July 2007
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United Republic of Tanzania: 2007 Article IV Consultation and First Review Under the Policy Support Instrument—Staff Report; Staff Supplement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for the United Republic of Tanzania

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2007 Article IV consultation with the United Republic of Tanzania and first review under the policy support instrument, the following documents have been released and are included in this package.

- The staff report for the combined 2007 Article IV Consultation and First Review Under the Policy Support Instrument, prepared by a staff team of the IMF, following discussions that ended on May 10, 2007, with the officials of the United Republic of Tanzania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 12, 2007. 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 staff supplement on the joint World Bank/IMF debt sustainability analysis.

- A Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its June 27, 2007, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

- A statement by the authorities of the United Republic of Tanzania.

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

Letter of Intent sent to the IMF by the authorities of the United Republic of Tanzania*
Memorandum of Economic and Financial Policies by the authorities of the United Republic of Tanzania*
*Also be included in Staff Report

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

UNITED REPUBLIC OF TANZANIA

Staff Report for the 2007 Article IV Consultation and First Review Under the Policy Support Instrument

Prepared by the African Department

(In consultation with the Finance, Fiscal Affairs, Legal, Monetary and Capital Markets, Policy Development and Review, and Statistics Departments)

Approved by David Nellor and Michael T. Hadjimichael

June 12, 2007

Main topics

- *Article IV consultation*. The report focuses on sustaining Tanzania's recent strong economic performance, broad-based growth and more rapid poverty reduction. This would require maintaining the structural reforms momentum—through measures that (i) enhance public resource mobilization and efficiency of spending; (ii) increase the financial sector's contribution to growth; and (iii) improve the business environment—while preserving macroeconomic stability.
- *Program review*. Economic growth, inflation, and the external position are in line with program objectives, and the program has remained broadly on track. All but one of the quantitative assessment criteria for end-December 2006 and all indicative targets for end-March 2007 were met, and structural policies are generally proceeding as envisaged. The staff recommends completion of the first review under the Policy Support Instrument. The government's letter of intent relating to the PSI is presented in Appendix I.

Mission discussions

- Discussions were held in Dar es Salaam April 25–May 10, 2007. The staff team comprised Messrs. Sharer (head), Abbas, Dunn, Sobolev (all AFR), Hobdari (PDR), Hajdenberg (FAD), and Ms. Radzewicz-Bak (MCM). The mission met with the Minister of Finance, Mrs. Meghji; the Permanent Secretary of Finance, Mr. Mgonja; the Governor of the Bank of Tanzania (BoT), Mr. Ballali; and other official and private sector representatives. Mr. Masawe (Executive Director's Office) participated in the discussions. The mission was assisted by Mr. Robinson, senior resident representative.

Selected Issues Papers

Three joint selected issues papers were prepared for the Article IV consultations with Kenya, Tanzania, and Uganda.

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Executive Summary

Tanzania has sustained strong economic performance for several years, solidifying its position as a mature stabilizer. With sound macroeconomic and market-oriented structural policies backed by substantial donor assistance, Tanzania has realized high growth, low inflation, a comfortable level of international reserves, and sustainable external debt.

Nevertheless, Tanzania remains very poor. It will need to sustain strong economic performance for many years to come and will have to rely heavily on donor assistance, particularly if a stepped-up effort is made to achieve the Millennium Development Goals (MDGs).

Tanzania has begun a new phase in its relationship with the Fund. The three-year program under the Policy Support Instrument (PSI) provides a streamlined framework for core macroeconomic and structural policies, guided by Tanzania's second-generation poverty reduction strategy (MKUKUTA). The PSI also signals to donors that government policies are sound.

The medium-term economic outlook is favorable. Real GDP growth is projected to pick up further, while inflation would remain subdued. Rising government revenues, together with substantial donor assistance, would allow for more government spending, particularly on MKUKUTA priorities, with minimal need for domestic financing. Financial sector deepening is expected to continue at a strong pace to support private sector growth.

Ongoing reforms aim to increase the efficiency and effectiveness of the public sector in the areas of tax policy and administration, public financial management, and civil service capacity building. Progress in these areas would also help to garner greater donor support.

The authorities are taking actions to address high and volatile T-bill yields, which are costly to the government and reduce the financial sector's incentive to extend credit to the private sector. Greater reliance on foreign exchange sales for sterilization purposes could further ease pressure on T-bill yields.

The authorities are taking steps to alleviate key bottlenecks constraining economic activity, notably by improving infrastructure and enhancing the business environment.

The report notes that Tanzania would seem to be a good case for possible scaling up of donor assistance.

The staff recommends the completion of the first review under the PSI. Staff also recommends that Executive Directors grant a waiver for the missed ceiling on reserve money for end-December 2006, based on the relatively small excess and corrective actions taken.

I. Background

1. **Tanzania's economic performance has been strong over the past decade, supported by prudent macroeconomic policies and far-reaching structural reforms.** In particular, sound financing of government operations—including substantial assistance from international donors—limited the government's recourse to domestic borrowing, which facilitated a monetary policy stance that reduced inflation while allowing for a rapid expansion of credit to the private sector for productive purposes. The structural reform agenda has focused on economic liberalization, improved public financial management and revenue administration, and financial sector development. Together with infrastructure investment and structural policies to enhance the business environment, this has contributed to solid productivity growth.[1] Moreover, thanks to the growing economy, increased government revenues, and donor assistance, government spending expanded at a swift pace, most notably on pro-poor initiatives outlined in MKUKUTA, which sets forth Tanzania's second-generation growth and poverty reduction strategies. Tanzania's strong performance has been characterized by

- ***Strong growth and low inflation.*** Since 2000, real GDP has grown by 6.3 percent a year on average. Growth has been broad based, and driven largely by productivity gains; a sharp contrast from the long period of economic stagnation experienced previously. Annual inflation, which had averaged some 30 percent in the past two decades, fell to single digits in 1998 and has generally been around the 5 percent mark since (Figure 1).

- ***Increased government spending with only limited recourse to domestic borrowing.*** Since 1999/2000, government revenues and donor support have risen by 4½ percentage points and 6½ percentage points of GDP, respectively, allowing government spending to grow by some 10 percentage points of GDP, to slightly over 28 percent of GDP in 2006/07. Aside from sizable borrowing in 2005/06, government

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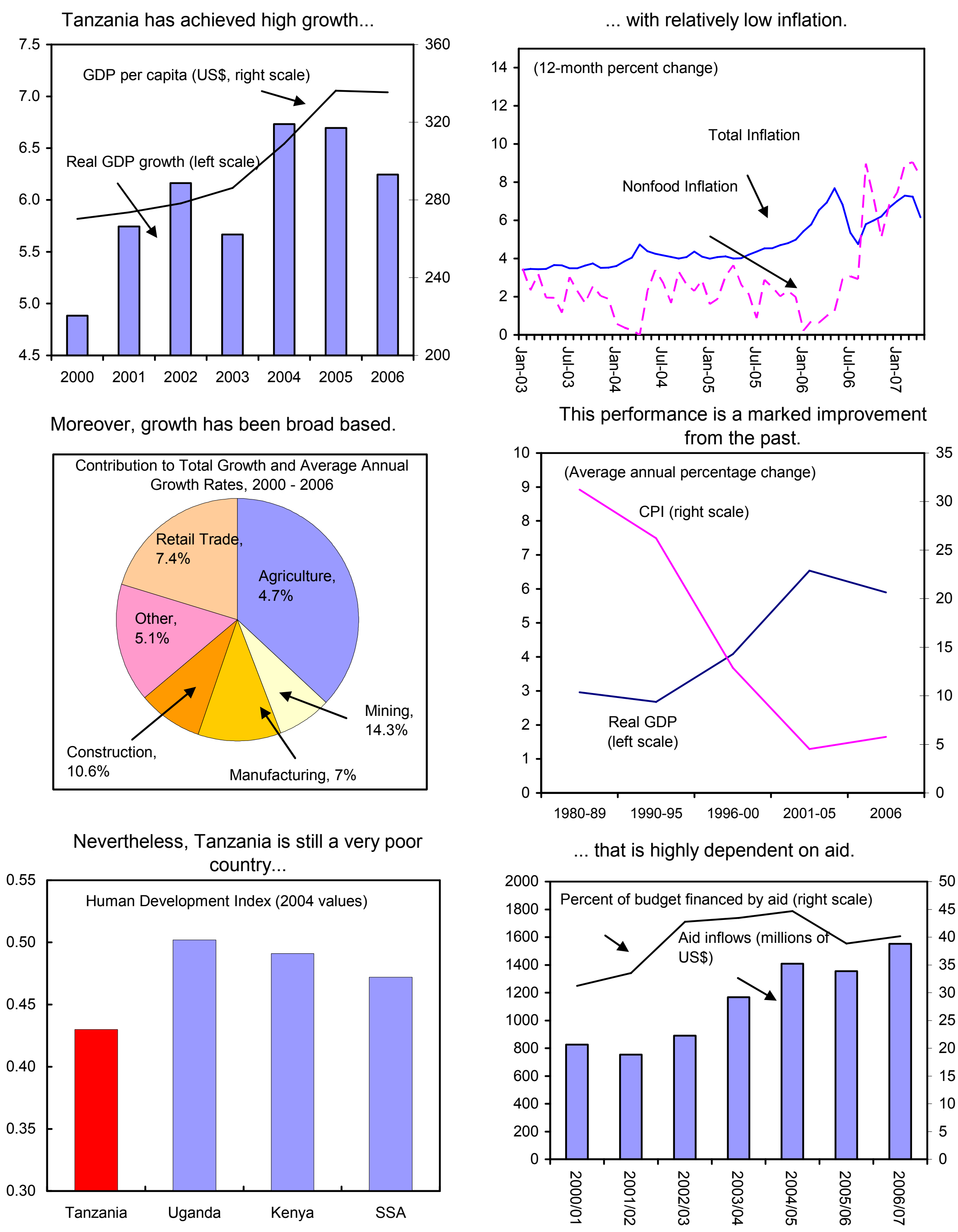
[1] For a discussion on GDP and productivity growth in Tanzania, see Box 2 of staff report for the Sixth Review Under the Three-year Arrangement Under the Poverty Reduction and Growth Facility and Request for a Three-Year Policy Support Instrument (Country Report 07/138).

Figure 1. Tanzania: Recent Performance and Achievements



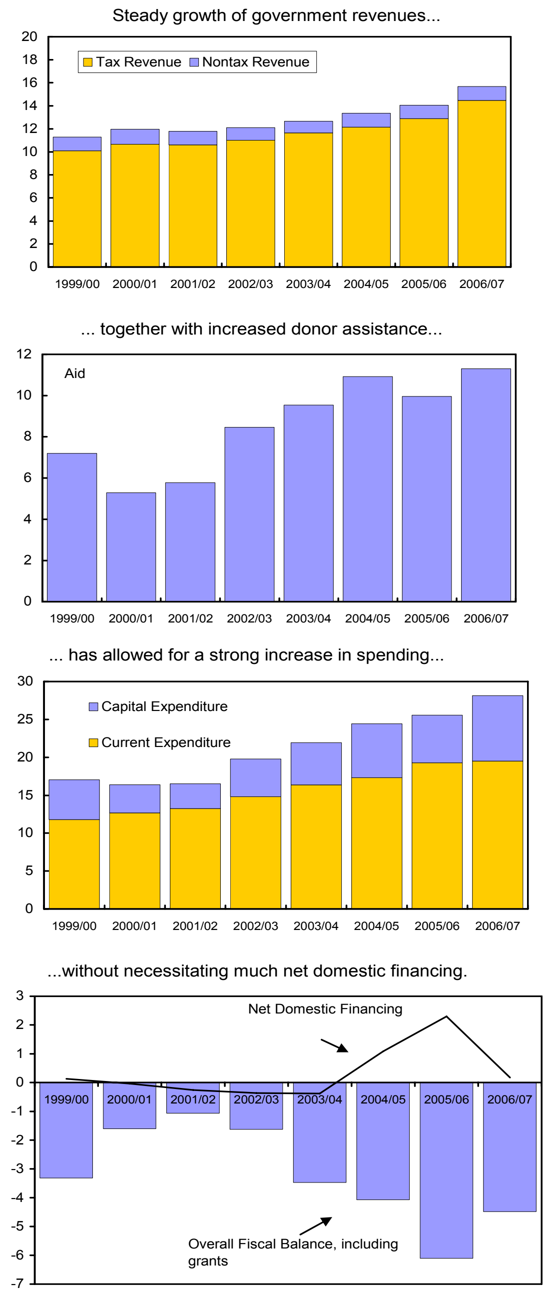
Sources: Tanzanian authorities; IMF staff estimates; and UNDP Human Development Indicators. The Human Development Index is a summary measure based on life expectancy, literacy rate, and GDP per capita.

net domestic financing (NDF) was negligible since 1999 (Figure 2). Planned government spending on MKUKUTA priorities rose to 13.6 percent of GDP in 2006/07, up from 12.8 percent of GDP a year ago.[2]

- ***Financial sector deepening.*** Intermediation by the banking system has expanded impressively, albeit from a very low base. The average stock of broad money (M3) reached 27 percent of GDP in 2006, while credit to the nongovernment sector reached 13 percent of GDP (from 17 percent and 5 percent of GDP, respectively, in 1999/00). On average, credit to the nongovernment sector grew by 32 percent a year during this period (Figure 3).[3]

- ***Strengthened external position.*** Exports of goods and services have grown by about 18 percent a year on average since 1999/00. At the same time, imports grew by about 20 percent a year—mainly reflecting investment-related capital goods—resulting in a widening of the current account deficit

Figure 2. Tanzania: Fiscal Developments, 1999/00-2006/07
(percent of GDP)



Sources: Tanzanian authorities and staff estimates.

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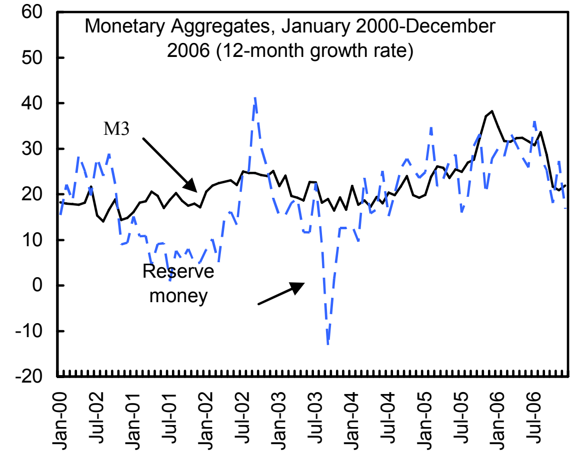
[2] Since 2005/06, the authorities are budgeting expenditure linked to MKUKUTA clusters: growth and income poverty, quality of life and social wellbeing, and governance and accountability. This has replaced the previous definitions of priority spending.

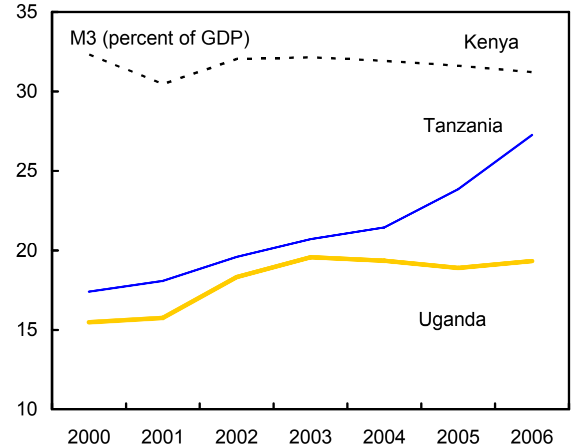
[3] Nevertheless, the banking system serves a narrow segment of the Tanzanian population. According to a recent survey, only 11 percent of adults have bank accounts.

Figure 3. Tanzania: Monetary and Financial Developments, 2000-06

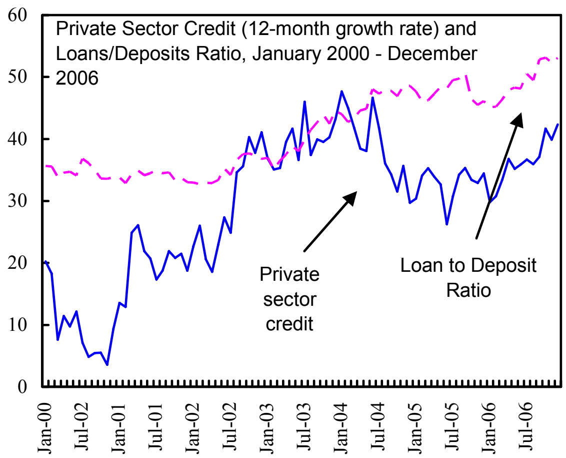
Monetary aggregates are growing at a robust but prudent pace...



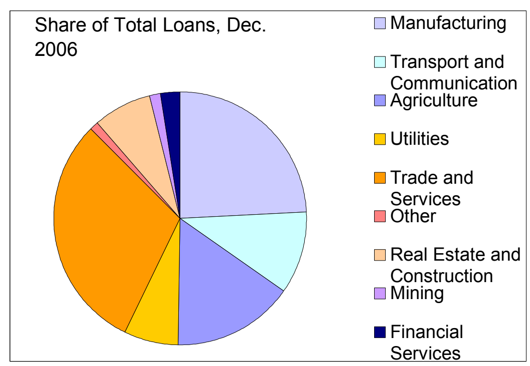
... reflecting rapid financial deepening.



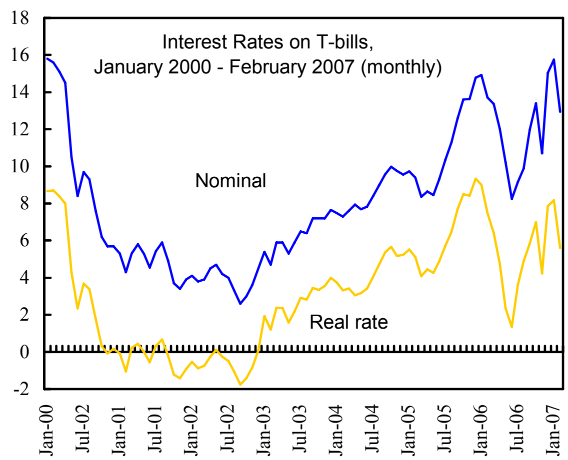
Lending is growing rapidly...



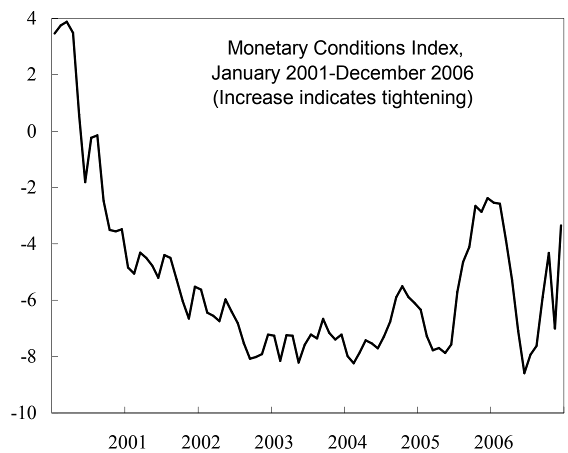
... largely to productive sectors.



Interest rates have been volatile and high in real terms...



... while monetary management has been uneven.



Source: Tanzanian authorities; IMF staff estimates.

(to a projected 11.2 percent of GDP in 2006/07). Foreign direct investment and donor project grants and concessional loans exceeded the current account deficit, which allowed for a strong buildup of international reserves (Figure 4). Gross reserves were then maintained at a comfortable level, as the Bank of Tanzania (BoT) has increased foreign exchange sales.

- ***Low level of public debt.*** Extensive debt relief under the HIPC and Multilateral Debt Relief Initiatives, as well as additional bilateral relief, have greatly reduced Tanzania's public debt burden (external and domestic), which was about 30 percent of GDP in net present value (NPV) terms at the end of June 2006.

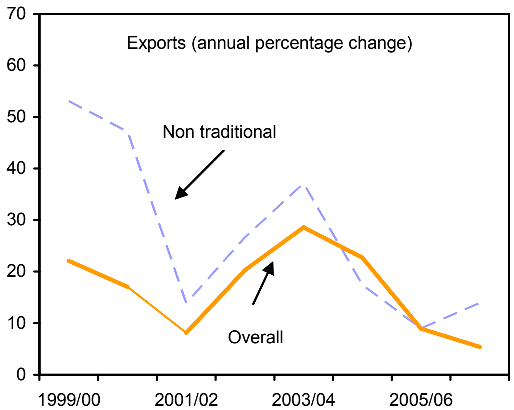
- ***Tanzania remains very poor.*** Notwithstanding the progress of recent years, GDP per capita is well below the average for sub-Saharan Africa and poverty is widespread. Tanzania's human development index also ranks below the average for sub-Saharan Africa.[4] In support of Tanzania's strong efforts, donor grants and concessional loans have risen to an expected 11.3 percent of GDP in this fiscal year (2006/07), equivalent to about 40 percent of total government spending. However, Tanzania will have very large needs for years to come, particularly in the areas of education, health, and infrastructure, and will continue to depend on donor support.

2. **In light of its status as a mature stabilizer with comfortable international reserves, Tanzania has entered a new phase in its long-term relationship with the Fund.** On February 16, 2007, the Executive Directors approved a three-year program under the Policy Support Instrument (PSI). The government views the PSI as essential to reinforce appropriate macroeconomic and structural policies, and signal the strength of government policies to development partners.

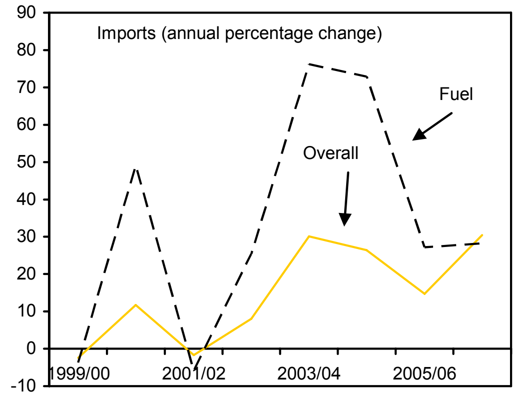
[4] Based on the 2001 household survey. Results from an ongoing survey should be available in 2008.

Figure 4. Tanzania: External Sector Developments

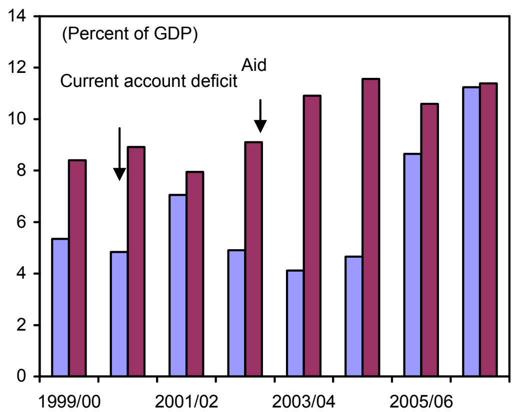
Export growth is strong...



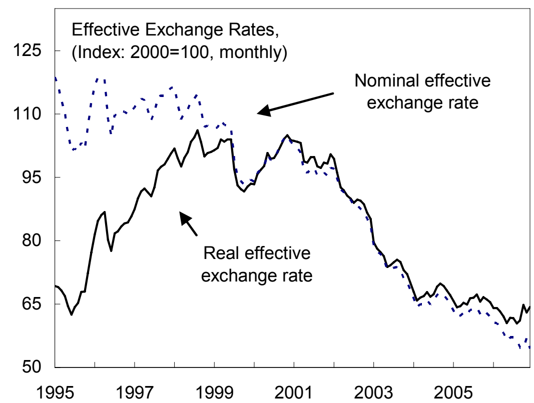
... though imports are growing more rapidly...



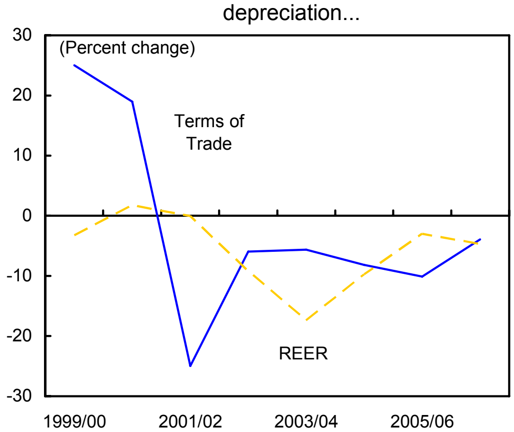
... contributing to a rising current account deficit.



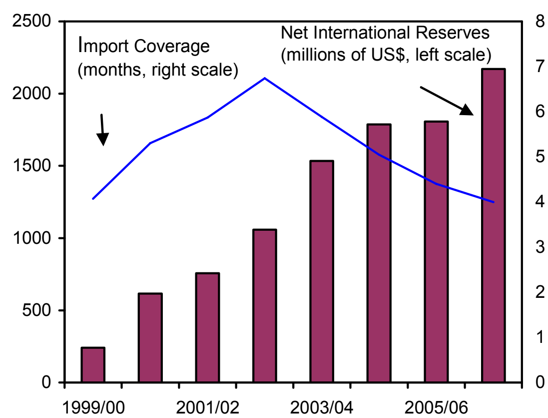
Effective exchange rate depreciation has slowed.



Deteriorating terms of trade has contributed to depreciation...



...but reserves have been maintained at a comfortable level.



Source: Tanzania authorities; IMF staff estimates.

II. Recent Economic Developments and Performance under the PSI

3. **Overcoming the aftermath of drought in early 2006, the economy continued to perform well in 2006/07.** Real GDP is estimated to have grown by a robust 6.2 percent in 2006, slightly above the envisaged 5.9 percent, and inflation picked up only moderately, peaking at 7.3 percent in February 2007. Notably, the recent return of good rainfalls has led to an ongoing bumper harvest; also positively, hydro power supplies have been fully restored, thus ending the power blackouts that threatened to undermine economic performance. Pressure on food prices is easing, and inflation is on course to end the year close to the 5 percent target.

4. **The authorities' demand-management policies have been effectively implemented;** NDF is expected to be near zero in 2006/07, mainly because strong revenues—which are expected to reach 15.7 percent of GDP, (1 percentage point above the program target), driven largely by tax administration reforms and the strong economy—more than offset delays in disbursement of donor support. On the spending side, higher than budgeted domestic interest costs, arising mainly from increases in T-bill yields, were largely offset by low primary expenditures.

5. **The trend toward greater financial sector deepening continued, though broad money growth slowed markedly,** as low NDF once again facilitated a rapid expansion of bank credit to the nongovernment sector. Financial indicators show that banks' balance sheets have stayed sound during the credit expansion, notwithstanding a modest increase in nonperforming loans. Gross official international reserves stood at nearly US$2.2 billion at end-March 2007—the equivalent of 4.2 months of projected imports of goods and services for the following year.

6. **Regarding performance under the PSI, all but one of the quantitative assessment criteria for end-December 2006 and all indicative targets for end-March 2007 were met, and most structural policies are proceeding as envisaged.** The targets for NDF and NIR were met by wide margins; the latter partly reflects delays in MDRI-financed expenditures. Average reserve money slightly exceeded the ceiling for the end-December 2006 test date, but was soon brought back on track. With regard to structural policies, a Cash Management Unit was established and the joint Ministry of Finance-BoT Cash Management Committee is expected to formulate its first three-month cash flow forecast by end-June 2007. However, the integration of ASYCUDA and TISCAN systems at customs has been delayed by technical factors. The Financial Recovery Plan for TANESCO was approved as envisaged. The Anti-Corruption Bill was submitted to parliament in February and subsequently passed

in April.[5] The government has continued to publish the list of recipients of tax exemptions. The Cabinet's approval of the second-generation Financial Sector Reform Action Plan in April will facilitate creation of a unified legal and regulatory framework for pension funds. However, the submission to government of the proposal has been delayed (until September 2007) for reasons outside the government's control.

III. Key Challenges: Stepping Up Sustainable Growth and Poverty Reduction

7. **The discussions focused on policies aimed at achieving and sustaining a higher rate of economic growth and poverty reduction.** There was broad agreement that the MKUKUTA provides an appropriate framework for macroeconomic and structural policies, and that enhanced implementation and increased resources are key to achieving higher growth and more poverty reduction. The discussions covered the following issues:

- ***Macroeconomic stability and growth.*** The authorities continue to view maintaining macroeconomic stability, anchored by sound financing of governmental operations, as a key to sustainable growth. They are firmly committed to maintaining low inflation, which they view as a key achievement of their reform efforts. Effective implementation of the structural reform agenda is also viewed as essential to further increase both public and private sector productivity, as is investment in infrastructure, particularly in the energy and transportation sectors.

- ***Public sector efficiency and effectiveness.*** Ongoing reforms in tax policy and administration, public financial management, and the civil service will continue to aim at increasing public resources and allocating them more efficiently. To achieve higher quality spending and build donor support, better monitoring and reporting of spending on MKUKUTA priorities should be a priority.

- ***Financial intermediation.*** Continued sound expansion of financial sector intermediation is central to strong and sustained private sector growth. Currently, the highly volatile yields on government securities reduce the financial sector's incentive to broaden the provision of credit to the private sector. To ease pressure on yields and enhance stability, the authorities are taking steps to improve monetary policy operations and the functioning of the money market.

- ***Exchange rate policy.*** The authorities recognize that the large donor inflows have led to liquidity management issues and put upward pressure on the exchange rate, raising

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[5] The new act indirectly strengthens the prosecutorial powers of the Prevention of Corruption Bureau (PCB) by, inter alia, expanding the definition of corruption.

concerns about competitiveness. In this context, the BoT will continue to maintain a flexible exchange rate policy while smoothing its implementation of monetary policy.

- ***Debt management.*** The authorities reiterated their commitment to preserve recent gains in debt sustainability. Accordingly, they intend to avoid any future government contracts for or guarantees of nonconcessional debt and envisage strict curtailment of domestic borrowing.

- ***Governance.*** The authorities recognize the importance of efforts to fight corruption and institute good governance practices, including through greater transparency.

- ***Regional integration.*** The authorities view regional integration as an important supplement to their efforts to sustain sound economic policies and boost growth. As noted in Box 1, they view the East African Community (EAC) as the primary vehicle to strengthen their regional integration efforts.

- ***Poverty reduction.*** Sustaining high rates of broad-based growth that encompasses agricultural and rural development would have the greatest impact on reducing poverty, which is indeed the focus of the MKUKUTA. Rapid expansion in the coverage and quality of education and health services is similarly essential. Efforts to strengthen information and control systems to link MKUKUTA goals to the annual budget and medium-term expenditure framework are intended to strengthen poverty reduction.

Box 1: Moving Toward Greater Regional Integration Within the East African Community

The authorities view Tanzania's economic future as being closely tied to the EAC. Efforts under way within the EAC to achieve greater regional economic and political integration include establishing a single market, harmonizing policies to promote cross-border trade and investment, developing regional infrastructure, and enhancing technological and human resource development. A key achievement, since the creation of the EAC in 2000, has been the establishment of the Customs Union (effective 2005) with a Common External Tariff (CET), which is expected to enhance intraregional trade (Table 1).

Table 1. EAC Main Trading Partners

	exports			imports		
	1990s	2000-04	2005	1990s	2000-04	2005
	(percent of EAC exports)			(percent of EAC imports)		
African countries	24.8	28.6	30.2	14.4	19.1	20.1
of which: intra EAC	14.0	14.3	14.8	7.6	8.1	7.9
COMESA	19.3	25.0	26.4	8.6	9.5	9.6
SADC	8.3	8.4	9.2	6.6	10.7	11.8
EU	43.5	36.2	30.2	34.7	23.3	20.1
Asia	13.8	13.1	14.9	16.1	19.5	21.5
Middle East	6.1	6.0	6.4	14.2	18.7	21.6
Memorandum Item						
Trade as pecentage of EAC GDP	11.4	12.7	14.5	21.6	24.4	30.6

Source: IMF, Direction of Trade Statistics

Policy discussions on deepening regional integration focused on harmonizing investment incentives and further trade liberalization. Discussions drew on the joint Selected Issues Paper prepared for Kenya, Tanzania, and Uganda.

- *Investment incentives.* The authorities recognized the potential benefits of a coordinated approach to providing investment incentives in the EAC, possibly through a code of conduct that would set out rules for managing investment incentives and help avoid a mutually damaging "race to the bottom."

- *Trade liberalization.* The authorities agreed that Tanzania could benefit from lowering the CET top band and bringing "sensitive" products into the CET; they are committed to working with the Partner States to fully implement the EAC Customs Union Protocol, including the review of the CET by 2010.

The authorities are working with EAC Partner States to address the issue of overlapping memberships in regional trade arrangements. Tanzania is also a member of the Southern African Development Community (SADC) (Kenya and Uganda are members of the Common Market for Eastern and Southern Africa (COMESA)). Through the EAC Secretariat, consultations with COMESA and SADC are underway on how the three regional integration blocks can work together to avoid potentially conflicting obligations.

IV. The PSI Program: Policies for the Medium Term

A. Medium-Term Economic Outlook

8. **The authorities' demand-management policies will be geared to maintaining macroeconomic stability.** Productivity trends are projected to drive high real GDP growth over the medium term. Real GDP is projected to grow by 7–8 percent a year, with particularly strong growth in the construction, manufacturing, mining, and tourism sectors.[6] Given agriculture's large share in the economy, and its direct role in reducing poverty, it will be essential to effectively implement policies to enhance the growth of agriculture—a primary focus of MKUKUTA programs. Structural reforms and investment in infrastructure, particularly in the transport and energy sectors, will also be critical. Sound and prudent monetary policies would contain inflation. In line with the MKUKUTA, the authorities will continue to target inflation to about 5 percent in the medium term.

9. **Macroeconomic stability would be underpinned by sound fiscal policies.** In particular, the authorities stressed their continued commitment to contain NDF to near zero in the medium term to avoid crowding out resources for productive private sector activity. Sustained tax and customs administration reforms, supplemented by possible tax policy measures, target revenue of over 17 percent of GDP by 2009/10. With sustained donor support, this would permit the government to maintain high levels of spending on MKUKUTA priorities. Monetary aggregates are projected to expand at a strong pace, reflecting current trends in financial sector deepening, but the authorities stand ready to curb such growth if inflationary pressures emerge. External prospects remain broadly favorable. Driven by strong economic growth, both exports and imports would continue to rise, with the current account deficit falling slightly to about 14.5 percent of GDP. Gross official international reserves are projected to rise modestly to about $2.3 billion, or 3.5 months of the following year's imports.

B. Enhancing Public Resource Mobilization and Efficiency of Spending

10. **Ongoing efforts to strengthen tax and customs administration will continue to be a high priority.** In addition to providing increased resources for high priority MKUKUTA-related spending, raising the revenue-to-GDP ratio would reduce Tanzania's long-term reliance on donor support. Reforms in customs administration aim to enhance trade facilitation and strengthen compliance. On domestic taxation, efforts will focus on continued strengthening of auditing and enforcement capacity, with a particular emphasis on increasing

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[6] The medium-term growth projection is predicated on the continuation of the trend in total factor productivity observed over the past decade (see Box 2 in Country Report 07/138).

collections from sophisticated taxpayers and extending applicable procedures developed for large taxpayer enforcement to medium taxpayers. Over the medium term, the authorities may consider additional tax policy measures to help attain their medium-term revenue targets. In addition, the authorities plan to improve collection of nontax revenues, including by improving procedures for the licensing of natural resources.

11. **The authorities recognize the critical importance of further strengthening public financial management (PFM).** Substantial improvements in the budget preparation process, as well as in its execution and monitoring, are key to ensure that public resources are allocated efficiently and to put the objectives of MKUKUTA within reach. In addition, achieving greater budget flexibility through increased donor aid in the form of budget support is directly related to the quality of PFM. The authorities will assign top priority to enhance the credibility of the MTEF, with a view to strengthen the links between MKUKUTA and the budget. In this regard, the authorities plan to improve the integration of the Strategic Budget Allocation System (SBAS) and the Integrated Financial Management System (IFMS). The authorities also expressed their intention to implement most recommendations of the external review of the donor-financed public financial management reform program (PFMRP), particularly broadening the scope of the PFMRP to include line ministries and improved coordination with the Local Government Reform Program. Moreover, as noted below, important efforts are underway to strengthen cash management.

12. **Addressing capacity constraints in all areas of the government is essential for stepping up policy implementation.** The public service reform program (PSRP) and revised medium-term pay strategy (MTPS) are aimed at attracting and retaining high-quality staff through adequate remuneration. The authorities will soon launch phase II of the PSRP, which will incorporate forthcoming recommendations of the Presidential Commission on Public Service. The objective is to enhance accountability and coordination across government sectors to facilitate a stronger pro-growth and poverty reduction approach.

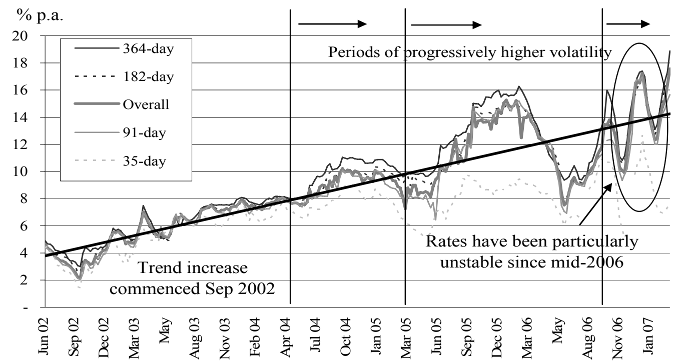
C. Increasing the Financial Sector's Contribution to Growth and Enhancing Monetary Policy

13. **The authorities are progressively implementing changes in monetary policy operations, in line with recommendations by technical assistance from the Fund aimed at providing a more stable setting for domestic markets.** These changes are also designed to help curb high yields on Treasury Bills and reduce volatility (Box 2). The BoT—armed with better projections of the government's cash flow needs, provided by the new Cash Management Committee—will aim to position reserve money on a continuous basis to avoid the need for sharp end-quarter contractions. In addition, the authorities will seek to reduce issuances of government securities; this will be achieved through fiscal policies to limit NDF,

Box 2. Tanzania: High and Volatile Government Securities Yields

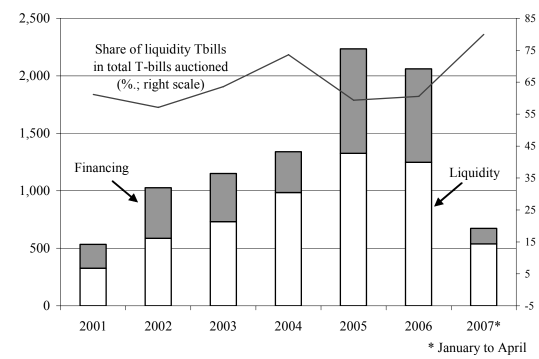
Tanzania's T-bill yields have risen steadily since late-2002, to more than 600 basis points above the average in other EAC countries in real terms. Since mid-2004, yields have become progressively more volatile, with peaks and troughs almost 9 percentage points apart. Moreover, yields appear to have demonstrated downward stickiness, so that volatility itself may have contributed to the rising trend (Figure 1).

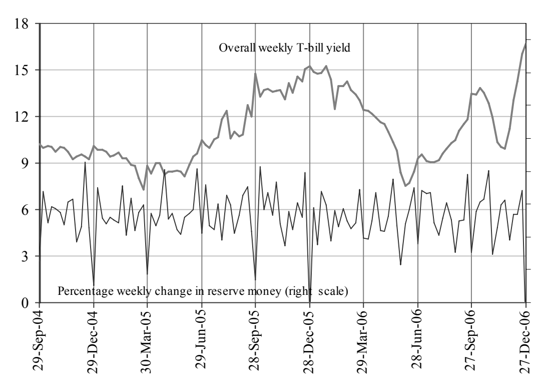
Figure 1: Tanzania T-bill rates (2002-2007)



Demand and supply factors have been driving these results. On the supply side, the volume of T-bill sales—used mostly for mopping up liquidity—began rising steadily in 2002, before increasing sharply in 2005, when the government incurred large domestic financing needs (Figure 2). In addition, sales of T-bills by the BoT were concentrated toward the end of the quarter (Figure 3). This concentration was intensified by the need to roll over maturing issues, resulting in predictable "pressure points" in the market. On the demand side, T-bills competed with strong private sector demand for credit in Tanzania's robust economy, including occasional but large syndicated loans and initial public offerings. Further complicating matters, demand is concentrated among a few large banks. Indeed, the government maintains large and growing unremunerated deposits with one of these banks, which further increases that institution's market power, and creates liquidity that the BoT then needs to mop up. The trend toward dollarization has also weakened demand for T Shilling assets in recent years. Finally, demand tends to be dampened at the end of the quarter—just when new issues are highest—because of business taxes falling due.

Figure 2: Gross T-bill sales by purpose (Tsh bn)





The authorities are taking steps to ease pressure on yields: (i) consistent with Fund advice, the BoT now targets the *daily average* of reserve money, instead of *end-quarter* point targets, thus spreading out liquidity management; (ii) the Cash Management Committee has been set up to provide weekly and monthly forecasts of government revenues and expenditures so monetary policy can be implemented in a more timely manner; (iii) the BoT conducts a larger share of sterilization operations through sales of foreign exchange. In addition, dollarization pressures have eased in line with a firming up of the exchange rate.

Looking ahead, additional measures could be considered to reduce volatility of yields and enhance competition in the T-bill market: (i) the use of repo operations for fine-tuning purposes could be increased, and spread across each quarter; (ii) the central government could transfer its deposits in commercial banks to the BoT; (iii) auctions and instruments could be rationalized around a few key benchmark maturities suited to the current stage of financial market development; (iv) retail participation in T-bill auctions could be encouraged; (v) Actions to encourage activity in the secondary market—such as, less frequent T-bill auctions and market-maker requirements for primary dealers—could facilitate price discovery and enhance efficiency in the primary market.

and by scaling back their use for sterilization operations through increasing foreign exchange sales for liquidity management purposes. Reflecting the authorities' broad agreement with staff's advice, the monetary program for 2007/08 calls for a net reduction in liquidity paper and a moderate increase in foreign exchange sales by the BoT.[7] Steps will also be taken to elevate competition in the T-bill/bond market and to develop the secondary market for these instruments over time.

14. **Notwithstanding significant progress in recent years, Tanzania's financial sector remains relatively small, and access to bank credit is limited.** The second-generation Financial Sector Reform Action Plan approved by Cabinet, encompasses a number of initiatives to address this problem, notably (i) a unified legal and regulatory framework and investment guidelines for pension funds; (ii) legal and regulatory framework for a credit information system; (iii) a survey of existing microfinance operations; and (iv) regulations to fully operationalize the recently approved BoT and Banking and Financial Institutions Acts.

15. **The government is continuing to implement limited direct initiatives to facilitate medium-term lending.** These are based on best practices for offering private sector credit promotion by partial government guarantee of commercial lending to the private sector. Amounts guaranteed under these facilities for loans to small and medium-size enterprises remain modest and consistent with the authorities' commitment to limit fiscal risks.

D. Exchange Rate Policies and Competitiveness

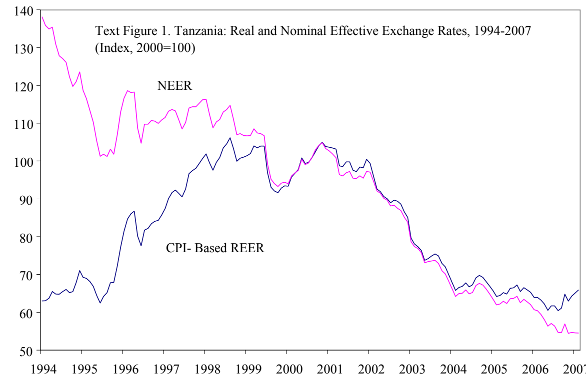
16. **The authorities stressed their intention to maintain the flexibility of their exchange rate policy.** Recognizing the pressures on liquidity emanating from substantial donor inflows, in addition to occasional interventions to maintain market order, the BoT intends to undertake increased foreign exchange sales for sterilization purposes. The authorities agreed with staff suggestions that the operation of the foreign exchange market could benefit from more frequent small sales of foreign exchange. They cautioned, however, that the market's thinness and seasonal volatility complicate their intervention operations.

17. **The staff believes that Tanzania has maintained its international competitiveness** (Box 3)**.** The staff continued to emphasize that structural factors leading to a high cost of doing business are the major barriers to enhanced competitiveness. The authorities agreed that, going forward, there is great scope to boost productivity and improve infrastructure to further strengthen competitiveness. However, they also expressed some concern that upward

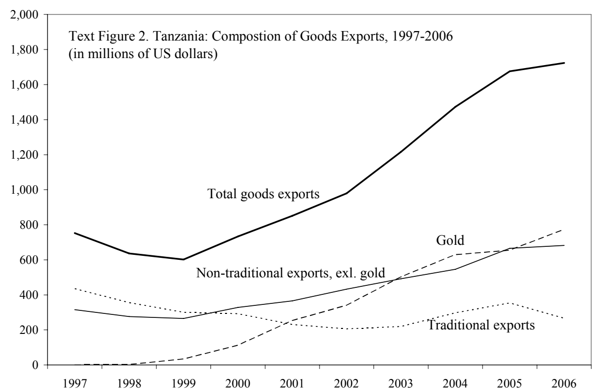
[7] The BoT is further studying operational issues regarding the planned foreign exchange sales.

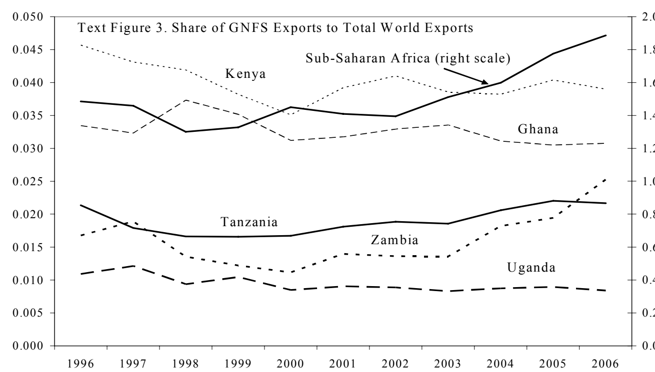
Box 3. Competitiveness in Tanzania

Recent developments suggest that, on balance, Tanzania's external competitiveness remains robust. Following a rapid depreciation in 2001–04, the real exchange rate has stabilized in recent years (Text Figure 1). Supporting the findings of a 2004 staff study (Country Report 04/284), two recent studies by staffs of the Fund (WP/07/90) and the World Bank (forthcoming) suggest that Tanzania's real exchange rate has fluctuated around its equilibrium value since the early 1990s, and remains broadly in line with fundamentals.



Export performance has been relatively strong, although developments across sectors have been mixed. Exports of gold and other nontraditional exports have continued to expand at a very rapid pace, with annual growth averaging about 26 percent and 14 percent, respectively, over the last five years (Text Figure 2). However, traditional exports—including cotton, coffee, tea, tobacco, and cashew nuts—have remained virtually flat in nominal U.S. dollar terms, hovering between US$250–350 million per year over the last decade. This seems to reflect mainly weak supporting financial and transport infrastructure for subsistence and small-scale farming, which continue to dominate Tanzania's agricultural production. Overall, Tanzania has maintained its share in global world export markets in recent years (Text Figure 3). The current account deficit has widened from 9½ percent of GDP in 2001/02 to an expected 15½ percent of GDP in 2006/07, but remains fully financed by growing external assistance (11½ percent of GDP) and FDI (4 percent of GDP)





Source: WEO database.

Institutional indicators suggest a continued improvement in the business environment and competitiveness, although from a low base (Table 1). Significant progress continues in improving investor protection, removing informal barriers to trade, reducing corruption, and strengthening governance. However, weaknesses remain in a number of areas, including restrictions in obtaining licenses, rigid regulation in the hiring and firing of workers, and ease of property registration. Weak energy and transport infrastructure also continues to hamper Tanzania's competitiveness.

Table 1. Institutional Indicators in Selected Countries in Sub-Saharan Africa

	Ease of Doing Business in 2006 1/		Global Competitiveness Index in 2006 2/	
	Rank	Change from 2005	Rank	Change from 2005
Ethiopia	97	-1	120	-4
Ghana	94	8	...	...
Kenya	83	-3	94	-1
Mozambique	140	-3	121	-9
Tanzania	142	8	104	1
Uganda	107	-4	113	-10
Zambia	102	-10	115	n.a.

1/ World Bank's Doing Business Database (http://www.doingbusiness.org/). Total of 175 countries included.
Positive change means an improvement in the rank.
2/ World Economic Forum (http://www.weforum.org). Total of 125 countries included.
Positive change means an improvement in the rank.

pressure on the exchange rate could affect traditional exports, which have stagnated for many years. The staff noted that, unlike other exports that have grown strongly in recent years, traditional exports did not respond to the shilling's depreciation since 2001.[8] This suggests that their disappointing performance reflects mainly weak supporting financial services and transport infrastructure for subsistence and small-scale farming, which continue to dominate Tanzania's agricultural production. Indeed, the staff views the level of the exchange rate as broadly appropriate and noted that lower-than-programmed foreign exchange sales could exacerbate the problem. of high interest rates, raise domestic debt service costs to the government, or lead to higher inflation.

E. Scaling Up Donor Assistance and Debt Sustainability

18. **Staff views Tanzania as a strong candidate for possible scaling up of aid (Box 4).** This view is based on Tanzania's strong economic performance together with extensive and pressing social and economic needs. Moreover, the reforms noted above and in the attached MEFP are designed to enhance the PFM reforms and capacity building to ensure that additional assistance would be used effectively. However, while donors view Tanzania's reform efforts favorably and will likely continue supporting the country, they do not appear to have plans to scale up assistance.

19. **At the authorities' request the staff prepared a scaling up scenario** (Table 10). The scenario assumes that annual disbursements of donor assistance will increase by US$1 billion over the current level over a three-year period (from US$1.7 billion in 2007/08 to US$2.7 billion in 2010/11).[9] Staff calculations indicate that the macroeconomic implications of such an additional increase in aid are manageable. The higher aid, all of which is assumed to be in the form of grants, is likely to have a modest stimulative effect, with annual real GDP growth projected to increase by about 0.2 percentage points over the medium term, and additional positive supply-side effects to materialize beyond 2010/11. The impact on the real exchange rate is also likely to be moderate. Relative to the size of the market, the additional sales of foreign exchange would be modest (about 2–3 percent of annual trading volumes) and would result in a real appreciation on the order of 1½–2½ percent a year. Correspondingly, export growth would likely be dampened slightly, while imports would grow at a slightly stronger pace, resulting in a commensurate widening of the external current account deficit. In keeping with the authorities' objectives to maintain annual

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[8] Following a strong appreciation in the second half of the 1990s, the shilling has steadily depreciated since 2001, largely because of deteriorating terms of trade, although the pace of depreciation has slowed recently.

[9] The increase to US$2.7 billion is a lower bound of estimated additional assistance needed to reach MDGs by 2015 (see Box 4), however, an updated estimate is not yet available. Achieving this level of annual disbursements by 2010/11 represents a US$0.4 billion increase over projected aid in 2010/11 in the program's baseline scenario. Going forward, the increase in aid relative to the baseline would then be maintained.

Box 4. Tanzania: Reaching the MDGs—A Case for Scaling Up

Tanzania has benefited from a significant increase in donor aid. In 2005 official development assistance to Tanzania was 12.5 percent of GNI, up nearly 50 percent in U.S. dollar terms relative to 2000 (Table 1). Despite this surge, aid to Tanzania, at US$39 per capita, remained below comparable sub-Saharan African countries.

Table 1. Official Development Assistance (ODA) in Selected Countries in Sub-Saharan Africa 1/

	2005		2000-2005
	ODA to GNI (in percent)	ODA per capita (in US$)	ODA Change (in percent)
Benin	8.2	41	36
Ethiopia	17.4	27	19
Ghana	10.6	51	87
Mozambique	20.8	65	47
Tanzania	12.5	39	48
Uganda	14.0	42	47
Zambia	14.2	81	19

Source: OECD DAC database for 2005 (latest year available).
1/ The data are reported on a calendar year basis, and expressed as a ratio to gross national income. They are thus not comparable to external assistance data elsewhere in the report, which are on a fiscal year basis and/or shown as a ratio to GDP.

Increased aid has contributed to progress toward the MDGs; but at current trends Tanzania will not achieve all the MDGs by 2015. Through prudent macroeconomic policy implementation, the authorities have generally used the increase in aid effectively, as evidenced by accelerated growth and sharply higher pro-poor spending in recent years. Significant progress has been made in achieving universal primary education and lowering the child mortality, but progress has been mixed with respect to reducing poverty and hunger, increasing access to water, and reversing the prevalence of HIV/AIDS (Table 2).

Table 2. Tanzania: Selected MDG Outcomes and Targets
(in percent, unless otherwise indicated)

	Actuals		Targets
	Benchmark obs. (1990)	Most recent obs.	MDG (2015)
Population under food poverty line	21.6	18.7	10.8
Population under basic needs poverty line	38.7	35.7	19.3
Net primary enrollment ratio	54.2	96.1	100.0
Under five mortality rate (per 1,000)	141.0	112.0	47.0
Maternal mortality ratio (per 100,000 live births)	529.0	578.0	132.3
Adult population suffering from HIV/AIDS	5.5	7.0	Begin to reverse

Source: World Bank and Tanzanian authorities (see also www.povertymonitoring.go.tz)

Tanzania appears relatively well prepared to absorb scaled-up aid. The increase in aid seen since 2000 has been used effectively while preserving competitiveness (Box 3), and despite higher T-bill yields arising partly from issuances for sterilization operations, credit to the private sector has grown at a rapid pace. Fiscal institutions are relatively strong: among SSA countries that are PRGF eligible, Tanzania has the highest rating in key public sector management indicators prepared by the World Bank, and a joint review conducted by Fund and World Bank staff in 2004 found that Tanzania had the highest ranking regarding the quality of public expenditure management systems among 26 HIPC countries. Public financial management is being further strengthened.

According to the United Nations Millennium Project and preliminary World Bank estimates, additional resources of at least US$1 billion over the current level of aid will be needed over the medium term to achieve the MDGs by 2015. However, there is no evidence that donors will scale up aid to Tanzania by the required amount during this period.

inflation at 5 percent or below, the stance on monetary policy was left essentially unchanged. Increased foreign exchange sales by the BoT would be used to mop up most of the additional liquidity injections arising from the non-import component of government spending, although a small amount of government securities may need to be issued to accommodate some buildup of gross international reserves so that import coverage is maintained.

20. **Following extensive debt relief, Tanzania's debt position has greatly improved.** As shown in Appendix II, Tanzania's external debt will remain sustainable under standardized shocks, assuming its current account deficit is financed at highly concessional terms. Tanzania's domestic debt remains relatively moderate (15 percent of GDP), and is expected to decline gradually relative to GDP in view of the authorities' commitment to limit NDF over the medium term. As noted above, the authorities will continue to refrain from nonconcessional funding. Moreover, improvements in debt management will aim to lower debt service costs to the government, optimize the maturity profile, and facilitate financial market development.

F. Supporting Private Sector Development and Other Structural Issues

21. **The authorities are taking steps to alleviate key bottlenecks constraining economic activity in Tanzania.** In addition to the measures outlined in the MEFP, notably policies aimed at improving energy and transport infrastructure and enhancing the legal environment, the authorities are working on further removing impediments to bank lending through land titling and formalization of the informal sector through implementing measures to separate the information function of business registration from the taxation function.

22. **The authorities are also continuing efforts to strengthen institutions of economic governance to minimize resource leakages and strengthen accountability.** This will be carried out through effective implementation of the recently enacted National Anti-Corruption Strategy Plan (NACSP II), reinforced by improved and transparent public expenditure management. The implementation strategy will focus on creating an institutional framework to facilitate the participation of local governments, civil society, media and the private sector entities through the establishment of the National Anti-Corruption Forum.

V. The PSI Program: Policies for 2007/08

23. **The policy direction for 2007/08 envisaged in the three-year PSI program remains appropriate.**[10] Reflecting the underlying medium-term growth trend, real GDP is projected to grow by 7.1 percent in 2007. In addition, prudent fiscal and monetary policies will aim to hold inflation to around 5 percent. Potential increases in electricity tariffs, as envisaged under the program, would create some modest pressure on inflation, but progress with reforms in the energy sector and TANESCO's financial viability should help expand the energy supply and sustain growth.

24. **The government's budget for 2007/08 directs more resources to pro-growth and social objectives** (MEFP, ¶ 20–28). Government revenues and spending are projected to increase to 16.1 percent and 28.4 percent of GDP, respectively, with donor grants and concessional lending providing sufficient financing to cover the difference. More than half of donor assistance will be delivered in the form of direct budget support (6.3 percent of GDP), including basket grants and loans directed to MKUKUTA priorities. Following a sharp increase last year, the wage bill in 2007/08 is expected to hold steady at about 5.8 percent of GDP, which includes the hiring of up to 11,000 new staff, mainly in education and health. In line with the authorities' objectives to ease pressure on T-bill yields, NDF would be zero.

25. **The continued strong performance of revenues in 2007/08 is based on sustained vigorous implementation of tax and customs administration reforms.** In particular, integration of the system-based procedures of the Customs and Excise Department and the Destination Inspection (TISCAN) will be finalized and implementation of risk management procedures will be given priority (structural benchmarks—MEFP ¶ 21). On domestic taxation, the Large Taxpayers Department (LTD) of the Tanzania Revenue Authority will continue to strengthen its audit capacity and, using techniques developed by the LTC, dedicated units will be established to cover medium taxpayers using techniques. Modest tax policy measures—including higher excise taxes on selected products and fuel levy and other road usage charges—being introduced in 2007/08 will reinforce the revenue target.

26. **The authorities will continue to improve cash management to strengthen both budget execution and the implementation of monetary policy**. The Cash Management Unit set up in the office of the Accountant General is expected to produce its first cash plan shortly. In addition, the Cash Management Committee, with representatives from the Ministry of Finance and BoT, initiated meetings in May. It will mainly prepare a liquidity

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[10] With the 2006/07 program broadly on track, the authorities did not seek any modifications to the quantitative assessment criteria for June 2007.

management plan for the fiscal year to optimize government resources and communicate imminent revenue and spending operations to inform the BoT's monetary policy operations. In addition, the Committee will oversee the closure of government accounts in commercial banks, or their linkage to the Treasury Single Account (TSA), as sub-accounts. This will reduce idle government balances in commercial banks and further facilitate the conduct of monetary policy (MEFP, ¶ 23).

27. **The BoT will maintain a cautious monetary stance aimed at ensuring that inflation remains subdued without constraining current trends in financial sector deepening** (MEFP, ¶s 29–31). Both reserve and broad money are targeted to grow by 21 percent 2007/08—a strong pace, but below the average in recent years.[11] Reflecting the slowdown in dollarization tendencies since early 2007, the ratio of foreign currency deposits to shilling deposits is expected to be largely unchanged in 2007/08. At the same time, much of the sterilization operations needed to mop up liquidity will be achieved through sales of foreign exchange, which will ease the need to issue government securities for this purpose and alleviate pressure on interest rates. The government's zero domestic financing will allow credit to the private sector to continue growing at a rapid pace (40 percent). While soundness indicators reflect a healthy position for the banking sector as a whole, the BoT's banking supervision department will remain vigilant, including a greater emphasis on risk-based assessment of bank balance sheets.[12]

28. **To further encourage financial sector deepening, the authorities intend to implement the new second-generation Financial Sector Reform Action Plan in 2007/08.** In particular, the BoT will make the preparations needed to create a credit reference database to facilitate lending operations by financial institutions; a unified legal and regulatory framework and investment guidelines for pension funds will also be developed and submitted to government (structural benchmarks—MEFP, ¶ 31 and Table 3).

29. **The external current account deficit before grants is projected to be unchanged relative to GDP in 2007/08.** In U.S. dollar terms, however, import growth is projected to be stronger than originally envisaged—driven mainly by capital goods imports—and would outpace the solid expansion in goods and services exports. The current account deficit is expected to be largely financed by positive capital account developments, notably increased foreign direct investment, but while donor support will continue to be substantial, it is

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[11] Given the uncertainties of money demand during a period of significant financial deepening and structural change, the program's monetary targets will need be kept under close review.

[12] Anecdotal evidence suggests there may be some foreign participation in the T-bill market through local subsidiaries of foreign banks. Going forward, such developments should be studied closely to ensure that the regulatory environment remains appropriate.

expected to fall short of earlier projections. As a result a modest overall balance of payments deficit is projected for 2007/08, in contrast to the small surplus that had been envisaged. Gross international reserves would decline slightly, to just under US$2 billion by the end of June 2008. While this is lower than the original program projection (US$2.2 billion), reserve coverage would remain comfortable at about 3.5 months of imports of goods and services projected for the following year.

30. **Strengthening the operations and finances of the energy sector will continue to be a major focus of structural reforms, and the authorities remain committed to moving rapidly to full commercial viability for TANESCO.** TANESCO's performance and finances have been significantly strengthened by the restoration of hydro capacity due to favorable rains. Nevertheless, further tariff increases and continued close monitoring will be essential. To this end, TANESCO will submit an application to the regulatory authority for an increase in electricity tariffs in July 2007 (structural assessment criterion, MEFP, ¶ 34)). In line with the new regulatory framework for the sector, the requested increase must be supported by detailed cost data. To comply with this requirement, TANESCO has contracted two experts to prepare cost-of-service and financial analyses. The submission will reflect the full cost recovery principle, including all current operations, system maintenance, depreciation, and commercial financing costs. EWURA is required to rule on the tariff request within 12 weeks.

31. **The authorities are moving forward expeditiously with the launching of the special audit of the government EPA account managed by the BoT** (MEFP, ¶ 36). The Terms of Reference have been finalized, in consultation with Fund staff, and the Controller and Auditor General (CAG) has initiated the tendering process. An auditor will be selected promptly, and it is expected that the audit will be completed by October 2007 (structural benchmark). Upon completion, the special audit will be made available to Fund staff and the staff will discuss possible next steps, including any remedial measures that may be appropriate, in the context of reviews of the PSI.

VI. Program Monitoring

32. **The PSI-supported program would be monitored through the quantitative and structural assessment criteria, indicative targets, and benchmarks specified in Tables 1 and 3 of Appendix I.** The second review will be based on quantitative assessment criteria for the end-June 2007 test date and the structural assessment criterion for end-July 2007. The third and fourth reviews will be based on quantitative assessment criteria for the end-December 2007 and end-June 2008 test dates, respectively. Quantitative indicative targets were also set for end-September 2007 and end-March 2008. Conditionality in key areas of the structural reform agenda include progress on the special audit noted above, revenue mobilization and public expenditure management, financial sector reform, and the energy sector.

33. **The authorities' economic program faces some policy risks,** notably with regard to effective implementation of energy reforms, possible pressure for more direct government interventions to accelerate growth and reduce poverty, and government implementation and monitoring capacity constraints. Tanzania is also vulnerable to climate and terms of trade shocks. While Tanzania depends heavily on donor aid, the ample stock of international reserves shields the economy and government operations from temporary shortfalls in disbursements. Steps have also been taken, such as enhanced donor coordination under the Joint Assistance Strategy for Tanzania, to ensure more predictable longer-term commitments of aid.

VII. Staff Appraisal

34. **Tanzania has sustained strong economic performance for several years; the approval of the PSI program in February 2007 solidifies its status as a mature stabilizer.** Relative to the region as well as to its own record, real economic growth has been high, inflation low, and the external position much improved during this period. This performance was underpinned by a good record of sound government financing, prudent monetary and exchange rate policies, and steady implementation of a market-oriented structural reform agenda. Moreover, the outlook is good for sustained strong economic performance in the medium term.

35. **Despite these developments, Tanzania remains a very poor country with many pressing social needs and significant capacity constraints.** The authorities will need to sustain for many years sound policies and structural reforms that will mobilize and efficiently use resources if they are to achieve their economic and social goals.

36. **Structural reforms to enhance public sector effectiveness and efficiency—critical factors in Tanzania's success—are expected to continue.** Improvements in revenue administration have translated directly into increased government revenues, which together with high economic growth and substantial donor support, have enabled government spending to expand at a very strong pace, with minimal recourse to costly domestic financing. Staff welcomes the authorities' resolve to continue their efforts in revenue administration. On the spending side, while there has been much progress with public financial management reforms (notably, the extended coverage of IFMS), more is needed. In particular, the MTEF process has yet to become an integral part of the annual budget formulation process and better tracking of MKUKUTA spending needs to be established. These improvements would not only provide more effective information to government policymakers, but also give the donor community a much better sense of how their assistance is being used, encouraging them to provide additional resources in the form of budget support.

37. **High and volatile yields on T-bills are costly to the government and could impair the financial intermediation that supports private sector growth.** The authorities are taking steps to reduce this volatility by minimizing the need to issue new T-bills at the time of heightened pressure points in the market, which occur mainly at the end of the quarter. Having shifted to targeting average reserve money, the BoT aims to position the daily reserve money stock early on, such that program ceilings can be met without resorting to intensive sales of T-bills at the very end of the period. In addition, to enable the BoT to better assess short-term liquidity management needs, the Cash Management Committee (CMC) formed in May 2007 should immediately begin to provide near-term forecasts of liquidity generated by government operations. Staff also encourages the CMC to make rapid progress with moving government deposits at commercial banks to the BoT, which will help absorb liquidity. Greater reliance on foreign exchange sales for sterilization operations and spreading maturities of debt rollovers across the yield curve, together with the government's target of zero NDF, should further ease pressure on T-bill yields. Looking ahead, steps would be needed to strengthen competition in the primary market and create an environment for secondary market trading.

38. **The authorities' flexible exchange rate policy—whereby the BoT generally enters the market only to meet potentially disruptive demand for or supply of foreign exchange—has served Tanzania well.** As a result, the shilling has depreciated in recent years, mainly as the terms of trade have deteriorated, which has helped to preserve Tanzania's international competitiveness in times of adverse shocks. In light of the need for large sterilization operations to mop up liquidity from donor-funded government spending, however, staff encourages the authorities to take a more proactive approach to sterilization, particularly through more systematic sales of foreign exchange by the BoT.

39. **Despite the banking sector's remarkable expansion of financial intermediation in recent years, a majority of Tanzanians still have little or no access to financial services.** With cabinet's approval of the second-generation Financial Sector Reform Action Plan, staff anticipates that progress in deepening and broadening financial services will be stepped up, notably by establishing the credit reference database and a unified legal and regulatory framework and investment guidelines for pension funds. Staff would caution the authorities, however, to ensure that proper incentives are upheld in credit guarantee schemes offered by the BoT and government to minimize contingent liabilities.

40. **While the outlook for Tanzania's public debt sustainability is benign, staff supports the authorities' cautious stance toward external borrowing on commercial terms.** In particular, the government should continue to refrain from guaranteeing commercial borrowing by public enterprises.

41. **Staff welcomes the efforts of the electricity utility TANESCO to vigorously implement its financial recovery program** by seeking a full cost recovery tariff increase in

the months ahead. With this measure, and in light of more favorable operating conditions, staff encourages the authorities to make rapid progress towards TANESCO's commercial viability. Sufficient revenues and sound financing are essential for necessary maintenance and expansion of the electricity network and supplies, whose shortcomings have been a serious impediment to doing business.

42. **Improvements in governance and transparency have supported Tanzania's recent economic development and helped to attract donor support.** In this regard, staff is encouraged by the authorities' efforts to strengthen the Prevention of Corruption Bureau through the recently approved Anti-Corruption Act. Staff also welcomes the authorities' expeditious tendering for the special audit of the government's external payment arrears account managed by the BoT in line with the terms of reference agreed with Fund staff. Staff will continue to follow progress with the special audit.

43. **Tanzania has set targets to implement the Anti-Money Laundering Act (2006) and create a Financial Intelligence Unit by mid 2007.** Staff welcomes these developments and will follow the progress of these measures. Tanzania will also undergo a technical assistance needs assessment (TANA) by the ESAAMLG, the FATF-style regional body for Eastern and Southern Africa, in 2007.

44. **The PSI program is broadly on track.** The small deviation from the envisaged reserve money path has been redressed, and the ambitious and broad-based structural reform program is proceeding as envisaged, notwithstanding modest delays in some areas, generally owing to technical factors. Tanzania's performance warrants the continued strong support of the international community. Staff thus recommends completion of the first review.

45. Staff proposes that the next Article IV consultation with Tanzania take place within 24 months, subject to the provision of the Decision on Consultation Cycles in program countries.

Table 1. Tanzania: Selected Economic and Financial Indicators, 2005/06-2009/10

	2005/06	2006/07		2007/08	2008/09	2009/10
	Est.	Prog.	Proj.	Proj.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)					
National income and prices [1]						
Nominal GDP (market prices; billions of T Sh)	14,209	16,004	16,016	18,096	20,448	23,156
Real GDP growth (factor cost)	6.7	5.9	6.2	7.1	7.5	7.9
Consumer prices (period average)	4.4	5.8	7.3	5.7	5.0	5.0
Consumer prices (end of period)	5.0	5.4	6.7	5.0	5.0	5.0
External sector						
Export, f.o.b (in U.S. dollars)	1,736	1,965	1,830	2,131	2,296	2,488
Imports, c.i.f. (in U.S. dollars)	-3,776	-4,368	-4,482	-5,131	-5,592	-6,035
Export volume	1.8	6.7	-3.1	15.0	3.2	10.5
Import volume	3.1	9.4	12.5	15.1	10.4	9.2
Terms of trade	-3.9	-8.7	-6.2	1.7	5.7	-0.8
Nominal effective exchange rate (end of period; depreciation -)	-10.3	...	…	...	...	...
Real effective exchange rate (end of period; depreciation -)	-7.6	...	…	...	...	...
Money and credit						
Broad money (M3)	31.6	24.2	21.0	21.0	…	…
Net foreign assets	38.5	4.8	8.6	5.4	…	…
Net domestic assets	14.2	83.5	58.9	53.7	…	…
Credit to nongovernment sector	35.9	36.0	35.1	39.5	…	…
Velocity of money (GDP/M3; average)	4.2	3.5	3.6	3.4	…	…
Treasury bill interest rate (in percent; end of period) [2]	9.3	…	16.0	…	…	…
	(Percent of GDP)					
Public finance						
Revenue (excluding grants)	14.0	14.7	15.7	16.1	16.6	17.1
Total grants	6.0	8.2	8.1	8.1	7.1	7.2
Expenditure (including adjustment to cash)	26.2	28.2	28.3	28.4	27.8	28.5
Overall balance (including grants)	-6.1	-5.3	-4.5	-4.2	-4.1	-4.2
Domestic financing [3]	2.3	0.4	0.2	0.0	0.0	0.0
Savings and investment [1]						
Resource gap	-10.5	-13.0	-13.2	-14.7	-15.3	-14.9
Investment	22.2	23.4	23.3	24.9	25.2	25.5
Government	6.7	7.6	7.6	8.9	8.9	9.0
Nongovernment [4]	15.5	15.8	15.8	16.0	16.3	16.5
Gross domestic savings	11.7	10.4	10.2	10.2	9.9	10.6
External sector						
Current account balance (excluding current transfers)	-12.6	-14.7	-15.4	-15.3	-15.1	-14.5
Current account balance (including current transfers)	-8.7	-10.5	-11.2	-11.3	-11.1	-10.6
	(Millions of U.S. dollars, unless otherwise indicated)					
Balance of payments						
Current account balance (excluding current transfers; deficit -)	-1,667	-2,022	-2,079	-2,299	-2,511	-2,511
Overall balance of payments (deficit -)	383	26	46	-69	171	182
Gross official reserves	1,995	2,025	2,045	1,975	2,146	2,146
In months of imports of goods and nonfactor services	4.4	4.0	4.0	3.5	3.5	3.5

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

[1] Data are on calendar year basis. For example, 2005/06 data are for calendar year 2005.

[2] Monthly weighted-average yield of 35-, 91-, 182-, and 364-day treasury bills. March 2007 figure used for 2006/07.

[3] Excluding new debt issued to recapitalize government-owned banks during their restructuring.

[4] Including change in stock.

Table 2. Tanzania: National Accounts, 2005-10

	2005	2006		2007	2008	2009	2010
		Prog.	Prel.	Proj.	Proj.	Proj.	Proj.
GDP at market prices							
Nominal (billions of T Sh, calendar-year basis)	14,209	16,004	16,016	18,096	20,448	23,156	26,169
Real (percentage change)	6.7	5.9	6.2	7.1	7.5	7.9	8.0
Deflator (percentage change)	7.7	6.7	6.5	5.8	5.5	5.4	5.0
Sectoral components of GDP							
Agriculture	5.1	4.2	4.1	4.7	5.2	5.2	5.2
Industry	10.2	7.4	9.6	9.3	9.8	10.2	10.6
Services	6.9	7.2	7.2	8.5	8.4	9.1	9.2
Memorandum items:		2005/06	2006/07		2007/08	2008/09	2009/10
	2004/05	Prel.	Prog.	Proj.	Proj.	Proj.	Proj.
Nominal GDP (billions of T sh, fiscal-year basis)	13,287	15,113	17,088	17,056	19,272	21,802	24,663
Nominal GDP growth	15.3	13.7	13.1	12.9	13.0	13.1	13.1
Real GDP growth	6.7	6.5	6.6	6.7	7.3	7.7	7.9
CPI inflation (average)[1]	4.1	5.6	6.0	6.2	5.0	5.0	5.0
CPI inflation (end period)[1]	4.2	6.8	4.5	5.0	5.0	5.0	5.0

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

Table 3. Tanzania: Central Government Operations, 2005/06-2009/10 [1]
(Billions of Tanzania Shillings)

	2005/06	2006/07		2007/08	2008/09	2009/10
	Actual	Prog.	Proj.	Proj.	Proj.	Proj.
Total revenue	2,125	2,511	2,673	3,103	3,619	4,230
Tax revenue	1,946	2,321	2,469	2,866	3,343	3,907
Import duties	191	221	247	286	334	390
Value-added tax [2]	803	956	833	967	1,127	1,318
Excises [2]	262	333	500	580	676	791
Income taxes	554	643	672	780	910	1,064
Other taxes	137	168	218	253	295	345
Nontax revenue	178	191	204	237	276	323
Total expenditure	3,873	4,825	4,800	5,477	6,056	7,047
Recurrent expenditure	2,920	3,349	3,327	3,729	4,160	4,796
Wages and salaries	657	1,004	1,004	1,113	1,280	1,453
Interest payments	219	144	247	276	285	256
Domestic	164	122	219	240	245	213
Foreign [3]	55	22	28	36	40	42
Goods and services and transfers	2,044	2,201	2,076	2,340	2,595	3,087
Of which: MDRI (IMF) related	0	53	15	0	0	0
Development expenditure	953	1,476	1,473	1,749	1,896	2,251
Domestically financed	296	667	616	710	715	912
Of which: MDRI (IMF) related	0	230	214	204	0	0
Foreign financed	657	810	856	1,039	1,180	1,339
Overall balance before grants	-1,748	-2,314	-2,126	-2,375	-2,436	-2,816
Grants	911	1,406	1,385	1,566	1,541	1,791
Program (including basket grants) [4]	507	708	697	768	869	956
Project	328	413	459	595	673	763
HIPC grant relief	76	2	0	0	0	0
MDRI grant relief	0	283	229	204	0	0
Overall balance after grants	-837	-908	-742	-808	-895	-1,025
Adjustment to cash [5]	-87	0	-23	0	0	0
Overall balance	-924	-908	-764	-808	-895	-1,025
Financing	924	908	764	808	895	1,025
Foreign (net)	561	852	737	832	926	1,025
Foreign loans	669	882	772	896	995	1,103
Program (including basket loans) [4]	340	485	375	452	487	528
Project	329	397	397	444	507	576
Amortization	-108	-29	-34	-65	-69	-78
Domestic (net)	349	67	30	0	0	0
Bank financing	127	20	...	...	...	...
Nonbank financing	222	47	...	...	...	...
Amortization of parastatal debt	-19	-11	-3	-23	-31	0
Privatization proceeds	33	0	0	0	0	0
Financing Gap	0	0	0	0	0	0
Memorandum items:						
Treasury vouchers	24	36	36	31	31	0
Public domestic debt (in percent of GDP)	15.5	14.9	13.9	12.3	10.9	9.6
Recurrent expenditures to total revenues (percent)	137	133	124	120	115	0
Nominal GDP	15,113	17,088	17,056	19,272	21,802	24,738

Table 3 (concl.) Tanzania: Central Government Operations, 2005/06-2009/10 [1]
(Percent of GDP)

	2005/06	2006/07		2007/08	2008/09	2009/10
	Actual	Prog.	Proj.	Proj.	Proj.	Proj.
Total revenue	14.1	14.7	15.7	16.1	16.6	17.1
Tax revenue	12.9	13.6	14.5	14.9	15.3	15.8
Import duties	1.3	1.3	1.4	1.5	1.5	1.6
Value-added tax [2]	5.3	5.6	4.9	5.0	5.2	5.3
Excises [2]	1.7	1.9	2.9	3.0	3.1	3.2
Income taxes	3.7	3.8	3.9	4.0	4.2	4.3
Other taxes	0.9	1.0	1.3	1.3	1.4	1.4
Nontax revenue	1.2	1.1	1.2	1.2	1.3	1.3
Total expenditure	25.6	28.2	28.1	28.4	27.8	28.5
Recurrent expenditure	19.3	19.6	19.5	19.3	19.1	19.4
Wages and salaries	4.3	5.9	5.9	5.8	5.9	5.9
Interest payments	1.4	0.8	1.4	1.4	1.3	1.0
Domestic	1.1	0.7	1.3	1.2	1.1	0.9
Foreign [3]	0.4	0.1	0.2	0.2	0.2	0.2
Goods and services and transfers	13.5	12.9	12.2	12.1	11.9	12.5
o/w MDRI (IMF) related	0.0	0.3	0.1	0.0	0.0	0.0
Development expenditure	6.3	8.6	8.6	9.1	8.7	9.1
Domestically financed	2.0	3.9	3.6	3.7	3.3	3.7
o/w MDRI (IMF) related	0.0	1.3	1.3	1.1	0.0	0.0
Foreign financed	4.3	4.7	5.0	5.4	5.4	5.4
Overall balance before grants	-11.6	-13.5	-12.5	-12.3	-11.2	-11.4
Grants	6.0	8.2	8.1	8.1	7.1	7.2
Program (including basket grants) [4]	3.4	4.1	4.1	4.0	4.0	3.9
Project	2.2	2.4	2.7	3.1	3.1	3.1
HIPC grant relief	0.5	0.0	0.0	0.0	0.0	0.0
MDRI (IMF) grant relief	0.0	1.7	1.3	1.1	0.0	0.0
Overall balance after grants	-5.5	-5.3	-4.3	-4.2	-4.1	-4.1
Adjustment to cash [5]	-0.6	0.0	-0.1	0.0	0.0	0.0
Overall balance	-6.1	-5.3	-4.5	-4.2	-4.1	-4.1
Financing	6.1	5.3	4.5	4.2	4.1	4.1
Foreign (net)	3.7	5.0	4.3	4.3	4.2	4.1
Foreign loans	4.4	5.2	4.5	4.7	4.6	4.5
Program (including basket loans) [4]	2.2	2.8	2.2	2.3	2.2	2.1
Project	2.2	2.3	2.3	2.3	2.3	2.3
Amortization	-0.7	-0.2	-0.2	-0.3	-0.3	-0.3
Domestic (net)	2.3	0.4	0.2	0.0	0.0	0.0
Bank financing	0.8	0.4	...	...	...	...
Nonbank financing	1.5	0.1	...	...	...	...
Amortization of parastatal debt	-0.1	-0.1	0.0	-0.1	-0.1	0.0
Privatization proceeds	0.2	0.0	0.0	0.0	0.0	0.0
Financing Gap	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Ministry of Finance; Bank of Tanzania; and Fund staff projections.

1 Fiscal year: July-June.

2 Program VAT and excise collections were projected before the announcement to abolish VAT on oil products and the increase of excise rates.

3 Some projected external debt obligations are under negotiation for relief with a number of creditors.

4 Basket funds are sector-specific accounts established by the government to channel donor support to fund-specific activities.

5 Unidentified financing (+)/expenditure(-). Includes expenditure carryover from the previous year.

Table 4. Tanzania: Summary Accounts of the Bank of Tanzania, 2006/07-2007/08
(Billions of Tanzania Shillings, unless otherwise indicated; end of period)

	2006				2007						2008	
	Jun	Sep	Dec		Mar		Jun		Sept	Dec	Mar	Jun
	Actual	Actual	Prog.	Actual	Prog.	Actual	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.
Net foreign assets	2,380	2,675	2,627	2,704	2,697	2,544	2,505	2,463	2,644	2,684	2,524	2,431
Net international reserves	2,415	2,709	2,662	2,739	2,732	2,579	2,540	2,498	2,679	2,718	2,558	2,465
(Millions of U.S. dollars)	1,927	2,129	2,119	2,171	2,161	2,076	1,954	1,952	2,081	2,099	1,965	1,883
Medium- and long-term foreign liabilities	-35	-35	-35	-35	-35	-35	-35	-35	-35	-35	-35	-35
Net domestic assets	-1,084	-1,263	-1,076	-1,261	-1,083	-1,067	-832	-790	-859	-759	-558	-405
Credit to government	-873	-1,083	-1,091	-1,168	-1,148	-1,082	-961	-954	-1,082	-1,041	-899	-807
Other items (net)	-211	-180	16	-93	64	15	129	164	223	282	341	402
Of which: MDRI (IMF)	-421	-395	-257	-386	-259	-340	-149	-202	-152	-102	-51	0
Reserve money	1,296	1,412	1,552	1,444	1,614	1,477	1,674	1,674	1,785	1,925	1,966	2,025
Currency outside banks	856	941	1,033	976	1,075	971	1,148	1,091	1,204	1,294	1,210	1,320
Bank reserves	440	471	519	468	539	506	526	583	580	631	756	706
Currency in banks	91	98	99	127	101	115	103	103	106	109	112	115
Deposits	349	373	420	341	438	390	423	480	474	522	644	591
Required reserves (calculated)[1]	299	312	339	319	354	336	368	360	380	398	426	440
Excess reserves (calculated)	50	61	81	22	84	54	55	121	94	124	218	151
Memorandum items:												
Stock of liquidity paper	638	512	568	588	662	731	761	696	595	484	551	550
Average reserve money	1,302	1,429	1,536	1,557	1,604	1,586	1,664	1,664	1,775	1,915	1,956	2,013

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

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

Table 5. Tanzania: Monetary Survey, 2006/07-2007/08
(Billions of Tanzania Shillings, unless otherwise indicated; end of period)

	2006				2007						2008	
	Jun	Sep	Dec		Mar		Jun		Sep	Dec	Mar	June
	Actual	Actual	Prog.	Actual	Prog.	Actual	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.
Net foreign assets	3,241	3,619	3,469	3,754	3,557	3,542	3,398	3,521	3,769	3,867	3,749	3,710
Net domestic assets	1,058	930	1,450	1,045	1,563	1,368	1,941	1,681	1,767	1,953	2,280	2,584
Domestic credit	1,771	1,638	1,995	1,726	2,064	2,020	2,388	2,235	2,292	2,449	2,746	3,020
Credit to government (net)	114	-268	32	-302	-18	-113	134	-5	-254	-404	-265	-105
Credit to nongovernment sector	1,657	1,906	1,962	2,028	2,082	2,134	2,254	2,239	2,546	2,853	3,011	3,125
Other items (net)	-713	-708	-545	-681	-501	-652	-447	-554	-525	-496	-466	-436
M3	4,299	4,549	4,919	4,799	5,120	4,910	5,339	5,202	5,537	5,820	6,029	6,294
Foreign currency deposits	1,354	1,499	1,432	1,605	1,580	1,617	1,651	1,713	1,823	1,916	1,985	2,073
M2	2,946	3,050	3,486	3,194	3,540	3,293	3,688	3,489	3,713	3,903	4,044	4,222
Currency in circulation	856	941	1,033	976	1,075	971	1,148	1,091	1,204	1,294	1,210	1,320
Deposits (Tanzania Sh)	2,089	2,109	2,453	2,218	2,465	2,322	2,540	2,398	2,509	2,609	2,834	2,902
Memorandum items:												
M3 growth (12-month percent change)	31.6	28.6	25.0	22.0	24.6	19.5	24.2	21.0	21.7	21.3	22.8	21.0
Foreign currency deposits (12-month percent change)	50.4	50.5	27.1	42.4	24.1	27.0	22.0	26.6	21.6	19.4	22.8	21.0
M2 growth (12-month percent change)	24.5	20.1	24.1	13.7	24.8	16.1	25.2	18.4	21.7	22.2	22.8	21.0
Credit to nongovernment sector (12-month percent change)	35.9	37.1	37.7	42.3	36.0	39.3	36.0	35.1	33.6	40.7	41.1	39.5
Reserve money (12-month percent change)	25.9	25.1	25.5	16.8	23.8	13.3	29.1	29.1	26.4	33.3	33.1	21.0
Average reserve money (12-month percent change)	20.7	17.3	16.3	17.9	23.0	21.6	27.8	27.8	24.2	23.0	23.3	21.0
Currency/M3 (in percent)	19.9	20.7	21.0	20.3	21.0	19.8	21.5	21.0	21.8	22.2	20.1	21.0
Reserve money multiplier (M3/reserves)	3.3	3.2	3.2	3.1	3.2	3.1	3.2	3.1	3.1	3.0	3.1	3.1
Velocity of money (M3; end-period)	3.7	3.5	3.3	3.3	…	3.7	3.2	3.5	3.3	3.1	3.4	3.2
Nonbank financing of the government (net) [1]	222	12	73	88	60	129	47	149	10	50	85	100
Bank financing of the government (net) [1]	127	-383	-82	-416	-132	0	20	-119	-240	-350	-175	-100
Bank and nonbank financing of the government (net) [1]	349	-371	-9	-328	-72	129	67	30	-230	-300	-90	0

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

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

Table 6: Financial Soundness Indicators, 2002–06
(Percent, end of calendar year)

	2002	2003	2004	2005	2006
Access to bank lending					
Claims on the private sector to GDP [1]	6.1	7.7	8.6	10.0	12.4
Capital adequacy					
Capital to risk-weighted assets	20.6	21.0	21.2	22.0	16.3
Capital to assets	8.6	9.9	10.2	10.0	7.6
Asset composition and quality					
Total loans and advances to total assets	25.4	30.2	33.7	33.7	37.3
Sectoral distribution of loans					
Trade	22.1	23.8	23.6	23.7	18.9
Mining and manufacturing	24.4	27.3	23.4	22.5	22.6
Agricultural production	12.9	14.1	13.9	12.4	12.6
Building and construction	3.6	5.5	4.0	5.8	4.0
Transport	11.8	10.3	8.7	7.6	9.3
Foreign exchange loans	28.1	27.2	28.9	32.7	33.6
Gross nonperforming loans (NPLs) to gross loans [2]	8.3	4.5	3.5	4.9	7.3
Large exposures to total capital	58.2	59.3	64.1	53.3	27.3
Earnings and profitability					
Return on assets	1.8	2.1	2.9	3.3	3.9
Return on equity	20.6	20.7	28.4	33.1	37.0
Interest margin to gross income	48.0	51.5	54.8	60.9	74.9
Noninterest expenses to gross income	70.1	67.1	61.6	56.9	43.8
Personnel expenses to noninterest expenses	41.3	39.9	39.0	39.6	39.5
Trading and fee income to total income	45.2	42.3	39.1	33.6	28.9
Interest rate earned on loans and advances	15.7	13.8	14.8	15.0	16.4
Interest rate paid on deposits	3.4	3.9	4.4	5.3	7.2
Spread (lending vs. deposit rates) [3]	12.3	10.0	10.4	9.7	9.2
Liquidity					
Liquid assets to total assets	58.0	56.3	53.6	55.0	48.2
Liquid assets to total short term liabilities	68.9	62.8	62.0	62.4	55.2
Total loans to customer deposits	34.0	41.2	44.4	42.4	50.1
Foreign exchange liabilities to total liabilities	34.1	36.5	34.7	34.9	38.6

Sources: Bank of Tanzania and Fund staff estimates.

[1] Calendar year; end of period claims relative to annual GDP.
[2] The increase in non-performing loans to gross loans between 2005 and 2006 was due largely to a change in reporting standards.
[3] Difference between lending rate and time deposit rate.

Table 7. Tanzania: Balance of Payments, 2005/06-2009/10

(Millions of U.S. dollars, unless otherwise indicated)

	2005/06	2006/07		2007/08	2008/09	2009/10
	Act.	Prog	Proj.	Proj.	Proj.	Proj.
Current account	-1,105	-1,410	-1,496	-1,680	-1,829	-1,927
Trade balance	-1,700	-2,012	-2,251	-2,541	-2,796	-3,007
Exports, f.o.b.	1,736	1,965	1,830	2,131	2,296	2,488
Traditional	356	400	259	360	377	395
Nontraditional	1,380	1,565	1,571	1,771	1,919	2,093
Imports, f.o.b	-3,436	-3,977	-4,081	-4,672	-5,092	-5,494
Services (net)	112	88	242	278	334	399
Income (net)	-78	-98	-70	-36	-49	-51
Of which : interest payments due	-64	-34	-39	-43	-42	-41
Of which : interest on public debt	-49	-17	-22	-28	-30	-31
Of which : interest on central government debt [1]	-49	-17	-22	-28	-30	0
Current transfers (net)	561	612	583	619	682	732
Of which : official transfers	503	555	555	593	655	704
Of which : program grants	435	553	542	593	655	704
HIPC relief	68	2	13	0	0	0
Capital account	662	4,998	5,029	492	586	690
Of which : project grants	281	323	359	442	534	637
Debt stock reduction under MDRI (including HIPC)	336	4,626	4,621	0	0	0
Of which: HIPC	37	1,157	1,157	0	0	1
Financial account	933	-3,561	-3,487	1,119	1,413	1,418
MDRI (including HIPC)	0	-4,626	-4,621	0	0	0
Of which: HIPC	0	-1,157	-1,157	0	0	0
Direct investment	488	520	554	650	739	887
Other investment	443	542	577	465	671	529
Of which: Program loans	293	379	292	349	368	388
Project loans	278	313	310	343	383	404
Government-scheduled amortization [1]	-87	-23	-23	-50	-52	-57
Errors and omissions	-107	0	0	0	0	0
Overall balance	383	26	46	-69	171	182
Financing	-383	-26	-46	69	-171	-182
Change in BoT reserve assets (increase, -)	-26	-30	-50	69	-171	-182
Use of Fund credit	-357	4	4	0	0	0
Exceptional financing	0	0	0	0	0	0
Change in arrears (increase +)	0	0	0	0	0	0
Debt rescheduled	0	0	0	0	0	0
Memorandum items:						
Gross official reserves (BoT)	1,995	2,025	2,045	1,975	2,146	2,328
Months of imports of goods and services (next year)	4.4	4.0	4.0	3.5	3.5	3.5
Current account deficit (percent of GDP)						
Excluding official current transfers	-12.6	-14.7	-15.4	-15.3	-15.1	-14.5
Including official current transfers	-8.7	-10.5	-11.2	-11.3	-11.1	-10.6
External debt service foregone due to MDRI (including HIPC)	33.3	171.8	172.4	117.1	170.3	164.8
IMF	33.3	71.9	72.3	12.4	62.2	47.4
IDA	0	94.6	94.8	99.2	102.3	110.3
AfDB	0	5.3	5.3	5.5	5.7	7.1
Foreign program and project assistance (percent of GDP)	10.6	11.7	11.4	11.6	11.8	11.8
Foreign direct investment (percent of GDP)	3.8	3.9	4.2	4.4	4.5	4.9
Nominal GDP	12,776	13,401	13,305	14,884	16,442	18,146

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

[1] Relief on some projected external debt obligations is being negotiated with a number of creditors.

Table 8. Tanzania: Program Assistance, 2005/06-2009/10 [1, 2]

(Millions of U.S. dollars, unless otherwise indicated)

	2005/06	2006/07		2007/08	2008/09	2009/10
	Act.	Prog.	Proj.	Proj.	Proj.	Proj.
Grants	**434.8**	**553.0**	**542.3**	**593.1**	**655.2**	**723.8**
Multilateral	**39.1**	**49.7**	**52.2**	48.7	...	...
EU PRBS grants [3]	39.1	49.7	52.2	48.7	...	...
World Bank (PRBS)	0.0	0.0	0.0	0.0	...	...
Bilateral	**395.7**	**503.4**	**490.1**	**544.5**	**601.5**	**664.4**
PRBS [3]	**246.8**	**338.7**	**360.2**	**409.4**	**452.2**	**499.6**
Canada	0.0	21.4	16.6	0.0	...	...
Denmark	9.8	15.3	15.2	12.6	...	...
Finland	4.9	11.1	11.1	13.8	...	...
Germany	6.3	10.2	10.4	10.4	...	...
Ireland	5.9	13.2	13.2	15.3	...	...
Japan	5.0	4.7	4.7	4.6	...	...
Netherlands	12.0	19.1	38.1	65.2	...	...
Norway	15.5	27.5	33.9	26.6	...	...
Sweden	25.8	41.4	42.5	49.7	...	...
Switzerland	4.8	4.8	4.6	4.8	...	...
United Kingdom	156.8	169.9	169.9	206.4	...	...
Sectoral baskets	**148.9**	**164.7**	**129.8**	**135.1**	**149.2**	**164.9**
Belgium	0.0	7.0	1.3	6.5	...	...
Canada	24.9	7.1	8.8	2.5	...	...
Denmark	16.9	20.1	22.3	20.2	...	...
EU	2.3	23.4	24.6	14.3	...	...
France	0.6	2.0	2.0	1.2	...	...
Finland	6.7	5.7	3.3	9.1	...	...
Germany	3.1	5.7	12.8	12.4	...	...
Ireland	10.1	14.4	11.5	16.7	...	...
Italy	0.0	0.0	0.0	0.0	...	...
Japan	0.5	0.5	2.1	0.5	...	...
Netherlands	36.4	33.2	14.6	32.7	...	...
Norway	1.6	4.8	4.8	3.9	...	...
Sweden	23.3	5.2	1.4	3.5	...	...
Switzerland	4.8	5.5	5.6	5.6	...	...
United Kingdom	17.6	23.7	14.3	4.7	...	...
Others	0.0	6.3	0.6	1.1	...	...
Loans	**292.6**	**378.9**	**291.7**	**349.4**	**386.0**	**426.4**
Multilateral	**292.6**	**378.9**	**275.1**	**332.7**	**367.5**	**406.0**
World Bank	218.9	305.1	275.1	258.9	...	...
PRBS loans	204.0	206.4	206.4	190.0	...	...
Basket Loans	14.9	98.7	68.7	68.9	...	...
African Development Bank	73.7	73.8	0.0	73.8	...	...
Bilateral	0.0	0.0	16.6	16.7	...	...
Total program assistance	**727.4**	**932.0**	**834.0**	**942.6**	**1,041.2**	**1,150.2**
(Percent of GDP)	5.7	7.0	6.3	6.3	6.3	6.3

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

[1] Fiscal year: July-June.

[2] For 2006/07 based on actual disbursements for Q1-Q3 and projections for Q4. For 2007/08 based on currently identified aid commitments.

[3] Poverty reduction budget support.

Table 9. Tanzania: Status of HIPC Initiative Agreements by Creditor

	Debt Relief in Nominal Terms (US$ mil.)	Agreement to Provide Relief Beyond HIPC?	Comments
Multilateral Creditors			
IMF	120.0	n/a	Provided grants through PRGF-HIPC Trust fund. Average of 48 percent of debt service payments.
AfDB/AfDF	190.7	n/a	Debt service reduced by 80% annually until debt relief delivered.
IDA/IBRD	1,157.1	n/a	Debt-service relief of 69.1 and 63.6 percent on debts outstanding at end-June 1999 and 2001, respectively.
IFAD	24.5	n/a	Reduced 100 percent of debt -service due.
BADEA	14.7	n/a	Concessional rescheduling of the debt and reduced interest rate.
OPEC	9.8	n/a	Concessionnal loans and restructuring of debt.
NDF	3.2	n/a	Contribution to HIPC initative trust fund to pay 100 percent debt service.
EADB	0.6	n/a	Reduced interest rate and extension of repayment period.
EU	37.9	n/a	Provided grants at the completion point to pay off outstanding loans.
Paris Club Creditors			
Austria	31.3	Yes	Bilateral Agreement for PC VII was signed on May 7, 2002.
Belgium	74.3	No	Bilateral Agreement for PC VII was signed on November 29, 2002.
Brazil	-	No	Reminder letter to submit draft agreement for PC VII sent May 19, 2004. Awaiting reply.
Canada	31.1	Yes	Bilateral Agreement for PC VII was signed on October 16, 2002.
France	89.9	Yes	Bilateral Agreement for PC VII was signed on March 6, 2003.
Germany	60.6	Yes	Bilateral Agreement for PC VII was signed on April 29, 2003.
Italy	132.0	Yes	Bilateral Agreement for PC VII was signed on May 7, 2002.
Japan	631.9	Yes	Bilateral Agreements signed on March 2, 2004 and January 12, 2007, which canceled 100 percent of ODA and commercial debt, respectively. No relief offered yet on Japanese Food Agency debts.
Norway	11.1	Yes	Bilateral Agreement for PC VII was signed on December 5, 2002.
Netherlands	99.1	Yes	Bilateral Agreement for PC VII was signed on March 17, 2002.
Russia	69.6	No	Bilateral Agreement for PC VII was signed on July 18, 2003.
United Kingdom	129.2	Yes	Bilateral Agreement for PC VII was signed on July 4, 2002.
United States	21.3	Yes	Bilateral Agreement for PC 7 was signed on July 4, 2002.
Non-Paris Club Bilateral Creditors			
Algeria	-	No	In active negotiation.
Angola	-	No	In active negotiation.
Bulgaria	23.6	No	Bilateral Agreement was signed on December 12, 2003.
China	113.1	No	15 interest-free loans maturing 31 Dec, 1999 cancelled. China has not offered HIPC debt relief.
Czech Republic	-	No	The debt originally owed to Czechoslovakia was frozen in 1998, and later written off completely.
Egypt	-	No	Request for debt relief under Paris Club VII terms sent April 17, 2002. Awaiting reply.
Hungary	13.0	No	Bilateral Agreement at Paris Club: comparable terms was signed on September 27, 2005.
India	28.9	No	Bilateral Agreement signed on September 14, 2004 cancelled all intergovernmental loans. Negotiations ongoing with the Export Credit Agency.
Iran	-	No	In active negotiations.
Iraq	-	No	Request for debt relief under PC VII terms sent April 17, 2002. Awaiting reply.
Kuwait	40.2	n/a	Signed bilateral agreement on March 8, 2003. Rescheduled 9 pre-CD loans.
Libya	101.7	No	Bilateral Agreement for Paris Club comparable terms was signed on July 20, 2005 .
Romania	-	No	Request letter for debt relief under Paris Club VII terms sent April 17, 2002. Awaiting reply.
United Arab Emirates	12.2	n/a	HIPC relief agreement signed in August 2006. Debt service will start in January 2007.
Yugoslavia	-	No	Request for debt relief under Paris Club VII terms sent April 17, 2002. Awaiting reply.
Zambia	-	No	Request for debt relief under Paris Club VII terms sent April 17, 2002. Awaiting reply.

Source: Bank of Tanzania.

Table 10. Tanzania: Alternative Macroeconomic Framework--Scaling Up of Donor Assistance[1]

	2006/07	2007/08	2008/09	2009/10	2010/11
Baseline scenario					
	(Annual percentage change)				
Real GDP Growth	6.7	7.3	7.7	7.9	8.0
CPI (period average)	6.2	5.0	5.0	5.0	5.0
Real Exchange Rate (+, appreciation)	-0.3	...	...	...	...
Exports	5.4	16.4	7.7	8.4	7.8
Imports	18.8	14.5	9.0	7.9	8.5
	(Percent of GDP)				
Donor support	11.4	11.6	11.8	11.8	11.8
Grants	6.8	7.0	7.2	7.4	7.5
Loans	4.5	4.7	4.7	4.5	4.3
Overall fiscal balance, including grants	-4.5	-4.2	-4.1	-4.2	-4.2
Overall fiscal balance, excluding grants	-11.3	-11.2	-11.3	-11.5	-11.7
External current account balance, including grants	-11.2	-11.3	-11.1	-10.6	-10.1
External current account balance, excluding grants	-15.4	-15.3	-15.1	-14.5	-13.9
	(Millions of US dollars, unless otherwise specified)				
Donor support	1,502	1,727	1,958	2,153	2,357
Gross international reserves (end of period)	2,045	1,975	2,146	2,328	2,479
(In months of imports)	4.0	3.5	3.5	3.5	3.5
Scaling up scenario					
	(Annual percentage change)				
Real GDP Growth	6.7	7.3	7.8	8.1	8.2
CPI (period average)	6.2	5.0	5.0	5.0	5.0
Real exchange rate relative to baseline (+, appreciation)	-0.3	0.0	2.0	2.0	2.0
Exports	5.4	16.4	6.9	7.6	7.1
Imports	18.8	14.5	10.8	11.1	12.9
	(Percent of GDP)				
Donor support	11.3	11.6	12.3	12.6	12.8
Grants	6.8	7.0	7.7	8.3	8.8
Loans	4.5	4.7	4.6	4.3	4.0
Overall fiscal balance, including grants	-4.5	-4.2	-4.1	-4.2	-4.2
Overall fiscal balance, excluding grants	-11.3	-11.2	-11.8	-12.5	-13.0
External current account balance, excluding grants	-15.4	-15.3	-15.6	-15.6	-15.4
	(Millions of US dollars)				
Donor support	1,502	1,727	2,054	2,376	2,727
Gross international reserves (end of period)	2,045	1,975	2,156	2,360	2,548
(In months of imports)	4.0	3.5	3.4	3.4	3.5
Main Assumptions					
Foreign exchange market					
Demand elasticity	0.7				
Supply elasticity	0.4				
Share of government spending on imports (percent)	60				
Additional reserve accumulation as a share of aid receipts (percent)	10				
Growth impact of a 1 percent of GDP increase in grants (percentage points)					
1st year	0.30				
2nd year	0.20				
3rd year	0.10				

Source: Fund staff projections.

[1] Assumes an increase of US$1 billion in annual donor support phased in over three years.

Table 11. Tanzania: PSI Work Program, 2007 – 2009

Board Date	Event
February 16, 2007	Approval of the three-year PSI program
June 27, 2007	Completion of the first PSI review against end-December 2006 assessment criteria
December 2007	Completion of the second PSI review against end-June 2007 assessment criteria
April 2008	Completion of the third PSI review against end-December 2007 assessment criteria
October 2008	Completion of the fourth PSI review against end-June 2008 assessment criteria
April 2009	Completion of the fifth PSI review against end-December 2008 assessment criteria
October 2009	Completion of the sixth PSI review against end-June 2009 assessment criteria

Source: Fund staff.

Table 12. Tanzania: Millennium Development Goals, 1990–2004

	1990	1995	2000	2005
1. Eradicate extreme poverty and hunger	2015 target = halve 1990 $1 a day poverty and malnutrition rates			
Population below $1 a day (percent)	*61.5*	...	57.8	...
Poverty gap ratio at $1 a day (incidence X depth of poverty)	*22.7*	...	20.7	...
Percentage share of income or consumption held by poorest 20 percent	*7.4*	...	7.3	...
Prevalence of underweight in children (percent of children under 5)	*28.9*	*30.6*	*29.4*	21.8
Population below minimum level of dietary energy consumption (percent)	*37.0*	*50.0*	...	44.0
2. Achieve universal primary education	2015 target = net enrollment to 100			
Net primary enrollment ratio (percent of relevant age group)	*49.0*	...	51.0	91.0
Proportion of pupils starting grade 1 who reach grade 5	81.0	...	81.0	76.0
Youth literacy rate (percent ages 15-24)	83.0	...	...	78.0
3. Promote gender equality	2015 target = education ratio to 100			
Ratio of girls to boys in primary and secondary education (percent)	96.0	...	97.0	95.0
Ratio of young literate females to males (percent ages 15-24)	87.0	...	...	*94.0*
Share of women employed in the nonagricultural sector (percent)	...	...	*45.4*	...
4. Reduce child mortality	2015 target = reduce 1990 under 5 mortality by two-thirds			
Under 5 mortality rate (per 1,000)	161.0	159.0	141.0	122.0
Infant mortality rate (per 1,000 live births)	102.0	100.0	88.0	76.0
Immunization, measles (percent of children under 12-23 months)	80.0	78.0	78.0	91.0
5. Improve maternal health	2015 target = reduce 1990 maternal mortality by three-fourths			
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	1500.0	...
Births attended by skilled health staff (percent of total)	*44.0*	*38.0*	*36.0*	43.0
6. Combat HIV/AIDS, malaria, and other diseases	2015 target = halt, and begin to reverse, AIDS and other major diseases			
Prevalence of HIV, total (percent ages 15-24)	...	...	...	6.5
Contraceptive prevalence rate (percent of women ages 15-49)	*10.0*	*18.0*	*25.0*	26.0
Incidence of tuberculosis (per 100,000 people)	179.0	271.0	342.0	342.0
Tuberculosis cases detected under DOTS (percent)	...	56.0	47.0	45.0
7. Ensure environmental sustainability	2015 target = various			
Forest area (percent of total land area)	47.0	...	42.0	40.0
Nationally protected areas (percent of total land area)	...	...	...	*42.4*
GDP per unit of energy use (2000 PPP dollars per kg oil equivalent)	1.4	1.4	1.3	*1.3*
CO2 emissions (metric tons per capita)	0.1	0.1	0.1	*0.1*
Access to an improved water source (percent of population)	46.0	...	...	*62.0*
Access to improved sanitation (percent of population)	47.0	...	...	*47.0*
Access to secure tenure (percent of population)	...	...	...	...
8. Develop a Global Partnership for Development	2015 target = various			
Youth unemployment rate (percent of total labor force ages 15-24)	...	...	...	...
Fixed-line and mobile telephones (per 1,000 people)	3.0	3.0	8.0	56.0
Personal computers (per 1,000 people)	...	2.0	3.0	7.0
General indicators				
Population (millions)	26.2	30.9	34.8	38.3
Gross national income (billions of U.S. dollars)	4.8	4.9	8.9	12.7
GNI per capita (U.S. dollars)	190.0	160.0	260.0	340.0
Adult literacy rate (percent of people ages 15 and over)	63.0	...	...	*69.0*
Total fertility rate (births per woman)	6.1	5.6	5.6	5.2
Life expectancy at birth (years)	53.0	50.0	47.0	46.0
Trade (percent of GDP)	50.1	59.3	37.1	43.4

Source: http://www.developmentgoals.org, retrieved May 9,2007.

APPENDIX I—LETTER OF INTENT

June 12, 2007

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

Dear Mr. de Rato:

LETTER OF INTENT AND MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. The Government of the United Republic of Tanzania is implementing a financial and economic programme with support from the Fund through its Policy Support Instrument (PSI). We recently held discussions with the Fund staff on the first review of the new programme approved by the Executive Board of the Fund on 16th February, 2007. On behalf of the Government, I hereby transmit the attached Memorandum of Economic and Financial Policies (MEFP), which reviews recent economic developments, progress in the implementation of our 2006/07 programme, and sets out the policies that the Government intends to pursue in 2007/08.

2. Implementation of the 2006/07 programme has been satisfactory, with all but one of the quantitative assessment criteria for end-December 2006 and most structural benchmarks observed. The end-December target for reserve money was missed by a narrow margin, but the financial programme has been brought back into line with the PSI framework, as evidenced by all end-March indicative targets being observed. The submission of a proposed unified legal framework and investment guidelines for pension funds, a structural benchmark for end-June 2007, has been delayed due to factors outside the Government's control and is now anticipated to be completed by end-September 2007. In this regard, we request the completion of the first scheduled review under the PSI.

3. The Government will continue to pursue appropriate fiscal and monetary policies and implement the necessary structural reforms, especially the Second Generation Reforms of the Financial Sector, tax and customs policy and administration reforms, and improvement of the business environment to promote investment, as the prerequisites for accelerated and sustainable growth in a stable macroeconomic environment. We also intend to aggressively pursue the growth agenda through investment in productive infrastructure in order to sustainably protect gains made in the provision of social services, reduce aid dependency,

and ensure progress towards attaining our poverty reduction objectives as specified in the MKUKUTA.

4. Although the power situation has improved following the recovery of hydro-generation capacity, we will continue with implementation of the various measures outlined in TANESCO's Financial Recovery Plan in order to address the energy crisis. The 2007/08 programme aims at continuing the fiscal and financial sector reforms currently underway. The programme also provides for continued strengthening of public expenditure planning and budgeting, and hiring of additional staff in the education and health sectors.

5. In the context of the PSI framework, we will keep the IMF regularly updated on economic and policy developments, and provide the data needed for the monitoring of the programme. We would request that the second review of performance under the programme take place before end-December 2007 and that the third and fourth reviews take place by April 30, 2008 and October 31, 2008, respectively. The Government will also consult regularly with the Fund on any relevant developments at the initiative of the Government, or whenever the Managing Director of the IMF requests such a consultation.

6. The Government of Tanzania intends to make this letter and the attached MEFP, together with Fund staff reports related to the Article IV Consultation and the first review under the PSI, available to the public and authorises publication on the IMF website once the review is completed by the Executive Board.

Yours sincerely,

/s/

Zakia Hamdani Meghji (MP)
Minister for Finance
United Republic of Tanzania

Attachment**:** Memorandum of Economic and Financial Policies

ATTACHMENT I
TANZANIA: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

I. RECENT MACROECONOMIC DEVELOPMENTS AND PROGRESS UNDER THE PROGRAMME

Introduction

1. Tanzania continues to enjoy strong overall macroeconomic performance, after sustained economic reforms over the last ten years. However, 2006 was characterised by a slow down in economic activity on account of persistent drought which adversely affected agricultural production and hydro-power generation, and the high oil prices on the world markets. Real gross domestic product (GDP) is now estimated to have grown by 6.2 percent compared to 6.8 percent recorded in 2005. The trade and tourism, manufacturing, mining, construction, and communication sectors continued to register strong growth.

2. Inflation was maintained at a single digit level, albeit with a rising trend mainly on account of food and oil prices. From 5.4 percent at the beginning of 2006, inflation peaked at 7.7 percent in May 2006 before declining to 7.2 percent in March 2007 and further to 6.1 percent in April 2007. Inflation is expected to decline further in the coming months as food prices decline reflecting an expected good harvest with the return of favourable weather conditions.

Fiscal policy and public resource management

3. The Government's fiscal programme for 2006/07 (July–June) has been implemented successfully, with outcomes broadly in line with programme targets. Despite the energy crisis, domestic revenue collections have been well in excess of programme estimates and are projected to reach 15.7 percent of GDP, a full 1 percent of GDP above the programme target, mainly due to better than expected performance of import duties, corporation tax, and domestic excises. The good performance witnessed in recent years is premised on robust economic performance and recent policy and administration reforms, whereby the Tanzania Revenue Authority (TRA) is benefiting from the integration of its operations and increased use of technology.

4. The tax and customs administration reforms progressed well on the basis of TRA's Second Corporate Plan, as evidenced by improved revenue performance and taxpayer service. TRA's Large Taxpayer Department (LTD) achieved International Standards Organization (ISO) certification during 2006/07. The Customs Department rolled out ASYCUDA^{++} to seven more stations including Tunduma, Kasumulu, and Zanzibar, and started implementation of a time bound action plan for integrating ASYCUDA^{++} with the destination inspection programme. TRA also finalized the Facilitated Client Scheme, under

which importers with a good track record can make use of expedited import clearing procedures.

5. Government expenditure was on track too, and is projected at 28.1 percent of GDP, marginally below the programmed forecast. The Government continued to exercise a cautious stance in budget execution, observing the evolving impact of drought, oil prices, and increasing domestic interest payments. Foreign financing is likely to be below expectation mainly due to non-disbursement because of delays in the implementation of some legislative reforms. Nevertheless, expenditure for priority social services linked to the achievement of the MDGs was implemented as budgeted. The overall budget deficit has been contained and is projected at 12.5 percent of GDP, 1 percent of GDP lower than the programme projection, with domestic financing of the budget within the programme target.

6. Following the substantial increase of the wage bill in the 2006/07 budget, implementation was monitored closely, and results were in line with projections at 5.9 percent of GDP. The Presidential Commission on Public Service Pay submitted its report in December, 2006 as envisaged, focusing on a medium term policy to relate Government employment levels and their budgetary implications. The Government is currently reviewing the Commission's recommendations against MKUKUTA implementation priorities and budgetary feasibility, with a view to developing an updated medium term pay policy.

7. The focus of our expenditure management strengthening programme continues to be promoting transparency and accountability in public expenditure, consistent with the objectives of the MKUKUTA. The Integrated Financial Management System (IFMS) has now been rolled out to 85 of the 122 Local Government Authorities (LGAs). In view of the observations of the Controller and Auditor General expressed in the National Audit Office's (NAO) audits of the 2005/06 public accounts (the reports are posted on the NAO's website) in relation to the capacity of accounting staff, and following a major recruitment exercise during the year, the Government continued to train accounting staff at both central and local Government levels. The objective is to ensure that all Ministries, Departments, and Agencies (MDAs) and LGAs have appropriately qualified accounting and internal audit staff.

8. The Public Procurement Regulatory Authority (PPRA) and the Public Procurement Appeals Authority (PPAA) are now fully staffed and operational. The PPRA has developed a capacity building plan covering all public institutions, including Parliament, as well as civil society organisations. It has also commenced procurement audits in line with its mandate under the Public Procurement Act, 2004. The Government continues to set aside sufficient resources to ensure effective implementation of the institutions' functions. The National Audit Office has continued to strengthen itself, with the 2005/06 reports released on a timely basis for a second consecutive year.

9. In order to improve the effectiveness of the BoT's liquidity management, a Cash Management Unit (CMU) was established in the office of the Accountant General. The unit supports the functions of a Joint Treasury – Bank of Tanzania Cash Management Committee (CMC), including forecasting of liquidity injection from Government operations and developing recommendations for both Government expenditure and monetary operations programming.

Monetary policy

10. Against a backdrop of the drought and oil price related inflationary pressure, the Bank of Tanzania (BoT) has geared monetary policy to contain inflation at single digit level. The rate of growth of broad money supply has been reduced from 32 percent at end-June 2006 to a projected 21 percent at end-June 2007.

11. The financial system continued to portray signs of a thin market, with high interest rate spreads. The BoT's decision to substantially reduce the minimum bid amount from TZS 50 million to TZS 5 million (aimed at widening the circle of direct participation) resulted in an increase in non-bank private participation in the treasury bills market. Demand for Treasury Bills has remained strong, as investors responded to the upward trend in yields. The Treasury bond market remained active during the year, with concentration of preference on 2-year and 5-year bonds.

Financial sector reforms

12. The Government is implementing the second generation financial sector reforms in the context of its Financial Sector Reform Implementation Action Plan (FSIAP). The plan and its action matrix, which identifies key actions and the corresponding development partner support in each of the nine major areas of reform,[1] have been formally adopted by the Government in March 2007, which has also signed funding instruments with development partners for implementation of some of the plan's key components. Proposals for draft leasing and mortgage laws are currently being discussed by stakeholders, with the intention of presenting them to Parliament in the course of 2007/08. Commercial banks' lending to SMEs has also improved, with some banks introducing specific desks and products for this purpose. The use of the Government's SME Credit Guarantee Scheme has improved too, and the inter-agency committee on financial sector reform is finalising a proposed unified legal

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[1] The nine areas are: (1) monetary policy reform; (2) strengthening the banking sector; (3) developing financial markets; (4) reforming the pension sector; (5) strengthening the insurance industry; (6) facilitating the provision of long term development finance; (7) strengthening micro and rural finance; (8) legal and judicial reform; and (9) land administration.

and regulatory framework and investment guidelines for pension funds for submission to Government for adoption and implementation. An anti-money Laundering legislation was approved by Parliament, and implementation will commence earnestly in the coming year.

External sector developments

13. The external sector performance has been positive, although the export sector remains vulnerable to exogenous factors such as climatic conditions and terms of trade shocks. During 2006/07, developments in the external sector were highly influenced by changes in global oil prices and drought related requirements at home. A sharp increase in international oil prices, coupled with increased demand for oil in the energy sector resulted in a higher import bill which erased the gains from exports, with consequent widening of the current account deficit. Nonetheless, the overall balance of payments position remained positive due to continued strong inflows of donor assistance and debt relief received under the Multilateral Debt Relief Initiative.

14. Foreign currency reserves have been maintained at around USD 2 billion, equivalent to about 4 months of next year's import cover. The BoT's interventions in the foreign exchange market, aside from sales for sterilisation purposes, have therefore been limited to periods of erratic market movements not in line with economic fundamentals. The foreign exchange market was characterised by a general depreciation trend of the shilling vis-à-vis the USD.

Energy

15. Tanzania suffered major drought during the last three years, leading to loss of a substantial portion of its power generation capacity. Aggravated by a long non-investment period and high world oil prices, this precipitated an energy crisis in Tanzania, and a financial crisis in TANESCO. To mitigate the impact of these developments on the economy, the Government adopted a Financial Recovery Plan (FRP) for TANESCO, including the acquisition of leased gas and diesel fired generation, improvement of hydrology management procedures in the dams' catchment areas, a tariff adjustment and an investment programme of about USD 1.3 billion. While there has been a significant recovery of hydro generation capacity recently, the leased capacity (140MW of gas-fired and 40MW of diesel-fired) contracted on an emergency basis in line with the FRP, is being drawn upon to cover any supply deficits. Government action in dealing with the energy crisis is premised on the recognition that, unless the problems in the sector are adequately addressed, the economic growth rates envisaged in the MKUKUTA cannot be attained, with substantial implications for our poverty reduction effort. In line with the FRP, a 6 percent tariff increase was implemented in February 2007, following approval by the Energy and Water Utilities Regulatory Authority (EWURA).

Infrastructure

16. The Government has prepared a draft Medium Term Transportation Infrastructure Investment Plan (TSIP) covering all sub-sectors and reforms in the sector, including Local Government and cross-cutting issues. The preparation process was highly consultative. Upon finalisation, the TSIP will be prioritised and aligned with the Medium Term Expenditure Framework. TANROADS has continued to improve its performance, as reflected by its improved absorptive capacity, maintenance performance, and road conditions. The Government is committed to the maintenance of the existing road network and will, through the Roads Fund and increases in the fuel levy to generate greater yield, explore financing options for increasing the resource envelope for this purpose.

Poverty reduction

17. The 2006 status report on progress towards achieving the MKUKUTA goals shows progress in most areas. In education, primary school enrolment has reached 96 percent—compared to just 59 percent in 2000—secondary school enrolment has also increased, and pupil:teacher ratios are falling. However, many indicators remain substantially below the MKUKUTA targets and there are significant regional disparities. Data on other priority areas are not readily available, so the Government is developing additional data sources to enable more effective monitoring of progress under the MKUKUTA.

18. The report, in recognition of the centrality of faster and broad based growth for sustainable poverty reduction, recommends implementation of clear growth strategy in order to focus investment in the productive sectors of the economy. As regards the energy sector, the report calls for the diversification and expansion of energy supplies in order to counter the cyclic shortfalls in hydro power generation and meet the growing demand. As implementation of decentralisation by devolution policy progresses into its next phase, it is also recognised that financing of activities and spending at the LGAs' level will need special monitoring. The government appreciates these and other challenges in the effort to eradicate poverty, and in linking resources with MKUKUTA targets.

II. Programme for 2007/08

19. The economy is expected to recover during 2007/08 as improved weather leads to good agricultural harvest and alleviates recent difficulties with the power supply. Economic growth is projected at 7.1 percent in 2007 and 7.5 percent in 2008, and 7.9 percent in 2009. Pressure on prices is expected to moderate in the coming months following the harvest, with inflation anticipated to stabilise at around our medium term objective of 5 percent.

Fiscal Programme

20. For 2007/08, the programme cautiously envisages that domestic revenue could reach TZS 3,103 billion, or 16.1 percent of GDP, reflecting the impact of continued tax and customs administration reforms and tax policy measures to be implemented in the 2007/08 budget. The measures include indexation of the specific excise duty rates for non-petroleum products, including alcoholic drinks, tobacco products, soft drinks, and an upward adjustment of the fuel levy and charges on road usage to raise resources for maintenance of the expanded road network (expected to yield about 0.7 percent of GDP). Taking into account projected foreign financing, it is expected that net domestic financing of the budget will be eliminated. The 2007/08 budget has been formulated assuming more revenue than in the program. However, consistent with the commitment not to resort to domestic financing of the budget, implementation of the budget will keep expenditures aligned with the resources available, while protecting high priority spending.

21. The Government will continue to implement tax administration reforms based on the TRA's Second Corporate Plan and the Tax Modernisation Project. The programme for 2007/08 prioritises further Customs reform, especially (i) rolling out ASYCUDA++ to the remaining stations, (ii) completing the integration of customs' and TISCAN's import clearance processes by end-March 2008 (structural benchmark); (iii) continuing developing risk management and selectivity principles, with an action plan to be completed to this effect by end-September 2007 (structural benchmark) and its subsequent implementation; (iv) strengthening post-clearance auditing; and (v) starting to interconnect the information systems of EAC countries to strengthen control of transit goods. Other actions include new customer service centres, and further integration of TRA's operations, and the establishment of dedicated units within six TRA offices to serve medium-sized taxpayers. The LTD, which assumed responsibility for qualifying taxpayers outside Dar es Salaam and increased the number of cases under its jurisdiction to 370 taxpayers with effect from 1st July, 2006, will continue to strengthen its audit capacity. The Government will also continue to publish the list of tax exemption beneficiaries each quarter.

22. Improving public expenditure management will remain a key priority in the coming year. In this sense, the Government will strengthen the link between budgetary resource allocation and MKUKUTA priorities, in particular by achieving greater integration of the Strategic Budget Allocation System (SBAS) and the IFMS, and emphasizing the role of the Medium Term Expenditure Framework in the budget formulation process. In addition, a Planning & Reporting System (PlanRep) similar to the SBAS has been introduced in all Local Government Authorities (LGAs) for preparation of their budgetary requirements for 2007/08. The allocations for direct MKUKUTA interventions in the 2007/08 framework account for 65% of the total budget, compared to 46 percent and 43 percent in 2005/06 and 2006/07 respectively. In view of increased expenditure on education, the allocation for Improvement of Quality of Life and Social Well-being (Cluster II) interventions increased

from 36 percent in 2006/07 to 47 percent of the resources allocated for direct MKUKUTA interventions, with 37 percent allocated for Growth and Reduction of Income Poverty (Cluster I); and 16 percent for Governance and Accountability (Cluster III). The Government will continue to build capacity to monitor budget implementation against these targets, in addition to the broader MKUKUTA Monitoring System (PMS) which monitors the impact of interventions by all stakeholders on the status of poverty in the country. In addition, the Expenditure Tracking and Monitoring Unit established at the Ministry of Finance is monitoring budget implementations by MDAs in order to improve further the efficiency in resource utilisation. To enhance budget reporting, with technical assistance from East AFRITAC, the Government is examining options for tracking budget execution along the MKUKUTA clusters with a view to putting in place a functional classification capable of supporting such reporting for the next budget cycle.

23. Further improvements in cash management are planned during 2007/08. The CMC has already identified all Government accounts with commercial banks and is currently preparing a plan to complete their transfer to the BoT. The CMU is developing a cash plan for 2007/08 together with three month cash flow forecasts, and the CMC will monitor its implementation through the year. The cash flow forecast will be updated every quarter (structural benchmark).

24. The budget for 2007/08 envisages a slight decline of the wage bill as a percentage of GDP, achieved through a slow down of the nominal increase of the allocation for salaries and wages relative to GDP growth. The Government is reviewing the recommendations of the Presidential Commission on Public Service Pay as a basis for updating the Medium Term Pay Policy (MTPP). The Government is aware of the need for additional staff, especially in frontline services, against the broadly recognised fact that without a motivated and better performing public service the efforts to reduce poverty can be frustrated. Implementation of the updated MTPP, however, will continue to reflect the MKUKUTA priorities, and overall sustainability of the fiscal and macroeconomic frameworks.

25. Development expenditure is projected at 9.1 percent of GDP, compared to an expected 8.6 percent in 2006/07, with the increase coming from higher foreign financing. Other expenditures are projected to increase modestly, with total expenditure at 28.4 percent of GDP compared to 28.2 percent under the 2006/07 programme. Notable increases relative to the 2006/07 programme are expected in domestic interest payments (from 0.7 percent of GDP to 1.2 percent of GDP) and foreign financed development expenditure (from 4.7 percent of GDP to 5.4 percent of GDP). Public debt management continues to receive the attention of the Government, to avoid a slide back to unsustainable debt.

26. In the medium term, there is expected to be a growing increase of expenditures on infrastructure relative to increases in social service expenditure, in part to implement a faster

growth strategy and reduce liquidity pressures arising from use of aid for public domestic procurement of non tradable goods and services.

27. Donor coordination is an important and integral element in the Government's effort to strengthen planning and budgeting. In December, 2006, the Joint Assistance Strategy for Tanzania (JAST), or *Mkakati wa Pamoja wa Misaada Tanzania (MPAMITA)* in Swahili, was adopted. The JAST is a result of a broad Government–led consultative process with development partners and non-state actors, and reflects the Government position on rationalization and harmonization of donor support. The overriding objective of this initiative is to reduce further the transaction costs associated with different strategies and enhance national ownership and Government leadership of the development process. Based on the JAST, the 19 participating development partners have, in close consultations with the Government, prepared a Joint Programming Document (JPD) fully aligned to the MKUKUTA objectives.

28. Building on the JAST and JPD, the Government will address the problem of inadequate predictability of external assistance by leading joint analysis with development partners on alternative scenarios for expenditure and external financing, aiming at a clearer consensus on medium term strategies and expenditure plans prior to the 2008/09 budget cycle. It is envisaged that this will facilitate scaling up of aid in line with the international community's commitments in pursuit of faster growth and poverty reduction.

Monetary policy

29. Monetary policy during 2007/08 will continue to focus on achieving the inflation target of 5 percent. Controlling the growth of reserve money will remain central in the implementation of monetary policy, and the BoT views the programmed deceleration of the annual growth rate of reserve money to 21 percent by end-June 2008 as consistent with the targeted reduction in inflation.

30. The BoT and the Government will enhance the coordination between monetary and fiscal policies in order to avoid undue volatility in financial markets. The regular projections of the Government's cashflow will be produced by the Cash Management Committee will contribute to more accurate projections of liquidity conditions. In addition, with the move to targeting monthly average reserve money, the BoT will continue to strengthen the mechanisms for positioning the stock of reserve money early each month to avoid the need for sharp adjustments at the end of the month to meet the reserve money targets. The continued strengthening of a more even application of monetary policy and flexibility in the use of an appropriate mix of instruments for sterilisation purposes, coupled with the policy of no domestic financing of the budget deficit, should help ease pressure on interest rates. While the implementation of monetary policy will continue to be refined in response to market developments, it is expected that, given the current comfortable level of international

reserves, sales of foreign exchange by the BoT will continue to play an important role in sterilisation operations. In order to enhance the predictability of the BoT's policy stance, the BoT will, subject to market conditions, seek to move to a more regular pattern of sales of a small amount of foreign exchange for sterilisation purposes. The BoT will continue to inform market players on the objective and rationale of this approach.

31. The financial programme is consistent with continued strong growth in credit to the private sector. Small and medium sized enterprises, exporters and other investors in the productive sectors of the economy are also poised to benefit from financial sector reforms underway, including the already established credit guarantee schemes and the envisaged Development Finance Guarantee Facility (DFGF). The Government and the BoT will continue to carefully monitor the usage of these credit guarantee schemes in order to maximize their effectiveness in a transparent manner, while minimizing fiscal risks. In accordance with the financial sector reform programme, the BoT is working to establish a credit reference database for the collection of information on payment records of borrowers in banks, other financial institutions and entities. The database and its operating guidelines are expected to be operational by end-June 2008 (structural benchmark).

Energy:

32. The Government will continue implementing reforms in the energy sector in order to improve performance of the sector. The Government strategy in this regard is guided by the following objectives:

(a) Ensure the sector makes an appropriate contribution to the country's growth agenda through better quantity, quality, and pricing of energy;

(b) Support TANESCO in achieving financial sustainability in the medium term, and operational financial viability as soon as possible;

(c) Finance capital expenditures, with support from development partners, as required by TANESCO to improve its power generation and service delivery to consumers, and to diversify the electricity generation resource base;

(d) Support interventions to expand access to modern energy services, particularly to the peri-urban and rural population; and

(e) Support enabling conditions to attract more private investment in the sector, notably for the addition of new generation, to promote competition, and lower operational costs.

33. Improved weather conditions have led to an early recovery of the hydro generation capacity, and improved finances for TANESCO. The Government intends to use this favourable development to move more rapidly to commercial viability for TANESCO. However, implementing a tariff increase by July 2007 (a structural benchmark) is not feasible—consistent with the recently introduced regulatory environment for public utilities, all tariff requests must now be submitted to a newly instituted independent regulator (EWURA). In approving the February 2007 increase, EWURA requested that future tariff requests be based on a detailed cost analysis (including audited accounts and other information). To help prepare the tariff submission in line with EWURA requirements, TANESCO has procured the services of financial and tariff experts who are expected to complete their work by July 2007.

34. It is intended that by end-July 2007 TANESCO will submit to EWURA a request for a tariff increase to return TANESCO to full cost recovery on operational basis, including the full cost of current operations, maintenance and depreciation, and the cost of servicing its commercial borrowing (structural assessment criterion). This would exclude the cost of capital investment projects to expand generation, transmission, and distribution capacity. The next tariff increase would be subject to review by the regulator (up to 90 days), following which the approved tariff would be implemented. TANESCO is committed to seek to implement future increases to maintain tariffs at the level sufficient to recover the full commercial cost of its operations. Implementation of the FRP will continue to be monitored through monthly meetings of a special Government – Development Partners Task Force on Energy. The government appreciates the Fund's continued support in dealing with the energy crisis, including agreeing to the use of MDRI resources for procurement of emergency leased generators and rehabilitation of the power infrastructure, and joining the government effort to mobilise donor support for implementing the five year investment plan.

Governance

35. In addition to deepening reforms to address the remaining structural constraints to faster economic growth, the Government is committed to strengthening institutions of economic and political governance and fighting corruption to minimise resource leakages and strengthen accountability as outlined in the MKUKUTA. In this regard, the second National Anti-Corruption Strategy Action Plan (NACSAP II) was launched in December 2006 and a new Anti-Corruption law was submitted to Parliament for first reading in February 2007 (structural benchmark) and approved in April 2007. The law integrates all anti-corruption conventions ratified by Tanzania, and contains measures to strengthen the capacity and effectiveness of the Prevention of Corruption Bureau (PCB) and the prosecution of corrupt practices. With the support of development partners, the Government is also scaling up its efforts to implement its comprehensive Legal Sector Reform Programme (LSRP). Other measures in this area include the continued strengthening of the NAO, and capacity building for public expenditure tracking by local communities.

36. The Government will continue working closely with the Fund in relation to the planned special audit of the external payment arrears (EPA) account operated by the BoT on behalf of the Government. As detailed in our supplementary Letter of Intent dated February 8, 2007, the Controller and Auditor General has launched, at the request of the Government, a competitive bidding process for a special audit of the transactions related to the account. The special audit will be conducted by an international audit firm compliant with International Standards of Auditing (ISA) and experienced in International Financial Reporting Standards (IFRS). The Terms of Reference for the special audit were agreed with Fund staff and are drawn to cover all the transactions from the EPA account during 2005/06, as well as the verification, monitoring, and control procedures related to the account. It is intended that the special audit be completed by end-October 2007 (structural benchmark) and the results of the audit will be shared with Fund staff. Following the completion of the audit, the Government is committed to the adoption and implementation of appropriate remedial measures as may be necessary. These will be discussed with Fund staff in the context of the reviews under the PSI. The Government has suspended all payments from the account until finalisation of the audit. Thereafter, any outstanding obligations and planned payments will be integrated in the fiscal framework of the Government.

Conclusion:

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

MINISTRY OF FINANCE
DAR ES SALAAM, TANZANIA

DAR ES SALAAM
JUNE, 2007

Table 1. Tanzania: Quantitative Assessment Criteria and Indicative Targets Under the Policy Support Instrument, 2006/07 and 2007/08

	2006			2007						2008	
	December			March			June	September	December	March	June
	Assessment Criteria	Adjusted	Actual	Indicative Targets	Adjusted	Actual	Assessment Criteria	Indicative Targets	Assessment Criteria	Indicative Targets	Assessment Criteria
Net domestic financing of the government of Tanzania (cumulative, ceiling) 1/ 2/	-9	123	-328	-72	245	-99	67	-230	-300	-90	0
Accumulation of budgetary arrears (ceiling; indicative target only)	0	0	0	0	0	0	0	0	0	0	0
Average reserve money (upper bound) 3/	1,551	1,551	1,557	1,620	1,620	1,586	1,680	1,793	1,934	1,975	2,033
Average reserve money target 3/	1,536	1,536	---	1,604	1,604	---	1,664	1,775	1,915	1,956	2,013
Average reserve money (lower bound) 3/	1,520	1,520	---	1,588	1,588	---	1,647	1,757	1,896	1,936	1,993
Net international reserves of the Bank of Tanzania (floor) 4/	1,919	1,816	2,171	1,961	1,713	2,076	1,754	1,881	1,899	1,765	1,683
Accumulation of external payments arrears (ceiling) 5/	0	0	0	0	0	0	0	0	0	0	0
Contracting or guaranteeing of external debt on nonconcessional terms (ceiling) 5/	0	0	0	0	0	0	0	0	0	0	0
Memorandum item:											
Foreign program assistance (cumulative grants and loans)	754	---	651	924	---	676	932	502	774	818	943

Note: For precise definitions of the aggregates shown and details of the adjustment clauses, see the Technical Memorandum of Understanding (TMU) attached to the Government's letter of November 20, 2006.

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

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

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

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

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

Table 2. Tanzania: Status of Previously Agreed Structural Assessment Criteria and Benchmarks under the Policy Support Instrument, December 2006-July 2007

Measure	Agreed Date of Implementation	Status
Fiscal Reforms		
Develop a dated action plan for integration of ASYCUDA and TISCAN system-based processes, consistent with para. 19 of the MEFP. [1]	End-December 2006	Observed.
Cash Management Unit, with representatives from the Ministry of Finance and the Bank of Tanzania, to complete 2007/08 Government cash plan, including a three month cash flow forecast, consistent with para. 25 of the MEFP. [2]	End-June 2007.	Delayed
Monetary and financial sector reform		
Inter-agency committee on financial sector reform will submit to Government a proposed unified legal and regulatory framework for all pension funds, and investment guidelines, consistent with para. 34 of the MEFP. [2]	End-June 2007.	Delayed
Governance		
Submit Anti-Corruption Bill to Parliament, consistent with para. 58 of the MEFP. [2]	End-February 2007.	Observed
Publish the list of companies, individuals, and NGOs that have received tax exemptions each quarter. [2]	Continuous.	Observed
Energy		
Government to adopt the Medium-Term Financial Recovery Plan for TANESCO, consistent with paras. 54-56 of the MEFP. [3]	End-December 2006	Observed.
Raise electricity tariffs effective July 2007 to keep TANESCO on its path to financial viability, consistent with paras. 54-56 of the MEFP. [2]	End-July 2007.	Modified

Note: MEFP references relate to the November 20, 2006 Letter of Intent, unless othewise specified.

[1] Originally a proposed structural benchmark to be implemented by end-December 2006.

[2] Structural benchmark.

[3] Originally a proposed structural assessment criterion to be implemented by end-December 2006.

Table 3. Tanzania: Structural Assessment Criterion and Benchmarks Under the Policy Support Instrument, July 2007-June 2008

Measure	**Date of Implementation**
Fiscal	
Cash Management Unit in the Accountant General's Department and Cash Management Committee, including both MoF and BoT staff, to produce updated Government's three month rolling cash flow forecast and liquidity management plan at the end of each quarter.	Continuous.
Customs and Excise Department to develop a risk management strategy/plan, with a detailed timetable, to strengthen risk management and selectivity principles.	End-September 2007
Complete the integration of the Customs and Excise Department and TISCAN's import clearance processes.	End-March 2008
Financial Sector	
Inter-agency committee on financial sector reform will submit to Government a proposed unified legal and regulatory framework and investment guidelines for pension funds.	End-September 2007
Establish the credit reference databank and its operating guidelines.	End-June 2008
Governance	
Complete the special audit of the NBC-EPA debt in accordance with the agreed terms of reference.	End-October 2007
Energy	
Submit to the regulator a request for an aggregate electricity tariff increase based on full cost recovery (including all current operations, system maintenance, depreciation, and commercial financing costs), consistent with paras. 54-56 of the MEFP attached to the authorities LOI of November 20, 2006. 1/	End-July 2007

1/ Assessment criterion.

INTERNATIONAL DEVELOPMENT ASSOCIATION AND
INTERNATIONAL MONETARY FUND

UNITED REPUBLIC OF TANZANIA

Joint World Bank/IMF Debt Sustainability Analysis

Prepared by the staffs of the International Development Association and
the International Monetary Fund

June 12, 2007

Tanzania's debt sustainability has strengthened further following completion of the Multilateral Debt Relief Initiative (MDRI) and additional debt relief provided recently by bilateral donors. While Tanzania's risk of debt distress is low, this hinges on continued substantial financing of government spending by donors at highly concessional terms.

1. **The baseline scenario assumes that Tanzania's performance during the recent past will be sustained**. In particular, it assumes that real GDP growth will increase to 8 percent in 2010, compared to an average of 6½ percent during 2001-06, predicated on the continuation of trends in total factor productivity observed over the past decade (see Box 2 in Country Report 07/138). Growth is projected to decline gradually thereafter to 6 percent by 2015 and remain unchanged through 2026. Foreign direct investment is also projected to be slightly higher relative to the average of the past 10 years, reflecting strong overall ratings of Tanzania's macroeconomic policies, as well as ongoing structural reforms in key areas. Donor assistance is assumed to remain unchanged as a ratio to GDP over the medium term, and start to gradually decline after 2011, with the grant element assumed to remain at about 50 percent throughout the forecast period. In addition, the baseline scenario reflects government's commitment of continued zero net domestic financing over the medium term, and no external foreign borrowing at commercial terms throughout the projection period.

External Debt Sustainability

2. **Tanzania's external debt sustainability has strengthened further.** Following completion of the MDRI in 2006 by the IMF, World Bank, and African Development Bank, Tanzania has received additional debt relief in recent months from bilateral donors.[1] As a result, Tanzania total external debt as of end-February 2007 declined to about US$4.5 billion,

[1] In January 2007, Japan canceled US$523 million of its outstanding debt to Tanzania, and Russia announced a debt swap scheme of its remaining external debt to Tanzania (US$21 million).

or 34 percent of GDP.[2] The NPV of public external debt now stands at about 16½ percent of GDP and 63 percent of exports, whereas public external debt service is around 2 percent of exports of goods and services (Table 1). All these indicators are significantly below the indicative debt-burden thresholds that apply to Tanzania, indicating low risk of debt distress.[3]

3. **The bound tests indicate that Tanzania's external debt will remain sustainable under the individual standardized shocks and their combination** (Table 2 and Figure 1). Given that Tanzania does not breach any of the indicative thresholds for low-income country DSA in any scenario or bound test, the IMF and World Bank staffs classify Tanzania as "low risk" according to the Fund-Bank guidance for debt distress assessments.

4. **However, Tanzania's external debt sustainability hinges on continued financing of its large current account deficit at highly concessional terms**. Currently, total donor assistance is about 11½ of GDP, of which about 7 percent of GDP is in the form of grants, and the remainder has a grant element of about 50 percent. As shown in Table 2, for example, even a 2 percentage point increase in the interest rate on new borrowing, while leaving unchanged the long grace and maturity periods and the significant amount of external grants under the baseline, would gradually increase Tanzania's NPV-to-GDP ratio to about 22 percent of GDP by 2026. Furthermore, if the share of grants to GDP were to decline by only 3 percentage points, with the gap having to be financed at commercial terms, Tanzania will breach the indicative external debt thresholds towards the end of the projection period.

Fiscal Sustainability

5. **The public DSA is based on the assumption of continued expansion of domestic revenue mobilization to finance increased priority spending.** Specifically, based on sustained revenue administration improvement and policy measures, domestic revenues are assumed to increase gradually to about 19 percent of GDP, as external grants decline moderately from 7 percent of GDP in FY 2006/07 to about 6 percent of GDP in FY 2025/26. Primary expenditures would increase to around 29 percent of GDP. In this context, the primary fiscal deficit is projected to expand slightly, to 4 percent of GDP. External financing is assumed to remain concessional and broadly constant at about 4 percent of GDP. Moderate domestic borrowing is projected to resume over the medium term, and stabilize at ½ a percent of GDP.

[2] This external debt stock includes the estimated amount of interest arrears of about US$1.2 billion.

[3] Based on the 3-year average of the World Bank's Country Policy and Institutional Assessment Index, Tanzania is classified as a "strong performer". Its thresholds therefore are: 50 percent of NPV of debt-to-GDP ratio, 200 percent of NPV of debt-to-exports ratio, 300 percent of debt-to-revenue ratio, 25 percent of debt service-to-exports ratio, and 35 percent of debt service-to-revenue ratio.

6. **Under the baseline fiscal DSA scenario, the NPV of public debt is projected to decline gradually.** Domestic debt, including securities issued for financing and sterilization purposes, accounts for almost half of Tanzania's public debt NPV. The projected improvement in the debt profile is driven by the decline of domestic debt, which will fall from about 15 percent of GDP at end 2005/06 to around 5 percent of GDP at the end of the DSA period, on the back of limited net domestic financing and declining bond issuances for sterilization purposes. A lower stock of domestic debt would reduce the risk of crowding out private investment and would lower the interest bill. From about 30 percent of GDP at end FY2005/06, total public debt will reach 20 percent of GDP in FY20025/26 (Table 3). Debt service indicators also show favorable trends, with debt-service-to-revenue declining to about 5 percent in 2025/26.

7. **Tanzania's public debt remains sustainable under alternative scenarios.** However, lower GDP growth would pose moderate risks (Table 4). In this sense, the least favorable case is represented by a decline of one standard deviation in real GDP growth during 2007/08 and 2008/09 relative to historical values. Under this scenario, the NPV of debt would climb to 39 percent of GDP in 2025/26 and debt service would rise gradually to 11 percent of revenue in 2025/26 (Figure 2).

Table 1. Tanzania: External Debt Sustainability Framework, Baseline Scenario, 2006-2026 1/
(In percent of GDP, unless otherwise indicated)

	Actual										Historical Average[6]	Standard Deviation[6]	Projections									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005			2006	2007	2008	2009	2010	2011	2006-11 Average	2016	2026	2012-26 Average
External debt (nominal) 1/	**118.6**	**98.2**	**90.0**	**88.6**	**83.2**	**79.1**	**75.2**	**73.6**	**70.5**	**64.5**			**35.5**	**36.2**	**36.0**	**35.6**	**34.3**	**32.4**		**28.7**	**30.5**	
Of which: public and publicly guaranteed (PPG)	118.4	98.1	89.8	88.3	83.0	78.8	74.8	72.3	69.2	64.4			35.5	36.2	36.0	35.6	34.3	32.4		28.7	30.5	
Change in external debt	-21.3	-20.4	-8.3	-1.4	-5.4	-4.1	-3.9	-1.6	-3.1	-6.0			-29.0	0.7	-0.2	-0.4	-1.2	-1.9		-0.3	0.4	
Identified net debt-creating flows	-18.1	-14.7	-1.0	4.0	-4.1	-1.7	-1.1	-3.6	-6.7	-4.3			2.1	4.6	4.3	3.6	2.8	2.7		3.4	3.3	
Non-interest current account deficit	**0.8**	**4.5**	**9.7**	**9.0**	**4.9**	**4.5**	**5.5**	**3.6**	**3.9**	**6.1**	**5.7**	**2.2**	**9.8**	**10.8**	**10.6**	**10.3**	**9.9**	**9.7**	**10.2**	**10.0**	**11.0**	10.2
Deficit in balance of goods and services	9.4	9.4	14.9	12.7	8.3	8.5	7.3	6.6	7.5	10.4			13.9	14.8	14.8	14.4	13.8	13.6		13.7	14.6	
Exports	22.0	16.2	13.5	13.5	14.4	15.2	16.4	19.6	22.5	23.3			25.3	25.9	26.4	26.2	26.0	26.0		29.1	38.8	
Imports	31.4	25.6	28.3	26.2	22.7	23.6	23.7	26.2	30.0	33.7			39.2	40.8	41.2	40.6	39.9	39.6		42.8	53.4	
Net current transfers (negative = inflow)	-8.3	-5.7	-5.1	-3.9	-4.3	-4.4	-3.0	-3.8	-4.4	-4.6	-4.8	1.4	-4.5	-4.3	-4.2	-4.1	-4.0	-3.9	-4.2	-3.7	-3.5	-3.7
Other current account flows (negative = net inflow)	-0.3	0.8	-0.1	0.1	0.9	0.4	1.3	0.7	0.8	0.3			0.4	0.2	0.0	0.0	0.0	0.0		0.0	0.0	
Net FDI (negative = inflow)	**-2.3**	**-2.1**	**-3.3**	**-3.1**	**-5.1**	**-3.5**	**-4.2**	**-4.6**	**-4.3**	**-3.8**	**-3.6**	**1.0**	**-3.9**	**-4.0**	**-4.2**	**-4.4**	**-4.8**	**-4.8**	**4.4**	**-5.1**	**-6.2**	-5.4
Endogenous debt dynamics[2]	**-16.6**	**-17.1**	**-7.5**	**-1.9**	**-3.9**	**-2.7**	**-2.4**	**-2.6**	**-6.3**	**-6.6**			**-3.8**	**-2.1**	**-2.2**	**-2.3**	**-2.3**	**-2.2**		**-1.4**	**-1.6**	
Contribution from nominal interest rate	1.4	0.8	1.3	1.0	0.4	0.5	0.4	0.9	0.6	0.5			0.2	0.2	0.2	0.2	0.2	0.2		0.2	0.1	
Contribution from real GDP growth	-5.5	-3.5	-3.3	-3.1	-4.3	-5.0	-5.5	-4.1	-4.5	-4.2			-4.0	-2.3	-2.5	-2.6	-2.6	-2.5		-1.6	-1.7	
Contribution from price and exchange rate changes	-12.5	-14.4	-5.5	0.3	0.0	1.8	2.7	0.5	-2.4	-2.8			...	...	...	...	...	...	...	...	...	
Residual 3/	**-3.3**	**-5.7**	**-7.2**	**-5.4**	**-1.3**	**-2.4**	**-2.8**	**2.0**	**3.7**	**-1.7**			**-31.1**	**-3.9**	**-4.5**	**-4.0**	**-4.0**	**-4.6**		**-3.7**	**-2.9**	
Of which: exceptional financing	-0.4	-6.4	-7.0	-2.9	-2.6	-10.3	-4.7	-4.4	-2.2	-2.1			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of external debt[4]	...	...	...	...	...	...	...	...	...	14.6			15.8	16.5	16.7	16.8	16.4	15.7		14.3	15.5	
In percent of exports	...	...	...	...	...	...	...	...	...	62.6			62.4	63.5	63.1	64.0	63.0	60.1		49.3	39.9	
NPV of PPG external debt	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**15.4**	**14.5**			**15.8**	**16.5**	**16.7**	**16.8**	**16.4**	**15.7**		**14.3**	**15.5**	
In percent of exports	...	...	...	...	...	...	...	...	68.3	62.2			62.4	63.5	63.1	64.0	63.0	60.1		49.3	39.9	
Debt service-to-exports ratio (in percent)	16.2	12.2	25.9	20.2	16.1	14.7	11.2	14.4	12.9	6.8			1.9	1.7	2.2	2.1	2.1	2.0		2.1	2.3	
PPG debt service-to-exports ratio (in percent)	15.2	11.2	24.8	18.4	14.9	12.5	8.8	7.6	7.1	6.3			1.9	1.7	2.2	2.1	2.1	2.0		2.1	2.3	
Total gross financing need (billions of U.S. dollars)	...	...	...	0.7	0.2	0.3	0.3	0.2	0.3	0.5			0.8	1.0	1.1	1.1	1.1	1.2		1.8	3.9	
Non-interest current account deficit that stabilizes debt	22.1	24.8	17.9	10.4	10.3	8.6	9.4	5.2	7.0	12.1			38.8	10.1	10.9	10.7	11.1	11.6		10.2	10.6	
Key macroeconomic assumptions																						
Real GDP growth (in percent)	4.5	3.5	3.7	3.5	5.1	6.2	7.2	5.7	6.7	6.7	5.3	1.4	6.2	7.1	7.5	7.9	8.0	8.0	7.5	6.0	6.0	6.0
GDP deflator in US dollar terms (change in percent)	9.8	13.8	5.9	-0.3	0.0	-2.1	-3.3	-0.7	3.4	4.2	3.1	5.5	-4.4	2.8	2.8	2.5	2.7	2.5	1.5	2.0	1.6	2.0
Effective interest rate (percent)[5]	1.2	0.8	1.5	1.1	0.5	0.6	0.5	1.3	0.8	0.8	0.9	0.3	0.3	0.5	0.7	0.8	0.8	0.8	0.6	0.7	0.4	0.6
Growth of exports of G&S (US dollar terms, in percent)	25.9	-13.0	-8.7	3.4	12.2	9.5	12.2	25.4	26.8	15.3	10.9	13.9	10.0	13.1	12.5	9.7	10.2	10.7	11.0	11.0	11.0	11.0
Growth of imports of G&S (US dollar terms, in percent)	-3.9	-4.0	21.7	-4.6	-8.8	8.2	3.8	16.4	26.1	25.1	8.0	13.4	17.9	14.7	11.7	8.9	8.9	10.0	12.0	10.3	10.3	10.3
Grant element of new public sector borrowing (in percent)						...	...	...	...	...	...	...	56.0	52.1	50.9	50.8	52.7	55.4	53.0	49.0	44.4	47.7
Memorandym item:																						
Nominal GDP (billions of US dollars)	6.5	7.6	8.4	8.6	9.1	9.4	9.8	10.3	11.3	12.6			12.8	14.1	15.6	17.2	19.1	21.2		32.0	68.2	

Source: Staff simulations.

[1] Includes both public and private sector external debt.
[2] Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
[3] Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
[4] Assumes that NPV of private sector debt is equivalent to its face value.
[5] Current-year interest payments devided by previous period debt stock.
[6] Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2. Tanzania: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2006-26
(In percent)

	Projections							
	2006	2007	2008	2009	2010	2011	**2016**	2026
NPV of debt-to-GDP ratio								
Baseline	16	16	17	17	16	16	**14**	16
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26 1/	16	14	12	11	9	7	**...**	...
A2. New public sector loans on less favorable terms in 2007-26 2/	16	17	18	19	19	19	**19**	22
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	16	17	18	18	18	17	**15**	17
B2. Export value growth at historical average minus one standard deviation in 2007-08 3/	16	18	22	22	21	20	**17**	17
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	16	17	18	19	18	17	**16**	17
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 4/	16	18	19	19	18	18	**16**	16
B5. Combination of B1-B4 using one-half standard deviation shocks	16	19	22	22	22	20	**18**	18
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 5/	16	23	24	24	23	22	**20**	22
NPV of debt-to-exports ratio								
Baseline	62	64	63	64	63	60	**49**	40
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26[1]	62	54	46	41	35	28	**2**	...
A2. New public sector loans on less favorable terms in 2007-26[2]	62	67	70	73	74	72	**64**	57
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	62	64	63	64	63	60	**49**	40
B2. Export value growth at historical average minus one standard deviation in 2007-08[3]	62	82	112	112	109	104	**81**	57
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	62	64	63	64	63	60	**49**	40
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08[4]	62	68	72	72	71	68	**54**	41
B5. Combination of B1-B4 using one-half standard deviation shocks	62	74	90	90	88	84	**66**	49
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007[5]/	62	64	63	64	63	60	**49**	40
Debt service ratio								
Baseline	2	2	2	2	2	2	**2**	2
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2007-26[1]	2	2	2	2	2	2	**1**	...
A2. New public sector loans on less favorable terms in 2007-26[2]	2	2	2	2	3	3	**3**	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	2	2	2	2	2	2	**2**	2
B2. Export value growth at historical average minus one standard deviation in 2007-08[3]	2	2	3	3	3	3	**4**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	2	2	2	2	2	2	**2**	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08[4]	2	2	2	2	2	2	**2**	2
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	3	3	3	3	**3**	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007[5]	2	2	2	2	2	2	**2**	2
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	50	50	50	50	50	50	**50**	50

Source: Staff projections and simulations.

[1] Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
[2] Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
[3] Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
[4] Includes official and private transfers and FDI.
[5] Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
[6] Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3.Tanzania: Public Sector Debt Sustainability Framework, Baseline Scenario, 2003/04-2025/26
(Percent of GDP, unless otherwise indicated)

	Actual			Historical Average[5]	Standard Deviation[5]	Estimate	Projections								
	2003/04	2004/05	2005/06			2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2015/16	2016/17	2017/18	2025/26
Public sector debt[1]	87.4	79.2	67.1			44.1	42.9	43.1	42.9	42.9	42.9	45.1	46.1	47.0	53.4
Of which: foreign-currency denominated	75.6	66.6	52.2			28.6	29.9	31.4	32.5	33.6	34.4	38.7	39.9	41.0	48.2
Change in public sector debt	1.1	-8.2	-12.2			-23.0	-1.1	0.1	-0.1	0.0	0.0	1.1	1.0	0.9	0.6
Identified debt-creating flows	-4.1	-6.9	2.1			-2.8	-0.2	-0.1	-0.1	-0.4	0.1	0.9	0.8	0.8	0.1
Primary deficit	2.3	2.7	4.3	-0.2	3.0	2.9	2.8	2.8	3.1	2.9	3.0	3.9	3.9	3.9	3.9
Revenue and grants	18.7	21.0	20.1			23.8	24.2	23.7	24.3	24.7	24.8	24.6	24.6	24.6	24.7
Of which: grants	6.0	7.7	6.0			8.1	8.1	7.1	7.2	7.4	7.3	6.7	6.6	6.5	5.8
Primary (noninterest) expenditure	21.0	23.7	24.4			26.7	27.0	26.5	27.5	27.7	27.7	28.5	28.5	28.5	28.6
Automatic debt dynamics	-6.5	-9.1	-1.6			-5.6	-2.9	-2.9	-3.2	-3.4	-2.9	-3.0	-3.1	-3.2	-3.8
Contribution from interest rate/growth differential	-6.8	-6.9	-5.6			-4.9	-2.9	-3.0	-3.3	-3.4	-2.9	-3.1	-3.2	-3.3	-3.9
Of which: contribution from average real interest rate	-1.3	-1.4	-0.8			-0.7	0.1	0.1	-0.2	-0.3	-0.3	-0.6	-0.6	-0.7	-0.9
Of which: contribution from real GDP growth	-5.5	-5.5	-4.8			-4.2	-3.0	-3.1	-3.2	-3.2	-2.6	-2.5	-2.6	-2.6	-3.0
Contribution from real exchange rate depreciation	0.3	-2.1	4.0			-0.7	-0.1	0.1	0.1	0.1	0.1	0.1	...	...	...
Other identified debt-creating flows	0.0	-0.5	-0.6			-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	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
Recognition of implicit or contingent liabilities	0.7	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief (HIPC and other)	-0.7	-0.5	-0.6			-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other (specify, e.g. bank recapitalization)	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
Residual, including asset changes	5.3	-1.3	-14.3			-20.2	-0.9	0.2	0.0	0.4	0.0	0.2	0.2	0.2	0.5
NPV of public sector debt	11.9	26.9	30.8			31.8	29.9	28.9	27.5	25.9	24.4	20.4	20.1	19.8	20.4
Of which: foreign-currency denominated	0.0	14.3	16.0			16.3	16.9	17.2	17.1	16.5	15.9	14.0	13.9	13.8	15.3
Of which: external	...	14.3	16.0			16.3	16.9	17.2	17.1	16.5	15.9	14.0	13.9	13.8	15.3
NPV of contingent liabilities (not included in public sector debt)	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
Gross financing need 2/	3.5	4.1	6.8			4.5	4.7	4.5	4.5	4.2	4.2	4.9	4.9	4.9	4.8
NPV of public sector debt-to-revenue ratio (in percent)[3]	63.6	127.8	153.4			133.6	123.5	121.9	112.9	104.5	98.5	83.1	81.5	80.4	82.7
Of which: external	...	...	79.4			68.7	69.7	72.8	70.3	66.9	64.1	57.1	56.4	56.1	62.0
Debt service-to-revenue ratio (in percent)[3 4]	6.1	6.6	12.5			6.8	7.8	7.2	5.9	5.3	5.0	4.0	3.9	3.8	3.7
Primary deficit that stabilizes the debt-to-GDP ratio	1.2	10.9	16.4			25.9	3.9	2.7	3.3	2.9	2.9	2.8	2.9	3.0	3.3
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.8	6.7	6.5	5.4	1.3	6.7	7.3	7.7	7.9	8.0	6.5	6.0	6.0	6.0	6.0
Average nominal interest rate on forex debt (in percent)	0.5	0.6	0.6	0.9	0.3	0.4	0.7	0.7	0.6	0.5	0.8	0.5	0.5	0.4	0.3
Average real interest rate on domestic currency debt (in percent)	0.0	1.3	5.3	-1.8	5.1	3.1	4.4	5.3	4.0	3.9	3.1	2.8	2.8	2.8	3.2
Real exchange rate depreciation (in percent, + indicates depreciatior	0.5	-3.1	6.6	-0.4	6.8	-1.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	7.8	8.0	7.5	10.3	4.7	6.5	5.3	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Growth of real primary spending (deflated by GDP deflator, in percer	18.8	20.3	8.7	12.8	15.1	16.1	8.4	5.7	12.1	8.0	7.2	6.2	5.8	5.8	5.1
Grant element of new external borrowing (in percent)	0.0	...	56.0	...	...	53.9	51.0	50.0	51.9	55.8	56.4	50.4	49.3	48.4	44.3

Sources: Ministry of Finance; Bank of Tanzania; and Fund staff projections.

[1] Central government.

[2] Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

[3] Revenues including grants.

[4] Debt service is defined as the sum of interest and amortization of medium and long-term debt.

[5] Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

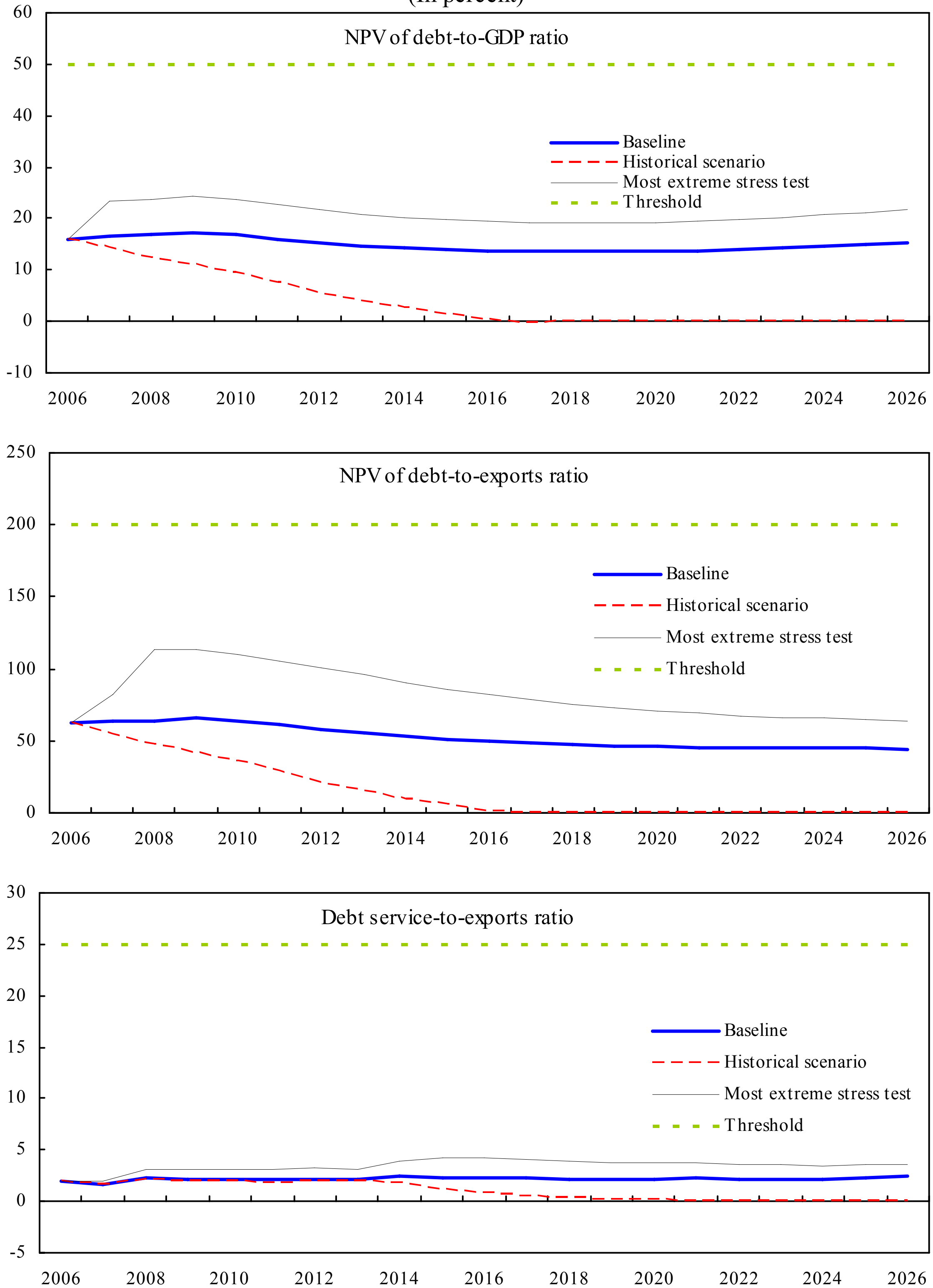
Table 4.Tanzania: Sensitivity Analysis for Key Indicators of Public Debt 2006/07-2025/26

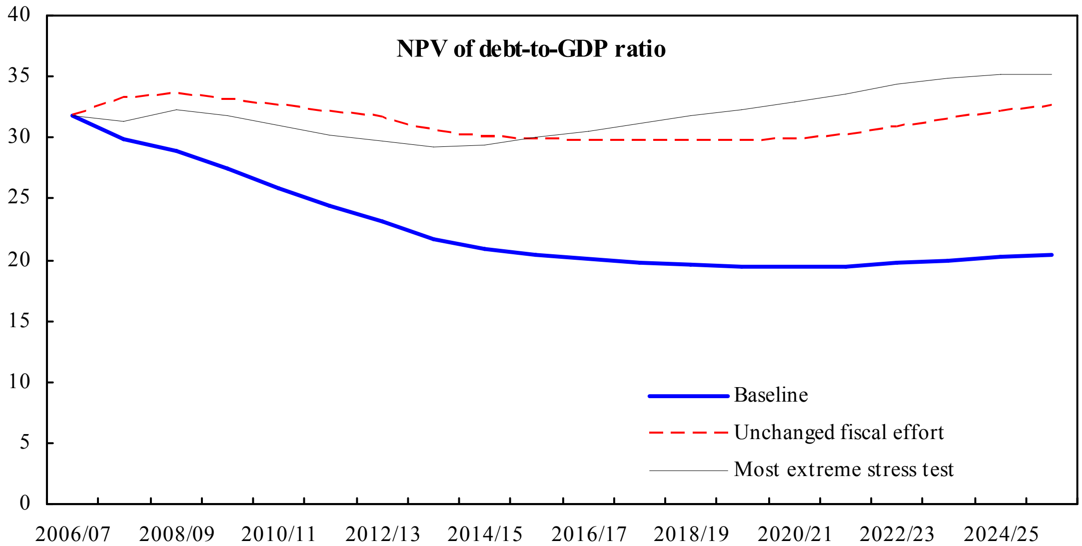
	Projections							
	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2016/17	2025/26
NPV of Debt-to-GDP Ratio								
Baseline	31.8	29.9	28.9	27.5	25.9	24.4	20.1	20.4
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	37.9	38.7	34.3	30.9	26.9	23.1	3.1	0.0
A2. Primary balance is unchanged from 2006/07	33.8	33.3	33.5	33.0	32.6	32.2	29.6	32.7
A3. Permanently lower GDP growth[1]	32.0	30.0	28.9	27.4	25.8	24.3	21.5	24.1
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007/08-2008/09	31.8	31.3	32.3	31.8	31.0	30.3	30.6	35.2
B2. Primary balance is at historical average minus one standard deviations in 2007/08-2008/09	31.8	30.0	28.9	27.5	25.9	24.4	20.6	19.0
B3. Combination of B1-B2 using one half standard deviation shocks	31.7	30.6	30.2	28.2	26.1	24.0	17.9	13.6
B4. One-time 30 percent real depreciation in 2007/08	31.8	35.8	33.2	30.4	27.4	24.6	15.8	11.0
B5. 10 percent of GDP increase in other debt-creating flows in 2007/08	31.8	39.2	37.5	35.6	33.7	31.9	26.1	26.0
NPV of Debt-to-Revenue Ratio[2]								
Baseline	133.6	123.5	121.9	112.9	104.5	98.5	81.5	82.7
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	213.0	169.4	147.3	135.2	114.3	96.5	0.0	0.0
A2. Primary balance is unchanged from 2006/07	155.9	138.2	142.2	136.2	132.6	130.5	120.8	133.0
A3. Permanently lower GDP growth[1]	135.2	124.4	122.2	112.9	104.7	98.2	86.8	97.8
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007/08-2008/09	133.6	128.0	133.7	128.0	123.0	119.9	122.0	142.1
B2. Primary balance is at historical average minus one standard deviations in 2007/08-2008/09	133.6	123.8	122.2	113.1	105.0	98.4	83.6	77.7
B3. Combination of B1-B2 using one half standard deviation shocks	133.3	125.3	125.6	114.2	103.9	95.4	71.5	55.3
B4. One-time 30 percent real depreciation in 2007/08	133.6	147.7	140.3	124.8	110.9	99.4	64.2	44.9
B5. 10 percent of GDP increase in other debt-creating flows in 2007/08	133.6	161.9	158.6	146.4	136.5	128.9	106.1	106.6
Debt Service-to-Revenue Ratio[2]								
Baseline	6.8	7.8	7.2	5.9	5.3	5.0	3.9	3.7
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	12.5	6.3	8.9	3.6	0.8	0.0	0.0	0.0
A2. Primary balance is unchanged from 2006/07	7.4	9.8	10.3	9.3	8.6	8.7	7.2	9.3
A3. Permanently lower GDP growth[1]	6.8	7.5	6.9	5.5	5.0	4.7	4.6	4.1
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007/08-2008/09	6.8	8.0	8.3	7.8	7.7	7.5	8.0	9.3
B2. Primary balance is at historical average minus one standard deviations in 2007/08-2008/09	6.8	7.8	7.3	5.9	5.3	4.9	4.2	2.2
B3. Combination of B1-B2 using one half standard deviation shocks	6.8	7.8	7.5	5.9	4.7	4.0	2.7	0.0
B4. One-time 30 percent real depreciation in 2007/08	6.8	8.0	7.6	6.3	5.7	5.4	4.8	2.7
B5. 10 percent of GDP increase in other debt-creating flows in 2007/08	6.8	7.8	20.7	10.9	8.0	7.0	5.3	6.5

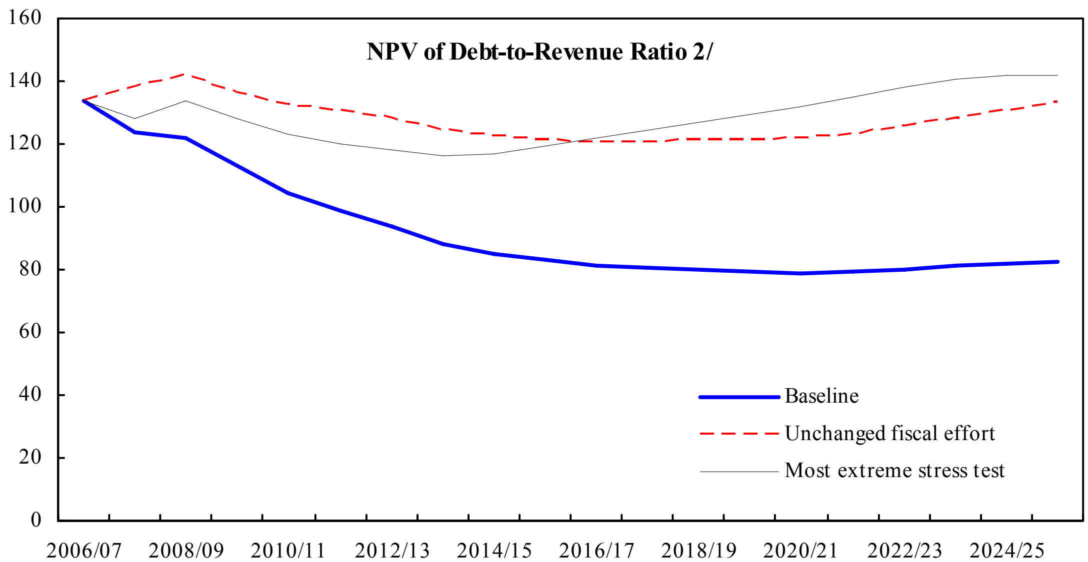
Sources: Ministry of Finance; Bank of Tanzania; and Fund staff projections.

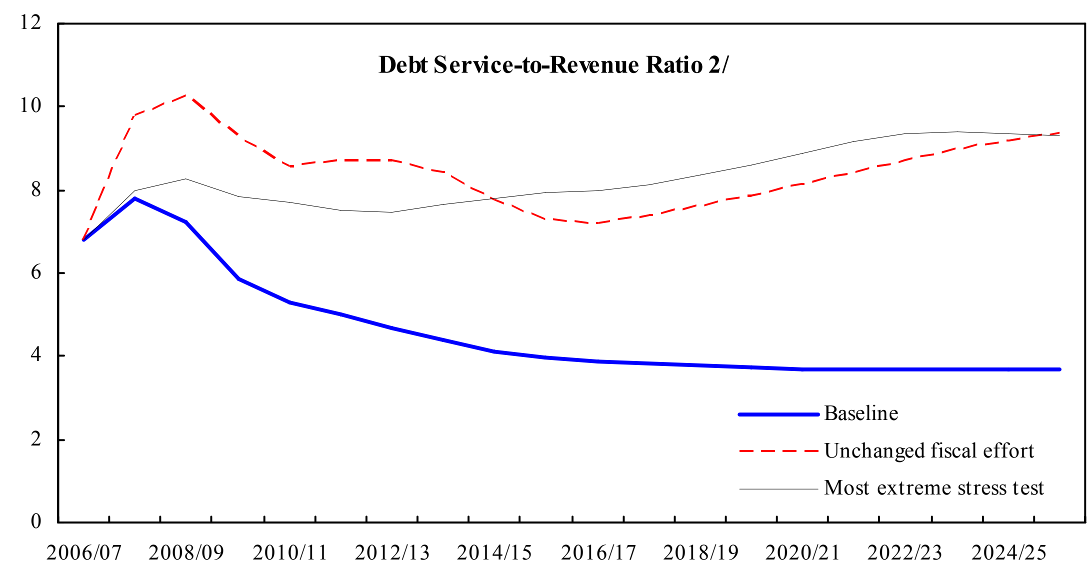
[1] Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).
[2] Revenues are defined inclusive of grants.

Figure 1. Tanzania: Indicators of Public and Publicly Guaranteed External Debt
Under Alternative Scenarios, 2006-2026
(In percent)




NPV of debt-to-GDP ratio
40
35
30
25
20
15
10
5
0
2006/07
2008/09
2010/11
2012/13
2014/15
2016/17
2018/19
2020/21
2022/23
2024/25
Baseline
Unchanged fiscal effort
Most extreme stress test


NPV of Debt-to-Revenue Ratio 2/
160
140
120
100
80
60
40
20
0
2006/07
2008/09
2010/11
2012/13
2014/15
2016/17
2018/19
2020/21
2022/23
2024/25
Baseline
Unchanged fiscal effort
Most extreme stress test


Debt Service-to-Revenue Ratio 2/
12
10
8
6
4
2
0
2006/07
2008/09
2010/11
2012/13
2014/15
2016/17
2018/19
2020/21
2022/23
2024/25
Baseline
Unchanged fiscal effort
Most extreme stress test

INTERNATIONAL MONETARY FUND

UNITED REPUBLIC OF TANZANIA

2007 Article IV Consultation and First Review Under the Policy Support Instrument—Informational Annex

Prepared by the African Department

June 12, 2007

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I. Tanzania: Relations with the Fund
(As of April 30, 2007)

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

		SDR million	Percent Quota
II.	**General Resources Account:**	SDR million	Percent 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	Percent Allocation
	Net cumulative allocation	31.37	100.00
	Holdings	0.52	1.66
IV.	**Outstanding Purchases and Loans:**	SDR million	Percent Quota
	Poverty Reduction and Growth Facility Arrangements	11.20	5.63

V. Latest Financial Arrangements:

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
PRGF	08/16/2003	8/15/2007	19.60	19.60
PRGF	04/04/2000	08/15/2003	135.00	135.00
PRGF	11/08/1996	02/07/2000	181.59	181.59

VI. Projected Payments to Fund
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2007	**2008**	**2009**	**2010**	**2011**
Principal	--	--	--	0.28	1.40
Charges/interest	1.03	1.36	1.36	1.36	1.36
Total	1.03	1.36	1.36	1.64	2.76

VII. Implementation of HIPC Initiative:

	Enhanced framework
Commitment of HIPC assistance	
Decision point date	Apr 2000
Total assistance (US$ million)	2,026.00
Of which: Fund assistance (US$ million)	119.80
Completion point date	11/21/01
Delivery of Fund assistance (SDR million)	
Amount disbursed	88.95
Interim assistance	26.68
Completion point balance	62.27
Additional disbursement of interest income[1]	7.45
Total disbursements	96.40

VIII. Implementation of MDRI Assistance:

1.	Total debt relief (SDR million)[2]	234.03
	Of which: MDRI	207.00
	HIPC	27.03

2. Debt relief by facility (SDR million)

	Eligible Debt		
Delivery date	**GRA**	**PRGF**	**Total**
January 2006	N/A	234.03	234.03

[1] Under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative, an additional disbursement is made at the completion point that corresponds to interest income earned on amounts committed but not disbursed during the interim, 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.

[2] The Multilateral Debt Relief Initiative (MDRI) provides 100 percent debt relief to eligible member countries that are qualified for the assistance. The debt relief covers the full stock of debt owed to the Fund as of end-2004 which remains outstanding at the time the member qualifies for such debt relief. The MDRI is financed by bilateral contributions and the Fund's own resources, as well as the resources already disbursed to the member under the HIPC Initiative (see Section VII above).

IX. Safeguards Assessments:

Under the Fund's safeguards assessment policy, Bank of Tanzania (BoT) was subjected to an assessment with respect to the PRGF arrangement approved on August 16, 2003. A safeguards assessment of the BoT was completed on December 05, 2003 and concluded that whereas the bank had a relatively strong internal control environment, some vulnerabilities existed, notably in the external audit and financial reporting areas. Staff proposed recommendations are reported in Country Report 07/138. The BoT has implemented most of the recommendations of the safeguards assessment.

X. Exchange Arrangements:

The currency of Tanzania is the Tanzania shilling. The official exchange rate is determined in relation to 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 1,239 per U.S. dollar as of end-March, 2007. The exchange system is free of restrictions on the making of payments and transfers for current international transactions.

XI. Article IV Consultation:

The most recent Article IV consultation was concluded on August 6, 2004 (Country Report 04/285). The next Article IV consultation is expected to be completed in mid-2007.

XII. Technical Assistance, 2003–06:

Department	Date	Form	Purpose
Fiscal Affairs	2002–03	Long-term consultant	Public expenditure management
	Mar.–May 2003	Peripatetic advisor	Tax administration
	April 2003	Mission	Inspection and tripartite review
	June–Sep. 2003	Long-term consultant	Public expenditure management
	Sep.–Oct. 2003	Peripatetic advisor	Tax administration
	Oct 2003	Mission	Tax administration
	November 2003	Multicountry mission	EAC tax harmonization
	April 2004	Mission	Customs administration
	July 2004	Peripatetic advisor	Tax administration
	July 2004	Mission	Public Expenditure Management Assessment and Action Plan
	September 2004	Mission	Review of mining taxation
	September 2004	Mission	Tax administration (Zanzibar)
	April 2005	Mission	Customs administration
	July 2005	Mission	Improve the effectiveness of the Ministry of Finance
	Aug.- Sep. 2005	Mission	Tax administration
	Oct.–Nov. 2005	Mission	Strengthen macro fiscal analysis at the Ministry of Finance
	December 2005	Mission	Tax policy

	April 2006	Peripatetic advisor	Strengthen macro fiscal analysis in Ministry of Finance
	April - May 2006	Expert	Customs Administration
	October 2006	Mission	Customs Administration
Legal	March – April, 2003	Mission	Income tax law
	Sept. 2003	Mission	Income tax law
	June 2004	Mission	Income tax law
	July 2004	Mission with MFD	Central and commercial bank legislative reform
	July–November 2004	Desk review	Foreign Exchange Act, Evidence Act, Bills of Exchange Ordnance, National Payment System bill, Electronic Transactions bill
Monetary and Capital Markets	Feb. 2003	Mission	Pre-FSAP mission
	May 2003	Mission	FSAP
	November 2003	Mission	FSAP follow-up workshop
	March 2004	Mission	Accounting and banking supervision
	June 2004	Mission	BoT accounting
	July 2004	Mission	Central and commercial banking legislation reform with LEG
	August 2004	Mission	Financial sector reform/FSAP follow-up
	November 2004	Mission	BoT accounting
	December 2004	Mission	Second FSAP follow-up workshop
	May 2005	Mission	Financial sector reform/FSAP follow-up
	September 2005	Mission	Credit reference database and IFRS-generated reports
	January 2006	Mission	Monetary and foreign exchange operations
	January 2006	Mission	Problem bank resolution
	February 2006	Mission	Prudential regulations
	December 2006	Mission	Monetary and foreign exchange operations follow-up
Statistics	2002–03	Long-term consultant	Multisector statistics
	August 2003	Mission	Government finance statistics
	Jan.-Feb. 2005	Mission	Monetary statistics
	October 2005	Mission	Balance of payments statistics
	December 2005	Mission	Technical assistance evaluation
	February 2006	Mission	CPI software application
	November 2006	Mission	Monetary and financial statistics

XIII. Resident Representative: Mr. David O. Robinson has been the Senior Resident Representative since March 2007.

II. TANZANIA: RELATIONS WITH THE WORLD BANK GROUP

Partnership in Tanzania's Development Strategy

Tanzania's development strategy is set forth in the MKUKUTA (2005-2010). It is a successor to the Poverty Reduction Strategy Paper (PRSP) that covered 2000-2004. The MKUKUTA addresses three clusters of outcomes: (i) growth and the reduction of income poverty, (ii) improving the quality of life and social well-being, and (iii) strengthening governance and accountability.

Bank Group Strategy

The Bank's Board discussed a new Country Assistance Strategy (CAS) for Tanzania on April 24, 2007. The Joint Assistance Strategy for Tanzania (JAST) comprises four parts, which collectively will serve as the World Bank Group CAS for FY07 to FY10. Part I is the national medium-term framework established by Government for managing development co-operation with its Development Partners (DPs) so as to improve the collaboration in achieving national development and poverty reduction goals. In discussion of the draft JAST, Government and DPs agreed on the need for further joint work on parts II-IV below, engaging the entire DP community and focusing on the Government's own planning process, the MTEF in particular. The appropriate balance of roles between Government and DPs in the JAST and wider planning process has been a fruitful area of dialogue, under continuing review through the Government-led JAST Working Group. Part II and Part III are the Joint Program Document (JPD) developed in consultation with Government by the Development Partners Group (DPG) as a response to Tanzania poverty reduction strategies (MKUKUTA for mainland Tanzania; MKUZA for Zanzibar) and the JAST. Part II is a joint country analysis describing Tanzania's development achievements and challenges. Part III is the joint program part, reflecting DPG planned support and aid effectiveness commitments to Tanzania over the 4 remaining years of MKUKUTA, FY07-10. The World Bank Group (WBG) Part IV describes the WBG's strategic approach and proposed program over support over the FY07-10 period (advice, analytic work and financing, both ongoing and planned). Based on the Results Matrix for all DPs in Part III, Part IV also includes a WBG specific results matrix with milestones that facilitate monitoring of progress during the FY07-10 period.

The Bank is supporting implementation of the MKUKUTA through its full range of instruments, including general and sectoral budget support, project support, analytic and advisory activities, guarantees, and equity investments by IFC.

General budget support is provided in the form of Poverty Reduction Support Credits (PRSCs), jointly with a group of 13 other donors. There is joint performance assessment and a common review process. Tanzania's first PRSP was supported through a series of three PRSCs (2003-2005). After the finalization of Tanzania's second PRSP, the Bank together with the other budget support donors developed a new Performance Assessment Framework based on Tanzania's new PRSP. Its implementation is expected to be supported by the Bank through a series of five PRSCs, the first and second of which (PRSC-4 and PRSC-5) were approved by the Bank's Board of Executive Directors on May 9, 2006 and April 24, 2007. It covers six focus areas. These are the three clusters of the MKUKUTA (i.e., growth and the reduction of income poverty, improvements of quality of life and social well being, and governance and accountability), macroeconomic stability, resource allocation and budget consistency, and public financial management. The most recent annual review of general budget support to Tanzania was held in October 2006.

In the social sectors, the Bank provides support through a sectoral development policy credit and grant for secondary education (US$150 million each), the third and last tranche (US$50million) of which is expected to be disbursed in FY07. The objectives are to improve education, expand school access, and increase retention at both primary and secondary levels. Bank support has already facilitated a significant increase in school enrollments. In April 2007, the Board approved a credit for US$42 million to support the education improvement project for Zanzibar. The objectives of the program are to improve completion on lower secondary education including achieving better examination results. This will be facilitated through construction of secondary schools, laboratories and facilities for teacher training, by providing in-service mathematics and science training to teachers, and making text books in core subjects available to all primary secondary schools in Zanzibar. After the focus on primary and secondary education, in FY08 the Bank will also support reforms of higher education and science and technology in Tanzania through a proposed credit in the amount of US$150 million. The Bank contributes to the health sector multidonor "basket fund," which supports sector reforms and funds nonwage expenditures. A multisector HIV/AIDS project supports Tanzania's efforts to reduce HIV transmission and mitigate the adverse consequences of AIDS. In the water sector, one project supports technical, commercial, and financial rehabilitation of the water supply and sanitation services in Dar es Salaam. Another supports access to improved and sustained water and sanitation services in rural communities. A new Water Sector Support Program project (US$200 million) was approved by the Board in February 2007. It supports GoT's strategy for improving governance of water resources management and sustainable delivery of water supply and sanitation services. The objective of the IDA-funded Tanzania Social Action Fund (TASAF) is to enhance the capacities of communities and other stakeholders to prioritize, implement, and manage sustainable development initiatives and in the process improve socioeconomic services and opportunities. The Bank's Board approved the Tanzania Second Social Action Fund (US$150 million) on November 30, 2004, to continue the successful outcomes from TASAF-1.

In the agriculture sector, the Bank's Board approved in FY06 a project to support Tanzania's Agriculture Sector Development Program. In addition, the Participatory Agricultural Development and Empowerment Project Credit supports investments in technologies to reduce soil fertility decline.

A Forest Conservation and Management Project helps the government implement policy, particularly by building a framework for long-term sustainable management and conservation of Tanzania's forests. The Marine and Coastal Environment Management Project, aims to strengthen the management of the marine and coastal environment. In FY08, the Bank is expected to approve the multi-country (Tanzania, Uganda, Kenya, Rwanda and Burundi) Lake Victoria Environmental Project II which aims to support reagional efforts to improve management of the Lake Victoria ecosystem.

Efforts to improve Tanzania's infrastructure are supported by road and railway projects. In April 2004, the Bank's Board approved a credit of US$122 million to (1) upgrade strategic road links, (2) enhance road management capacity, and (3) improve the operations of Tanzanian Railways (TRC and TAZARA). In FY08, Bank support to this project is expected to be increased by a supplementary credit of US$100 million. The policy dialogue is now helping prepare a new Road Act, which will be the basis for strengthening the policy and institutional framework for road building and maintenance.

The Bank has also helped the government implement the Power Sector Restructuring Program. It has encouraged the government to build the domestic gas market and generate lower-cost power through the Songo Songo Gas Development and Power Generation Project, and is currently assisting the government in implementation of the Financial Recovery Plan for TANESCO and the development of a medium to long term strategy for the energy sector, which will provide the basis for further investment support. A credit to support rural electrification and access to ICT in the amount of US$105 million is under preparation for presentation to the Board in FY08.

The Local Government Support Project (US$150 million) is designed to strengthen fiscal decentralization, improving accountability in the use of local government resources, and improving management of intergovernmental transfers. Other project objectives are to increase access to infrastructure and services in unplanned areas of Dar es Salaam and improve revenue performance for sustainable operations and maintenance.

In December 2005, the Board approved a private sector competitiveness project to support Tanzania's efforts to create an enabling environment for its private sector and enhance its competitiveness; the focus is on micro-, small, and medium enterprises. The project will support Tanzania's Business Environment Strengthening (BEST) program, help set up computerized land and business registries, support judicial reform, and develop the financial sector.

An accountability, transparency, and integrity project was approved by the Board in May 2006. The project contributes to improved access to judicial and legal services and the accountable and transparent use of public financial resources. This will be achieved by improving the skills and systems to deliver judicial/legal services and public financial management, and strengthening the capacity of oversight institutions to perform their role.

The International Finance Corporation's (IFC) strategic focus in Tanzania is on the financial, agribusiness, tourism, infrastructure and SME sectors. Recent activities include a US$10 million investment in Bonite Bottlers, a carbonated soft drinks manufacturer, a US$5 million Exim Bank trade facility, and a US$5 million Tier II facility to Stanbic Tanzania. At present, the Multilateral Investment Guarantee Agency (MIGA) has no exposure in Tanzania and no projects planned.

Tanzania joined the World Bank Group in 1962. Beginning with an IDA credit for education in 1963, it has received a total of US$6.2 billion (US$6 billion from IDA) in credits, loans and grants from the World Bank. Total disbursements amounted to US$5.2 billion as of April 30, 2007 (US$4.7 billion from IDA, US$356 million from the IBRD, and US$214 million in IDA grants). Currently, the portfolio comprises 23 active projects, with commitments of US$1.9 billion, in all major sectors; the undisbursed balance is US$1.1 billion.

Statement of Loans, Credits, and Grants (As of April 30, 2007; U.S. dollars)

	IBRD	IDA Credits	IDA Grants	Total
Original Principal	361,030,400	6,004,469,393	274,400,000	6,639,899,793
Cancellations	5,477,944	235,719,662	0	241,197,606
Disbursed	355,552,456	4,662,178,055	214,406,832	5,232,137,342
Undisbursed	0	1,320,691,187	70,337,151	1,391,028,338
Repaid	355,462,456	470,731,336	0	826,193,792
Due	0	1,160,921,834	0	1,160,921,834
Exchange Adjustment	0	0	0	0
Borrower Obligation	0	1,160,921,834	0	1,160,921,834

Source: World Bank Group

Bank-Fund collaboration in specific areas

The IMF and World Bank staffs collaborate closely in supporting Tanzania's structural reforms. As part of its assistance—through lending, country analytic work, and technical assistance—the Bank, in collaboration with the Fund, supports policy reforms in the following areas:

- **Public expenditure management.** Improvements in public expenditure management have been a top priority of the Tanzanian government since 1995. The Bank, the Fund, and other donors have worked closely to give the government needed support for institutional and policy reforms. The Fund is leading the dialogue on fiscal policy; the Bank concerns itself with strategic resource allocation and operational efficiency of public expenditures. To enhance strategic resource allocation and operational efficiency, the Bank is supporting a government-led, participatory public expenditure review/medium-term expenditure framework (MTEF) process. This effort has helped to strengthen and open up the budget process and the allocation of resources to pro-poor priority areas. The Bank is also involved in the fiscal decentralization process through analytical work and the Local Government Support Project. The Bank and the Fund work together to support institutional budget and expenditure management reforms. The annual Bank-led Public Expenditure and Financial Assessment Report (PEFAR) - the most recent one was issued in May 2006 - is the main instrument for the donor community to assess progress in these areas. It also integrates the assessment of Tanzania's financial management and procurement systems, which previously had been assessed through separate Country Financial Accountability Assessment and Country Procurement Assessment Reports.

- **Tax policy and administration reform.** The Bank and the Fund have, over the past few years, cooperated closely to support the government's efforts to modernize the tax system and enhance domestic revenue collection. The Fund has taken the lead in reforms of tax policy; the Bank has taken the lead in reforms to strengthen tax administration.

- **Financial sector reforms.** Tanzania has instituted far-reaching reforms in the financial sector with strong support from both the Bank and the Fund. Besides contributing to the policy dialogue, the Bank has provided significant technical assistance for financial sector reforms, primarily through two financial institution development projects that support government withdrawal from banking and nonbanking financial institutions while strengthening financial sector supervision. Among successful outcomes of these reforms are the privatization of Tanzania's largest bank and the entry of a fairly large number of international banks into the Tanzanian market. The Bank has also been involved in reform of the capital and securities authority, reform of pension systems, and 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 Program (FSAP) was completed in June 2003. The recommendations of the FSAP have been incorporated into a reform strategy document for the financial sector. The Bank and the Fund have been allocated specific donor responsibilities in implementing the strategy document and have been active in coordination of the implementation process, including donor coordination.

- **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 increase accountability, transparency, and integrity in the public sector. Among them are (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 improving governance; (vi) the establishment of a Good Governance Coordination Unit in the president's office; and (vii) the launch of the Legal Sector Reform Program. The PSRP has been central to these reforms because its objective is to improve the accountability, transparency, and resource management of service delivery. The reforms are closely linked with other major reforms in public finance and decentralization. The PSRP aims to transform 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 directly affects fiscal stability and public sector financial management.

- **Energy sector.** The Bank and the Fund are working closely to find ways to address the crisis in the energy sector. The Bank takes the lead in assisting the authorities with developing emergency power generation plans to alleviate power supply shortages.

- **Trade reforms.** The Bank and the Fund are working closely to help Tanzania establish a pro-growth trade program. Within the context of the Integrated Framework, the Bank led the preparation of a Diagnostic Trade Integration Study that was issued in July 2005. The Bank will carry out follow up trade and competitiveness analytical work in the coming years, possibly through the soon—to –be-established Multi-Donor Trust Fund for Mainstreaming Trade The Bank is working toward trade expansion though its regional trade facilitation project. It is also active at the regional level in the dialogue on trade reforms within the East African Community.

World Bank Lead Economist: Paolo Zacchia

III. Tanzania: Statistical Issues

Economic and financial statistics are adequate for surveillance and program monitoring purposes, but remain weak despite progress in some areas and considerable technical assistance. There are few statistical publications and no fully articulated publication policy. Only limited data are reported for Zanzibar. The authorities are committed to improving the production and dissemination of macroeconomic and socio-demographic statistics through the General Data Dissemination System (GDDS). GDDS metadata were posted on the IMF's Dissemination Standards Bulletin Board (DSBB) in July 2001 and were last updated in November 2005. A mission to prepare the data module for the Report on the Observance of Standards and Codes (data ROSC) was completed in October 2002, and the report was published in March 2004.

National accounts

National accounts statistics for mainland Tanzania are prepared by the National Bureau of Statistics (NBS) on the basis of data collected by its regional offices and by other government entities. Separate accounts for Zanzibar are compiled by the Office of the Chief Government Statistician for Zanzibar. The data sources for compiling the estimates for Tanzania by expenditure category, the external sector data, and the indicators used to extrapolate benchmark production levels suffer from deficiencies that complicate estimation of savings-investment. The accounts are largely based on the *1968 System of National Accounts* (*1968 SNA*), but also include certain elements of the *1993 SNA*, such as the inclusion of elements of government expenditure (health and education) as household consumption, and the valuation of imports of goods at free-on-board (fob) prices. Annual national accounts are published at current and constant (1992) prices. Annual GDP estimates are also compiled at current prices for 21 regions of Tanzania. To improve the quality of the national accounts, the authorities, with help from donors, are changing the base year of the national accounts from 1992 to 2001. The revised series will be based on the Household Budget Survey (HBS) 2000/01, Integrated Labour Force Survey (ILFS) 2000/01 and Annual Survey of Industrial Production 1999/2000. An East AFRITAC mission in April 2006 provided training and assistance in the compilation of quarterly national accounts (QNA), which have been compiled at current prices since 2001 but have not been yet released. The series have some methodological shortcomings, and in particular suffer from poor source data in the retail and wholesale sector. Recommendations have been made for improvements and for the compilation of constant (2001) price quarterly national accounts, pending also the production of annual accounts using the new base year.

Prices

The NBS compiles a monthly consumer price index (CPI) for mainland Tanzania based on consumer expenditure in 20 urban centers, and a separate price index (urban) is compiled for

Zanzibar. The CPI has, since September 2004, been compiled (retroactively to January 2003) using weights based on the 2000/01 HBS data. Key changes were a reduction in the weight given to food from 71 percent to 56 percent and an expansion of the number of products. The index excludes imputations for the price changes of owner-occupied housing. However, methodological problems that may have understated inflation led to the release of a revised CPI from September 2006, though this has not been backdated. The NBS has plans for a new HBS to be conducted in 2006/07, which should eventually lead to revision of the CPI weights.

Government finance statistics

The authorities provide Fund missions with monthly data on central government revenue, expenditure, and financing on a timely basis. Although the underlying concepts broadly follow the *Government Finance Statistics Manual 1986*, the reporting differs from international standards in coverage and the treatment of lending minus repayments, and transfer payments. Coverage of data on the operations of the central government refers to Tanzania mainland only – recently the Ministry of Finance of Zanzibar established a unit tasked with developing a fiscal reporting framework for Zanzibar. The data also exclude the operations of extra-budgetary units and funds. Data for general government are not available as no information is yet provided on the financial position of local governments, although the authorities have stated their intention to produce such reports.

Despite improvements in the recording of government transactions, discrepancies remain between revenue and expenditure data, on the one hand, and financing data. The discrepancies are related to the lack of a fully integrated set of accounts and the delineation of the public sector and its sub-sectors, differing source data, and timing differences.

The Ministry of Finance created a database of donor-funded projects in 2001/02 (July-June), with donor assistance. Since then, the number of foreign-financed projects reported by and channeled through the budget has increased significantly.

The government has completed the computerization of its accounting system for budgetary units. Although the authorities indicated that it would allow resumption of reporting in the *Government Finance Statistics Yearbook (GFSY)*, no data were reported for the 2006 *GFSY*. The computerized accounting system does not yet provide details about donor funded development expenditure and has not yet been extended to cover the extra-budgetary units. The authorities regularly report fiscal data for inclusion in the *IFS*.

Monetary statistics

The monetary statistics are broadly adequate for policy and analysis purposes. Nevertheless, a November-December 2006 mission confirmed earlier findings of methodological problems, such as (a) exclusion of some deposit-taking financial institutions from the institutional coverage of monetary survey, (b) arbitrary application of the residency criterion by the commercial banks, (c) inadequate subdivision of the resident sector data, (d) misclassification of certain accounting data among statistical aggregates, (e) discrepancies between reported interbank positions, (f) non-transparent treatment of repurchase agreements, and (g) key information gaps in the bank reporting system. It was also found that international reserves data included certain assets that did not qualify as reserve assets.

To address these problems, recommendations were made to improve the following definitions: net international reserves, foreign assets, foreign liabilities, loans to other resident sectors, claims on the central government, government deposits, central bank liabilities to commercial banks, and deposits included in broad money. The mission also (a) introduced the standardized report form─1SR for reporting central bank data to the IMF; (b) recommended that some additional schedules for reporting of data by commercial banks be introduced to fully satisfy compilation needs, in particular with respect to the sectoral breakdown of financial instruments used by commercial banks in their activities; and (c) recommended the expansion of the depository corporations to include other deposit-taking financial institutions, such as the savings and credit cooperatives, Pride Tanzania L.M.T., Presidential Trust Fund (PTF), Small Enterprises Development Agency, Tanzania Investment Bank, Tanzania Postal Bank, Twinga Bancorp Limited, Mufindi Community Bank, and Mwanga Community Bank. A follow-up mission in FY2008 will assist the authorities in developing the standardized report form for other depository corporations.

Balance of payments statistics

Foreign trade data are prepared by Fund staff missions on the basis of customs data provided by the Bank of Tanzania, which in turn are compiled by the Tanzania Revenue Authority (TRA) based on customs records. A balance of payments statistics mission in May 2002 found continued and significant under-recording of trade and a dearth of information on services. The authorities acknowledged these problems in their response to the data ROSC report published in March 2004 and indicated that the Bank of Tanzania plans to commission a joint study by the NBS and the TRA to determine the magnitude of underrecorded trade and design an appropriate method of estimation. Re-exports are now included in trade data. Balance of payments statistics are reported annually to STA for publication in the *IFS*, along with the annual International Investment Position (IIP).

Tourism revenues are now estimated using the model that was developed from the International Visitor’s Exit Survey conducted in 2001. Using the model and subsequent annual surveys, estimates have been made for 2001 through 2005.

Information on official grant and loan receipts is prepared by Fund staff based on contacts with official agencies. The data on current and capital transfers (grants) are estimates, based on data provided by the Ministry of Finance and United Nations Development Program projections. Disaggregation of the data has improved, but more work is needed including on the coverage and periodicity of data.

Data on private capital flows are presently minimal. While some information on private banking sector flows can be derived from the monetary survey, other private capital flows are not adequately captured through the International Transaction Reporting System (ITRS) and are largely reflected in "errors and omissions." However, the authorities have made commendable progress in collecting information on certain components. The results of the Private Capital Flows Survey for 2000 and 2004 have now been incorporated into the balance of payments and IIP accounts, which improved estimates of foreign direct investment inflows as well as dividend payments and distributed branch profits. The Private Capital Flows Survey is designed to capture information on foreign direct investment and also asks investors to report committed and projected (for the near future) direct investment flows.

Data on the gross and net official reserves of the Bank of Tanzania are provided monthly with a short lag, and are available to the Fund with higher frequency on request. Similarly, data on the foreign assets and liabilities of the banking system are provided with relatively short lags.

Significant improvements in the quality of external debt data have been made in the context of the creditor reconciliation exercise under the HIPC Initiative. At present, all multilateral and Paris Club debts (accounting for about 80 percent of total external debt) have been fully reconciled. However, less progress has been made in reconciling debt owed to other bilateral and commercial creditors. Information on external debt not guaranteed by the public sector, mostly private sector debt, is also limited and not captured in a timely manner.

East AFRITAC has provided assistance in international investment position statistics, most recently in March 2007. The missions have worked on training, questionnaires, and revised guidelines for international transaction dealers.

TANZANIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of May 23, 2007)

	Date of latest observation	Date received	Frequency of data[6]	Frequency of reporting[6]	Frequency of publication[6]	Memo Items: Data Quality – Methodological soundness[7]	Memo Items: Data Quality Accuracy and reliability[8]
Exchange Rates	April 2007	May 2007	M	M	M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	February 2007	March 2007	D, M	D, M	M		
Reserve/Base Money	April 2007	May 2007	M	M	M	LO, LO, LO, LO	LO, O, O, O, LO
Broad Money	April 2007	May 2007	M	M	M		
Central Bank Balance Sheet	April 2007	May 2007	M	M	M		
Consolidated Balance Sheet of the Banking System	April 2007	May 2007	M	M	M		
Interest Rates[2]	April 2007	May 2007	M	M	M		
Consumer Price Index	April 2007	May 2007	M	M	M	O, LO, O, LO	LNO, LNO, LNO, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	...	...	...	...	...	LNO, LNO, LNO, LO	LO, O, O, LO, O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	March 207	May 2007	M	M	Q		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	January 2007	March 2007	M	M	A		
External Current Account Balance	2005	September 2006	A	A	A	LO, LO, LO, LO	LO, LNO, O, LNO, LNO
Exports and Imports of Goods and Services	April 2007	May 2007	M	A	A		
GDP/GNP	2005	May 2006	A	A	A	LO, LO, LO, LO	LNO, LNO, O, LO, LO
Gross External Debt	June 2006	September 2006	M	M	A		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC published March 23, 2004 and based on the findings of the October 2002 mission for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[8] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 07/79
FOR IMMEDIATE RELEASE
July 16, 2007

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2007 Article IV Consultation with the United Republic of Tanzania

On June 27, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the United Republic of Tanzania.[1]

Background

Tanzania's economic performance has been strong over the past decade, supported by prudent macroeconomic policies and far reaching structural reforms. In particular, sound financing of government operations—including substantial assistance from international donors—facilitated a monetary policy stance that reduced inflation while allowing for a rapid expansion of credit to the private sector for productive purposes.

The structural reform agenda has focused on economic liberalization, improved public financial management and tax and customs administration, and financial sector development. Together with infrastructure investment and structural policies to enhance the business environment, this has contributed to solid productivity growth. The growing economy, together with increasing government revenues and donor assistance, has enabled government spending to expand at a swift pace, most notably on pro-poor initiatives outlined in MKUKUTA (Tanzania's second generation growth and poverty reduction strategy). Nevertheless, with a GDP per capita of less than US$340 and widespread poverty, Tanzania still has a long way to go to reach its

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Millennium Development Goals (MDGs), and will therefore require continued donor financing for many years to come, particularly, in the areas of education, health, and infrastructure.

Since 2000, real GDP growth has averaged 6.3 percent per annum, one of the highest in sub-Saharan Africa. Growth has been broad-based, led by the mining, construction, retail/trade and manufacturing sectors. Agricultural growth has been affected however by recurrent droughts. The most recent of these, in 2005-06, also coincided with poor hydrology to markedly reduce Tanzania's hydropower-generating capacity, forcing many businesses and consumers to rely on high-cost thermal generators. With world fuel prices trebling over the same period, the high cost of electricity squeezed business profits, and placed upward pressure on the import bill and inflation. Thus, real GDP growth slowed down to 6.2 percent in 2006—0.5 percentage points slower than in the previous two years—while inflation accelerated slightly to 6.7 percent. Going forward, strong rains and full recovery in hydropower production are expected to help boost growth and dampen inflation.

Exceptional improvements in tax and customs administration and public expenditure management have both reinforced development partner confidence in the authorities' commitment to reform, and increased the effectiveness of government expenditures. Since 1999/2000, government revenues and donor support have, respectively, risen by 4½ and 6½ percentage points of GDP, allowing government spending to grow by some 10 percentage points of GDP, to slightly over 28 percent of GDP in 2006/07. Moreover, the increased spending has focused on MKUKUTA priorities, with allocations rising to 13.6 percent of GDP for 2006/07, up from 12.8 percent the previous year.

Monetary aggregates have grown at a robust but prudent pace since 2000, reflecting rapid financing deepening, albeit starting from a very low base. Bank lending to productive nongovernment sectors has expanded sharply—at an average rate of 32 percent per annum—while the spread between lending and deposit rates has continued to narrow, indicating more efficient intermediation by banks.

The sharp increase in private sector lending coupled with higher issuance of treasury bills—mainly, for liquidity absorption purposes—have put upward pressure on government securities yields, with rates peaking at 18 percent in March 2007. The rates have also become increasingly volatile since 2005, reflecting a combination of challenges in liquidity forecasting and smooth implementation of reserve money targets. Going forward, pressure on nominal yields should subside with reduced reliance on domestic sterilization of aid inflows, near zero net domestic financing of the budget, improved liquidity forecasting system, and more even implementation of monetary policy.

The recent widening of the trade deficit reflects the rise in capital-goods and energy-related imports over the last two years. The exchange rate, which had depreciated in line with the terms of trade deterioration, has stabilized of late due to higher foreign exchange sales by the central bank and a reduction in the need for energy-related imports. The external position has also benefited from debt relief provided under the Heavily Indebted Poor Countries Initiative (HIPC) and Multilateral Debt Relief Initiative, as well as additional bilateral relief. Tanzania's external debt burden, in net present value terms, was reduced to about 16 percent of GDP at end-2006.

In light of its status as a mature stabilizer with comfortable international reserves, Tanzania has entered a new phase in its long-term relationship with the Fund. On February 16, 2007 Executive Directors approved a three-year program under the Policy Support Instrument (PSI). The government views the PSI as essential to reinforce appropriate macroeconomic and structural policies, and signal the strength of government policies to development partners.

Executive Board Assessment

Executive Directors commended Tanzania's strong overall economic performance in recent years, which has been grounded on a sound macroeconomic policy framework, progress on structural reforms, and substantial donor assistance. However, Directors noted that major challenges remain, including the high and pervasive poverty, significant capacity constraints in the public sector, and insufficient infrastructure and human capital. They emphasized the need to maintain prudent market-oriented policies and steadfastly pursue structural reforms, particularly in the agricultural sector, as the basis for attracting additional donor inflows and achieving the Millennium Development Goals.

Directors agreed that fiscal policy remains appropriately focused on minimizing domestic borrowing while raising spending on poverty reducing activities. They commended the strong revenue performance in recent years, observing that revenue growth is essential to reducing dependence on donor financing, and welcomed plans to further strengthen tax and customs administration. They also encouraged the authorities to press forward with reforms to improve public financial management to ensure that public resources are allocated efficiently and in line with the priorities of the poverty reduction strategy. Directors considered Tanzania to be a good candidate for a significant increase in donor support, but noted the importance of further work to assess the macroeconomic effects of aid.

Directors commended the authorities' prudent monetary policy stance that has kept inflation comparatively low. They noted the challenge of properly managing bank liquidity in the context of substantial donor inflows and under-developed financial markets. They supported increased reliance on foreign exchange sales to contain liquidity, noting that this will help to ease pressure on treasury bill yields. However, they stressed that appropriate balance will need to be struck in the use of liquidity management instruments. Directors also supported the authorities' other efforts to improve liquidity management to reduce the level and volatility of treasury bill yields, including domestic bond market development, better liquidity forecasting through improved coordination between monetary and fiscal policy, daily targeting of average reserve money, and transfer of government deposits from commercial banks to the central bank.

Directors considered the real exchange rate to be broadly in line with fundamentals. They were of the view that the flexible exchange rate policy has helped to preserve Tanzania's international competitiveness in the face of several adverse shocks. Nevertheless, they underlined the need to remove structural impediments to competitiveness. Directors encouraged the authorities to continue to avoid non-concessional borrowing in order to preserve external debt sustainability.

Directors noted that ongoing financial sector reforms have contributed to a rapid expansion of financial intermediation, although small- and medium-sized enterprises and the rural sector have not benefited much. They welcomed the second-generation Financial Sector Reform Action Plan, which is intended to address this gap. Directors, however, stressed the importance of minimizing contingent liabilities in connection with the partial guarantee of commercial lending to small- and medium-sized enterprises.

Directors emphasized the importance of the authorities' commitment to improving governance and transparency. They welcomed efforts to address the allegations of improprieties in the management of the external payment arrears account at the Bank of Tanzania, and looked forward to timely completion of the special audit of this account. They recommended that another safeguards assessment of the Bank of Tanzania be undertaken to complement the audit. Directors encouraged the rapid implementation of the recently approved Anti Money Laundering Act, and welcomed the adoption of the National Anti-Corruption Strategy Action Plan and the approval of the Anti-Corruption Act.

Directors welcomed the authorities' plans to remove key bottlenecks to economic activity in Tanzania, particularly those to upgrade the energy and transport infrastructure and to further modernize and simplify the legal framework governing business activity. They encouraged vigorous implementation of the financial recovery program for the energy parastatal to ensure its commercial viability and reduce the potential drain on the budget.

Directors considered that Tanzania has much to gain from deeper regional cooperation and integration. They supported a coordinated approach to providing regional investment incentives, full implementation of the East African Community's Customs Union Protocol, and further trade liberalization to deepen the regional integration process.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Tanzania: Selected Economic Indicators, 2004/05 - 2006/07 1/

	2004/05	2005/06	2006/07 Proj.
	(Annual percentage change)		
Domestic economy 2/			
Real GDP	6.7	6.7	6.2
Consumer prices (end of period)	4.1	5.0	6.7
	(In millions of U.S. dollars) 3/		
External economy			
Exports, f.o.b.	1,594	1,736	1,830
Imports, f.o.b.	2,728	3,436	4,081
Current account (excluding official transfers)	-1,144	-1,608	-2,051
(in percent of GDP)	-9.4	-13.3	-15.4
External assistance 4/	1,409	1,354	1,515
Public external debt service paid	124	68	32
(in percent of exports of goods and nonfactor services)	4.6	2.3	1.0
Gross official reserves	1,969	1,995	2,045
(in months of imports of goods and nonfactor services)	5.9	4.4	4.0
Change in real effective exchange rate (in percent) 5/	-0.6	-7.6	--
	(In percent of GDP)		
Public finance			
Domestic revenues	13.3	14.1	15.7
Central government balance (including grants)	-3.5	-6.1	-4.5
Net domestic financing	1.1	2.3	0.2
Public external debt 2/	69.2	64.4	35.5
	(In percent)		
Monetary and financial variables			
Change in broad money	25.5	31.6	21.0
Change in credit to nongovernment sector	26.2	35.9	35.1
Treasury bill rate 6/	10.4	9.3	16.0
Spread (lending vs. deposit rates) 2/	10.4	9.7	9.2

Sources: Tanzanian authorities, and IMF staff estimates
1/ Fiscal years run from July to June.
2/ Data are on calendar year basis; 2004/05 data are for calendar year 2004.
3/ Unless otherwise indicated.
4/ Multilateral and bilateral grants and loans (including IMF disbursements).
5/ (+) = appreciation
6/ Monthly weighted average of 35-, 91-, 182- and 364-day treasury bills. March 2007 figure is used for 2006/07.

Press Release No. 07/144
FOR IMMEDIATE RELEASE
June 27, 2007

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes the First Review under the Policy Support Instrument for Tanzania

The Executive Board of the International Monetary Fund (IMF) today completed the first review under a three-year Policy Support Instrument (PSI) for Tanzania. The PSI was approved on February 16, 2007 (see Press Release 07/26).

In completing the review, the Executive Board agreed to waive the missed ceiling on reserve money for end-December 2006, based on the relatively small excess and corrective actions taken.

The IMF's framework for PSIs is designed for low-income countries that may not need IMF financial assistance, but still seek close cooperation with the IMF in preparation and endorsement of their policy frameworks. PSI-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners. This is intended to ensure that PSI-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. Members' performance under a PSI is reviewed semi-annually, irrespective of the status of the program (see Public Information Notice No. 05/145).

Following the Board's discussion on Tanzania, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, made the following statement:

"For several years, Tanzania has sustained strong economic performance through market-oriented policies within an appropriate macroeconomic framework. Nevertheless, Tanzania remains a poor country, and the authorities will need to maintain sound policies and pursue structural reforms diligently in order to remove impediments to growth and achieve their long-term economic and social objectives.

"Tanzania's macroeconomic framework and structural reform agenda under the Policy Support Instrument remain a good basis for raising economic growth and reducing poverty. Fiscal policy will continue to anchor a stable macroeconomic environment by maintaining near-zero net domestic financing, while strong revenue growth and substantial donor support would allow for high levels of spending on economic and social priorities.

“The monetary stance remains appropriate. An important challenge for the authorities is to contain liquidity arising from donor-funded government spending while avoiding high and volatile short-term interest rates. In this context, greater reliance on foreign exchange sales is necessary, along with efforts to better coordinate monetary and fiscal policy and to develop the domestic bond market.

“A reliable and ample energy supply is key to economic growth. In this regard, rapid progress towards the commercial viability of the energy parastatal, TANESCO, is critical. The authorities should vigorously support TANESCO’s financial recovery program, including its forthcoming application for an electricity tariff increase that would enable full recovery of operating costs.

“The Tanzanian authorities are undertaking appropriate actions and commitments to improve governance and transparency. They are making good efforts to strengthen the Prevention of Corruption Bureau and to address the allegations of improprieties in the management of the government’s external payment arrears account at the Bank of Tanzania. The forthcoming special audit of this account should be conducted in a timely manner and in line with best international standards,” Mr. Portugal said.

Statement by Peter Gakunu, Executive Director for United Republic of Tanzania and Joseph L. Masawe, Senior Advisor to Executive Director
June 27, 2007

Over the review period, the Tanzanian authorities remained committed to the objectives of the program, which has resulted in continued robust performance of the economy. They thank management and staff for the constructive dialogue, and the Board for its support and guidance. The authorities reaffirm their commitment to pursuing prudent polices as agreed under the PSI and request the completion of the first review. The Tanzanian authorities are in general agreement with the assessment by staff on the economic developments and program implementation during the review period.

1.0 Program Performance

The implementation of the PSI has been satisfactory, with all structural benchmarks and all but one of the quantitative assessment criteria for end-December 2006 being achieved. The reserve money target for end-December 2006 was narrowly missed, but the financial program has been brought back to the PSI targets, with all end-March 2007 indicative targets observed. However, a structural benchmark for end-June 2007 pertaining to the submission of a proposed unified legal framework and investment guidelines for pension funds was delayed due to reasons beyond the authorities' control. This will now be completed by end-September 2007.

The year 2007/08 is expected to witness stronger economic performance, arising mainly from improvements in hydrological conditions that would normalize electricity generation and contribute to good harvests. GDP growth is projected to reach 7.1 percent in 2007, rising further to 7.5 percent and 7.9 percent in 2008 and 2009, respectively. This is expected to relieve pressure on food prices, which constitute over 55 percent of the CPI, allowing inflation to stabilize at around 5 percent.

2.0 Recent Developments and Medium Term Outlook

2.1 Macroeconomic performance

Tanzania has continued to grow strongly over the past decade, with real GDP growth averaging 6.3 percent over the past six years. During 2006/07, the economy continued to perform outstandingly well, with real GDP growth estimated to reach 6.2 percent, above a projected level of 5.9 percent. This robust growth has been achieved despite a severe drought which hit the country in early 2006, adversely affecting agriculture and energy production. Similarly, against the odds, inflation was maintained at a single digit level, albeit with a rising trend mainly on account of food and oil prices. Inflation is however projected to decline in the coming months, to reflect the impact of declining food prices and improved power generation arising from good weather.

2.2 Fiscal Performance

The outcomes of the 2006/07 fiscal program are broadly in line with targets. This was achieved despite the energy crisis which could have caused major disruption in revenue collection. Revenue performance is above program target, and is expected to reach 15.7 percent by end-June 2007, compared to the projected level of 14.7 percent of GDP. This was as a result of the strong economic performance and ongoing reforms at the Tanzania Revenue Authority (TRA) to improve its operations.

Expenditure is projected to be below programmed level, due to prudent fiscal approach adopted by the government, despite the pressure, to avoid possible breach of targets which could arise from larger than projected domestic payments resulting from the impact of the drought and rising fuel prices. Expenditures for priority sectors, which are linked to the achievement of the MDGs, remained protected.

Consistent with the objectives of MKUKUTA, the Tanzanian authorities continued to strengthen expenditure management by promoting transparency and accountability in public expenditure and training accounting staff at all levels. The Integrated Financial Management System (IFMS) now covers 85 percent of the Local Government Authorities (LGAs). The government continues to train accounting staff, with the objective of ensuring that the government is served with qualified accounting officers at all levels. A Cash Management Unit (CMU) has been established at the Ministry of Finance to support the joint functions of expenditure management of the office of the Accountant General and liquidity management of the Bank of Tanzania.

Revenue collection is further projected to reach 16.1 percent of GDP in 2007/08, driven by the ongoing customs and tax reforms, including the integration of ASYCUDA and TISCAN systems in customs. The authorities will continue to improve public expenditure management, to ensure that expenditures remain aligned with resources available. In this regard, the link between budgetary resources and MKUKUTA priorities will be strengthened, through the integration of the Strategic Budget Allocation System (SBAS) and the IFMS at all levels of government.

In the medium term, the government projects a gradual increase in infrastructure spending, in part to implement the growth strategy, while at the same time reduce liquidity pressures in the economy, arising from increased donor inflows. In the meantime, the government will strengthen donor coordination through the Joint Assistance Strategy for Tanzania (JAST) which should facilitate scaling up of aid, in line with the international community's commitment.

2.3 Monetary and Financial Sector Policies

The monetary policy of the Bank of Tanzania is geared towards the containment of inflationary pressures, arising from the impact of the drought as well as the rising fuel prices. However, interest rates remained high with a wide spread between deposit and lending rates, reflecting the thinness of the markets. Nevertheless, the demand for government securities remained strong following the widening of the circle of primary market participation by the Bank of Tanzania.

The authorities remain committed to financial sector reforms continued to be implemented in line with the Financial Sector Reform Implementation Action Plan (FSIAP) whose objectives include putting in place leasing and mortgage laws and modalities for the introduction of specific products for commercial banks' lending to small and medium scale enterprises (SMEs).

Monetary policy during 2007/08 policy will continue to focus on the primary objective of price stability. This will be achieved through the control of reserve money, consistent with the growth and inflation objectives of the government. At the same time coordination between fiscal and monetary policies will be strengthened to avoid undue volatility in the market. The BOT will seek to attain a proper mix of its available monetary instruments to ensure orderly developments in the markets. The BOT will therefore, step up its foreign exchange sales in the market, especially given the comfortable level of official reserves.

Continued credit growth will be given priority, in line with the financial program. At the same time, measures to enhance the flow of credit to SMEs through existing credit guarantee schemes, including the Development Finance Guarantee Facility (DFGF), will be strengthened.

2.4 External Sector Developments

The export sector in Tanzania remains vulnerable to exogenous shocks, especially those associated with weather and terms of trade. During the review period, developments in the external sector were highly influenced by the sharp increase in international prices of oil, which considerably raised the oil import bill and imports in general. Nevertheless, over the review period, the overall performance of the external sector was positive due to continued strong inflows of donor assistance and debt relief received under the MDRI.

The Tanzanian authorities recognize that regional cooperation will continue to play an important role towards sustaining sound macroeconomic policies and enhancing growth. The government will continue to participate actively in regional efforts to strengthen the existing regional trading arrangements, especially within the East African Community (EAC). The authorities recognize that the EAC will continue to be the primary vehicle in its efforts to strengthen regional cooperation. The Tanzanian authorities will work closely with other EAC partner states, to formulate a coordinated approach to investment and trade liberalization in the region. Meanwhile, efforts will continue to be taken to address the issue of overlapping membership in regional cooperation arrangements, including Tanzania's membership in SADC and Kenya and Uganda's membership in COMESA.

2.5 Improving Energy Supply and Infrastructure

A major drought that hit the country during the last three years led to substantial loss in power generation capacity and a financial crisis to the state-owned power utility company, TANESCO. A financial recovery plan (FRP) for TANESCO has been adopted by the government and additional gas based generation capacity to supplement the current hydro-based generation has been acquired by TANESCO. With a view to bringing the utility company back to profitability, some tariff increases through full cost recovery have been implemented and will continue to be implemented by the company.

On infrastructure, a draft medium term transportation infrastructure investment plan (TSIP), to be aligned with the medium term expenditure framework (MTEF), has been prepared by the government to facilitate a planned investment in the sector.

The Tanzanian authorities recognize that faster and broader based growth will be necessary for Tanzania to succeed in its efforts to reduce poverty. The government is fully aware that progress towards achievement of the objectives of MKUKUTA remains slow and is committed to accelerate its efforts in this endeavor.

To this end, reforms in the energy sector will be deepened to enhance the contribution of the sector to growth. In line with the FRP, TANESCO will, implement gradual electricity tariff increases to match the rising cost of power generation and thereby ensure its financial sustainability. Measures are also underway to attract more private sector investors into the energy sector to complement TANESCO's efforts.

2.6 Improving Governance

The Tanzanian authorities remain committed to strengthening institutions of economic and political governance in the fight against corruption, while it combats corruption. The government launched the second National Anti-Corruption Strategy Action Plan (NACSAP II) in December 2006 and parliament approved a new Anti-Corruption Law in April 2007. The law will go a long way towards strengthening the fight against corruption in Tanzania, through among other means, strengthening the Prevention of Corruption Bureau (PCB). My government is working closely with the Fund on the special audit of the BOT accounts related to external payment arrears (EPA), as detailed in its supplementary letter of intent of February 8, 2007. The government, through the Controller and Auditor General (CAG) has launched a competitive bidding process for a special audit of the transactions related to the account, by an audit firm compliant with International Standards of Auditing (ISA) and experienced in International Financial Reporting Standards (IFRS). The special audit is expected to be completed in October 2007. The authorities will take the appropriate remedial measures in consultation with the Fund. Meanwhile, all outstanding obligations and planned payments from the account have been suspended.

3.0 Conclusion

The Tanzanian authorities remain committed to the continued implementation of prudent policies and deepening of the reform agenda. This will be achieved through effective implementation of the Fund supported PSI as spelt out by the national growth strategy, MKUKUTA, which seeks to attain sustained macroeconomic stability, enhanced public resource mobilization, efficiency in spending and enhanced contribution of the financial sector to growth. The authorities will continue to take measures to improve the business environment and fight corruption. Consistent with the PSI, the government will particularly continue to limit domestic financing to reduce inflation, while facilitating further expansion of private sector credit for productive purposes. My authorities are grateful for the support they continue to enjoy from the Fund and from the international community as a whole and count on their continued future support.