reach agreements as quickly as possible.

"The new three-year arrangement under the Poverty Reduction and Growth Facility will provide the necessary framework for the authorities' continuing reform efforts. Much of the outstanding reform agenda falls within the Fund's core areas of expertise. The continued engagement of the Fund is intended as an endorsement of the authorities' commitment to sound economic policy. It should facilitate disbursements of assistance by other donors and help achieve the government's objectives for growth, poverty reduction, and social progress," Mr. Sugisaki stated.

ANNEX

Recent Economic Developments

Under IMF-supported programs, Tanzania has achieved considerable macroeconomic and structural adjustment since the mid-1990s. Real GDP growth averaged 4.6 percent during 1996-2002 against 2.7 percent during 1990-95; at the same time, inflation fell to below 5 percent from about 30 percent. Fiscal imbalances have been reduced, expenditures reoriented to the social sectors and the external position substantially strengthened. Moreover, Tanzania reached the completion point under the Heavily Indebted Poor Countries (HIPC) Initiative in 2001. Nevertheless, poverty remains pervasive, particularly in the rural areas.

Program Summary

The new PRGF-supported program for 2003-06 aims to contain inflation at about 4 percent and raise real GDP growth further, to above 6 percent. Growth will be underpinned by substantial investments in physical infrastructure as outlined in the Poverty Reduction Strategy Paper. The current account deficit is projected to decline steadily, given robust growth in exports and a modest increase in imports.

To facilitate these objectives, Tanzania will pursue a three-pronged strategy, aimed at:

- mobilizing revenue, in order to strengthen domestic savings and reduce aid dependency;
- further liberalizing the trade regime in order to enhance efficiency and strengthen the tradables sector; and
- improving the economy's supply response by removing key impediments to growth , including measures to improve the efficiency of the financial sector and promote private sector development.

Thus the reform agenda focuses on key areas within the core mandate of the Fund, notably steadily increasing the revenue to GDP ratio in order to bolster macroeconomic performance and reduce reliance on foreign aid, and improving the effectiveness of the financial system to improve economic efficiency and attract investment.

In support of the program's medium-term revenue target, the authorities are taking a range of measures to bolster tax administration substantially, including adoption of a new medium-term corporate plan for the Tanzania Revenue Authority, refocusing of management and administrative resources that will facilitate a broadening of coverage of large taxpayers; a revamp of the administration of VAT and presumptive taxation, and actions to broaden the tax base through curtailing exemptions.

Table 2. Tanzania: Selected Economic and Financial Indicators, 2000-04

	2000	2001	2002		2003	2004
			Prog.	Actual	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)					
National income and prices						
Nominal GDP (billions of Tanzania shillings)	7,267	8,186	9,039	9,068	10,030	11,156
Real GDP growth	4.9	5.7	5.9	6.2	5.5	6.3
Real GDP per capita	2.2	3.4	3.8	4.2	3.5	4.0
Consumer prices (period average)	5.9	5.2	4.6	4.6	5.0	5.0
Consumer prices (end of period)	5.5	4.9	4.5	4.4	6.1	4.0
External sector 1/						
Exports, f.o.b. (in U.S. dollars)	714.5	816.1	880.2	953.0	1,169.7	1,278.5
Imports, c.i.f. (in U.S. dollars)	-1,581.2	-1,685.3	-1,828.9	-1,873.8	-2,335.3	-2,426.7
Export volume	26.4	15.0	3.8	10.1	10.0	7.9
Import volume	5.4	2.6	5.6	10.1	14.6	4.3
Terms of trade	-4.7	-0.5	4.1	2.3	2.7	3.3
Nominal effective exchange rate (end of period)	-1.0	-12.3	...	-17.2	...	...
Real effective exchange rate (depreciation -)	1.6	-9.5	...	-20.3	...	...
Public finance 1/						
Revenue (excluding grants)	20.3	12.2	12.4	14.5	16.6	14.7
Total expenditure	3.5	16.3	35.4	25.2	22.3	8.4
Current expenditure	22.2	18.7	29.4	21.8	26.4	12.0
Development expenditure and net lending	-20.5	1.8	101.1	52.0	31.0	-3.1
Money and credit 1/						
Broad money	21.7	17.0	13.0	22.1	20.5	17.2
Net foreign assets	57.6	44.9	32.5	31.4	49.9	9.7
Net domestic assets	-3.0	-14.1	10.5	4.4	-49.1	69.9
Credit to government 2/	21.8	-54.6	-55.5	-105.1	300.9	-136.8
Credit to nongovernment sector	12.1	20.7	27.0	27.4	24.6	24.5
Velocity of money (GDP/M3; average)	6.0	5.4	5.3	4.9	4.4	4.5
Treasury bill interest rate (in percent; end of period) 3/	9.0	8.6	...	4.6	...	...
	(In percent of GDP, unless otherwise indicated)					
Public finance 1/						
Revenue (excluding grants)	12.0	12.1	12.3	12.5	13.1	13.6
Total grants	3.7	4.5	5.7	5.3	6.3	5.7
Expenditure	17.3	18.0	22.2	20.4	22.5	22.0
Overall balance (including grants)	-1.6	-1.1	-4.2	-2.6	-3.1	-2.7
Domestic financing 4/	0.0	-0.3	0.7	-0.2	0.4	0.5
Savings and investment						
Resource gap	-7.5	-7.4	-8.1	-6.4	-11.3	-10.4
Investment	17.6	17.0	17.4	18.2	19.4	18.8
Government	4.4	3.5	4.0	4.8	5.7	5.1
Nongovernment	13.2	13.5	13.4	13.4	13.8	13.8
Gross domestic savings	10.1	9.6	9.3	11.8	8.2	8.4
External sector, public debt, and debt service 1/						
Current account balance (excluding official transfers)	-9.4	-8.9	-9.1	-9.3	-11.7	-10.5
Current account balance (including official transfers)	-4.4	-4.8	-4.4	-4.0	-6.1	-5.2
External debt service due (before debt relief; in percent of exports of goods and nonfactor services) 5/	-28.3	-21.6	-16.0	-14.6	-12.9	-11.3
	(In millions of U.S. dollars, unless otherwise indicated)					
Balance of Payments 1/						
Current account balance (excluding grants; deficit -)	-866.8	-832.4	-885.6	-885.0	-1,161.5	-1,145.0
Overall balance of payments (deficit -)	-7.8	28.1	234.1	418.3	150.6	185.6
Gross official reserves	982.9	1,212.7	1,492.4	1,671.2	1,818.7	1,963.5
In months of imports of goods and nonfactor services	5.3	5.9	7.3	6.8	7.0	7.2

Sources: Tanzanian authorities; and IMF staff estimates and projections.
1/ Fiscal years (July-June), beginning in the year indicated in the column header.
2/ Including new debt issued for the recapitalization of banks.
3/ Weighted-average yield of 91-, 182-, and 364-day treasury bills.
4/ Excluding new debt issued to recapitalize government-owned banks.
5/ For 2002/03 onward, debt service due is net of expected HIPC relief from bilateral and commercial creditors.

**Statement by Ismaila Usman, Executive Director for Tanzania,
and Peter Ngumbullu, Alternate Executive Director
July 28, 2003**

Key points:

- *Tanzania has made considerable progress in establishing macroeconomic stability and in deepening structural reform. The steady performance in continuing with the reforms reflects commitment and determination of the authorities, including at the highest political level to moving the country onto a higher growth path in order to accelerate poverty reduction.*

- *Macroeconomic performance under the program has been strong. In 2002, real GDP growth rose to 6.2 percent, therefore above program expectation. Inflation rate was contained at 4.3 percent in June 2003; international reserves remained at a comfortable level equivalent to about seven months of imports cover during this period.*

- *With the exception of one, all quantitative performance criteria and benchmarks through end-March 2003 were observed, some by wide margins.*

- *To improve effectiveness in utilization of donor aid, absorptive capacity in social sectors and public investment is being strengthened. Monetary policy instruments are being strengthened to mop up excess liquidity. To encourage deeper financial intermediation, a number of measures are being taken in line with the findings of the FSAP.*

- *Implementation of the Poverty Reduction Strategy Paper (PRSP) is on target as reflected in budgetary allocations and other policy interventions.*

- *The request for a new PRGF arrangement, with reduced access is intended to help the authorities to address the outstanding challenges of mobilizing domestic resources to reduce dependency on donor aid in the longer-term and to improve the investment climate through deepening structural reforms.*

Introduction

Our authorities appreciate the level of cooperation and understanding demonstrated by the staff mission during the discussions for the sixth review and the proposed new PRGF arrangement. The authorities also wish to express their appreciation to the Fund as well as other multilateral institutions and bilateral donors for their continued support. The strong support, both financial and technical, from the international community, continue to play a key role in underpinning and consolidating the reform process. The authorities are committed to pursuing prudent macroeconomic policies and to deepen structural reforms with a view to enhance the investment climate and promote private sector development in order to place Tanzania on a higher growth path, a necessary condition for reducing poverty.

Background

Up until the late 80s, Tanzania was among the most poor of the poorest countries in the world. The authorities embarked on a determined effort to defy this situation. Today the country's fortunes have changed. Supported by successive Fund arrangements and by the international community, and buoyed by political stability and the strong commitment to economic reform, Tanzania holds inspiration to countries in similar situations and proves that strong political and economic leadership as well as macroeconomic and social stability are the toolkit in the quest for reducing poverty and enhancing prosperity.

The progress made has already been discussed by the Board on numerous occasions and is detailed by the staff, including in the current report; we will therefore dwell on the agenda for the period ahead. In this connection, it is important to underscore a few key aspects. The key goal of macroeconomic stabilization has been relatively achieved; inflation is kept at low levels, the country has moved away from high chronic deficits on the fiscal and external sectors and the real GDP has increased steadily to a higher growth path. This has contributed to significant gains in poverty reduction such that Tanzania has moved up on the UNDP Human Development Index. The legacies of a command economy have been completely reorganized and both the institutional setup and the incentive structure for a market economy are taking root, contributing to significant mineral exploration activities and the expanding role of the private sector in other economic activities. The strong commitment of the authorities has assisted them to successfully go through the decision and completion points under the HIPC Initiative process and, combined with modest diversification of exports and prudent debt management, Tanzania has reached debt sustainability, which has contributed to the credibility of the HIPC Initiative.

The authorities have continued to build a strong track record under Fund-supported programs. All but one performance criteria under the just concluded PRGF program were met and corrective measures were taken on the missed performance criterion for which the authorities are requesting a waiver. Program objectives regarding inflation, growth and removal of structural impediments are being met. Donor and investors perceptions of the country have improved markedly in recent years and Tanzania has become a favorable destination of FDI and concessional assistance. The challenge now is the prudent management of these resources so as to avoid the Dutch disease by increasing absorptive capacity and further enhancing pro-poor growth. Reflecting success in the various measures being taken to improve governance, Tanzania's rating on the Transparency International's index has improved from 91 to 71. Tanzania also has made significant progress in liberalizing trade and its rating on the IMF's trade openness index has improved from 7 in 1996 to 5 in 2002.

The Future Agenda and the Authorities' Strategy

Notwithstanding these achievements, poverty remains widespread, unemployment is high, growth is not sufficient to achieve the MDGs, and the budget remains highly dependent on donors' aid. However, achieving debt sustainability has boosted the authorities' commitment and desire to forge ahead and to see the country stand on its own feet. They have expressed the desire to eventually graduate from heavy dependency on aid and the use of Fund resources in the longer term. To achieve this, they have laid out the agenda for the period ahead and their efforts will be directed largely to three areas; mobilizing domestic resources to achieve fiscal sustainability and reduce dependency on aid; addressing administrative and structural impediments to growth and private sector development, to broaden the sources of growth, create more employment opportunities and enhance the country's chances to achieve the MDGs; and, further liberalizing trade to enhance access to regional and international markets to consolidate external debt sustainability.

In order to start the gradual exit process, the authorities are requesting for a PRGF arrangement with reduced access. Such a program would enable the authorities to address the outstanding challenges and provide the necessary signal for donors to continue providing budgetary support for poverty reduction and infrastructure development, and for FDI to continue to flow. The authorities are determined to make this strategy work to make Tanzania a successful test case for the international community's involvement in poor countries and a lesson to be learnt in the development of the Fund's policy on gradual exit strategy.

The New PRGF Arrangement

The new program is intended to consolidate on achievements to date, reducing the fiscal deficit and dependency on aid, maintaining inflation in the low single digits, deepening structural reforms and improving the environment for private sector activities. The government will also promote new sources of growth in agriculture, infrastructure, manufacturing, services, tourism and others. These measures are intended to place the economy on a high growth path and accelerate the reduction of poverty.

Fiscal Policy and Mobilization of Domestic Resources

A key concern of the authorities is that current revenue is insufficient to meet current expenditures, making the budget highly dependent on aid, whose long term commitment and disbursement is often unpredictable. The primary objective of fiscal policy is therefore to increase reliance on domestic resources and to improve absorption capacity in the social sectors and in the government investment program, particularly on infrastructure development. In this regard, the medium-term fiscal program targets an increase in revenue-to-GDP ratio from 12.5 of GDP in 2002/2003 to 14.9 percent by 2006. To achieve this objective, the authorities are placing high priority on rationalizing tax policy, simplifying and strengthening tax administration, curbing tax evasion and reducing tax exemptions. The government is following-up on the recommendations from a number of studies, including an

IMF TA report on priorities and strategies for revenue administration reforms, a Public Expenditure Review study on tax policy and administration and a government's commissioned study on estimation of potential revenue gaps for Tanzania.

The effectiveness of the Tanzania Revenue Authority is being enhanced by strengthening tax compliance management in large taxpayers department, modernizing operations and organizational structure and adoption of self-assessments. To expedite these reforms, government is undertaking a comprehensive review of tax laws. By end-October, government will submit to Parliament a new income tax act aimed at modernizing the tax regime, introducing the principle of self assessment and removing discretionary powers to grant exemptions, removing complexities in the current income tax act, abolishing stamp duties and fees and their replacement by a presumptive tax. To further curb tax exemptions, government will submit to Parliament amendments to the Customs Tariff Act, Excise Ordinance, and Stamp Duty Tax Act, removing all discretionary power to grant exemptions from imports, excise and stamp duties and vest the power with Parliament. Furthermore, in 2003/04, tax exemptions to religious NGOs will be administered through a voucher system. Government is also taking measures to improve compliance in petroleum taxes.

With regard to the export processing zones (EPZ), the authorities wish to reiterate that the main objective of setting up of EPZs is to create more employment opportunities and to enhance diversification of exports in order to benefit from expansion in regional trade, access the U.S. African Growth and Opportunity Act (AGOA) and the Everything But Arms (EBA), the Canadian and other such exports initiatives. To minimize the potential for EPZs to undermine the revenue base, the government will tighten licensing procedures and limit tax concessions to companies with proven export capability. They are in the process of tightening loopholes to avoid revenue leakages and they look forward to benefiting from a comparative study of the benefits from tax incentives in EPZs in the region, to be undertaken with Fund technical assistance.

On the expenditure side, the authorities will enhance public expenditure management through increasing allocations to priority sectors in line with the poverty reduction strategy, tracking poverty-related expenditures and enhancing the absorption capacity. They will continue to strengthen public expenditure reform and to enhance transparency including through the existing Integrated Financial Management Systems (IFMS) mechanism. In this connection, the authorities will continue to harmonize presentation of priority expenditures across PRSP, the budget and budget execution reports to facilitate better tracking of outlays for poverty-reducing expenditures. These procedures have been embedded in the 2003/04 budget guidelines. Moreover, efforts are underway to introduce functional classification and the adoption of the IMF's government finance statistics (GFS) system in preparation of all local government budgets. The authorities will continue to enhance prudent fiscal management and transparency at the local authority level in order to consolidate fiscal decentralization. To this end, budget guidelines for local authorities are being aligned with those for the central government and fiscal years are being harmonized. Civil service pay reforms will continue, aimed at retaining key personnel while keeping the wage bill under control

Monetary and Exchange Rate Policies

The authorities seek to maintain price stability as the main objective of monetary policy. The Bank of Tanzania (BoT) will continue to monitor closely domestic as well as international economic developments in order to ensure appropriate monetary policy measures to underpin macroeconomic and financial stability. In this context, the authorities concurred with staff's proposal to monitor reserve money as a performance criterion to reinforce the BoT's policy framework on achieving the inflation target, particularly in view of projected donor inflows in 2003/04 and the need for the BoT to mop up the excess liquidity. They will target liquidity management to ensure that growth in monetary aggregates will reflect program targets.

The government will ensure effective utilization of donor aid by improving the absorptive capacity in social sectors and the public investment program, thereby minimize the potential for undue exchange rate appreciation and the Dutch disease. In addition, the BoT, along with the government will increase the supply of long-term instruments in the market in order to augment capacity to mop up excess liquidity. Furthermore, the Bank of Tanzania has put in place the daily liquidity forecasting framework to strengthen reserve money management. In a similar vein, the BoT will conduct timely and targeted sterilization operations with liquid paper and other instruments. However, open market operations will remain the main monetary policy instrument supplemented by foreign exchange.

To accelerate improvements of the financial system, the authorities will utilize the findings of the recently concluded Financial Sector Assessment Program (FSAP) as a basis for further reforms in the financial sector. In this context, they recognize the need to strengthen banking supervision and move towards a risk-based system of supervision and therefore wish to request technical assistance in this area in the near future.

Debt Sustainability

The government has started to implement the key recommendations of the National Debt Strategy (NDS) which was approved in August 2002. The strategy underlines the importance of fiscal sustainability through improvement in procedures, selectivity of projects, risk management, and strengthening of the legal and institutional framework with respect to borrowing and managing debt. As regards external debt, the authorities continue to seek debt relief on HIPC comparable terms from non-Paris Club creditors. Notwithstanding their commitment to reach an agreement on this issue, underscored by placing in a special account an amount of US$ 5 million and further provisions in the budget, the response from the non-Paris creditors has been disappointing. The authorities therefore wish to reiterate their request for assistance of the Fund and the World Bank in finding a more permanent solution to their outstanding external debt to the non-Paris Club creditors as well as to the HIPC-HIPC problem.

Structural Reforms

With respect to the business climate, the authorities recognize the importance of an investor-friendly environment and the catalytic role it could play in attracting investment and advancing the government's objective of private sector development. In this regard, they will continue to intensify efforts to interact and consult with the business community with a view to enhancing the investment climate. It is in this vein that a second meeting of the Investors' Round Table (IRT) was held in May 2003 to review progress in areas identified during the inaugural meeting in July 2002, and to chart the way forward with concrete proposals. In order to facilitate implementation of decisions made at the IRT, a Steering Committee consisting of government Ministers, the private sector and donors has been formed to follow up, trace implementation and advise the President accordingly. Meanwhile, an action plan to reform and simplify business licensing system will be adopted by December 2003, in response to stakeholders consultations. A new labor policy and revised Labor Act prepared in consultation with stakeholders, to address impediments in the investment climate, is expected to be submitted to parliament by October 2003.

The privatization program will be accelerated to expand the role of the private sector and to attract FDI. Measures are being taken to increase investment and modernize infrastructure. The authorities will promote commercial banks lending to the private sector through improvements in the legal framework and changing the incentive structures regarding collateral and curbing non-performing loans. In this regard, government has made progress during this month with respect to the proposed draft amendments to the Land Act. Stakeholders, including Ministry of Lands, the Attorney General Chambers, the Bank of Tanzania and Tanzania Bankers Association have agreed to the amendments to ensure that the Land Act is consistent with the objective of increasing access to bank credit. Consequently, Cabinet adopted the proposed amendments this month which will be presented to Parliament for enactment in October 2003. The privatization of the National Microfinance Bank is being expedited with a view to improving efficiency of the financial system and to promote the interest of SMEs and the rural areas in the provision of microfinance. The authorities are currently revising the strategy for privatizing the bank and expect that the process will be completed by the second half of 2004.

The authorities view that perceptions of pervasive corruption in Tanzania are somewhat exaggerated. Nevertheless, they consider that further improvements in governance is warranted and is central to the overall attractiveness of the investment climate. Measures to improve governance consist of institutional strengthening, changing the incentive structure and reducing the scope of discretion in decision making by government officials. Many of these measures are in the pipeline, including eliminating discretion in granting exemptions and empowering Parliament, strengthening the TRA and enforcing the rule of law. It is expected that implementation of the wide-ranging reforms to improve governance and poverty reduction will eventually significantly improve the private investment climate in Tanzania.

Poverty Reduction Strategy

The government's second annual PRSP progress report reaffirms the government's commitment to reducing poverty embedded in the government's development vision 2025, the National Poverty Eradication Strategy of 1997 and the Zanzibar Poverty Reduction Plan 2002 and reaching the Millennium Development Goals (MDG). These efforts are being integrated into the PRSP process including through the public expenditure reviews (PER) and the medium term expenditure framework (MTEF). The PRSP progress report recognizes the need to reduce aid dependency and to intensify efforts at domestic revenue mobilization. To complement the PRSP process, the authorities are putting emphasis on maintenance of macroeconomic stability, identifying sources of growth that would be poverty reducing and employment generating.

Conclusion

While significant achievements have been made thus far, the road to prosperity remains a very long and arduous one. Tanzania has successfully implemented the "first generation" reforms and now intends, with even stronger commitment, to implement "second generation" reforms. The main challenge is to move the economy to a higher growth trajectory and to intensify domestic resource mobilization efforts to begin the process of weaning itself from aid dependency. Our authorities also recognize the importance of strengthening institutions and removing impediments to investment and growth prospects. Technical assistance as well as concessional financing remain critical in complementing the limited and over-stretched human and financial resource capacity. Moreover, the main challenge confronting the authorities is the need to identify sources of growth that would lead Tanzania to a higher growth path and that will reduce poverty significantly.