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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

ON A PROPOSED DEVELOPMENT POLICY CREDIT

IN THE AMOUNT SDR 65.2 MILLION
(US$100 MILLION EQUIVALENT)

TO THE

UNITED REPUBLIC OF TANZANIA

FOR A

SECOND POWER AND GAS SECTOR DEVELOPMENT POLICY OPERATION

February 26, 2014

Poverty Reduction and Economic Management 5, AFTP5
Eastern Africa Country Cluster 1, AFCE1
Africa Region

TANZANIA - **GOVERNMENT FISCAL YEAR**
July 1 – June 30

CURRENCY EQUIVALENTS
Exchange Rate Effective (as of January 31, 2014)

Currency Unit	Tanzania Shilling (T Sh)
US$1.00	T Sh 1,623.01

Currency Unit	Special Drawing Right (SDR)
US$1.00	SDR 0.65

(Weights and Measures
Metric System)

ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank
BRN	Big Results Now
BoT	Bank of Tanzania
CAG	Controller and Auditor General
CAS	Country Assistance Strategy
CEM	Country Economic Memorandum
CIDA	Canadian International Development Agency
CPIA	Country Policy and Institutional Assessment
COD	Commercial Operation Date
CoSS	Cost of Service Study
CSO(s)	Civil Society Organization(s)
DfID	Department for International Development (United Kingdom)
CSR	Corporate Social Responsibility
DPs	Development Partners
DPO(s)	Development Policy Operation(s)
DSA	Debt Sustainability Analysis
EAC	East African Community
EDPG	Energy Development Partner Group
EIA(s)	Environmental Impact Assessment(s)
EITI	Extractive Industries Transparency Initiative
EMA	Environmental Management Act
EPPs	Emergency Power Projects
ESCBP	Energy Sector Capacity Building Project
EU	European Union
EWURA	Energy and Water Utilities Regulatory Authority
FDI	Foreign Direct Investment
FY	Fiscal Year (Financial Year)
FYDP	Five Year Development Plan
GBS	General Budget Support
GDP	Gross Domestic Product
GoT	Government of Tanzania
GSAs	Gas Sales Agreements

HBS	Household Budget Survey
HFO	Heavy Fuel Oil
IDA	International Development Association
IMF	International Monetary Fund
IPPs	Independent Power Producers
KPIs	Key Performance Indicators
kWh	Kilowatt(s)-hour
LNG	Liquefied Natural Gas
MCC	Millennium Challenge Corporation
MDGs	Millennium Development Goals
MEM	Ministry of Energy and Minerals
MKUKUTA	Mkakati wa Kukuza Uchumi na Kupunguza Umaskini Tanzania
mmbtu	Million British Thermal Unit
mmscfd	Million Standard Cubic Feet per Day
MoF	Ministry of Finance
MW	Megawatt(s)
M&E	Monitoring and Evaluation
NAO	National Audit Office
NKRAs	National Key Result Areas
NEMC	National Environmental Management Council
NEPAD	New Partnership for Africa's Development
NORAD	Norwegian Agency for Development
OGI	Open Government Initiative
OGP	Open Government Partnership
OSHA	Occupational Safety and Health Authority
PABs	Public Authorities and Other Bodies
PAF	Performance Assessment Framework
PDB	Presidential Delivery Bureau
PDO(s)	Program Development Objective(s)
PGSDPO	Power and Gas Sector Development Policy Operation
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PFM	Public Financial Management
PFMRP	Public Financial Management Reform Program
POPC	President's Office Planning Commission
PPP(s)	Public Private Partnership(s)
PPRA	Public Procurement Regulatory Authority
PRBS	Poverty Reduction Budget Support
PRSC	Poverty Reduction Support Credit
PSI	Policy Support Instrument
PSMP	Power System Maser Plan
PSPF	Public Service Pension Fund
SADC	Southern African Development Community
SCF	Standby Credit Facility
SEA	Strategic Environmental Assessment
SEAP(s)	Sector Environment Action Plan(s)
SESIA	Strategic Environmental and Social Impact Assessment
SIM	Subscriber Identity Module
TANESCO	Tanzania Electric Supply Company
TASAF	Tanzania Social Action Fund
Tcf	Trillion Cubic Feet

TDV	Tanzania Development Vision
TEDAP	Tanzania Energy Development and Access Project
TPDC	Tanzania Petroleum Development Corporation
TRA	Tanzania Revenue Authority
TSh	Tanzanian Shilling
USAID	United States Agency for International Development
US¢	United States Cents
US$	United States Dollars
VAT	Value Added Tax
VETA	Vocational Education Training Authority
VPO	Vice President's Office

Vice President:	Makhtar Diop
Country Director:	Philippe Dongier
Sector Director:	Marcelo Giugale
Sector Manager:	Albert Zeufack
Sector Leader:	Jacques Morisset
Task Team Leader:	Yutaka Yoshino

The Credit has been prepared by an IDA team consisting of: Yutaka Yoshino (Task Team Leader, AFTP5); Vladislav Vucetic, Natalyia Kulichenko, Mustafa Zakir Hussain (AFTG1); Jacques Morisset, Emmanuel Mungunasi, Victoria Cunningham, Nicola Woodroffe, Lydie Ahodehou (AFTP5); Zhengjia Meng (TWIFS); Alexander Huurdeman (SEGOM); Justina Kajange (AFCE1); Zoe Kolovou (LEGAM); and Luis Schwarz (CTRLA). The core team benefited from support of Roy Sudharshan Canagarajah (AFTDE), Hilda Emeruwa (AFTPM), Oliver Braedt (AFTSN), Ann Jeannette Glauber, Amy Faust (AFTN3), Helen Shahriari (AFTCS), Alexandra C. Bezeredi, Hanneke Van Tilburg (AFTSG), Leah Mukuta (AFCE1), Isis Gaddis, Nadia Belhaj Hassine – Belghith (AFTP5), Mercy Sabai (AFTME), and Donald Mneney (AFTPC) and other reviewers at various stages of the preparation. Philippe Dongier (AFCE1), Sajjad Ali Shah (AFCTZ), Marcelo Giugale (AFTPM), Albert Zeufack (AFTP5), Jamar Saghir (AFTSM), Lucio Monari (AFTG1), and Pankaj Gupta (TWIFS) provided guidance. Milan Brahmbhatt (PRMVP), Charles Feinstein (EASWE), and Havard Halland (PRMPS) are the peer reviewers.

TABLE OF CONTENTS

I. INTRODUCTION AND COUNTRY CONTEXT 1
II. MACROECONOMIC POLICY FRAMEWORK 3
A. Recent Economic Developments 3
B. Macroeconomic Outlook and Debt Sustainability 7
C. IMF Relations 11
III. THE GOVERNMENT'S PROGRAM 11
A. National Development Program 11
B. The Power and Gas Sector Programs 12
IV. THE PROPOSED OPERATIONS 14
A. Link to Government Program and Operation Description 14
B. Prior Actions, Results, and Analytical Underpinnings 16
C. Link to CAS and Other Bank Operations 26
D. Consultations and Collaboration with Other Development Partners 27
V. OTHER DESIGN AND APPRAISAL ISSUES 28
A. Poverty and Social Impact 28
B. Environmental Aspects 30
C. Public Financial Management, Disbursement, and Auditing Aspects 33
D. Monitoring and Evaluation 35
VI. SUMMARY OF RISKS AND MITIGATION 35

ANNEXES

ANNEX 1: POLICY AND RESULTS MATRIX 38
ANNEX 2: LETTER OF DEVELOPMENT POLICY 41
ANNEX 3: FUND RELATIONS ANNEX 54
ANNEX 4: RESULTS OF UPDATED TANESCO FINANCIAL MODEL 56
ANNEX 5: NEPAD FRAMEWORK OF NATURAL RESOURCE CHARTER 60
ANNEX 6: EXPECTED IMPACT OF THE PGSDPO SERIES ON ECONOMIC GROWTH AND POVERTY REDUCTION 61
ANNEX 7: ENERGY SECTOR CAPACITY BUILDING PROJECT (ESCBP) 67
ANNEX 8: MAP OF TANZANIA 68

CREDIT AND PROGRAM SUMMARY
UNITED REPUBLIC OF TANZANIA
SECOND POWER AND GAS SECTOR DEVELOPMENT POLICY OPERATION

Borrower	United Republic of Tanzania
Implementing Agency	Ministry of Finance
Financing Data	IDA credit for the amount of SDR 65.2 million (US$100 million equivalent); Standard IDA terms: 40-year maturity with a 10-year grace period.
Operation Type	Programmatic (2nd of 3). Single Tranche.
Pillars of the Operation and Program Development Objective(s) (PDOs)	The objective of the proposed program is to: (i) strengthen the country's ability to bridge the financial gap in its power sector; (ii) reduce the cost of power supply and promote private sector participation in the power sector; and (iii) strengthen the policy and institutional framework for the management of the country's natural gas resources. The operation has three pillars corresponding to those three sub-objectives of the PDO.
Result Indicators	The outcome indicators of the series, with the targets set for 2016, are aligned with the three policy areas. They are: (i) Tanzania Electric Supply Company (TANESCO) operating deficit; (ii) TANESCO accounts (trade and other) payable; (iii) TANESCO technical and nontechnical losses in transmission and distribution; (iv) amount of gas-fired power generation capacity commissioned; (v) average unit cost of power sales, (vi) number of bid for gas power plants launched on a competitive basis; (vii) Ministry of Energy and Minerals (MEM) documents on sector reforms published for public knowledge; (viii) volume of gas produced; (ix) amount of on-shore proven natural gas reserves; and (x) annual monitoring under Natural Resource Charter initiative.
Overall risk rating	Substantial
Operation ID	P145254

I. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Second Power and Gas Sector Development Policy Operation (PGSDPO-II) to the United Republic of Tanzania will be the second in a series of three annual programmatic development policy operations (DPOs).** The proposed operation is an International Development Association (IDA) credit for the amount of US$100 million. The program development objective (PDO) of the series is to: (i) strengthen the country's ability to bridge the financial gap in its power sector; (ii) reduce the cost of power supply and promote private sector participation in the power sector; and (iii) strengthen the policy and institutional framework for the management of the country's natural gas resources.

2. **The Tanzanian power sector has been facing serious financial difficulty in recent years.** Over the past few years, Tanzania has suffered from a growing power generation deficit caused by below-average hydrological conditions and insufficient development of new generation capacity. At the peak of the crisis in 2011, Tanzania experienced up to 12 hours of load shedding per day in certain areas. The state-owned power utility, Tanzania Electric Supply Company (TANESCO), responded by entering into high-cost short-term contracts with private emergency power projects (EPPs). This shift to EPPs reduced load shedding, but increased the average unit cost of sales significantly. The sector developed a sizable financial gap and accumulated arrears to the EPPs, independent power producers (IPPs), as well as fuel and other suppliers.

3. **The Government of Tanzania (GoT) has begun implementing a strategy to bring the sector back to a financially sustainable path by enhancing revenues in the power sector in the short term and reducing the cost of electricity supply in the medium term.** In the short term, the GoT has been closing the financial gap of TANESCO by a combination of Government transfers to TANESCO as a budget support subsidy measure, as well as TANESCO's commercial borrowing and revenue-enhancing measures. This strategy relies on more transparent and controlled budgetary transfers, tariff adjustments, reduced technical and commercial losses, and improved collections of bills.

4. **In the medium term, cost savings will be realized by shifting the power generation mix from liquid fuel-based technologies to natural gas-based power plants and other sources of cheaper and cleaner energy, with broader and competitive private sector participation.** In addition, the Government has taken a series of measures to improve the management of TANESCO, including ensuring increased public reporting and transparency through performance-based management contracts and the reshuffle of TANESCO management. Further improvements in investment policies have been initiated, such as the increasing use of private investment, and more efficient procurement including competitive selection of developers of IPPs. The construction of a major gas pipeline from the gas producing fields in Mnazi Bay and Songo Songo areas to Dar es Salaam, has also begun.

5. **As the country anticipates a large revenue windfall from offshore natural gas within a decade, a strong institutional and legal framework for the sector needs to be built.** While existing near-shore natural gas reserves will be critical to enable the shift to more efficient power generation in the short-to-medium term, it is the abundance of offshore natural gas reserves—an estimated 38.5 trillion cubic feet (Tcf) gas-in-place as of today— that will ensure sustainability

of the gas-to-power projects and offer the highest transformational opportunity for Tanzania over the medium to long term. Beyond serving as a critical source of energy for future power generation in Tanzania, natural gas also is also expected to become a major source of Government revenue for productive and social investments. A large volume of foreign direct investment (FDI) in the sector is projected over the next five years with large export and budget revenues to follow in a decade. A key challenge is for the country to prepare itself for the natural gas economy and establish strong foundations to leverage this resource for the benefit of the Tanzanian people, including the development and implementation of an appropriate policy framework for the optimal use of the revenues as well as the development of synergies with the local private sector.

6. **While some challenges remain, the GoT has taken vigorous efforts since the First Power and Gas Sector DPO (PGSDPO-I) was approved by the World Bank's Board of Executive Directors on March 26, 2013.** TANESCO's financial situation has improved markedly as the level of arrears to EPPs and IPPs stabilized in 2013 (US$243 million in December 2013 compared to US$276 million in December 2012). Further improvement is expected in 2014 following a 39 percent increase in electricity tariffs, effective January 1, 2014, which should bring over US$150 million per year as additional revenues to TANESCO. In the meantime, the GoT has also adopted and started implementing significant transformational decisions from the Big Results Now (BRN) initiative to improve its overall energy sector performance, including the process for competitive procurement of new gas-based private sector IPP project(s). On the long-term natural gas agenda, the GoT has adopted the Natural Gas Policy following a broad set of local consultations, including with Parliamentarians, development partners (DPs), the private sector, the civil society, and other stakeholders. The GoT has launched the Natural Resource Charter and set-up inter-ministerial institutions to manage the sector. A direct outcome of this process has been the adoption by the Cabinet, in October 2013, of the roadmap for developing and harnessing natural gas for the country's development.

7. **Tanzania has also continued to take steps to ensure macroeconomic and fiscal stability.** Private consumption and public investment as well as rapid expansion in a few selected economic sectors (communication, construction, financial services, and mining) have continued to propel Tanzania on a rapid growth trajectory, which has averaged around seven percent in the past 10 years. However, over the past three years, fiscal space has been reduced due to the combination of lower-than-expected improvements in tax collection, diminishing aid disbursements, and higher investment toward infrastructure projects. The Government has relied on external non-concessional borrowing to finance the country's huge infrastructure and social needs, which has to be accompanied by close monitoring and efficient financial as well as debt management.

8. **Despite the strong and stable economic growth, poverty has reduced marginally from 34 percent in 2007 to 28 percent in 2012.** [1] The low elasticity of growth on poverty reduction is explained by a lagging impact of improvements in the human capital stock on income generation opportunities and by the lack of growth in labor intensive sectors, including

[1] The poverty figures between the two years are not directly comparable due to changes in methodology. The ongoing Poverty Assessment includes recalculation of the 2007 poverty data to allow direct comparability.

agriculture in rural areas where 80 percent of poor households are located based on the 2007 Household Budget Survey (HBS). It is also the result of the limited productivity gains in the manufacturing and agriculture sectors. The ongoing Poverty Assessment by the World Bank, using the new 2012 HBS database, will further shed light on the causes behind the persistent relatively high poverty rate in Tanzania.

9. **This DPO series helps the country reduce poverty and improve its shared prosperity by facilitating implementation of the Government's strategy in the power and gas sectors, which will help to increase access to electricity and private sector development.** Access to electricity remains very low (around 24 percent of the population) and has only improved marginally over the past few years.[2] Higher access to electricity, faster growth and a continuous improvement in the reliability of power supply will boost private sector development particularly in job-creating manufacturing (over three-quarters of firms perceive it as a severe constraint to their expansion) and improve living conditions for households. Increased generation is a necessary, if not sufficient, step for improving access. Furthermore, this DPO series will support the Government's effort to ensure good management of natural gas by developing strong institutional structures. Such structures will contribute to enhancing shared prosperity through public spending based on new government revenues from the gas sector and through fostering gas economy through backward and forward linkages. These reform measures will help Tanzania achieve faster and more equitable economic growth.

II. MACROECONOMIC POLICY FRAMEWORK

A. Recent Economic Developments

10. **Tanzania's recent developments have been overall favorable with stable economic growth, rapid export growth, and lower inflation, despite deterioration in fiscal accounts.** Tables 1, 2, and 3 present key macroeconomic, fiscal, and balance indicators. Gross Domestic Product (GDP) growth remains robust, reaching 7 percent in fiscal year (FY) 2012/13 and is projected to improve to 7.1 percent in FY2013/14. Inflation has gradually declined over the past 18 months due to tight monetary policy and falling energy and food prices. The inflation rate was 6.1 percent in September 2013, down from over 20 percent at end-2011.

11. **Tanzania has continued to experience high and steady economic growth driven by several fast-growing sectors, such as mining, communication, financial services, construction, manufacturing, and retail trade, as well as sustained domestic demand.** Over the past few years, the industrial and construction activities witnessed the biggest expansion, growing at around 9 percent on average while the mining sector has boomed, especially gold that accounts for 40 percent of total merchandise exports today. Simultaneously, the services sector has grown at around 8 percent, driven by the expansion in communication, financial services, and retail trade. By contrast, labor-intensive sectors such as agriculture—the sector on which about 80 percent of households depend as their primary economic activity—posted slower growth and weaker productivity gains.

[2] The figure is based on the Government/Ministry of Energy and Minerals (MEM) data 2013.

12. **Sustained public and private consumption and investment have been the main drivers of economic growth from the demand side.** Household consumption has remained high between 2007 and 2013, accounting for 57 percent of GDP growth. The contribution of private investment in GDP growth has also remained high at 34 percent between 2007 and 2013. Comparing two periods of 2001-2006 and 2007-2013, the share of public consumption and investments in GDP growth also increased from 29 percent to 40 percent and from 11 percent to 15 percent respectively, reflecting the Government's effort to sustain social service provision while scaling up economic and social infrastructure investments in the country.

13. **However, the relatively high economic growth has created a limited number of productive jobs for a rapidly growing labor force in the country.** Not only from the high population growth rate (over 2.5 percent) but also from the age structure of the population (with almost half of the population being under 15 years old), over 700,000 young workers now enter the domestic labor market every year. So far Tanzania has not been able to stimulate job creation at a sufficiently rapid pace because productivity growth has been limited in key economic sectors and the shift in labor toward more productive sectors has not been fast enough.[3] Not only productivity growth but also increased diversification of the economy will be central to enhancing the expansion of private firms and their capacity to create productive jobs. These issues are at the center of the forthcoming Country Economic Memorandum (CEM), which is being prepared in close collaboration with the Tanzanian authorities.[4]

14. **Tanzania's economy has become more open, with increasing diversification toward new products and markets during the past five years.** The trade-to-GDP ratio has risen from 64 percent in 2008 to 77 percent in 2012, the highest among the countries of the East African Community (EAC), with merchandise exports multiplying by five over this period. Although the export structure remains largely dependent on primary commodities such as minerals (gold), coffee, tea, cashew, and cotton, the recent surge in manufactured exports to EAC and the Southern African Development Community (SADC) has been a notable and welcome development. During the same period, imports grew faster than exports, leading to a growing trade deficit over time.[5] The current account deficit was, however, financed by official aid and growing FDI inflows into natural resources sectors.

15. **The balance of payment, which had improved significantly during the first half of FY2012/13 due to lower import growth and the relatively good performance in exports, started to deteriorate during the second half of FY2012/13.** Decline in commodity prices in 2013 adversely affected Tanzania's export basket, which is still driven by several commodities. The overall fall in unit prices of both traditional and non-traditional exports, especially gold (as reflected in the decline in the terms of trade), together with a decline in manufactured exports resulted in a decline in total export value by around one percent. The value of imports of goods

[3] Overall labor productivity has grown by only 0.7 percent between 1991 and 2006 and there has been no sign of acceleration in recent years. Output and employment growth rates (annual average) between 1991 and 2006 were 4.2 percent and 5 percent respectively for manufacturing, 6.7 percent and 4.7 percent respectively for service, but 3.4 percent and 3.8 percent respectively for agriculture.

[4] The overall theme of the forthcoming CEM is on fostering productive jobs.

[5] Drivers for the faster growth of imports include higher energy import bills and capital imports for mining and natural gas sectors.

and services increased by two percent in the year ending October 2013, compared to the amount recorded in the year ending October 2012. Much of the increase was observed in imports of intermediate goods particularly oil and fertilizers, with oil import value increasing by 20.1 percent to US$4,217 million. Gross official reserves, however, amounted to US$4,652 million as of the end of October 2013, sufficient to cover 4.6 months of projected imports of goods and services excluding those financed by foreign direct investment.

Table 1: Key Macroeconomic Indicators

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Real Economy	Annual percentage change, unless otherwise indicated						
GDP (nominal, TSh million)	34,913	41,125	48,264	55,549	62,769	70,684	79,625
Real GDP	6.7	6.7	6.9	7.1	7.1	7.3	7.3
Nominal GDP per Capita (US$)	512	547	630	682	724	762	--
Contributions: Consumption	9.3	9.0	6.6	6.2	5.8	5.4	5.5
Contributions: Investment	5.5	5.8	2.7	1.5	1.4	1.9	2.4
Contributions: Net exports	-8.1	-8.1	-2.4	-0.7	-0.1	-0.2	-0.6
Imports (goods & services)	21.5	32.5	4.6	7.4	6	7.2	8.9
Exports (goods & services)	28.3	13.7	6.1	14.1	13.2	12	11.5
Unemployment Rate	--	--	--	--	--	--	--
GDP deflator	8.1	10.3	8.7	6.1	5.0	5.0	5.0
CPI (e.o.p.)	10.9	17.4	7.6	6.0	5.0	5.0	5.0
Fiscal Accounts	Percent of GDP, unless otherwise indicated						
Expenditures	27	26.2	26.8	29.8	27.5	27.1	26.5
Revenues	16.4	18.1	17.8	18.9	18.6	18.6	18.6
Overall Balance (Including Grants)	-6.6	-5.0	-6.2	-5.0	-4.6	-4.0	-4.0
Public debt	39.4	39.8	43.0	43.7	45.0	45.3	45.5
Public debt (Alt)*	39.4	39.8	43.0	43.7	45.5	46.3	46.7
Selected Monetary Accounts	Annual percentage change, unless otherwise indicated						
Reserve Money	19.3	14.2	14.5	11.4	12.2	--	--
Credit to Private Sector	24.3	18.6	17.1	17.2	16.8	--	--
Interest Rate (Treasury Bill 91 days; e.o.p.)	3.7	13.4	11.9	n.d.	n.d.	n.d.	n.d
Balance of Payments	Percent of GDP, unless otherwise indicated						
Current Account Balance	-9.4	-16.5	-13.5	-14.9	-13.4	-12.1	-11.1
Imports (goods, f.o.b.)	-33.8	-41.1	-34.4	-33.7	-32.4	-31.5	-30.7
Exports (goods, f.o.b.)	20.7	21.6	17.7	15.6	15.2	15.5	15.4
Foreign Direct Investment	4.3	6.3	5.9	5.6	5.9	6.1	6.6
Gross Reserves (in US$ million, e.o.p.)	3,610	3,797	4,360	n.d.	n.d.	n.d.	n.d.
In months of next year's imports (g & s)	3.3	3.5	3.7	n.d.	n.d.	n.d.	n.d.
As % of short-term external debt	n.a.	n.a.	n.a.	n.d.	n.d.	n.d.	n.d.
External Debt	33.1	34.4	35.9	37.5	39.6	40	40.1
Terms of Trade (annual change)	1.2	1.4	-1.6	-9.4	-4.3	-0.6	-0.8
Exchange Rate (Tsh/US$; p.a.)	1,47	1,594	1,589	n.d.	n.d.	n.d.	n.d.

Source: Bank of Tanzania, IMF, World Bank staff
Note: public debt (alt) is the case in which GoT fails to pay future liabilities from PSPF pre-1999 accrued benefits from 2014/15 onwards. "n.a." is not applicable. "n.d." is not disclosable. "n.r." not required

16. **The Central Bank has continued to follow a tight monetary policy, which resulted in falling inflation during the last two years.** Annual growth of average reserve money declined to 16.3 percent in the year ending June 2013, down from 22.4 percent a year ago. Growth in broad money (M3) declined as well—from more than 22 percent to 15 percent during the same period. As a result, together with falling domestic food prices, inflation reached only 5.6 percent in December 2013—a significant achievement compared to 19 percent in December 2011.

17. **In contrast to the contractionary monetary policy, fiscal policy has been used by the authorities to finance infrastructure projects and social services in addition to TANESCO's operational gap**. This shift is partly embedded in the BRN initiative, which has identified a series of priority investments for the short to medium terms so that the country can address existing deficiencies, broadly share prosperity and put the economy on an even faster growth trajectory. This drive to fund investments has led to an increase in public spending by 0.6 percent of GDP between FY2011/12 and 2012/13. Concurrently, the level of public revenues was lower than the target by 0.3 percent of GDP in FY2012/13. As a result, the overall deficit increased from 5 percent of GDP in FY2011/12 to 6.2 percent of GDP in FY2012/13. This deterioration of the fiscal accounts, while manageable, contrasts sharply with the overall objective of further fiscal consolidation.

18. **During FY2012/13, fiscal management was greatly affected by the financial difficulties of TANESCO, although the utility is now on a more sound footing**. The Government transferred US$252 million (TSh 403 billion) to TANESCO to finance the deficit and payments of arrears, in addition to extending guarantees for TANESCO's commercial borrowing of US$65 million. As a result, the total value of TANESCO's arrears to EPPs and IPPs, which was US$276 million at the end of December 2012, was reduced to around US$243 million as of December 2013. In recent months, the Government has taken further measures to close the financial gap in TANESCO: it has guaranteed a commercial loan to TANESCO for the amount of US$150 million, it supported TANESCO's application for a tariff increase, which resulted in the Energy and Water Utilities Regulatory Authority (EWURA) decision to raise the electricity tariff by an average of 39 percent starting from January 2014.

19. **The Government budget for FY2013/14, approved by the Parliament in June 2013, aims at reducing the overall fiscal deficit to 5 percent of GDP**. This target is consistent with the Government's objective of maintaining fiscal sustainability, lowering the risk of debt distress, and avoiding inflation pressure. This projected fiscal deficit is based on a relatively ambitious increase in domestic revenue that will help finance priority programs and projects in infrastructure and social services. The level of total expenditure is projected to increase significantly to around over 30 percent of GDP in 2013/14—its highest level in recent history and about three percent of GDP higher than in 2012/13 (Table 2). Development expenditure has increased largely due to the Big Results Now (BRN) initiative. The Government has prioritized key development projects in six priority sectors as part of the BRN initiative to foster shared growth in the country. DPs, including the World Bank Group, have been working very closely with the authorities on the prioritization of the investments in selected sectors. The year-to-year increase of development expenditure from 2012/13 to 2013/14 is also pronounced because of the under-execution of the development budget of 2012/13 (with actual expenditure of 7 percent of GDP compared to 9.2 percent in the approved budget).[6] The 2013/14 budget also reflects a relatively sharp projected increase in the public wage bill as a result of the adjustment in minimum wage to keep up with the rising cost of living. The increase in wage bill is also caused by new hires in the education, health and agriculture sectors with the goal of improving quality of service delivery.

[6] Foreign-funded development expenditure was significantly under-executed in 2012/13 due to lower-than-anticipated disbursement of projects and delays in recording foreign direct spending to project funds.

20. **Based on the preliminary results of the first semester, significant fiscal adjustments are planned during the second half of the FY2013/14 in order to achieve the targeted fiscal deficit of 5 percent.** Domestic revenue collections during the first half of FY fell short of initial targets by almost 10 percent. Recognizing this, the Government is set to implement significant fiscal adjustments during the mid-year budget review. On the revenue side, collections are expected to recover during the second half of the FY thanks to the agreement reached with telephone companies to replace the proposed subscriber identity module (SIM) card tax by a higher excise tax rate of 17 percent up from 14.5 percent. On the expenditure side, the Government plans significant expenditure cuts on non-priority current spending while slowing down domestically funded development projects that are not part of the BRN initiative.

Table 2: Key Fiscal Indicators

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
			(percent of GDP)			
Overall Balance	-6.4	-6.6	-5.0	-6.2	-5.0	-4.6
Primary balance	-5.5	-5.1	-3.4	-4.7	-3.4	-2.9
Total Revenues (excluding grants)	15.9	16.4	17.6	17.8	18.9	18.6
Tax revenues	14.6	15.2	15.8	16.2	16.9	16.8
Taxes on goods and services (VAT, Exercise)	7.4	7.4	7.3	7	7.1	7.1
Import duties	1.2	1.3	1.2	1.2	1.5	1.4
Income tax	4.4	4.8	5.5	6.3	6.1	6.1
Non-tax revenues	1.2	1.3	1.8	1.7	2.2	2.2
Grants	4.7	5.2	5	3.2	3.6	3.6
Expenditures	27.5	27	26.2	26.8	29.8	27.5
Recurrent expenditures	18.8	19.2	17	19.6	20	19.1
Wages and compensation	5.7	6.7	6.6	6.9	7.6	7.8
Goods, services, and transfers	12.3	11.4	9.3	11.2	10.8	9.6
o/w Transfers to TANESCO	..	..	..	0.8	0.3	0.2
Interest payments	0.8	1	1.1	1.5	1.6	1.7
Development expenditures	8.6	7.9	9.2	7.1	9.8	8.4
General Government Financing	6.4	6.6	5	6.2	5	4.6
External (net)	4.6	3.1	4.2	4.8	6.5	4.6
Domestic (net)	1.9	3.6	0.8	1.5	-1.6	0

Source: IMF and World Bank staff

Table 3: Balance of Payment Financing Requirements and Sources

	2012/13	2013/14	2014/15	2015/16	2016/17
Financing requirements			(US$ million)		
Current account deficit	-4,106	-5,068	-4,927	-4,867	-4,884
Debt amortizations	141	248	274	438	555
Financing Sources			(US$ million)		
FDI and portfolio investments (net)	1,794	1,920	2,169	2,457	2,913
Capital grants	545	824	770	806	639
Debt disbursements (general government)	2,165	1,792	1,426	1,458	1,593
Change in reserves (net)	455	240	409	484	551
IMF credit (net)	114	0	0	0	0

Source: IMF and World Bank staff

B. Macroeconomic Outlook and Debt Sustainability

21. **Tanzania's economic growth is projected to remain stable around 7 percent in the medium term.** Growth will be largely driven by the same set of rapidly expanding sectors and

by an increase in public investment (as part of the BRN initiative) (see Tables 1 and 2). In particular, the communication, financial, retail trade and construction sectors should continue to benefit from sustained increases in domestic demand as a result of technological changes and urbanization. In the medium term, the expected massive FDI inflows toward the mining and natural gas sectors should also drive the economy, notably through a boom in construction. The rate of inflation is expected to stabilize around five percent, pending no shock on food and energy prices, with no major changes in monetary as well as exchange rate policy.

22. **On the external front, the current account deficit should remain relatively high.** The current account deficit, however, is expected to improve significantly in the medium term after domestic natural gas replaces liquid fuel as the main source of thermal power generation, thereby reducing presently costly energy imports. Over the next few years, the official reserves are projected to remain around four months of imports of goods and services.

23. **Tanzania has good prospects of becoming a major producer of natural gas in the medium term but the magnitude and timing of related investments remain uncertain**. Tanzania has seen favorable natural gas exploration results. There appear to be good prospects that commercial quantities of natural gas will be confirmed, resulting in multibillion dollar FDI in Tanzania's natural gas sector over the next five years, and subsequent large export and budget revenue flows around the end of the 2020s. The challenge is to prepare the country for the gas economy and establish strong foundations to best take advantage of this potential resource wealth.

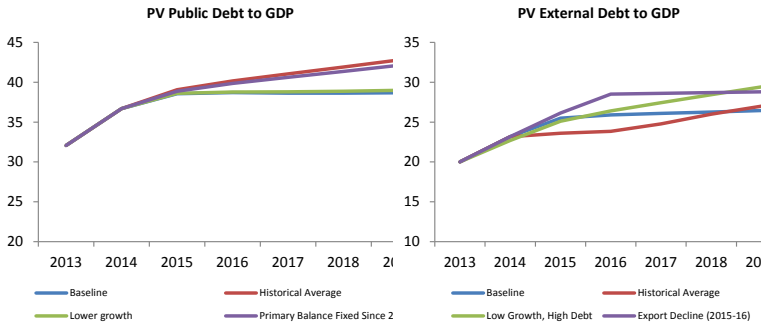
24. **The medium-term fiscal policy framework aims at further reducing the overall fiscal deficit to below 5 percent of GDP and stabilizing the total public debt at around 45 percent of GDP in FY2014/15.** These targets are consistent with the Government's objective of maintaining fiscal sustainability, low debt distress, and avoiding the risk of renewed inflation pressure. Towards this end, the Government is taking some measures. The review of value-added tax (VAT), enactment of the Tax Administration Act and ongoing Extractive Industries Transparency Initiative (EITI) payments reconciliation exercise, together the rationalization of existing tax exemption regimes should help the Government to increase revenue collection from both tax and non-tax sources. The control of recurrent spending, notably the wage bill will be required as well as considerable improvements in the selection and management of investment projects. Moreover, reforms being implemented in parastatal organizations such as TANESCO and the pension system should help reduce expenditure pressures on the Government budget. Close monitoring and improvement in both fiscal and debt management remain critically important. Nevertheless, this medium term fiscal framework is associated with some risks (which are described at the end of this section).

25. **Tanzania's current risk of debt distress remains low provided fiscal consolidation is maintained.** The last IDA-International Monetary Fund (IMF) Debt Sustainability Analysis[7] (DSA) (April 2012) shows that Tanzania's risk of debt distress was low. The IMF's Policy Support Instrument (PSI) staff report discussed by the IMF's Board in June 2013 also provided a similar assessment. However, while the debt distress is expected to remain low, the preliminary

[7] DSA covers only the debt by central government and does not include parastatals and local government authorities.

assessment from the ongoing preparation of the new DSA (to be ready in April 2014) indicates that public debt sustainability continues to be sensitive to fiscal consolidation (Figure 1) including measures to resolve pension-related liabilities (Table 1). This increased sensitivity, while manageable, is explained by the recent rapid increase in non-concessional borrowing (including in domestic debt) by the public sector. This risk highlights the importance of a sound debt management strategy, a conservative approach to non-concessional borrowing, and improving capacity to plan and execute public investments in order to ensure future debt and fiscal sustainability.

Figure 1: Debt Sustainability



External Debt Position FY 2012/13

	US$ milli on	% of Total External Debt	% of GDP
Total External Debt	10,912	100%	36%
by Central Government	8,897	82%	29%
by Parastatals	504	5%	2%
by Private Sector	1,511	14%	5%
Medium/Long Term	10,912	100%	36%
Short Term	0	0%	0%

Source: IMF and World Bank staff

26. **The positive economic prospects face a number of macro-fiscal challenges described below, which are presented in order of relative significance.**

27. **The first challenge is related to the fiscal stance.** Tanzania's infrastructure needs are so pressing that the Government might borrow more to finance those projects, especially if the authorities fail to meet their ambitious revenue target in FY2013/14 and FY2014/15. Experiences around the world show that maintaining prudence in fiscal policy is important in the context of a political cycle. The trade-off between prudent debt management and sustained public investment will have to be closely monitored by the Government. The IMF and the World Bank will need to continue providing technical assistance in management of debt. In addition, the joint Public Expenditure Review (PER) process provides an opportunity for the World Bank and other development partners to support the Government in monitoring the public debt and investments. Ensuring fiscal transparency and consolidation will also be critical. The Government should move toward a consolidated presentation of the State's financial accounts, including those of the main parastatal agencies operating in the energy and mining sectors.

28. **The second challenge is linked to the Government's level of debt, the value of which stood at around 43 percent of GDP as of June 2013.** As discussed above, this level appears manageable as long as the authorities maintain a relatively prudent fiscal policy. In that context, the Government is forecasting external borrowing on a non-concessional basis of around US$1.3 billion during the next two fiscal years. This expected borrowing should be sufficient to finance a number of new investment projects, while at the same time keeping debt to a sustainable level of 46.8 percent of GDP at end FY2014/15. Any significant deviation from this plan may endanger the Government's creditworthiness as it will increase its debt service (which is already close to nine percent of total expenditures) and its capacity to refinance at affordable costs on both the international and domestic markets.

29. **The third challenge could arise from financial distress within the energy sector, especially TANESCO's large deficit.** While considerable progress was achieved in recent months, the size of the TANESCO deficit is itself sensitive to a number of factors outside of the Government's control. For example, an increase in world oil prices will automatically lead to higher generation costs and therefore, to a higher TANESCO deficit. A combination of drought, increase in oil prices and time required to improve TANESCO's financial and operational situation would add significant pressure to the Government's fiscal accounts.

30. **The fourth challenge relates to the accumulation of arrears by the Government, including with pensions**. The value of the Government's arrears grew substantially during FY 2012/13, reaching almost Tanzania Shilling (TSh) 376 billion at the end of June 2013. The high and growing level of Government arrears fails to incorporate important categories of delayed payment by the State, in particular to pension funds, which was estimated to reach TSh1,200 billion as of December 2012.[8] This already significant figure, equivalent to about 3 percent of GDP, should increase rapidly if the Government fails to act, underscoring the need for urgent reforms in the pension system. The Government has recognized this problem and is taking some measures. Through the joint PER process supported by the DPs, a study has been initiated which will establish the levels, sources, solutions and ways of curtailing reoccurrence of payment arrears in the future.

31. **The fifth and final challenge is associated with external factors.** While the Tanzanian economy is not overexposed to global market volatility, it is not completely immune. Major fluctuations in commodity prices, notably gold and oil, will affect trade balance. The magnitude and timing of anticipated FDI inflows to the natural gas sectors will also impact the local economy, especially in the geographical areas where those investments will take place. The new investments are expected to be in the range of US$4-5 billion per year. Even if the majority of these funds are used to purchase imported goods, as is likely, their magnitude will modify the current equilibrium in the domestic financial markets and possibly have an impact on exchange rates.[9] These potential impacts will have to be carefully managed by the authorities.

32. **Recent macroeconomic and fiscal developments have been adversely affected by the reduction in fiscal space, financial distress in the energy sector, higher debt levels and debt service, and remaining volatility in the external environment. Nevertheless, the positive medium- and long-term economic outlook, as well as the relatively prudent overall macroeconomic policy stance in Tanzania, provides an adequate basis for a development policy operation.**

[8] The Public Service Pension Fund (PSPF) is in serious financial distress. Prior to 1999, the pension scheme in the public sector was non-contributory. As the PSPF was established in 1999 based on the contributory scheme, the Government has inherited the existing and future liabilities of pension benefits accrued under the pre-1999 non-contributory scheme, which is estimated to be about US$2,500 million (TSh 4 trillion) based on the actuarial report prepared in 2010. As of December 2012, the Government had accumulated about US$750 million (TSh 1.2 trillion) in arrears with PSPF, which has continued to pay pensioners on behalf of the Government

[9] To illustrate if only 20 percent of the annual expected FDI inflows are spent in Tanzania, this might still represent around US$ 1 billion, which is equivalent to one-fifth of total banking credit today.

C. IMF Relations

33. **Currently the IMF has a Standby Credit Facility (SCF) program with Tanzania; however the Government has requested IMF support for a new PSI program.** The current precautionary 18-month arrangement under SCF for SDR 149.175 million (about US$224.9 million), which was approved by the IMF's Board in July 2012, is designed to provide Tanzania a financial cushion to withstand deterioration in external demand and access to global financing. The SCF arrangement has been extended to April 30, 2014 from its original expiry date of January 5, 2014 to allow time for the conclusion of the third and final review. The Government requested an extension in order to complete the remaining policy and structural measures under the IMF-supported program. The IMF is also considering a new PSI arrangement following the expiry of the previous PSI (2nd PSI) in June 2013 based on a request from the Government. The periodic IMF assessments of Tanzania's macroeconomic performance serve as a key input to the dialogue and assessments on policies related to macroeconomic stability.

34. **The proposed operation has been developed in close collaboration with the IMF.** The deterioration of the financial situation in the energy sector has been a key concern under the IMF program due to its potential implication for the central government's budget. As a result, the World Bank and IMF teams have collaborated closely in pursuing a dialogue with the authorities on the financial gap in TANESCO and the set of actions required to restore the sector's sustainability in both the short and longer terms. There has been extensive collaboration in preparing this operation, including the IMF's participation in the preparation missions of this operation and the Bank providing technical inputs to the IMF's PSI review.

III. THE GOVERNMENT'S PROGRAM

A. National Development Program

35. **Tanzania has a medium-term poverty reduction strategy called Second National Growth and Poverty Reduction Strategy (2010/11-2014/15) or MKUKUTA II in Kiswahili acronym, complemented by the First Five Year Development Plan (FYDP I; 2011/12-2015/16)**.[10] MKUKUTA II is a medium-term mechanism to achieve the goals of Tanzania's Development Vision 2025 (TDV 2025) and the Millennium Development Goals (MDGs). TDV 2025 sets forth Tanzania's aspiration to become a middle income country by year 2025. MKUKUTA II is organized into the following three clusters: (i) growth and reduction of income poverty; (ii) improvement of quality of life and social wellbeing; and (iii) good governance and accountability. With the overarching goal of unleashing the country's growth potential by fast-tracking the provision of the basic conditions for a broad-based pro-poor growth, FYDP I presents the Government's high-level policy priorities in operationalizing TDV 2025 and MKUKUTA II.

36. **Scaling up investments in energy infrastructure and leveraging the country's natural gas reserves are centrally featured in the FYDP I.** As one of the strategic interventions in the medium term, the FYDP I emphasizes the need to secure reliable, affordable,

[10] Concurrently, the Revolutionary Government of Zanzibar has adopted the Zanzibar Strategy for Growth and Reduction of Poverty (Kiswahili acronym MKUZA II), covering the same period.

and adequate energy supply. It lays out a medium-term master plan of public investments, which include investments in infrastructure for additional power supply capacity and natural gas production. The FYDP I also recognizes a range of benefits the economy could receive by tapping into natural gas, including downstream manufacturing development, skill development opportunities and revenue mobilization.

37. **The Government has also launched the BRN initiative with the objective of enhancing implementation of the FYDP I.** The BRN initiative will help the Government to establish a strong and effective system to oversee, monitor, and evaluate the implementation of its development plans and programs, following the Malaysian Big Fast Results approach. The Government has established the Presidential Delivery Bureau (PDB) and conducted the first wave of "Labs." Detailed action plans have been developed by the "Labs" in six National Key Result Areas (NKRAs), namely agriculture, education, energy, transportation, water, and resource mobilization. The action plans, which include concrete indicators for measuring progress, have also been approved by the Government after public hearing and following extensive engagement with DPs and have been implemented starting from the 2013/14 budget.

B. The Power and Gas Sector Programs

38. **The Government has undertaken reforms in the power sector over the last decade.** It adopted the National Energy Policy in 2003, establishing affordable and reliable energy supplies in the country as a key objective while stressing the importance of increasing rural energy access. An independent regulator, EWURA, became operational in 2006. In 2007, the Government developed a Power Sector Reform Strategy, which presented a vision for the power sector in Tanzania over the medium to long-term. The reform strategy envisages the evolution of the sector from the current market structure, in which TANESCO is a single-buyer/single-seller of electricity, to eventually a more liberalized and more competitive wholesale market structure in which the producers would be able to sell directly (or through a pool or voluntary electricity exchange) to the distribution companies and large consumers. The strategy was followed by the adoption of a comprehensive Electricity Act in 2008, which takes into account many international best practices for power sector reforms as tailored to the Tanzanian environment. The Act also established a general framework for the powers of the Minister responsible for energy, including the new mandates and requirements to prepare and publish a policy for the reorganization of the electricity market and to develop a rural electrification plan and database. The Electricity Act led to the strengthening of the governance of TANESCO, reforming its top management structure and creating a Board of Directors with public and private sector stakeholder representations.

39. **In FY2010/2011, Tanzania started to develop serious problems with electricity supply due to a drought that reduced hydropower energy production, the main source of generation.** At the peak of the crisis, in mid-2011, some parts of the country experienced daily load shedding of up to 12 hours. As an emergency measure, TANESCO entered into expensive contracts with EPPs. These steps stabilized power supply somewhat but resulted in a significant increase in the cost of supply and turned the power crisis into a financial crisis. In 2012, the share of electricity generation of the EPPs was slightly higher than 11 percent, but their share of costs was about 45 percent. In mid-2012, TANESCO's financial shortfall was more than US$40

million per month, as the hydrological condition continued to be below average, while electricity demand kept increasing.

40. **Given the crisis, the Government has developed a strong program that aims at achieving sustainable development of Tanzania's energy sector.** The program has support at the highest levels of Government and has been developed in close collaboration with DPs. The program, which is the backbone of the DPO series, is designed, in the short term, to stabilize and bring about the recovery of the sector after the financial crisis and contain the fiscal risks; and, in the medium to long term, ensure that the power and the gas sectors are developed and operated in a more efficient, transparent and financially sustainable manner. The reform program, which incorporates lessons from other countries that have faced crises in their energy sector, includes policy measures across a spectrum of areas. The policy measures include: increasing sector revenues and reducing costs; adjusting the tariff and subsidy policies; improving the technology and primary energy mix of the power plants with an orientation toward higher use of domestic natural gas for electricity generation; developing the natural gas sector; improving technical and commercial efficiency in power system operation; improving efficiency and sustainability of power generation investments with increased reliance on the private sector and a competitive selection process for developers of new power plants; and improving governance of the power sector through strengthened corporate governance of TANESCO and optimized business structure of the sector.

41. **The Government program was endorsed at the highest level following a five-week Energy Lab in April 2013 as part of the BRN initiative.** Recognizing that the current power generation capacity limits the country's growth potential and the efforts to reduce poverty, the Lab has recommended achieving results in the three areas that will lead to more than doubling of base energy capacity by 2015. The Energy Lab also has made some transformational recommendations, which suggest that the Government has clear sense of urgency in transforming the sector to deliver results. First, BRN recommends a 50 percent growth target in energy delivered and in TANESCO's revenues. This target is expected to be achieved by revamping the operations of existing assets, including delivering new gas to underutilized power plants, upholding water management practices, limiting energy losses in transmission and distribution, launching demand management initiatives and optimizing EPPs dispatching and fuel supply. Second, BRN recommends a selective approach through delivering 14 prioritized generation projects and 590,000 new connections, supported by "business unusual" approaches to delivery, which will involve greater focus on prioritization, monitoring and evaluation (M&E), use of alternative sources of funding and fast-tracking approval for current system bottlenecks. Third, BRN recommends redefining of the sector strategy and structure, including a gradual restructuring of TANESCO to bring viability to the entire system.

42. **In the context of the critical need to expand power supply in the country, the Government has adopted a strategic objective of leveraging existing near-shore gas fields to scale up domestic use of gas for power generation.** Near-shore gas fields provide an immediate and sustainable solution to the energy crisis by replacing costly liquid fuel for the power plants with cheap natural gas fuel. Increased production capacity in the near-shore gas fields and a credible gas purchaser would enable supply to reach the power market in 2015. The Government is building a coastal gas pipeline through loans from the ExIm Bank of China and additional processing facilities that are expected to be operational in early 2015. Timely

expansion of production in the two existing near-shore gas fields (Songo Songo and Mnazi Bay) is equally important to ensure availability of additional quantities of gas, once the pipeline is completed.

43. **Successful transformation to a more gas-based power supply in Tanzania and the prospects for exploiting new large gas reserves will put Tanzania in a strong position to make significant contribution to regional energy developments.** Tanzania is a member of the East African Power Pool and the Southern Africa Power Pool, but currently has limited means of contributing to regional energy developments. This is likely to change, as Tanzania develops its large natural gas reserves to complement other regional energy resources, such as hydropower and other forms of renewable energy. Strengthening of regional electricity interconnections is already being undertaken, both by Tanzania and other countries in the region (for example, Zambia-Tanzania-Kenya interconnector, Ethiopia-Kenya transmission line, and others).

44. **With the discoveries of large offshore gas deposits, the Government has embarked on a series of actions to strengthen the natural gas policy framework to manage the natural gas sector and wealth in Tanzania.** The Government plans include the initial development of a full gas value chain. If successfully implemented, this strategy will generate significant revenue streams that can be used to invest in the Tanzanian society. Once this 'anchor' development is in place, the Government intends to explore different strategic options and consider tradeoffs for the use of additional volumes of discovered gas (domestically or for export) to maximize the benefits for the broader Tanzanian population. Sequencing these actions requires gas policy, gas planning, and the necessary new legislation. In October 2013, the Government adopted the Roadmap for Natural Gas Development which sets out short-, medium-, and long-term action plans to ensure optimal use of this resource. The Roadmap covers a broad range of gas-related issues such as necessary legislative and regulatory frameworks, fiscal regime, market development (both domestic and export), and capacity building along value chains.

45. **To build an appropriate framework for the optimal use of natural gas reserves, the Government has started to prepare key strategic documents that will set the stage for future decision-making and policies**. The Government adopted the Natural Gas Policy in 2013, which was prepared based on a broad-based participatory consultative process. As the next step, the Government will prepare and implement a Natural Gas Utilization Master Plan and pursue further development of the legal and regulatory framework for the hydrocarbon sector, including drafting the Natural Gas Act and the Natural Gas Implementation Strategy aligned with the Natural Gas Policy, with the goal of creating an environment conducive to investment. On the broader natural resource governance agenda, the Government has launched the Natural Resource Charter. The Government is also making progress toward adopting EITI legislation, following its accreditation as an EITI compliant country in 2012.

IV. THE PROPOSED OPERATIONS

A. Link to Government Program and Operation Description

46. **Supporting the Government's strategy to increase access to reliable and affordable electricity, the program under the series is structured under three pillars.** Those pillars are: (i) strengthening the country's ability to bridge the financial gap in its power sector; (ii) reducing the cost of power supply and promoting private sector participation in the power sector; and (iii)

strengthening the policy and institutional framework for the management of the country's natural gas resources. The program also has a cross-cutting emphasis on transparency to improve governance of the power and gas sectors.

47. **The DPO series has been designed as a series of three operations, each supporting the three-pillar framework incrementally.** The financial distress faced by TANESCO has required immediate attention because it puts at risk both electricity supply and fiscal sustainability at the national level (pillar 1). Close attention has also been given to the medium-term agenda of implementing the power sector development program for making a transition to a lower-cost structure and strengthening governance arrangements in the sector (pillar 2). The pillar on natural gas is aimed at supporting national initiatives on developing policy, legal and institutional frameworks for the gas subsector, necessitated by recent discoveries of large-scale off-shore gas reserves (pillar 3).

48. **The implementation of the DPO series presents clear progression of reform achievements in the power and gas sector.** The first operation (PGSDPO-I), while supporting all three pillars, *focused on arresting the rapidly growing accumulation of arrears* in the power sector and bringing it under control. This operation, which is the second in the series (PGSDPO-II), will continue to support reforms under all three pillars of the program, with *a particular emphasis on strengthening the revenue side of the power sector* with strong measures to mitigate the fiscal impact and setting the policy and institutional foundations for managing the sector on a sustainable basis. The third operation (PGSDPO-III) will consolidate the policies implemented under the first two operations, with additional *focus on reducing the cost of electricity supply by supporting reforms in the power and the gas sectors* through (a) advancing the Government's policy on private investment in power generation and gas production, and (b) supporting the institutional reforms in governing the gas and power sectors. In parallel, each operation under the DPO series supports the sequence of the Government's actions in building the key elements for the institutional framework on gas, in line with the Government's Roadmap on Natural Gas Development. Those actions constitute the critical initial phase of the long-term gas agenda.

49. **Lessons from previous operations in the energy sector around the world highlight the importance of securing a government's long-term commitment to reforms for programmatic operations**. Budget support operations in the energy sector often respond to severe financial crisis in the energy sector, creating a tension between the urgent need to close the financing gap and the need to design and implement sustainable reforms that would help the sector avoid such crisis in the future. A key risk associated with such operations is that the momentum for reforms diminishes once the financial distress is eased. A substantial reform of the energy sector typically takes several years to develop and implement, requiring significant and sustained political commitment to address vested interests, modify the status quo, and promote behavioral change within the sector and in the existing enterprises. In comparison to a one-time operation, a programmatic approach is better suited to such an effort, as it enables striking a better balance between the consistency of the reform process and the flexibility to adjust its content, pacing, and sequencing according to progress achieved over time.

50. **Somewhat uncharacteristically for power sector reforms, the program under this DPO series tackled the most difficult issues upfront**. In December 2013, the sector regulator (EWURA) approved an on average 39 percent tariff increase, which became effective in January

2014. This was in an addition to 40 percent tariff adjustments in January 2012. The average electricity tariffs practically doubled, from 8-9 US¢ per kilowatt hour (kWh) in 2011 to 16-17 US¢ /kWh in 2014. First, the actions undertaken should stabilize the sector financially and mitigate macroeconomic risks that had been created. Second, they would mitigate the key investment risks to private investors and financial institutions. Third, the actions would provide time needed to implement the investment programs in the energy sector and the accompanying institutional and structural reforms to improve efficiency, reverse the trend of increasing costs, and ensure long-term sustainability.

51. **The program is also designed to internalize parameters for policy actions in order to lock in the momentum for reforms in these priority sectors.** For example, by capping the level of transfers from the Government to TANESCO (budgetary subsidies), the DPO series helps create incentives for enhancing TANESCO's own revenue generation and reducing its costs, while managing the fiscal burden of the power sector.

B. Prior Actions, Results, and Analytical Underpinnings

52. **The list of proposed prior actions of this operation and triggers for the next operation are summarized in Table 5**. The complete policy and results matrix for the series, including outcome indicators, is presented in Annex 1.

Table 5: Status of PGSDPO-II Triggers, Proposed Prior Actions, and PGSDPO-III Proposed Triggers

Trigger for PGSDPO-II	Prior Action for PGSDPO-II and Comments	Status	Trigger for PGSDPO-III
I: Strengthen the country's ability to bridge the financial gap in its power sector			
1. TANESCO to increase revenues through a combination of better bills collection, reduction in losses, and, if necessary, requesting EWURA to adjust tariffs.	1. TANESCO has implemented new tariffs, approved by EWURA in December 2013, in order to increase its revenue. *Trigger modified to capture the stronger action taken by the Government (approved tariff increase) and to improve clarity.*	*Met*	1. The Government adopts a national subsidy policy which outlines the principles for providing subsidies in the energy sector.
2. To improve fiscal transparency the Government has provisioned in the FY2014 budget contingency funds that can be used to address the financing gap in TANESCO.	2. The Government had created in its approved FY2013/14 budget a specific code with funds for transfers to TANESCO to improve fiscal transparency. *Trigger modified to capture the stronger action taken by the Government. .*	*Met*	2. The Government has committed to reduce the level of transfers to TANESCO in FY2014/15 to the level not more than 2 percent of controlled total expenditure.
3. In FY2014, Government shall use a combination of tariff increases, commercial borrowing, and government subsidies to cover the financing gap in TANESCO. Government subsidies shall not exceed 2.5 percent of total expenditures (excluding consolidated funds services, wages, and development foreign).	3. The Government has taken actions to reduce the level of transfers to TANESCO from the level of FY2012/13 and has committed that the level will not exceed 2.5 percent of Controlled Total Expenditure in FY2013/14.[11] *Trigger modified to improve clarity.*	*Met*	
II: To reduce the cost of power supply and to promote private sector participation in the power sector			

[11] Controlled total expenditures is defined as total expenditure excluding wage, consolidated funds service (CFS), and foreign-funded development expenditure.

4. Government, and TANESCO as appropriate, have adopted concrete measures (including training, hiring transaction advisors if necessary, and completing necessary studies) to improve its technical and commercial capacity to develop PPP projects in the energy sector through transparent and competitive process, as well as to evaluate unsolicited proposals (where they have merits), including subjecting them to a competitive process.	4. The Government and TANESCO have implemented the initial phase of the 2013 Policy for Private Sector Participation in Power Generation through Competitive Processes by launching PPP capacity building programs for: (a) screening and conducting due diligence; (b) financial structuring; (c) structuring processes (for selecting developers and implementing transactions); (d) preparing legal and regulatory documents; and (e) managing government and public corporation fiscal risks. *Trigger modified to improve clarity.*	*Met*	3. TANESCO continues to improve and report publicly on collection performance and on operational losses and develops a plan to meet the targets set by EWURA Order in December 2013.
5. Government has completed an Energy Sector Review whose objective is to recommend structural reforms aimed at improving power sector performance (including efficiency and accountability), to comply with the Electricity Act (2008, including part viii), and has approved its recommendations.	5. The Government has adopted the recommendations of the Presidential Big Results Now Initiative to develop a roadmap for structural reforms of the energy sector and has established a Ministry Delivery Unit within MEM to oversee the implementation of the recommendations. *Trigger modified to capture recent high-level initiatives to accelerate implementation of results (BRN Energy Lab) which was not known at the time of PGSDPO-I and adjusted timeline for the structural review in line with the Lab report.*	*Met*	4. TANESCO phases out Emergency Power Projects by 150MW without lowering the reliability of power supply delivery.
			5. TANESCO implements the 2013 policy to promote private sector participation in power generation by launching at least one competitive bidding process for new gas-based power project(s) to diversify power generation sources.
			6. The Government approves the Roadmap for structural reforms of the energy sector (including the power and gas subsectors), which includes specific structural measures aimed at improving sector governance and overall efficiency.
III: Strengthen the policy and institutional framework for the management of the country's natural gas resources			
6. Government approves the Natural Gas Policy.	6. The Government has adopted the Natural Gas Policy. *Trigger slightly modified for editorial reasons.*	*Met*	7. The Government adopts a National Gas Utilization Master Plan.
7. Gas Act to be submitted to Parliament after participative public consultations, including (i) transparent and participative regulatory practices; and (ii) access to information and participative monitoring by stakeholders.	7. The Government has launched a program to adopt a Tanzania Natural Resource Charter and has established an expert panel to oversee the program. *Trigger has been modified. The Gas Act has not been submitted to the Parliament as an extended period was required to conduct public consultations At the same time, the Government implemented an equally significant action in*	*Met*	8. The Government to prepare a draft Gas Bill and tp submit it to the Parliament.

	strengthening the policy and institutional framework for the management of the natural gas resources by launching the Natural Resource Charter initiative. This replacement is to accommodate those latest developments while maintaining the strength of the overall program under this DPO.		
8. Government establishes a top-level institutional mechanism to enhance inter-sectoral cooperation on the gas policy agenda.	8. The Government has established a top-level institutional mechanism to enhance inter-ministerial coordination by mandating the Cabinet committee on economic affairs to handle the natural gas agenda and creating an inter-ministerial senior taskforce on natural gas. *Trigger slightly modified for editorial reasons.*	*Met*	9. The Government to prepare and to adopt a Petroleum Policy.
9. TPDC publishes (on its website and in print) its internal periodic performance reports, latest Audit Annual Report of the NAO and latest Annual Performance Report of the PPRA.	9. TPDC has published on its website its latest audited financial statement, its latest procurement audit report, and its key performance indicators. *Trigger modified to improve clarity.*	*Met*	

Pillar 1: Strengthening the country's ability to bridge the financial gap in its power sector

53. **Under the first pillar, the proposed operation continues to support the Government's efforts to reduce the financial gap in TANESCO's operations and improve financial sustainability.** At the outset of the DPO series (see program document for PGSDPO-I), the Government adopted a plan to address the TANESCO financial gap by causing TANESCO to undertake the following complementary measures: (i) reduce generation, transmission and distribution costs; (ii) increase sales and collections; and (iii) use commercial borrowing to finance part of the gap.

54. **A series of bold measures supported under the Government plan have already improved the financial situation of TANESCO**. Revenues from electricity sales in 2013 increased by 15 percent in comparison with 2012 on account of higher sales (17 percent) and improved efficiencies in operations (billings and collection of bills). The total revenues of TANESCO in 2013 are estimated at TSh 1,069 billion (US$668 million) with the sales volume of 4749 million kWh. The revenues are forecasted to increase by more than 40 percent in 2014 due to the tariff increase in December 2013, higher sales volumes, and further increase in operational efficiency.

55. **TANESCO financial deficit has shrunk in 2013 and the level of arrears has been put under some control.** TANESCO operated with a loss in both 2012 and 2013, but the size of the loss was reduced from 44 percent of electricity sales revenues in 2012 (US$228 million) to 33 percent in 2013 (US$195 million), excluding transfers from the Government. The company is expected to break even this year. While TANESCO is not projected to accumulate new arrears to suppliers going forward, it will still carry significant arrears accumulated over the last few years. While it has been stabilized, the total arrears (accounts payable) remain large. Arrears for EPPs and IPPs at the end of 2013 stood at about US$243 million, down from US$276 million a year earlier. The Government support will still be needed to help TANESCO clear the outstanding arrears over the next few years, as the contracts with the EPPs are expected to be phased out.

56. **To address its structural financial deficit in a more sustainable manner, TANESCO requested that the regulatory authority, EWURA, approve a substantial tariff increase, resulting in the raising of electricity tariffs by 39.12 percent on average, effective January 1, 2014.** TANESCO submitted the tariff application in October 2013. In December, EWURA announced its approval of a new tariffs schedule, which TANESCO started implementing from January 1, 2014 (*PGSDPO-II prior* action). It is estimated that the current average level of tariff of 16-17 US¢ /kWh (depending on the consumption mix) will generate over US$150 million per year as additional revenues for TANESCO, which will be sufficient to cover its operational costs once EPPs are replaced by new gas-based plants. The new tariffs will remain in effect until December 2016 unless a Cost of Service Study that will be undertaken in 2015 recommends new tariffs. During this three-year period, TANESCO can periodically adjust the tariff for changes in fuel cost, domestic inflation, and exchange rate fluctuations (with EWURA approval).

57. **This tariff increase is complemented by other measures to manage the deficit, such as commercial borrowing (with government guarantees) and transfers from the central government budget as budget support subsidies to TANESCO.** TANESCO has concluded negotiations with several commercial banks to borrow US$240 million in December 2013, out of which US$65 million is a repayment of a "bridge loan" obtained in 2012. The Government has provided guarantees for 85 percent of the loan. While the commercial borrowings will enable TANESCO to finance a part of the financial gap in the short term, this strategy needs to be carefully calibrated in terms of debt sustainability of the company.[12] During FY2012/13, the Government transferred US$252 million (TSh 403 billion) to TANESCO to subsidize its payments to IPPs and EPPs.

58. **The Government has taken actions to reduce the level of transfers to TANESCO to protect the overall fiscal sustainability of the Central Government** (*PGSDPO-II prior action*). First, the approved budget of FY2013/14 includes transfers to TANESCO amounting to US$170 million, which was already about one-third lower than the level transferred in the previous FY, but the Government has subsequently committed to further limiting these transfers to US$120 million.[13] In terms of ratio to controlled total public expenditure (total expenditure excluding wages, consolidated funds services, and foreign-funded development expenditure), the Government is expected to reduce the allocated amount of transfers from 6.1 percent in FY2012/13 to 2.5 percent in FY2013/14. Second, only US$20 million is to be funded from the domestic budget revenues during FY2013/14 (the amount which has been transferred already). Third, the amount of transfers will be further reduced to two percent or less of controlled total public expenditure in FY2014/15 (*PGSDPO-III trigger*).

59. **The Government has committed to ensuring transparency and predictability in its transfers to TANESCO.** In the approved budget of FY2013/14, the Government decided to have a separate budget line labeled as "transfer to TANESCO".[14] Such presentation has

[12] The repayment of the loan will be over a 7-year period with a 2-year grace period.

[13] The Government used the additional fiscal space provided by the PGSDPO-I, which was disbursed to the Government late FY2012/13, to close the financial deficit of TANESCO. Transfers to TANESCO during FY2013/14 up to the amount equivalent PGSDPO-I is not included in the calculation of the cap on the Government's transfers to TANESCO for FY2013/14.

[14] In the approved budget, TSh 273 billion has been allocated to the line.

improved both transparency and predictability of Government support to TANESCO (*PGSDPO-II prior action*).

60. **A comprehensive review of existing explicit and implicit subsidies is needed for building efficient and equitable power supply service in the country.** The Government has initiated a study with a view to developing a comprehensive, effective and output-based sustainable energy subsidy policy. The resulting policy is anticipated to appropriately define the principles for subsidizing the energy sector, including both consumption and supply sides. Such policy is expected to be adopted in 2014 (*PGSDPO-III trigger*).

61. ***Outcome indicators*.** The implementation of the actions supported by the DPO series has been monitored by the use of a series of indicators, including: (i) TANESCO operating deficit; and (ii) TANESCO accounts (trade and other) payable.

Pillar 2: Reducing the cost of power supply and promoting private sector participation in the power sector

62. **Reducing energy generation costs remains a key priority—including shifting toward domestic gas in power generation.** The key cost driver has been the increased use of liquid fuels in electricity generation and the cost of EPPs because of the below-average hydrological conditions. In order to control the increasing costs of generation and mitigate the hydrological and fuel price risks, Tanzania is rebalancing its generation mix toward more use of domestic natural gas in the next three years, while continuing to develop renewable generation as well. The efforts involve increasing gas production, construction of new gas pipelines and gas-fired power plants, and appropriate financing, contractual and commercial arrangements to ensure that these investments happen. The priority investment projects for electricity generation, included in the Power Sector Master Plan (PSMP) 2012 update (as adopted in May 2013), reflect the Government's diversification strategy for energy generation.

63. **There have been clear positive trends in cost reduction over the past year.** TANESCO reports a reduction in the cost of power procured from EPPs, as well as increased generation from their own plants, including hydropower. TANESCO also commissioned Mwanza power plant (60 megawatt, MW) in September 2013. As a result, the cost of electricity sales per unit (kWh) declined by 26 percent in 2013 in comparison with 2012. TANESCO continues to implement its investment plan; in 2013 it started construction of a 150-MW gas-fired power plant (Kinyerezi I), which is expected to be completed by the end of 2014. The Ministry of Finance (MoF) is actively working on closing financing for a 240-MW combined-cycle plant (Kinyerezi II).

64. **TANESCO's operational efficiency is also improving**. TANESCO reports important improvements in reducing technical and commercial losses in its transmission and distribution network, through improved metering infrastructure, better management, and other means. In 2012, these losses were 22.1 percent (calculated as the difference between the quantity of electricity generated and imported against the quantity billed), and in 2013 they fell to 19.4 percent. As one of its key performance indicators (KPIs), as well as a regulatory requirement, TANESCO is committed to addressing the issue further, through taking concrete measures

including developing a plan to meet the targets set in the EWURA Order of December 2013 (*PGSDPO-III trigger*).

65. **To support the shift toward more use of domestic gas, progress is being made in the construction of gas transport and gas production infrastructure.** The Government initiated construction of a major gas pipeline connecting the producing gas fields in Songo Songo Island and Mnazi Bay with Dar es Salaam, where most of the power generation and electricity load is concentrated. The pipeline and the associated gas processing facilities are expected to be completed in early 2015. Tanzania Petroleum Development Corporation (TPDC) is also negotiating with private investors in the producing gas fields (Songo Songo Island and Mnazi Bay) for additional quantities of gas to be delivered to the gas market.

66. **As part of the program supported by the DPO series, the Government has made a policy decision to strengthen involvement of the private sector in electricity generation through competitive and transparent processes.** The Government realizes that it needs to increase private investments through public and private partnerships (PPPs) in this critical segment of the sector. The Ministry of Energy and Minerals (MEM) adopted a revised PPP strategy in 2013. It adopted a policy in 2013 that future new power plants—beyond those committed ones—will be competitively tendered.[15]

67. **The implementation of the Government's policy has started with building capacity for PPP management including development of IPP/ PPP projects through a competitive, transparent process.** The Government has launched the PPP capacity building program to support the initial phase of the above 2013 policy to promote private sector participation through competitive selection processes (*PGSDPO-II prior action*). The capacity building program cover areas such as: (i) screening and conducting due diligence; (ii) financial structuring for private investment; (iii) structuring process for selecting developers and implementing transactions; (iv) preparing legal and regulatory documents; and (v) managing government and public corporation fiscal risks. Dedicated PPP units have been established both in the MEM and TANESCO, and these units are building capacity with the help of donors, including through the Bank's support for technical assistance through the Energy Sector Capacity Building Program (ESCBP), co-financed by the Canadian International Development Agency (CIDA). MEM also developed a comprehensive PPP training program in January 2014. TANESCO is in the process of selecting a transaction advisor for tendering about 250 MW of generation capacity under a PPP arrangement. The Government plans to launch at least one bidding process in 2014 (*PGSDPO-III trigger*). The Government has requested that the Bank support this process. The objective is not only to add new efficient power generation capacity to the system, but also demonstrate full benefits of a well-structured, transparent procurement process for attracting private investment.

68. **The Government is conducting a structural review of the energy sector as part of the BRN initiative, with the objective of improving its governance and efficiency.** The

[15] There are a number of other private sector financed projects being developed in Tanzania, including Singida wind power, Ruhuji hydropower, Kilwa gas-fired power plant, and several Kinyerezi gas-fired power plants. However, the private sector investors for all these projects were selected through direct negotiations rather than through an open competition.

Government has adopted the final report from the NKRA Lab on energy under the BRN initiative and started implementation of the recommendation. Specifically, a Ministry Delivery Unit has been established within MEM to monitor progress in implementing the Lab recommendations including drafting a time-bound Roadmap on the medium- and long-term structure of the power and gas sectors (*PGSDPO-II prior action*). It is expected that the Roadmap will cover such topics as TANESCO's restructuring, private sector participation, matching of objectives and targets to the updated PSMP, and expected state of the power sector in 2015, 2020, and 2035.[16] The Roadmap will be published by the Government by June 2014 and implemented over a period of time (*PGSDPO-III trigger*). The authorities are committed to continuing to improve TANESCO's governance. The position of Managing Director was confirmed in December 2013. The Government has signed a performance contract with key performance indicators with the Board of Directors of TANESCO, which in turn has signed a performance contract with the management of TANESCO. These KPIs have been posted on TANESCO's website. The performance-based management has been internalized within TANESCO and imbedded within its Corporate Business Plan for the various departments and units. The Roadmap should contribute to further improvement of the governance of TANESCO.

69. ***Outcome indicators.*** The implementation of the actions supported by the DPO series has been monitored by the use of several indicators, including: (i) reduction of TANESCO technical and non-technical losses in transmission and distribution; (ii) the amount (in MW) of gas-fired power generation capacity commissioned; (iii) the average unit cost of power sales; (iv) the number of bid for gas PPP power plants launched on a competitive basis; and (v) MEM documents on sector reforms published for public knowledge.

Pillar 3: Strengthening the policy and institutional framework for the management of the country's natural gas resources

70. **Tanzania's natural gas reserves appear large.** In addition to near-shore gas (1.4 trillion cubic feet, Tcf, proven reserve with potential upsides in the range of 8 Tcf), the offshore gas resources are estimated at 38.5 Tcf gas-in-place. Further work is ongoing to establish the size of the proven reserves. The challenge is to prepare the country for the gas economy and establish strong foundations to best take advantage of this potential resource wealth, including establishment of a sound fiscal regime to manage future revenue flows from such resource wealth and use of such revenues.

71. **This DPO series supports the Government's effort to strengthen the policy and institutional framework for managing resources from natural gas.** Such framework needs to be developed well ahead of the revenue windfall, which is expected to come in seven to ten years.

72. **With a view to developing a comprehensive strategy for the gas sector, the Government developed the Roadmap for Natural Gas Development in Tanzania**. Adopted by the Cabinet in October 2013, the Roadmap sets out short, medium, and long term action plans for the gas agenda, including for such areas as establishing high-level inter-agency coordination,

[16] Joint Energy Sector Review 2012/2013 (September 2013).

key legislative and regulatory framework building, transparency and accountability, capacity development along the natural gas value chain, natural gas revenue management, consistency with macro-fiscal policy, domestic market development and export development, downstream infrastructure development, public expectation management, corporate social responsibility, pricing structure, and PPPs.

73. **The Government has made progress in building gas-specific institution by adopting a Natural Gas Policy which was prepared through a broad public consultation process.**[17] The consultations, which started in October 2012, involved major stakeholders in the country such as private companies, donors, civil society, the Parliament, and the public at large through publication of a draft in national newspapers. The Cabinet approved the draft in November 2013 (*PGSDPO-II prior action*) and implementation is to start subsequently (*PGSDPO-III trigger*).

74. **Setting up an Authority to regulate the upstream natural gas sector is a critical next element in the natural gas institutional framework following the Natural Gas Policy.** While the final version of the Natural Gas Policy is generally satisfactory, it omits the upstream segment of the sector. However, the Government has embarked on preparing a Petroleum Policy which clarifies the roles of TPDC as a National Oil/Gas Company and the Minister as a regulator for upstream activities. (*PGSDPO-III trigger*).

75. **Preparation of a Gas Act and development of a Natural Gas Utilization Master Plan are equally important next steps in building the natural gas legal and institutional framework.** The process of developing a bill focusing on midstream legislation (transport, storage, LNG) to enact the Gas Act has been delayed due to the extensive consultative process required for the Natural Gas Policy. However, the Government is committed to submitting a bill to the Parliament during (FY2014/15) (*PGSDPO-III trigger*). Development of a Natural Gas Utilization Master Plan is also an ongoing exercise and needs to be completed (*PGSDPO-III trigger*).

76. **Following the multi-donor gas scoping missions in 2012 and 2013, the Government has launched a new initiative for developing Tanzania's own Natural Resource Charter to set a framework for improved management of resources, including those from natural gas.** A Natural Resource Charter sets principles for the Government and society on how best to harness the opportunities created by extractive resources, such as natural gas, for development. Based on the program under the New Partnership for Africa's Development (NEPAD), development of such natural resource charter will guide management of the chain of complex economic decisions to transform natural resources under the ground to development above the ground based on 12 precepts (see Annex 5). The panel was officially launched by the Government on December 13, 2013 (*PGSDPO-II prior action*). The benchmarking exercise, to be conducted by the panel, is a critical initial exercise in setting up Tanzania's Natural Resource Charter. Its aim is to diagnose gaps and opportunities along the decision chain for natural resource management, including natural gas, from extraction to investing the financial proceeds.

[17] The main objective of the Policy is to provide guidance for the sustainable development and utilization of the natural gas resource and maximization of the benefits therefrom and contribute to the transformation and diversification of the Tanzanian economy. This main objective is supported by 15 specific objectives. The Policy has been published on MEM website.

The results will be used to build an action plan and national vision to guide a program of activities to improve the governance and economic management of natural resource wealth.

77. **An important step forward is the establishment of a sound and transparent institutional framework to enhance top-level inter-sectoral coordination on the gas policy agenda** (*PGSDPO-II prior action*). Such coordination mechanism is to drive "whole of government" work on gas development and to design a longer program to make agencies "fit for purpose" in the new era including in management of future gas revenues. The Government has laid out its plan to establish a top-level mechanism for inter-ministerial coordination as one short-term action of the Government's Roadmap. Specifically, the Economic and Finance Committee of the Cabinet has been mandated to handle the natural gas agenda, which provides the authorizing environment for policy decisions in the sector. The Government also has set up a task force under the chairmanship of the Chief Secretary and with MEM's secretariat role, to provide oversight and guidance on all issues related to oil and gas governance in the country. The task force is comprised of the Chief Secretary, Commissioner General of Tanzania Revenue Authority (TRA), Governor of Bank of Tanzania (BoT), Executive Secretary of the President's Office Planning Commission (POPC), Permanent Secretary of MoF, Permanent Secretary of MEM, Managing Director of TPDC, and Attorney-General's Chamber.

78. **With respect to corporate governance, the Government will consolidate its new strategy based on the need to increase transparency and accountability in the energy sector**. Following the initiative to improve transparency of TANESCO under the first DPO, this operation supports a set of initiatives to improve transparency of TPDC through publication of key documents in its website such as audited financial statements, procurement performance audit reports, and KPIs (*PGSDPO-II prior action*). The latest financial statement (FY2011/12) of TPDC audited by the National Audit Office (NAO) has been posted on the website and so has the latest procurement audit report by the Public Procurement Regulatory Authority (PPRA) (for FY2011/12 and released in September 2012). The audited financial statement includes the latest confirmed KPIs.

79. ***Outcome indicators.*** The implementation of the actions supported by the DPO series has been monitored by the use of a series of indicators, including: (i) volume of gas produced; (ii) amount of on-shore proven natural gas reserves; and (iii) annual monitoring under the Natural Resource Charter initiative.

Analytical Underpinnings

80. **Analytical work on the power and the gas sectors.** The PSMP provides a detailed analysis on the demand for electricity and proposes a least cost investment plan for the power sector. The Government, in close collaboration with partners, produced a draft diagnostic study on the amount and the nature of subsidies currently used in the energy sector (December 2012). EWURA completed a Cost-of-Service Study (CoSS) in October 2012, as a background for determination of a 3-year tariff methodology for TANESCO (2013-2015). A number of studies have been conducted on power sector efficiency improvement such as TANESCO's system loss study by the Millennium Challenge Corporation (MCC) and energy efficiency and demand side management work by the United States Agency for International Development (USAID). Several sector reviews have been conducted including the Energy Lab Report of the BRN-

NKRA (2013) and Joint Energy Sector Review 2012/2013, which were prepared through the dialogue between the Government and the Energy Development Partner Group (EDPG). The 2012 multi-donor gas scoping mission as well as the 2013 follow-up mission, also provided analytical insights on the main challenges that the gas sector is expected to face in the coming years.[18]

81. **Analytical work on the challenge of governance and public sector management, including in public enterprise**s. The Bank has been leading the Public Expenditure Review (PER) process over the past decade, which is viewed as the main channel to provide technical advice on fiscal policy and management. The energy sector is covered in the Rapid Budget Analysis that is presented every year at the Annual General Budget Support (GBS) Review. Progress on budget transparency is explicitly monitored by the International Open Budget Partnership initiative, in which Tanzania participates. Public investment management was one of the topics included in the 2010 PER and is now one of the focus areas of the PER process. The public financial management (PFM) agenda has been supported by a number of studies, notably the Public Expenditure and Financial Accountability (PEFA) exercise, with the latest 2013 assessment signaling risks from parastatals. The Controller and Auditor General (CAG) publishes the audit report for public authorities and other bodies (PABs), which include TANESCO, on an annual basis. The preparation and the dissemination of the three EITI payments reconciliation reports have also contributed to the transparency agenda in the extractive sector. The 2013 Natural Resource Charter conference, held in Kuwait in May 2013, and the 2013 gas follow-up mission, led jointly by the Bank, United Kingdom Department for International Development (DfID), and the European Union (EU), have provided important inputs to the establishment of the Natural Resource Charter.

82. Table 6 presents the set of analytical products and relevant findings which have informed the design of the prior actions supported under this operation.

Table 6: Prior Actions and Analytical Underpinnings

No	Analytical Work Informing Design of Prior Action	Prior Action
I: Strengthen the country's ability to bridge the financial gap in its power sector		
1	CoSS (2012); BRN Energy Lab Report (2013); GoT-EDPG Joint Energy Sector Review (2013). The current level of revenues in the electricity sub-sector remains relatively below the supply cost. EPPs are particularly costly.	TANESCO has implemented new tariffs, approved by EWURA in December 2013, in order to increase its revenue.
2	PER Joint Rapid Budget Analysis (2012, 2013); Open Budget Partnership (various years). Budget transparency is an effective accountability mechanism.	The Government had created in its approved FY2013/14 budget a specific code with funds for transfers to TANESCO to improve budget transparency.
3	PER Joint Rapid Budget Analysis (annual); CoSS (2012); BRN Energy Lab Report (2013). The financial difficulty of TANESCO led for the need of GoT transfers to TANESCO, which needs to be managed for TANESCO to restore financial stability.	The Government has taken actions to reduce the level of transfers to TANESCO from the level of FY2012/13 and has committed that the level will not exceed 2.5 percent of Controlled Total Expenditure in FY2013/14.
II: To reduce the cost of power supply and to promote private sector participation in the power sector		
4	Power System Master Plan (2009, 2012); GoT-EDPG Joint Energy Sector Review (2013); BRN Energy Lab Report (2013). The country requires significant expansion of power supply capacity. Private sector participation on a more	The Government and TANESCO have implemented the initial phase of the 2013 Policy for Private Sector Participation in Power Generation through Competitive Processes by launching PPP capacity building programs

[18] The mission participants represented AfDB, China, UK DfID, EU, Germany, IMF, and the World Bank.

No	Analytical Work Informing Design of Prior Action	Prior Action
	competitive basis is an effective way to ensure cost efficiency in the sector. The first step is to build further capacity in the Government and TANESCO for managing PPPs.	for: (a) screening and conducting due diligence; (b) financial structuring for private investment; (c) structuring bidding processes for selecting developers and implementing transactions; (d) preparing legal and regulatory documents; and (e) managing government and public corporation fiscal risks.
5	Power System Master Plan (2009, 2012); GoT-ESDPG Joint Energy Sector Review (2013); BRN Energy Lab Report (2013). The country requires significant expansion of power supply capacity while improving efficiency of the energy sub-sector through structural reforms. Implementation of the Big Results Now initiative is a pragmatic way to achieve tangible results.	The Government has adopted the recommendations of the Presidential Big Results Now Initiative to develop a roadmap for structural reforms of the energy sector and has established a Ministry Delivery Unit within MEM to oversee the implementation of the recommendations.
III: Strengthen the policy and institutional framework for the management of the country's natural gas resources		
6	GoT Roadmap for Gas Development (2013); Multi-donor gas scoping mission report (2012). Finalization of the Natural Gas Policy is an important first step in building the institutional framework on gas.	The Government has adopted the Natural Gas Policy.
7	NRC (2013); EITI payments reconciliation report (annual); Multi-donor gas scoping missions (2012, 2013). Assessing the capacity needs along the decision chain is critical.	The Government has launched a program to adopt a Tanzania Natural Resource Charter and has established an expert panel to oversee the program.
8	GoT Roadmap for Gas Development (2013); Multi-donor gas scoping missions (2012, 2013). Inter-agency coordination is needed for effective development of the gas sector and diversification of the economy.	The Government has established a top-level institutional mechanism to enhance inter-ministerial coordination by mandating the Cabinet committee on economic affairs to handle the natural gas agenda and creating an inter-ministerial senior taskforce on natural gas.
9	GoT CAG report on PABs (2012). Transparency is an effective accountability mechanism for any public entity.	TPDC has published on its website its latest audited financial statement, its latest procurement audit report, and its key performance indicators.

C. Link to CAS and Other Bank Operations

83. **The proposed operation is well aligned with the current Country Assistance Strategy (CAS) for FY12-15 and the Bank's Africa Strategy, with alignment to be stronger in the forthcoming CAS Progress Report (CASPR).** As part of its second objective to build infrastructure and deliver services to the economy, the CAS adopts the broad aim of better meeting the demand for reliable and cost efficient energy and specifically notes the Bank's support to facilitate the restructuring of the power sector. Enhanced power supply also contributes to a better business environment and competitiveness of the economy, which are key objectives of the CAS as well as of the first pillar of the Regional Strategy. Improving access to reliable and affordable electricity is also a key factor in reducing household's vulnerability and improving their living conditions, which is the second pillar of the Regional Strategy. Lastly, the transparent and efficient management of the energy sector will reduce pressure on the budget and thus provide fiscal space for additional spending on other priorities such as education and health as well as infrastructure.

84. **The proposed DPO series will be the primary vehicle used by the World Bank to promote policy dialogue in the Tanzanian power and gas sector.** The proposed operation will complement: (i) the current and future investment projects that promote access (Energy Development and Access Expansion Project) and the development of the Transmission Backbone Project as well as the use of renewable energy resources through private sector participation; (ii) ESCBP; (iii) non-lending analytical work and technical assistance on the multi-

sector gas agenda; and (v) general budget support from the Poverty Reduction Support Credit (PRSC) series, which aims at improving effectiveness and transparency in public finance areas.

D. Consultations and Collaboration with Other Development Partners

85. **The reform agenda supported by the DPO series is derived from Tanzania's MKUKUTA II and FYDP I as well as consultations processes in the power and gas sectors.** Tanzania's national strategies have been traditionally developed through intensive consultative processes with a wide array of stakeholders**.** The Government prepared TDV 2025, MKUKUTA II, and FYDP I with significant stakeholder consultations. In the energy sector, the Government has also followed wide-ranging consultations on most policy reforms, and many of the policy areas covered by the DPO are underpinned by sector or thematic processes that are open to stakeholders from civil society organizations (CSOs), academic and research institutes, the private sector, and the donor community. The Natural Gas Policy has gone through an extensive local consultation process, including all major stakeholders, and is debated openly in public media. CoSS was discussed in various public forums, including with the participation of development partners. Finally, the GBS annual review addresses sector-specific issues, including energy, in a participatory format with the private sector and CSOs participating in the discussion together with the Government and DPs.

86. **The collaboration between DPs and the Bank has been at the center of the aid delivery framework in Tanzania over the past decade**. The energy sector has been a priority area and so has benefited from intense monitoring by DPs using a collaborative approach. A specific group (EDPG), chaired by the World Bank, leads the sectoral policy dialogue with the authorities, harmonizes views amongst donors, and prioritizes technical and financial assistance. The sector-level coordinated dialogue with other DPs contributes to the multi-donor harmonized framework of budget support, or GBS in Tanzania. The Performance Assessment Framework (PAF), which identifies a number of key actions and results to be achieved by the Government, has been used to promote policy dialogue as part of GBS. As part of 2013 PAF, two triggers for PGSDPO-II have been incorporated (corresponding to prior actions #3 and #4), emphasizing the close coordination with development partners. Some key triggers for PGSDPO-III are expected to be a part of PAF 2014.

87. **Many DPs are either planning to be or are already actively involved in the energy sector**. The most prominent partners are the United States (Millennium Challenge Corporation, USAID), EU, the African Development Bank (AfDB), Finland, Norway, Japan, and Sweden. So far the emphasis given by donors has been on transmission rather than generation capacities. Other partners, such as Germany and UK, propose to be associated with development of renewable energy. The United States has recently launched the Power Africa Initiative for a few African countries including Tanzania, with which the World Bank Group is collaborating. With respect to the gas/oil agenda, Norway, EU, Brazil, and China have been providing human capital development support. Canada is a co-financier of the ESCBP. On the policy front, this operation and the series are fully aligned with the GBS framework, which has given a special emphasis to the reforms supported by this DPO series. AfDB has provided additional financing of its existing GBS series and expects to develop a new series which specifically focuses on the power sector from 2014. Several other DPs, such as DfID and EU are also planning energy sector

budget support in Tanzania in coming years. Coordination with those new programs to create synergy in policy dialogue is important.

V. OTHER DESIGN AND APPRAISAL ISSUES

A. Poverty and Social Impact

88. **Overall, the Government's reforms supported by the operation and the series are expected to contribute to poverty reduction and shared prosperity in the long run.** Detailed discussion is presented in Annex 6.

89. **First, the Government's reforms, supported by this DPO series, strengthen policy and institutional frameworks and the financial stance of the power sector, which, together with improved governance, contribute to enhancement of power supply, reliability and access to electricity by firms and households over time**. Recovery of financial health of TANESCO (*pillar 1* of the DPO series) and transition to a low-cost power sector structure with improved cost efficiency and more diversified energy mix through more competition-based private sector participation in the sector (*pillar 2*), provide the enabling environment for both public and private sectors to invest in capacity and quality enhancement in power supply. Lack of stable power supply from public grids has negatively affected private sector activities with subsequent adverse impacts on employment and income. Furthermore, it had strong regressive impacts on firms since larger firms have more access to back-up power sources during power outages. The 2006 World Bank Enterprise Survey data shows that power outages cost about 12 percent loss of annual revenues among small and medium firms while six percent for very large firms. To the extent that most operating firms are small and informal, improved and more stable access to energy sources will help them growth faster and ultimately reduce poverty. Concurrently, improved access to electricity at competitive costs, which is one of the expected outcomes of the series (*pillar 2*), will increase the welfare of Tanzanian households. While the quantitative impact is difficult to estimate, the reform program, by boosting the generation capacity and increasing the number of connections, will help increase the current low access rate to electricity (only 18 percent of all households). Higher electricity access will have in turn direct benefits on social indicators as it facilitates the provision of education and health.

90. **Second, this DPO series supports the Government's reforms for the transition to a more sustainable cost structure in the energy sector, releasing the pressure on public expenditures and protecting expenditures on social sectors**. The Government is committed to closing the temporary financial gap in TANESCO through the combination of: (i) higher revenues; (ii) commercial borrowing; and (iii) government transfers to TANESCO. However, heavy reliance on commercial borrowing might further mortgage the future and affect the fiscal stance when payments are due to banks. If the Government's transfers are too large, there will be a trade-off within the existing budgetary allocations at the potential expense of pro-poor expenditures. The DPO series will reduce, though not eliminate, the need for the Government to use the three different instruments during the transition phase toward lower supply of energy, thereby mitigating their negative economic and social impacts. The agreed cap on the amount of the Government's transfers to TANESCO (*PGSDPO-II prior action* and *PGSDPO-III trigger*) has also proved to be effective in balancing the cost of financing between TANESCO's customers and tax payers. In the long term, the new subsidy policy (*PGSDPO-III trigger*)

should provide more transparency and effectiveness in the Government's possible intervention in favor of low-income households.

91. **Third, this DPO series supports the Government's programs to establish a sound institutional framework for natural gas development (*pillar 3*), through which the country can truly benefit from the rich natural resources both economically and socially.** Strong institutions are essential in order to optimize the benefits of the new resources for all. The additional prosperity can be shared at the national level through promoting investment in infrastructure, building more human capital and developing the local private sector. In the long-term, fiscal revenues if well managed could also be used to develop proper social safety nets. As presented during the Multi-Donor Scoping Missions in 2012 and 2013, lessons from international experience show that a critical success factor in turning natural resources into prosperity is to effectively use the small window of opportunity that exists between discovery and the revenues to create the institutional settings for success. This includes: coordination across ministries (*PGSDPO-II prior action*) to ensure the natural resource is an integral part of the medium- to long-term planning process for the country, managing expectations of the population, enshrining transparency at all stages of the process, building and strengthening the capacity of various institutions along the value chain of the natural resource to negotiate, select, implement and assess projects, manage revenues, and to supply the skills needed to grow. In the longer term, the transparent management of fiscal revenues derived from gas production as well as the linkages opportunities with the local economy will produce potential significant effects, on economic growth and poverty levels. The DPO series is designed to support both of these goals and complementary analytical work will reinforce this, specifically the studies on local content analysis and macro modelling. Through the 12 precepts of the Natural Resource Charter as shown in Annex 5, the initiative to establish a Tanzania Natural Resource Charter (*PGSDPO-II prior action*) will contribute to strengthening of the linkage between natural gas resources in Tanzania and poverty reduction and the shared prosperity agenda particularly by promoting 'sustained, inclusive economic development' and "securing the greatest economic benefits for its people." Civil society also has a role to play by providing information and encouraging the Government to be accountable to its citizens.

92. **The recent decision to increase electricity tariffs by an average of 39 percent is not expected to have significant direct adverse impacts on low-income households.** First, only a fraction of lowest-income households currently have access to electricity. Second, the new tariff schedule structure also included an upward shift in the threshold quantity beyond which a higher tariff rate is applied. Since the lowest-income households with access to electricity are generally low-amount consumers, the new tariff structure should have a limited impact on them (Annex 6).[19] Third, more broadly, the tariff increase allows the Government to reduce the transfers to TANESCO, preventing further budget cuts in social expenditures.[20] The negative impact of the recent tariff increase might however occur through the increase in the operational costs of some

[19] Preliminary estimation based on 2011/12 Household Budget Survey data implies that households of the lowest-income quintile with access to electricity may not be impacted negatively since their amount of electricity consumption is such that they may see their effective tariff rate even declined.

[20] During FY2012/13, the actual energy spending was 2 percentage points higher than the originally budgeted level in terms of share in total expenditure due to transfers to TANESCO, while for the share of health and education spending, the actual was 0.4 percentage point lower than the originally budgeted level.

private firms. Some energy-intensive industries, such as cement and fertilizers, may have to increase their prices, leading to higher costs for consumers. Small firms (among those with access to electricity) may not have sufficient financial resources to absorb the higher electricity costs and might therefore cut back on their activities. While these potential impacts on prices will need to be closely monitored in coming months both at the macro and micro levels, the expected increase in power generation should improve firms' access to electricity and facilitate their development over time. Firm level data in Tanzania and elsewhere show that firm productivity is affected more by quality of power supply such as power outages rather than cost of power. Also, Tanzania also has an effective social protection program at the national level, called Tanzania Social Action Fund (TASAF), which provide targeted social protection measures such as conditional cash transfers for the people/households in extreme poverty and protect the vulnerable groups from economic shocks.

B. Environmental Aspects

93. **The policy actions supported by this operation reinforce the Government's effort to increase the use of natural gas to replace liquid fossil fuels and help the country scale up economic growth with less impact on the environment compared to other means, particularly continued use of liquid fossil fuels.** Improved availability of electricity will alleviate some of the pressure on Tanzanian forest resources by reducing demand for fuel, wood, and charcoal as the primary energy sources. In addition, the operation and the series support the Government's effort to establish a proper institutional framework for the development of natural gas, including ensuring strengthening of the environmental safeguard mechanism for the development of natural gas.

94. **This operation supports the Government in its drive to set up the right institutional framework for gas sector development, which includes provisions for proper management of environmental issues as a priority.** The discovery of potentially large natural gas deposits represents an important environmental management challenge for Tanzania. Initial results suggest that natural gas deposits may be found in offshore marine and coastal waters, including areas in and around some of Tanzania's marine protected areas. Therefore, there are significant environmental risks from the natural gas sector's development unless adequately mitigated. While natural gas discoveries pose important environmental management challenges for Tanzania, the Government is focused on ensuring that environmental issues are mainstreamed into all operations in the natural gas industry, that all activities in the industry comply with environmental best practices, and that disaster management systems are in place to prevent and mitigate adverse impacts from natural gas operations. These objectives have been set forth in the Natural Gas Policy (*PGSDPO-II prior action*), which has a specific objective to ensure compliance with health, safety, environmental and biodiversity issues are integrated in all operations in the natural gas value chain and ensure compliance to standards in those areas. Further details on the environment management aspects will be prepared in the context of follow-up activities such as an implementation strategy for the Policy, as well as a Natural Gas Act and Regulations. By establishing an expert panel to conduct an international benchmark exercise (*PGSDPO-II prior action*), the Government has also committed to preparation of a Natural Resource Charter, the framework of which includes a precept on assessment, management, monitoring and mitigation of environmental consequences of natural resource exploitation (see Annex 5).

95. **The existing regulatory and institutional framework in Tanzania encourages sound environmental management of investments financed through the Government budget.** The Environmental Management Act of 2004 (EMA) and associated regulations require due diligence in managing environmental impacts emanating from government operations and investments, including investments by TANESCO to expand its power generation capacity.[21] The EMA gives a mandate to the National Environmental Management Council (NEMC), under the Vice President's Office (VPO), to oversee enforcement, compliance, review and monitoring of, and compliance with, environmental impact assessments; conduct research; facilitate public participation in environmental decision-making; raise environmental awareness; and collect and disseminate environmental information. The EMA also requires each sector to establish an environmental section to ensure that sectoral operations are conducted in accordance with the law's provisions, to coordinate aspects related to the environment, and to ensure that environmental considerations are integrated into sectoral planning and project implementation (such as power generation plants). These environmental units have been created in most sectoral ministries. Five ministries including MEM had developed their Sector Environmental Action Plans (SEAPs) for implementation by October 2011. Through implementation of SEAP, MEM is committed to strengthening its monitoring capacity on environmental compliance in resource exploration and extraction by adopting a set of performance indicators on environmental compliance in resource exploration and extraction, including one indicator specifically for upstream gas and petroleum activities.

96. **The importance of strengthening environmental management has been emphasized in the gas scoping mission in 2012, co-led by the Bank, which agreed with the Government on a set of actions including those in the area of environmental management.** The mission noted that the highest standards of environmental performance adopted by the multinational companies operating in the gas sector in Tanzania can help improve the overall standard of environmental planning and management of Tanzania's coastal zones by introducing new benchmarks for smaller industries to aspire to. Corporate social responsibility (CSR) programs of those companies can also significantly contribute to sustainable development.[22] On the other hand, the mission also noted that gas companies are increasingly seeking efficiencies by contracting out project activities to specialized service companies. Responsibility hence needs to be shared throughout the contracting chain, across company departments, and between the Government and the industry, with space for independent third party oversight. The mission stressed that Tanzania needs to follow an environmental and social management framework based on internationally accepted environmental principles. The GoT action plan based on the mission has been developed with actions to: (i) ensure GoT and gas companies develop and maintain "Emergency Response Plans" applicable to all operations; (ii) carry out strategic environmental and social assessments before any development and strengthening implementation; (iii) improve land and marine use planning, including identifying, demarcating

[21] In addition to EMA 2004, the National Energy Policy (2003) requires environmental impact assessments for all energy programs and projects.

[22] In addition, there is a continued effort to establish a the Marine Legacy Fund, which would provide stable long-term financing for marine and coastal conservation and sustainable resource management. The funds are not a substitute to governmental support to protected areas and sustainable fishing areas but will act to complement government programs. The initiative is currently led by the WWF, exploring contributions from non-governmental sources, leveraging CSR initiatives, in particular gas investors.

and protecting critical zones (habitats, conservation areas, ecosystems), and investing in marine and coastal zone environmental protection; and (iv) strengthen GoT capacity to monitor compliance and enforce environmental regulations.

97. **Preparation of a Strategic Environmental and Social Impact Assessment (SESIA) for the gas sector is underway.** While Tanzania has a proper legal framework for environmental impact assessments (EIAs), existing diagnostics point to the need to strengthen its implementation.[23] On top of EIA, the EMA calls for a strategic environmental assessment (SEA) to be undertaken on all laws, policies, programs or plans to assess the likely effects of those efforts on the natural environment. The Government, with World Bank support, has recently launched preparation of an SESIA to support development of the natural gas sector. This SEA is being financed through ESCBP and will provide guidance to NEMC, VPO and MEM on systematically integrating environmental and socio-economic concerns in project development, operations and maintenance of oil and gas sector activities. The procurement process to conduct SESIA has been in place with a report to be prepared within a year. The SESIA will include consultations with relevant stakeholders to ensure their interests, concerns and advice are taken into account and will identify needed changes in or additions to policy, legislation, regulations and guidelines. Alignment of the SESIA with implementation of the Natural Gas Policy—including preparation of the Natural Gas Act and its regulations— is important.

98. **Sound environmental management of newly discovered natural resources represents an emerging challenge, and requires significant additional capacity to be built in the Government to handle environmental work.** Management of gas exploration and development in these areas will require significant expertise and strong systems to ensure adequate response to spills and leaks, and to compensate for the sector's long-term environmental impacts. Given the novelty of the sector, such expertise must be developed at the local level.

99. **To help confront these new challenges, ESCBP has a package of capacity-building activities that has been agreed to by NEMC and is expected to help NEMC to provide effective and efficient oversight of the oil and gas sector in accordance with environmental regulations and in line with international best practices.** The project also provides guidance to NEMC on systematically integrating environmental and socio-economic concerns in project development, operations and maintenance of oil and gas sector activities, and prepares NEMC staff to execute their responsibilities under the environmental laws and regulations in the oil and gas sector effectively and efficiently. Specifically, ESCBP will finance, among others: (i) the provision of advisory services and training for NEMC staff on effective oversight of the environmental aspects of the oil and gas sector in line with international standards; (ii) the development of procedures, standards and processes related to hazardous waste management and gas venting and flaring; (iii) the ongoing development of an Oil Spill Contingency Plan by the Surface and Marine Transport Regulatory Authority; (iv) the development of a community-based early warning/response system; (v) workshops to disseminate information on the implementation of the Hazardous Waste Management Plan, the Oil Spill Contingency Plan and the Early Warning/Response system both within NEMC and in communities; and (vi) the purchase of measuring equipment for NEMC to allow the organization to make independent measurements

[23] For example, USAID Tanzania Environmental Threats and Opportunities Assessment (2012).

and compare them to threshold values and national or international standards to assess environmental impact.[24] This DPO series is complemented by the support provided under ESCBP in order to ensure that environmental aspects are adequately addressed (see Annex 7 for the description of ESCBP). Other DPs also have programs for capacity building specifically in the gas sector. For example, Norwegian Agency for Development (NORAD)'s Oil for Development program is providing support for GoT to ensure the coverage of environmental and safety issues in the review of petroleum policy and in the legislative and institutional frameworks, to strengthen knowledge, institutional competencies and regulatory capacities, and is also providing support in the areas of environmental data management systems and capacity building in relevant GoT institutions, including NEMC.

C. Public Financial Management, Disbursement, and Auditing Aspects

100. **While Tanzania's PFM remains among the best in Africa, there are still significant challenges.** The 2009 and 2013 PEFA scores reflect some deterioration of the PFM systems since 2005. The latest 2013 PEFA highlighted the two problem areas. The first major problem area is weaknesses in non-salary internal control systems. The second major problem area is the fiscal risk to the budget posed by some public enterprises. The main symptom of these two problem areas is the execution of the budget through the monthly cash rationing system. Tanzania lowered its rating in the area of PFM in 2011 Country Policy and Institutional Assessment (CPIA) by the World Bank and remained at the same rating in 2012.

101. **The Bank and other DPs continue to support the Government's effort to address challenges in the PFM system through PFM Reform Program (PFMRP).** Challenges stressed in PEFA 2009 and 2013 and other diagnostics include macro and fiscal forecasting, predictability of budget execution, harmonization of debt systems, and timely implementation of audit recommendations. The implementation of the fourth phase of PFMRP, which began in July 2012, responds to the areas of weakness identified through PEFA, CAG, and other reviews.

102. **The Government has increased the amount budget information made widely available to the public.** The Government budget for the financial year beginning July 1, 2013 (FY2013/14) was presented to the Parliament on June 13, 2013 (before commencement of the new financial year) and approved on June 21, 2013. The budget presented to the Parliament in the form of the budget speech (and accompanying four volumes of the budget books as submitted to Parliament) by the MoF was immediately made available on the MoF website. The approved budget books are also available in hardcopy and have been posted on the ministry's website starting last year. The approved budget of FY2013/14 has already been posted on the website.[25]

103. **Fraud and corruption risks exist but are not severe in Tanzania.** Tanzania performs better than the average in Sub-Saharan Africa on many international governance indices such as

[24] In addition, ESCBP will not only support capacity-building activities to improve the Government's ability to manage the potential environmental impacts generated from future activities in the oil and gas sector, but will also support the strengthening of the legal and regulatory framework for the gas sector to ensure that relevant legislation reflects the Government's desired natural gas policies and strategies.

[25] See http://www.mof.go.tz/index.php?option=com_content&task=view&id=22&Itemid=36.

the CPIA, World Governance Indicator, and Transparency International. However, some risks do exist. The transparency and accountability measures supported by the PRSC series, including policy actions on budget transparency, internal audit, EITI and recent Government commitment to the Open Government Initiative (OGI), forthcoming PFM/OGI operation and PER process reduce such risks.[26]

104. **The GBS accounts (called Poverty Reduction Budget Support or PRBS) used by the DPO series, is annually audited by CAG.** The latest CAG report for FY2012/13, issued in November 2013, provided an unqualified opinion. The Bank, like other DPs, was provided with a copy within a month after completion of the audit. This report confirmed the integrity of PRBS funds and made recommendations on a number of improvements to the mode of operations, which have resulted in new technical improvements to the related financial operations. In light of the above, the fiduciary risk to Bank funds being disbursed to the BoT for onward credit to the exchequer account is considered to be low.

105. **An updated IMF safeguards assessment of the BoT was finalized in November 2012**. It found a strengthened governance and safeguards framework at the BoT, including its audit committee and establishment of a risk-management function. The assessment noted the importance of continued strong oversight by the BoT's board of remaining noncore functions and of compliance with statutory limits on credit to government. The audited accounts of the BoT for 2012/13 with an unqualified opinion are published on the BoT's website.

106. **The proposed credit will follow the Bank's disbursement procedures for development policy loans/credits**. The untied finances will be disbursed against satisfactory implementation of the development policy program and not tied to any specific purchases. Once the credit is approved by the Board and becomes effective, and at the request of the Borrower, the proceeds of the credit will be deposited by IDA in an account designated by the Borrower and acceptable to the Bank at the BoT (central bank of Tanzania), and forming part of the country's foreign exchanges reserves. The Borrower shall ensure that upon the deposit of the loan into said account, an equivalent amount is credited in the Borrower's budget management system, in a manner acceptable to the Bank. The Borrower will report to the Bank on the amounts deposited in the foreign currency account and credited to the budget management system within 30 days after the disbursement is made.[27] If the proceeds of the credit are used for ineligible purposes as defined in the Financing Agreement, IDA will require the Borrower to, promptly upon notice from IDA, refund an amount equal to the amount of said payment to IDA. Amounts refunded to the Bank upon such request shall be cancelled. The administration of this credit will be the responsibility of the Ministry of Finance.

107. **Audit arrangements.** The proposed credit finances the Consolidated Fund, which is subject to audit by the CAG. The CAG is required by law to present the audit report on the

[26] The new PFM/OGI operation will include: (i) enhancing policy and legal changes to support the OGI, including the freedom of information bill and regulations; (ii) supporting the dissemination of high value public information for use by information intermediaries and citizens, and (iii) strengthening accountability mechanisms emerging from the availability of information and data to a broader audience.

[27] For the past PRSC operations, the authorities submitted such receipts after the disbursements with Exchequer Receipt Vouchers attached with some time lags of 40 to 70 days for PRSC-7, PRSC-7 supplemental, and PRSC-8.

public accounts to the Parliament within nine months of the financial year end. IDA will have access to those reports.

D. Monitoring and Evaluation

108. **The implementation of the DPO series will be monitored by the Government and the World Bank and through the Bank's participation in the preparation and the assessment of the annual PAF.** The implementation of the series has been conducted through periodic missions involving MoF, MEM and other relevant GoT offices, which allow the team to obtain updated data on a regular basis. As part of an overall framework, supervision and preparation of the operations in the series take place in collaboration with other donors and in consistency with the MKUKUTA review mechanism. The GBS review will be conducted annually for an overall assessment of progress made in each of the program areas. The Partnership Framework Memorandum of GBS sets the framework for M&E under GBS. The Government and GBS partners will keep track of their performance relative to jointly agreed indicators, targets, and actions listed in the PAF. The PAF has incorporated some the prior actions and triggers proposed in the DPO series. Monitoring and dialogue processes will follow an annual review process aligned with the Government's planning, budgeting, and MKUKUTA II review cycles. All formal performance assessments will be undertaken jointly by the Government and GBS partners.

VI. SUMMARY OF RISKS AND MITIGATION

109. **The overall risk of this operation is considered to be substantial.** Leading types of risks are from political economy factors on the sector reform agenda, macroeconomic-fiscal risks, and potential delays in implementing the Government's policy of reducing the cost of supply by establishing gas and power infrastructure projects to bring the sector to a financially sustainable path. While the tariff adjustments in January 2014 have helped to lower the overall risk, potential delays in shifting to cheaper energy sources, which affect the transition to a low-cost power sector structure, remain significant enough to keep the overall risk substantial. The following summarizes major risks and mitigating measures.

110. ***Political and country-level governance risks*.** While the action to raise the TANESCO tariffs from January 2014 has helped reduce the level of risks in this area significantly, the energy sector is still prone to political economic factors, which may impact some decisions related to sector reforms. The operation and the series' alignment with the BRN, with the leadership from the top political leaders, will mitigate such risks. The emphasis on greater transparency should help enhance accountability and commitment to results.

111. ***Macroeconomic-fiscal risks*.** Among the exogenous external risks, the economy remains exposed to variations in prices on the international market, notably of food, fuel, and gold. On the domestic front, the most important risks arise from fiscal policy as discussed in the earlier macroeconomic section and are: (i) shortfalls in revenue collection while increased public spending,; (ii) financial shortfall in the energy sector; (iii) accumulation of arrears particularly in the pension sector and contingent liabilities from the parastatals; and (iv) level of debt with increased non-concessional borrowing. Experiences around the world show that maintaining prudence in fiscal policy is important in the context of a political cycle. The proposed operation,

with the objective of closing the financial gap in TANESCO and replacing costly EPPs with less expensive domestic natural gas, is in itself a part of the strategy to mitigate the macro-fiscal risks. The DPO series also benefits from complementary dialogue channels, including the macro-fiscal dialogue through the IMF program, PRSC series which has a focuses on public investment management, the PER process which offers the platform to monitor recent fiscal developments and inform policymakers, and debt sustainability diagnostics such as DSA and debt management technical assistance activities.

112. ***Risks related to sector policies and institutions in the power and gas sectors.*** The implementation of the program supported by the DPO series may face several sectoral risks including: (i) possible delays in the implementation of gas and power infrastructure; (ii) delay in gas negotiations with producers. Those risks will be mitigated by the implementation of the parallel capacity building project ESCBP as well as exploring other options for technical supports, including through other DPs. The expected restructuring of the sector should also help better define priorities and responsibilities. To reduce the risk of insufficient gas supplies, the Government is pursuing gas sales agreements (GSAs) with key operators. On the governance front, the combination of policy actions supported by the series—such as improved reporting by TANESCO and TPDC, restructuring of the regulatory framework, competition through PPPs and transparent procurement procedures—should lead to better accountability and controls in the sector. The option of using risk mitigation instruments (partial risk guarantees) to attract investments in power and gas infrastructure could help mitigate the risks for the private sector. Alignment with the BRN would provide an overall environment in which investments and reforms in the sectors are being monitored and followed through.

113. ***Risks related to operational design, implementation, and sustainability.*** The DPO series has been designed to internalize policy parameters to lock-in incentives for reforms and limit the risk of political interference. Controlling the level of subsidy generates an incentive to enhance TANESCO's own revenue generation. Also, the programmatic approach taken by this operation should mitigate the risk of policy reversal in implementing the operation. Also, joint monitoring of the program, as being a part of GBS PAF, and close coordination with the IMF, help reduce risks of implementation delays.

114. ***Fiduciary risks.*** The overall PFM system in Tanzania remains adequate for DPOs and fiduciary risks directly related to this operation are low. However, the relatively low capacity in PIM and PFM continue to pose risk in the country's PFM system. The ongoing PFMRP IV program, the PER dialogue process, the PRSC series, as well as the new PFM/Open Government Partnership (OGP) operation, are important channels of dialogue and provide technical support in ensuring further deterioration of the PFM system would not happen.

115. ***Stakeholder relations and reputational risks.*** As the operation and the series deal with politically sensitive issues such as tariff increases and infrastructure development in relation to natural gas, there are reputational risks that need to be carefully managed. Transparency, participation, and good communications are key to mitigate such risks at the national level. This operation and the series support the immediate client, the Government, to ensure those aspects under this program. From the Bank side, preparation of the operation and overall implementation of the series need to be based on solid communication strategies with the Government, DPs, and the public.

116. ***Environmental and social impact risks.*** The operation broadly alleviates poverty and social conditions by helping the Government ensure expansion of access to electricity and improve reliability of the sector. Potential risks related to environmental damage from the overall natural gas development will be mitigated through this operation by supporting proper institutional building for the sector which follows international best practices. Constraints in implementation capacity, which do exist, will be mitigated by the implementation of the parallel capacity-building project ECBP. ECBP contains a window for helping the authorities to upgrade their environmental legal and regulatory framework.

117. ***Other—hydrological risks.*** The Tanzanian power system is highly dependent on hydropower. The Government program supported by the DPOs aims at reducing the hydrological risk by diversifying the source of energy toward gas, non-hydropower renewable technologies, and better designed hydropower plants with adequate management of reservoirs. This risk will remain during the transition as the new gas power plants will only become operational in 2015. There are several ongoing or new initiatives the Bank is taking on effective water resource management over competing demand for water resources in Tanzania, which will inform specific risk mitigation measures.[28]

[28] The Bank is currently undertaking three types of work in relation to effective and sustainable water management in Tanzania: (i) dialogue with the Government on multi-sectoral water management strategy in line of implementation of BRN; (ii) supporting GoT's Integrated Water Resource Management Program from IDA Water Sector Development Project; and (iii) a new analytical project to look at climate change vulnerability for hydro-power generation.

ANNEX 1: POLICY AND RESULTS MATRIX

PGSDPO-I Prior Action	PGSDPO-II Prior Action	PGSDPO-III Trigger	Results			
			Outcome Indicator	Baseline (2012)	Current (2013)	Target (2016)
Pillar I: The program objective is to strengthen the country's ability to bridge the financial gap in its power sector						
1. TANESCO has increased its collection of revenues by 30% between CY2011 and CY2012, through tariff increase and improved collections of bills. 2. To improve the financial conditions of TANESCO in FY 2013, (a) EWURA reviewed the current electricity tariffs; (b) the Government has identified the amount of subsidies to be transferred from the Government budget to TANESCO based on, among others, the above-mentioned tariff review; and (c) the Government has paid TSh 67 billion by June 2012 to clear its arrears to TANESCO for electricity consumed by governmental entities.	1. TANESCO has implemented new tariffs, approved by EWURA in December 2013, in order to increase its revenue. 2. The Government had created in its approved FY2013/14 budget a specific code with funds for transfers to TANESCO to improve fiscal transparency. 3. The Government has taken actions to reduce the level of transfers to TANESCO from the level of FY2012/13 and has committed that the level will not exceed 2.5 percent of Controlled Total Expenditure in FY2013/14.[29]	1. The Government adopts a comprehensive national subsidy policy which defines principles for providing subsidies in the energy sector. 2. The Government has committed to reduce the level of transfers to TANESCO in FY2014/15 to the level not more than 2 percent of controlled total public expenditure.	TANESCO operating deficit (US$) TANESCO accounts (trade and other) payable (TSh)	240 m 707 b	293m 741 b	50 m. 300 b

[29] Controlled total expenditure=total expenditure – consolidated funds service – wage – foreign development expenditure.

PGSDPO-I Prior Action	PGSDPO-II Prior Action	PGSDPO-III Trigger	Results			
			Outcome Indicator	Baseline (2012)	Current (2013)	Target (2016)
Pillar II: The program objective is to reduce the cost of power supply and to promote private sector participation in the power sector						
3. The Government has adopted, through a letter signed by the Minister or the Permanent Secretary of the MEM, a policy aiming to reduce the cost of power supply, improve the operational efficiency of the power sector, and promote the participation of the private sector in power generation through a competitive and transparent process that respects the national laws and the best practice of international environmental and social standards. 4. TANESCO and MEM have signed a performance contract which includes measurable key performance indicators for TANESCO to enhance its efficiency in CY 2013. 5. TANESCO has published (on its website and in print): (i) periodic performance reports prepared by TANESCO against the key performance indicators set out in the above-mentioned performance contract between TANESCO and MEM; (ii) its latest annual audit report issued by NAO; (iii) its latest annual performance report issued by PPRA.	4. The Government and TANESCO have implement the initial phase of the 2013 Policy for Private Sector Participation in Power Generation through Competitive Processes by launching PPP capacity building programs for: (a) screening and conducting due diligence; (b) financial structuring; (c) structuring processes (for selecting developers and implementing transactions); (d) preparing legal and regulatory documents; and (e) managing government and public corporation fiscal risks. 5. The Government has adopted the recommendations of the Presidential Big Results Now Initiative to develop a roadmap for structural reforms of the energy sector and has established a Ministry Delivery Unit within MEM to oversee the implementation of the recommendations.	3. TANESCO continues to improve and report publicly on collection performance and on operational losses and develops a plan to meet the targets set by EWURA Order in December 2013. 4. The Government phases out Emergency Power Projects by 150 MW without lowering the reliability of power supply delivery. 5. TANESCO implement the 2013 policy to promote private sector participation in power generation by launching at least one competitive bidding process for new gas-based power project(s) to diversify power generation sources in the country toward lower cost structure of the power sector. 6. The Government approves the Roadmap for structural reforms of the energy sector (including the power and gas subsectors), which includes specific structural measures aimed at improving its governance and overall efficiency and time-bound implementation schedule, and initiates its implementation.	TANESCO technical and non-technical losses in transmission and distribution.	21%	19%	18%
			Amount (in MW) of gas-fired power generation capacity commissioned	105	165	400
			Average unit cost of power sales (US$/MWh)	0.18	0.18	0.15
			Number of bid for gas IPP power plants launched on a competitive basis	0	0	1
			MEM documents on sector reforms published for public knowledge	0	0	2

PGSDPO-I Prior Action	PGSDPO-II Prior Action	PGSDPO-III Trigger	Results			
			Outcome Indicator	Baseline (2012)	Current (2013)	Target (2016)
PILLAR III: The Program objective is to strengthen the policy and institutional framework for the management of the country's natural gas resources.						
6. The Government has completed a nation-wide public consultation process for adopting its Natural Gas Policy. 7. The Government has adopted measures, including, clearing arrears with gas developers by paying them US$106.9 million by December 2012, and verifying the amount of natural gas reserves in the United Republic of Tanzania's territory, which will enable higher production of natural gas and its use in power generation after CY2014.	6. The Government has adopted the Natural Gas Policy. 7. The Government has launched a program to adopt a Tanzania Natural Resource Charter and has established an expert panel to oversee the program. 8. The Government has established a top-level institutional mechanism to enhance inter-ministerial coordination by mandating the Cabinet committee on economic affairs to handle the natural gas agenda and creating an inter-ministerial senior taskforce on natural gas. 9. TPDC has published on its website its latest audited financial statement, its latest procurement audit report, and its key performance indicators.	7. The Government adopts a National Gas Utilization Master Plan. 8. The Government to prepare a Gas Bill to the Parliament. 9. The Government to prepare and to adopt a Petroleum Policy.	Volume of gas produced (mmscfd) Amount of on-shore proven natural gas reserves (Tcf) Annual monitoring under the Natural Resource Charter initiative	78 1.0 No	92 1.4 No	250 3.5 Yes

ANNEX 2: LETTER OF DEVELOPMENT POLICY

THE UNITED REPUBLIC OF TANZANIA
MINISTRY OF FINANCE

Telegrams: "TREASURY", Dar es Salaam,
Tel: 2111174/6, Fax 2110326. Telex: 41329.
(All Official communications should be addressed to the Permanent Secretary to the Treasury and NOT to individuals).

P.O. Box 9111,
DAR ES SALAAM.

In reply please quote:

Ref. No. **CDB.441/562/01** **February 13, 2014**

Country Director for Tanzania, Uganda and Burundi,
World Bank Country Office,
50 Mirambo Street,
DAR ES SALAAM

RE: LETTER OF DEVELOPMENT POLICY FOR PROPOSED SECOND POWER AND GAS DEVELOPMENT POLICY OPERATION

On behalf of the Government of the United Republic of Tanzania, I hereby an request approval of the Second Power and Gas Development Policy Operation (PGSDPO-II) in the amount USD 100 million (SDR equivalent). This credit, the second in the series of three operations, will assist in implementation of the Government programme in the energy sector towards: (i) strengthening the country's ability to bridge the financial gap in its power sector; (ii) reducing the cost of electricity supply and promoting private sector participation in the power sector; and (iii) strengthening the policy and institutional framework for the management of the country's natural gas resources.

BACKGROUND AND RECENT DEVELOPMENTS

A. MACROECONOMIC PERFORMANCE

1. Tanzania continued to maintain high economic growth in 2012, with real Gross Domestic Product (GDP) growing at a higher rate compared to growth in 2011. The good economic performance was a

result of increased economic activities especially in communication, construction, financial services and mining sectors during the year.

2. Real GDP grew by 6.9 percent in 2012, higher than the growth rate of 6.4 percent in 2011, attributed to continued implementation of the Financial Sector Reform Program which resulted into improvements in banking and financial institution services; and increase in demand for money for investment in various projects; business services; and other economic activities. The sectors that performed well during the year include communications (20%), financial intermediation (13.2%), manufacturing (8.2), and mining and quarrying (7.8%).

3. The overall annual inflation has continued to decline during the last two years. The prudent and tight monetary policy implemented by the Government and falling domestic food prices has resulted into inflation declining to 5.6 percent in December 2013, down from 19.8 percent in December 2011. The Government continues to monitor movement in domestic food prices in the context of the food situation in neighbouring countries.

4. Annual average food and non-alcoholic beverages inflation has declined significantly to 8.6 percent in 2013 from 20.2 percent in 2012. Furthermore, the annual average non- food inflation has decreased to 7.5 percent in 2013 from 10.7 percent in 2012 while annual average inflation excluding food and energy (core inflation) has decreased to 6.2 percent in 2013 from 8.8 percent in 2012.

5. During the year ending November 2013, overall balance of payments recorded a surplus of USD 540.2 million compared with a surplus of USD 405.0 million recorded in the corresponding period in 2012. This development was partly due to increase in official capital inflows, non-concessional borrowing and foreign direct investments. Gross official reserves amounted to USD 4,538.7 million as at the end of November 2013, sufficient to cover 4.4 months of projected imports of goods and services excluding those financed by foreign direct investment. The current account recorded a deficit of USD 4,553.5 million compared to a deficit of USD 3,708.3 million reported in the year ending November 2012, mainly attributed to a fall in goods exports and official current transfers coupled with increase of imports.

6. The value of exports of goods and services declined to USD 8,479.8 million in the year ending November 2013, from USD 8,603.8 million recorded in the corresponding period in 2012. The decline was largely

explained by a decrease in the value of goods exports particularly gold and traditional exports that decreased by 16.9 percent and 8.1 percent, respectively when compared to the amount recorded in the year ending November 2012. The value of imports of goods and services increased to USD 13,588.3 million during the year ending November 2013, from USD 13,007.8 million recorded in the corresponding period in 2012. Much of the increase originated from oil imports, which rose by about 23 percent when compared to the amount recorded in the year ending November 2012 on account of increase in volume associated with rising demand for thermo power generation. Meanwhile, the share of oil to total value of goods import increased to 39.1 percent by November 2013 compared to 33.0 percent in the year ending November 2012.

7. In November 2013, extended broad money supply (M3) recorded an annual growth of 10.3 percent, compared with 10.6 percent recorded in the corresponding period in 2012. This growth was however lower than 13.2 percent recorded in the preceding month, mainly on account of slowdown in net government borrowing from the banking system. During the year ending November 2013, the Government borrowed a total of TZS 599.2 billion on net terms from the banking system compared to TZS 1,148.1 billion recorded in the year ending October 2013. Net Foreign Assets (NFA) of banks contracted by 66.7 percent, while credit to private sector recorded an annual growth of 14.6 percent from 13.7 percent in the year ending October 2013.

8. The Parliament approved the Government budget for FY2013/14 in June 2013 with overall fiscal deficit of five percent of GDP, a significant reduction in deficit compared to 2012/13. This target is consistent with the Government objective of maintaining fiscal sustainability, lowering the risk of debt distress, and avoiding inflation pressure. The Government had targeted higher domestic revenue collection supported by new tax policy and administration measures in order to finance priority programs and projects in infrastructure and social services. The Government has selected key development projects in six priority sectors as part of the BRN initiative to foster shared growth in the country while sustaining the gains achieved in social service delivery.

9. Nevertheless, domestic revenue collections during the first half of FY fell short of initial targets by almost 10 percent on account of non-implementation of some tax policy measures such as SIMCARD tax. Recognizing this, the Government is set to implement fiscal adjustments during the mid-year budget review to be finalized in February 2014 in order to achieve the fiscal target of five percent of GDP. While on revenue side, collections are expected to improve during the second half of the FY as a result of the agreement reached with telephone companies to replace

the proposed SIMCARD tax by a higher excise tax rate of 17 percent up from 14.5 percent. On the expenditure side, the Government will implement expenditure cuts on non-priority current spending as well as slowing down implementation of domestically funded development projects that are not part of the BRN initiative. Moreover, the recent increase in the electricity tariff is expected to reduce the amount of Government's subsidies to TANESCO.

10. As of December 2013, the national debt stock stood at TZS 27.0 trillion compared to TZS 22.7 trillion recorded at the end of December, 2012. This is an increase of 16.1 percent of this amount, TZS23.52 trillion is public debt and TZS3.52 trillion is private sector debt. The debt increase was due to increase in concessional and non-concessional borrowings and accumulation of interest arrears on external debt especially from Non Paris Club creditors that have not provided debt relief as per the agreement.

11. In order to ensure that the national debt is sustainable, the Government conducted Debt Sustainability Analysis (DSA) in February, 2012 (followed by another in September 2013) based on international standards namely: the ratio of present value of public debt to Gross Domestic Product (GDP); the ratio of present value of external debt to exports; and the ratio of total external debt services to revenue from exports. The results of this analysis revealed that, all important sustainability indicators were below the international set threshold and hence the national debt is sustainable.

B.MACROECONOMIC PROJECTIONS

12. The review of leading indicators of growth such as electricity generation, production and consumption based tax revenues, importation of industrial raw materials, and exports of manufactured goods, mineral and agricultural commodities and the trend of the economic performance in the first half of 2013 supported by Government continued efforts to stabilize power supply and implementing the FYDP 1 shows that the economy will remain buoyant in the short and medium term.

13. GDP was projected to grow at 7.0 percent in 2013. On the basis of the indicators discussed above, and the fact that the growth rate of GDP for the first half of 2013 was 7.0 percent, the projected GDP growth rate is likely to be achieved. Going forward, the growth is projected to increase, growing at annual average of 7.6 from 2014 to 2017. This performance is under the assumption of successful implementation of

economic policies; favorable weather condition; continued efforts by the Government to improve and stabilize power supply including the ongoing construction of the gas pipeline from Mtwara to Dar es Salaam; and recovery of the world economy in 2014.

C. THE ENERGY SECTOR BACKGRUND

14. Tanzania is endowed with diverse energy resources, including hydro, natural gas, biomass, coal, geothermal, and solar and wind, much of which remains untapped. There are no oil discoveries in the country up to date and, therefore, liquid fuel is imported for various uses including power generation. Access to modern energy is gradually expanding and has reached about 24 percent of the population. The installed generation capacity is about 1,583.MW composed of hydropower plants and 562 MW (or 36 percent), natural gas power plants of 527MW (or 33 percent) and liquid fuel power plants of 495MW (or 31 percent). About 417MW are generated independent power producers (IPPs) and Emergency Power Producers (EPPs)

15. Tanzania's natural gas discoveries up to date amount to about 35 trillion standard cubic feet (Tcf) of reserves, most of which are in deep offshore areas and are yet to be developed. There are two producing gas fields, at Songo Songo and Mnazi Bay, with proven reserves of 880 billion standard cubic feet (Bcf) and 262 billion Bcf, respectively. The Songo Songo project was developed as a joint venture between Government-owned Tanzania Petroleum Development Corporation (TPDC) and private companies. The field is connected to Dar es Salaam by a gas pipeline, where it supplies power plants and some other industrial consumers. The Mnazi Bay gas field is not yet connected by pipeline to the main market around Dar es Salaam and provides gas only to a small local power plant at Mtwara Region. The Government has issued a number of licenses for gas exploration and development to private sector developers (including some major international oil companies), who are particularly active in the deep offshore areas.

16. The Government has undertaken substantial reforms in the power sector over the last decade. In 2003, the National Energy Policy was adopted, which established affordable and reliable energy supplies in the whole country as a key objective and stressed the importance of increasing rural energy access through grid and off-grid extension. A Rural Energy Act was adopted in 2005, leading to the creation of the Rural Energy Agency (REA) and the related Rural Energy Fund (REF). An independent Energy and Water Utilities Regulatory Agency – EWURA – in charge of technical and economic regulation of the electricity, water

sectors and downstream petroleum and natural gas segments, became operational in 2006. In 2008, a comprehensive Electricity Act was adopted, which reflected many of the international best practices for electricity sector reforms, tailored to the specific realities of the Tanzanian environment. The Act also established a general framework for the powers of the Ministry of Energy and Minerals (MEM), including the new mandates and requirements to prepare and publish a policy for the reorganization of the electricity market and to develop a rural electrification plan and database.

17. The Electricity Act established a stronger framework for commercial operation and governance of TANESCO, whose Board of Directors includes representatives from both private and public sectors. The MEM has a performance contract with the Board, including key performance indicators (KPIs). The Board of Directors, in turn, has a performance contract with management of TANESCO, which also includes a set of KPIs. In terms of internal governance, TANESCO has a performance management process for all officers and employees and has been developing a Performance Development Program for its regional centers.

18. In 2010, we also adopted a National Public-Private Partnership (PPP) Law and the passing of the PPP Policy in 2009. This law makes reference to sector level PPP Nodes, including in the national electricity sector. Accordingly, the MEM and TANESCO have created PPP Nodes, which should help implement Government's policy of enhanced private sector participation in the power sector, especially in electricity generation.

Recent Development

19. Over years, Tanzania's mix of power plants has been depending on hydropower, making electricity supply vulnerable to the droughts. Since 2011, the country experienced below-average hydrology conditions, which reduced generation of hydropower. Given also fast growing demand, the existing thermal power plants were not able to cover the growing power generation gap. As result, TANESCO – the country's power utility – had to procure 325 MW in "emergency power plants" (EPPs) through short-term contracts with private operators, in order to avoid load shedding that would have been economically even more costly. The short-term, emergency nature of these contracts and the fact that EPP plants have to operate on liquid fuel as gas supply is limited, electricity produced by the EPPS is relative expensive. Unable to pass the increased prices on consumers in such a short period, TANESCO quickly developed significant financial arrears, estimated at over USD 270 million at the end of 2012.

III. THE GOVERNMENT PROGRAM

A. POLICY OBJECTIVE

20. To manage the situation in the sector and particularly in TANESCO, the Government has adopted a policy response that rests on two pillars: (i) help TANESCO cover part of the financial deficit through subsidies, commercial borrowing, and efficiency improvements, providing transitional time for electricity tariffs to catch up with the sudden input price shock and for building new power plants to replace the EPPs, smoothing out the economic and social impact and aligning tariff with long-term costs; and (ii) take measures in the electricity and gas sub-sectors to reduce cost of electricity supply by increasing gas supply and building more efficient gas-based power plants. In addition to reducing the cost, this would also mitigate the hydrology and oil price risks in a sustainable manner. This policy come naturally with the third pillar of the Government energy policy – (iii) to develop gas sector, both in the short and long term, ensuring sustained supply of gas to the power sector and expanding it to other domestic economic areas, as well as to export large quantities of gas to international markets to raise necessary revenue for domestic development.

21. The objectives of the Government program are to: (a) ensure self-standing financial equilibrium in the power sector by FY2018; (b) reduce the cost of power generation and vulnerability of the power sector to the risk of hydrological variations and other external shocks; (c) ensure sustainable development of the power and energy sectors in a transparent manner that would allow increasing access to electricity and other forms of modern energy at least cost and with requisite reliability and quality of supply; and (d) develop the gas sector in a manner that maximizes its benefits to Tanzania's social and economic development.

22. The policy measures in the energy sector respond to the current national growth and poverty reduction strategy, MKUKUTA II, which considers reliable supply of energy as a critical driver for growth and income poverty reduction with operational targets set for increases in generation of electricity, utilization of capacity and coverage by 2015. Similarly, the first Five Year Development Plan (FYDP I) (2011/12–2015/16) presents the Government's high-level policy priorities on infrastructure, including energy. FYDP I have included adequate investments in energy as a critical element for generating growth momentum and have adopted expansion of electricity generation capacity to 2,780 MW by 2015/16 as one of the 10 core investments in the

country. The Government has also launched the Big Results Now (BRN) initiative with the objective of enhancing implementation of FYDP I. The Government has established the Presidential Delivery Bureau (PDB) and conducted the first wave of "labs" in six National Key Results Areas (NKRAs), including one on energy

23. The Government has adopted the recommendation of the Energy Lab report of NKRA/BRN, which was finalized in April 2013, and focused on the following three actions: (a) increase by 50 percent TANESCO revenues and energy delivered by revamping operations of existing assets, including delivering new gas to underutilized power plants, upholding water management practices, limiting energy losses in transmission and distribution, launching demand management initiatives and optimizing dispatching of EPPs and fuel supply; (b) deliver 7 high-priority generation projects and connect 590,000 new customers, supported by "business unusual" approaches to delivery, which will involve greater focus on prioritization, monitoring and evaluation (M&E), use of alternative sources of funding and fast-tracking approval; and (c) gradually restructure the power sector, including TANESCO, to establish a more transparent and attract investment and reward efficiency.

24. In the gas sector, where recent explorations discovered offshore gas reserves of the magnitude that are sufficient to be developed for export markets, as well as to meet domestic supply obligation, so as to use it for enhanced and shared economic growth. The Government has adopted the Natural Gas Policy, which was prepared through a broad-based participatory consultative process, as the starting policy document on how to convert the captured rent of natural gas into investments with high social returns for sustainable development. Following the Natural Gas Policy, the Government will follow up with a Gas Master Plan and development of the legal and regulatory framework for the hydrocarbon sector, aligned with the Gas Policy and with the goal of creating conducive environment for investment.

B. DESCRIPTION OF POLICY AREAS

25. As described in the Letter of Development Policy for the previous DPO (PGSDPO-I), the Government adopted a plan to address the TANESCO financial deficit by causing TANESCO to undertake the following sets of measures: (i) improve efficiency, such as., reduce the cost of electricity supply; (ii) increase revenues and their collection; and (iii) use commercial borrowing to finance part of the gap during the transition period needed to align tariffs and costs.

26. The key efficiency measure is reduction of generation costs through implementation of an investment program that includes addition of new generation capacity, largely – although note exclusively – based on the use of domestic gas, to replace the expensive, short-term emergency power supply contracts and to meet demand growth with adequate reserve margin and reliability of supply. TANESCO should reduce the capacity of and electric energy generation under the contracts with EPPs and phase them out completely by 2016/17. TANESCO will also continue with its effort to reduce system losses in transmission, distribution, and customer service (billing, metering, and bill collections). In order to ensure additional gas supply for power generation, a new gas 542-km pipeline is being constructed that would connect the existing gas fields at Mnazi Bay and Songo Songo island with Dar es Salaam.

27. Following TANESCO's request for tariff adjustment in September 2013, in December 2013 EWURA issued a tariff order which raised electricity tariffs by 39.19 percent on average, effective January 1, 2014. The new tariffs will remain in effect for three years, until December 2016. The tariff order allows TANESCO to apply, during this period, for periodic tariff adjustment to reflect the movements in fuel prices, domestic inflation, and exchange rate fluctuations. The tariff increase is expected to result in a significant increase in TANESCO revenues, in excess of US$150 million annually for the coming years. TANESCO will finance any remaining financing gap from Government subsidies and commercial borrowing to the extent needed. Government has committed to limit the level of subsidies to TANESCO in FY2013/14 to 2.5 percent of controlled total budget expenditures (defined as total expenditure excluding wages, consolidated funds services, and foreign-funded development expenditures), and to 2 percent in the subsequent year. The Government has also committed to ensuring transparency and predictability in its transfers to TANESCO. In the approved budget of FY2013/14, the Government introduced a separate budget line labeled as "transfer to TANESCO".

28. The Government has initiated a study with a view to developing a comprehensive, effective and output-based sustainable energy subsidy policy. The resulting policy is anticipated to appropriately define the principles on how to subsidize the energy sector, including both consumption and supply sides. Such policy is expected to be finalized and approved by November 2014.

29. The Government realizes the importance of attracting private investors in the energy sector, including in power sector, to help finance the enormous investments needs that can only be met in partnership between the public and private sector (public-private partnership – PPP).

As stated in the Letter of Development Policy for PGSDPO-I, the Government has adopted a policy to promote Private Sector participation in power generation through competitive process. Under the policy, the Government will select investors through a transparent, competitive process wherever feasible, to ensure transparency, fairness, and efficiency of the outcomes, using the best practices of international environmental and social standards. As the initial phase of implementation, the Government has launched PPP capacity building programmes. Specifically, the Government has started building the capacity for PPP projects and ddedicated PPP units are already in place both in MEM and in TANESCO. MEM also adopted PPP strategy in 2013. A PPP training program has also been designed. Training courses covers such topics as designing legislative, institutional, and regulatory frameworks for successful PPP; and planning, measuring and managing continent liabilities and Government risks in PPP projects. The Government is committed to having at least one independent power plant (IPP) project under PPP arrangement being initiated and advanced to the point of inviting private sector bids under the DPO program and has identified a location for such a plant (a gas-fired power plant). The procurement process will be conducted by TANESCO. An invitation for expression of interests (EOIs) for transaction advisor for this project has been published. The scope of the services of such transaction advisor, if necessary will include but not necessarily be limited to the following: (i) site screening and due diligent; (ii) structuring the Project for private investment (developing PPP options; project structuring and risk allocation; financial modelling; market sounding; etc.); (iii) structuring the bidding process of selecting private sector developer; (iv) implementing the transaction: transaction marketing, pre-qualification of investors; development of contractual documents -- bidding and project documents such as a Power Purchase Agreement, Gas Fuel Supply Agreement, Implementation Agreement and others, as appropriate; implementing the bidding process; and assisting with the contract award; and (v) financial closure of the Project. Through such services, such transaction advisor. This policy is fully is aligned with the EWURA Order in December 2013, which states that all new power projects are procured competitively in line with the Electricity Act, the Public Private Partnership Act, 2010 and the Public Procurement Act, 2011, and Rules and Regulations made thereunder.

30. The Government has also initiated a structural review of the power sector with the objective of determining its optimal structure that would be able to respond to the challenges ahead in terms of attracting investments, expanding access, ensuring efficient and reliable services, and promoting transparency and good governance. The review should be

concluded and adopted by the Government by June 2014, with a time-bound Roadmap for implementation. The preparation of such Roadmap is a part of recommendations of the Big Results Now (BRN) Energy National Key Results Area (NKRA) lab report, which the Government has adopted. The Ministry Delivery Unit (MDU) created under the Ministry of Energy and Minerals oversees implementation of those recommendations.

31. Tanzania has large natural gas reserves. In addition to near-shore gas (1.4 Tcf proven reserve with potential upsides in the range of 8 Tcf), the offshore gas reserve are estimated between 26 and 35 Tcf gas-in-place. Further work is ongoing to establish the size of the proven reserves. The challenge is to prepare the country for the gas economy and establish strong foundations to best take advantage of this potential resource wealth, including establishment of a sound fiscal regime to manage future revenue flows from such resource wealth and use of such revenues.

32. The Government has made progress in building gas-specific institution by adopting a Natural Gas Policy which was prepared through a broad public consultation process. The consultations, which started in October 2012, involved major stakeholders in the country such as private companies, donors, and civil society, the Parliament, and the public at large through publication of a draft on national newspapers. The Cabinet approved the draft in October 2013 and implementation started subsequently.

33. Setting up an Authority to regulate the upstream natural gas sector is a critical next element in the natural gas institutional framework following the Natural Gas Policy. The Natural Gas Policy envisages the establishment of a national oil and gas company (NOC). If TPDC is to become the NOC, a new regulatory body for the upstream segment becomes essential since the NOC should be subject to an upstream authority. The functions of EWURA, which regulate the mid and downstream segments of the natural gas sub-sector, are well designed, but can be refined as well. To this effect, the Government envisages to establish an upstream regulator and to make small improvements in the EWURA Act for the mid and downstream natural gas sector.

34. Preparation of a Gas Act and development of a Natural Gas Utilization Master Plan are equally important next steps in building the natural gas legal and institutional framework, following the Gas Policy. The process of developing a bill focusing on midstream legislation (transport, storage, LNG) to enact the Gas Act has been delayed due to the extensive consultative process required for the Natural Gas Policy.

However, the Government is committed to submit a bill to the Parliament during (FY2014/15). Development of a Natural Gas Utilization Master Plan is also an ongoing exercise and needs to be completed as soon as possible.

35. The Government has embarked on the new initiative of developing Tanzania's own natural resource charter based on the program under the New Partnership for Africa's Development (NEPAD). The framework set for improved management of resources, including those from natural gas, and the Government has established an expert panel to conduct a benchmarking exercise. The panel was officially launched by the Government on December 13, 2013. The benchmarking exercise, to be conducted by the panel, aims to diagnose gaps and opportunities along the decision chain for natural resource management, including natural gas, from extraction to investing the financial proceeds. The results will be used to build an action plan and national vision to guide a program of activities to improve the governance and economic management of natural resource wealth.

36. An important step forward is the establishment of a sound and transparent institutional framework to implement a top-level institutional mechanism to enhance inter-sectoral cooperation on the gas policy agenda. The Government has set up a task force under the chairmanship of the Chief Secretary and with MEM's secretariat role, to provide oversight and guidance on all issues related to oil and gas governance in the country. The task force is comprised of the Chief Secretary, Commissioner General of TRA, Governor of BoT, Executive Secretary of the President's Office Planning Commission (POPC), Permanent Secretary of the Ministry of Finance (MoF), Permanent Secretary of MEM, Managing Director of TPDC, Attorney-General's Chamber. The Government has also mandated the Cabinet committee on economic affairs to cover the natural gas agenda.

37. With respect to corporate governance, the Government will consolidate its new strategy based on the need to increase transparency and accountability in the energy sector. Following the initiative to improve transparency of TANESCO under the first DPO, this operation supports a set of initiatives to improve transparency of TPDC through publication of key documents in its website such as audited financial statements, procurement performance audit reports, and Key Performance Indicators (KPIs). The latest financial statement (FY2011/12) of TPDC audited by NAO has been posted on the website so is the latest procurement audit report by PPRA (for FY2011/12 and released in September 2012). The audited financial statement includes

the latest confirmed KPIs. TPDC has also published the KPIs for 2015/16.

IV. CONCLUSION

38. The Government of the United Republic of Tanzania has a long history of cooperation with the World Bank in the energy sector, including in operations that are currently under implementation or preparation, such as Energy Development and Access Expansion Project, Backbone Transmission Investment Project, Energy Sector Capacity Building Project (ESCBP), and recently initiated Partial Risk Guarantee Project for investments in natural gas and power plants.

39. The Government remains committed to focusing on sustaining macroeconomic stability, promoting pro poor economic growth, and increased investment in core social services such as education, health and water. The Government recognizes the key role played by accessibility and reliability of electricity in achieving many of the MKUKUTA objectives and it is therefore committed to ensure financial sustainability of the energy sector. The Government is confident that various reforms pursued under the Power and Energy DPOs and others will put the sector in equilibrium in the near future. Further, the Government recognizes that the support by the Bank and other development partners will complement government's efforts to ensuring adequate funding to the sector in order to ensure sustainable growth and poverty reduction. Thus, the Government requests the World Bank to approve the provision of USD 100 million to complement the Government's efforts closing financial gap in TANESCO, thereby fostering and sustaining macroeconomic stability

Thank you for your continued cooperation and support.

Yours sincerely,

Dr. S. B. Likwelile
PERMANENT SECRETARY

ANNEX 3: FUND RELATIONS ANNEX

Tanzania: Taking Steps to Enhance Fiscal Sustainability

Press Release No. 14/67
February 25, 2014

A team from the International Monetary Fund (IMF), led by Paolo Mauro, visited Tanzania during February 12–25, 2014. The mission completed the assessment of the recent performance under the Standby Credit Facility (SCF) and discussed a possible new Policy Support Instrument (PSI) program.[i] The mission met with Hon. Saada Mkuya Salum, Minister of Finance, Professor Benno Ndulu, Governor of the Bank of Tanzania, and other senior government officials.

Mr. Mauro released the following statement at the end of the mission:

"Performance under the government's IMF-supported SCF program has been broadly favorable. Economic growth remains strong. With continued prudent monetary policy and benign developments in food prices in the region, inflation is expected to further moderate by mid-2014 to the medium term target of 5 percent. The current account deficit widened further in 2013, as the global prices of gold and traditional exports weakened.

"Fiscal pressures last year (fiscal year 2012/13, July to June) resulted in the ceiling on net domestic financing agreed under the government's IMF-supported program being breached by 1.2 percent of GDP. During the current fiscal year (2013/14), revenues are falling short of the assumptions embedded in the budget approved by Parliament. To attain a fiscal deficit close to the 5 percent of GDP target in the budget, the government has been appropriately cautious in releasing funds for budget implementation. The upcoming mid-year budget review is expected to reduce expenditure allocations to align these with available resources. Meanwhile, expenditure arrears have increased considerably, especially for road projects. To preserve the credibility of fiscal policy, further policy measures are needed to avoid the accumulation of new arrears and to clear existing ones after verification.

"Preserving macro-economic stability is necessary for rapid growth to continue in the medium term. The key challenge is to preserve fiscal space for infrastructure investment and priority social spending while gradually reducing the fiscal deficit to maintain debt sustainability. The government's tax policy reforms under preparation, including a review of the value added tax, have the potential to improve efficiency and to mobilize additional resources while sharing the burden more fairly. Nevertheless, the revenue shortfalls and subsequent expenditure compression experienced during the current fiscal year reinforce the importance of making realistic revenue assumptions during the upcoming budget cycle.

"Agreement was reached at the technical level on policy measures that, once endorsed by the Government, would permit concluding the final review under the SCF, subject to approval by the IMF's Executive Board. Broad agreement was also reached on the general outlines of a program that could eventually be supported under a new PSI, once detailed discussions are completed.

"The next IMF Executive Board meeting is tentatively planned for late April 2014.

"The IMF team is appreciative of the constructive and open policy dialogue and thanks the authorities for their warm hospitality during the visit."

[i] The SCF supports low-income countries that have reached broadly sustainable macroeconomic positions, but may experience episodic, short-term financing and adjustment needs, including those caused by shocks. The SCF supports countries' economic programs aimed at restoring a stable and sustainable macroeconomic position consistent with strong and durable growth and poverty reduction. It also provides policy support and can help catalyze foreign aid. (See http://www.imf.org/external/np/exr/facts/scf.htm.) The PSI is an instrument of the IMF designed for countries that do not need balance of payments financial support. The PSI helps countries design effective economic programs that, once approved by the IMF's Executive Board, signal to donors, multilateral development banks, and markets the Fund's endorsement of a member's policies (see http://www.imf.org/external/np/exr/facts/psi.htm). Details on Tanzania's current SCF are available at www.imf.org/tanzania.

IMF COMMUNICATIONS DEPARTMENT

Public Affairs	**Media Relations**
E-mail: publicaffairs@imf.org	E-mail: media@imf.org
Fax: 202-623-6220	Phone: 202-623-7100

ANNEX 4: RESULTS OF UPDATED TANESCO FINANCIAL MODEL

Baseline Scenario: Poor hydrological condition continues and new power plant construction is reasonably on time

	Actual				Forecast				
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Peak Demand	**833**	**830**	**851**	**899**	**989**	**1088**	**1251**	**1439**	**1654**
			3%	6%	10%	10%	15%	15%	15%
Installed Capacity (Grid)			1,431	1,492	1,492	1,505	1,645	2,155	2,285
Hydro			562	562	562	562	562	562	562
Tanesco Thermal			249	310	310	460	700	1,000	1,000
IPPs			620	620	620	483	383	593	793
Power Supplied - GWh	**5,322**	**5,200**	**5,631**	**5,994**	**6,327**	**6,812**	**7,765**	**8,635**	**9,403**
Supply Incremental - GWh		-122	431	363	333	485	953	870	768
Supply Incremental - %			8%	6%	6%	8%	14%	11%	9%
Energy Output - GWh									
Hydropower - GWh	**2,672**	**1,993**	**1,704**	**1,716**	**1,717**	**1,717**	**1,737**	**1,737**	**1,737**
			30%	29%	27%	25%	22%	20%	18%
Hydro Incremental		-679	-289	12	1	0	20	0	0
Tanesco thermal - GWh	**998**	**1,042**	**1,203**	**1,373**	**2,197**	**3,269**	**4,419**	**5,277**	**5,723**
			21%	23%	35%	48%	57%	61%	61%
Ubungo I			667	581	690	690	690	690	690
Tegeta GT Gas			286	313	297	297	297	297	297
Mwanza HFO			0	0	306	306	0	0	0
Ubungo II			250	479	698	698	698	698	698
Kinyerezi Gas I			0	0	0	1,026	1,026	1,026	1,026
Kinyerezi Gas II			0	0	0	0	1,430	1,430	1,430
Kinyerezi Gas III			0	0	0	0	0	828	1,241
Tanesco thermal Incremental			161	170	824	1,071	1,150	857	447
IPPs -GWh	**1,604**	**2,134**	**2,548**	**2,635**	**2,335**	**1,748**	**1,469**	**1,469**	**1,776**
Aggreko EPP AGO			186	469	46	0	0	0	0
Symbion (ex Dowans) EPP Dual Jet A1			100	36	80	0	0	0	0
Symbion (ex Dowans) EPP Dual Gas			216	247	250	160	0	0	0
IPTL HFO			432	409	400	30	0	0	0
Symbion 205 (50MW Dodoma) HFO			95	80	54	54	0	0	0
Symbion 205 (50MW Arusha) HFO			54	80	34	34	0	0	0
Songas			1,465	1,314	1,469	1,469	1,469	1,469	1,469
Somanga Fungu Gas			0	0	0	0	0	0	0
Singida			0	0	0	0	0	0	307
IPP Incremental		0	414	87	-300	-586	-279	0	307
Import - GWh	**48**	**31**	**176**	**270**	**78**	**78**	**139**	**152**	**167**
Hydro Import from Ethiopia - GWh	**0**	**0**	**0**	0	0	0	0	0	0
Other Import -GWh	48	31	176	270	78	78	139	152	167
Total Dispatch - GWh	**5,322**	**5,200**	**5,631**	**5,994**	**6,327**	**6,812**	**7,765**	**8,635**	**9,403**
Technical and Commercial Loss	1,245	1,113	1,188	1,245	1,230	1,267	1,418	1,549	1,655
Sales - GWh	**4,077**	**4,087**	**4,443**	**4,749**	**5,098**	**5,545**	**6,346**	**7,087**	**7,748**
Revenues - US$ m	**316**	**346**	**518**	**593**	**847**	**891**	**990**	**1074**	**1141**
Other Revenue	31	26	84	27	72	72	72	72	72
Weighted Average Tariff - TSh/kWh	**114**	**136**	**185**	**198**	**276**	**276**	**276**	**276**	**276**
Weighted Average Tariff - $c/kWh	0.08	0.09	0.12	0.12	0.17	0.16	0.16	0.15	0.15
Cost - US$ m	**386**	**554**	**849**	**837**	**855**	**825**	**896**	**1049**	**1146**
IPP Capacity Charge					190	107	134	169	169
IPP Energy Charge				577	118	77	43	44	85
Tanesco Owned Plant Fuel Charge					121	179	196	245	271
Import Cost					64	76	94	105	117
Operating Cost				162	208	221	237	258	271
Depreciation				54	64	69	96	131	138
Financing Cost				33	70	76	76	74	71
Bad Debt Provision				11	20	20	19	22	24
Unit Cost - Tsh/kWh	**139**	**214**	**304**	**285**	**281**	**257**	**251**	**271**	**279**
Unit Cost - $c/kWh	0.09	0.14	0.19	0.18	0.17	0.15	0.14	0.15	0.15
Before Government Subsidy - US$m	**-39**	**-182**	**-247**	**-217**	**64**	**138**	**165**	**96**	**66**
Tanesco Losses before Government Subsidy - US$m									
Government Grant	31	125	119	53					
Profit/Loss - $m	**-8**	**-57**	**-127**	**-164**	**64**	**138**	**165**	**96**	**66**
Financial Gap Financing - US$m									
Government Loans				200					
Remaining Surplus/Losses	-8	-57	-127	36	64	138	165	96	66
Tanesco Financial Obligations - US$m									
Trade and Other Payables	205	299	443	450					
Borrowing*	344	339	463	747					

* Borrowing includes both long term and short term debt

Upside Scenario: Hydrological condition resumes as 10 year average and new power plants construction goes reasonably on time

	Actual				Forecast				
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Peak Demand	**833**	**830**	**851**	**899**	**989**	**1088**	**1251**	**1439**	**1654**
			3%	6%	10%	10%	15%	15%	15%
Installed Capacity (Grid)			1,431	1,492	1,492	1,505	1,645	2,155	2,285
Hydro			562	562	562	562	562	562	562
Tanesco Thermal			249	310	310	460	700	1,000	1,000
IPPs			620	620	620	483	383	593	793
Power Supplied - GWh	**5,322**	**5,200**	**5,631**	**5,994**	**6,327**	**6,812**	**7,766**	**8,636**	**9,404**
Supply Incremental - GWh		-122	431	363	333	485	954	870	768
Supply Incremental - %			8%	6%	6%	8%	14%	11%	9%
Energy Output - GWh									
Hydropower - GWh	**2,672**	**1,993**	**1,704**	**1,716**	**1,805**	**1,805**	**1,826**	**1,826**	**1,826**
			30%	29%	29%	27%	24%	21%	19%
Hydro Incremental		-679	-289	12	89	0	21	0	0
Tanesco thermal - GWh	**998**	**1,042**	**1,203**	**1,373**	**2,197**	**3,219**	**4,331**	**5,189**	**5,635**
			21%	23%	35%	47%	56%	60%	60%
Ubungo I			667	581	690	690	690	690	690
Tegeta GT Gas			286	313	297	297	297	297	297
Mwanza HFO			0	0	306	256	0	0	0
Ubungo II			250	479	698	698	698	698	698
Kinyerezi Gas I			0	0	0	1,026	1,026	1,026	1,026
Kinyerezi Gas II			0	0	0	0	1,342	1,342	1,342
Kinyerezi Gas III			0	0	0	0	0	828	1,241
Tanesco thermal Incremental			161	170	824	1,021	1,113	857	447
IPPs -GWh	**1,604**	**2,134**	**2,548**	**2,635**	**2,247**	**1,710**	**1,469**	**1,469**	**1,776**
Aggreko EPP AGO			186	469	46	0	0	0	0
Symbion (ex Dowans) EPP Dual Jet A1			100	36	80	0	0	0	0
Symbion (ex Dowans) EPP Dual Gas			216	247	200	122	0	0	0
IPTL HFO			432	409	362	30	0	0	0
Symbion 205 (50MW Dodoma) HFO			95	80	54	54	0	0	0
Symbion 205 (50MW Arusha) HFO			54	80	34	34	0	0	0
Songas			1,465	1,314	1,469	1,469	1,469	1,469	1,469
Somanga Fungu Gas			0	0	0	0	0	0	0
Singida			0	0	0	0	0	0	307
IPP Incremental		0	414	87	-388	-536	-241	0	307
Import - GWh	**48**	**31**	**176**	**270**	**78**	**78**	**139**	**152**	**167**
Hydro Import from Ethiopia - GWh	**0**	**0**	**0**	0	0	0	0	0	0
Other Import -GWh	48	31	176	270	78	78	139	152	167
Total Dispatch - GWh	**5,322**	**5,200**	**5,631**	**5,994**	**6,327**	**6,812**	**7,766**	**8,636**	**9,404**
Technical and Commercial Loss	1,245	1,113	1,188	1,245	1,230	1,267	1,419	1,549	1,655
Sales - GWh	**4,077**	**4,087**	**4,443**	**4,749**	**5,098**	**5,545**	**6,347**	**7,088**	**7,749**
Revenues - US$ m	**316**	**346**	**518**	**593**	**847**	**891**	**990**	**1074**	**1141**
Other Revenue	31	26	84	27	72	72	72	72	72
Weighted Average Tariff - TSh/kWh	**114**	**136**	**185**	**198**	**276**	**276**	**276**	**276**	**276**
Weighted Average Tariff - $c/kWh	0.08	0.09	0.12	0.12	0.17	0.16	0.16	0.15	0.15
Cost - US$ m	**386**	**554**	**849**	**837**	**850**	**788**	**892**	**1044**	**1141**
IPP Capacity Charge					190	107	134	169	169
IPP Energy Charge				577	113	51	43	44	85
Tanesco Owned Plant Fuel Charge					121	168	191	240	266
Import Cost					64	76	94	105	117
Operating Cost				162	208	221	238	258	271
Depreciation				54	64	69	96	131	138
Financing Cost				33	70	76	76	74	71
Bad Debt Provision				11	20	20	19	22	24
Unit Cost - Tsh/kWh	**139**	**214**	**304**	**285**	**279**	**246**	**250**	**270**	**278**
Unit Cost - $c/kWh	0.09	0.14	0.19	0.18	0.17	0.14	0.14	0.15	0.15
Before Government Subsidy - US$m	**-39**	**-182**	**-247**	**-217**	**69**	**174**	**170**	**102**	**71**
Tanesco Losses before Government Subsidy - US$m									
Government Grant	31	125	119	53					
Profit/Loss - $m	**-8**	**-57**	**-127**	**-164**	**69**	**174**	**170**	**102**	**71**
Financial Gap Financing - US$m									
Government Loans				200					
Remaining Surplus/Losses	-8	-57	-127	36	69	174	170	102	71

Tanesco Financial Obligations - US$m				
Trade and Other Payables	205	299	443	450
Borrowing*	344	339	463	747

* Borrowing includes both long term and short term debt

Downside Scenario: Poor hydrological condition continues and new power stations are built later than expected due to construction delays and gas availability issues

	Actual				Forecast				
	2010	2011	2012	2013	2014	2015	2016	2017	2018
Peak Demand	**833**	**830**	**851**	**899**	**989**	**1088**	**1251**	**1439**	**1654**
			3%	6%	10%	10%	15%	15%	15%
Installed Capacity (Grid)			1,431	1,492	1,492	1,505	1,645	2,155	2,285
Hydro			562	562	562	562	562	562	562
Tanesco Thermal			249	310	310	460	700	1,000	1,000
IPPs			620	620	620	483	383	593	793
Power Supplied - GWh	**5,322**	**5,200**	**5,631**	**5,994**	**6,327**	**6,812**	**7,765**	**8,636**	**9,403**
Supply Incremental - GWh		-122	431	363	333	485	953	870	768
Supply Incremental - %			8%	6%	6%	8%	14%	11%	9%
Energy Output - GWh									
Hydropower - GWh	**2,672**	**1,993**	**1,704**	**1,716**	**1,544**	**1,544**	**1,561**	**1,561**	**1,561**
			30%	29%	24%	23%	20%	18%	17%
Hydro Incremental		-679	-289	12	-172	0	18	0	0
Tanesco thermal - GWh	**998**	**1,042**	**1,203**	**1,373**	**2,197**	**2,755**	**3,704**	**5,453**	**5,899**
			21%	23%	35%	40%	48%	63%	63%
Ubungo I			667	581	690	690	690	690	690
Tegeta GT Gas			286	313	297	297	297	297	297
Mwanza HFO			0	0	306	306	0	0	0
Ubungo II			250	479	698	698	698	698	698
Kinyerezi Gas I			0	0	0	513	1,026	1,026	1,026
Kinyerezi Gas II			0	0	0	0	715	1,430	1,606
Kinyerezi Gas III			0	0	0	0	0	1,004	1,241
Tanesco thermal Incremental			161	170	824	558	949	1,748	447
IPPs -GWh	**1,604**	**2,134**	**2,548**	**2,635**	**2,508**	**2,435**	**2,360**	**1,469**	**1,776**
Aggreko EPP AGO			186	469	146	0	0	0	0
Symbion (ex Dowans) EPP Dual Jet A1			100	36	120	100	0	0	0
Symbion (ex Dowans) EPP Dual Gas			216	247	284	305	315	0	0
IPTL HFO			432	409	400	400	400	0	0
Symbion 205 (50MW Dodoma) HFO			95	80	54	90	90	0	0
Symbion 205 (50MW Arusha) HFO			54	80	34	70	86	0	0
Songas			1,465	1,314	1,469	1,469	1,469	1,469	1,469
Somanga Fungu Gas			0	0	0	0	0	0	0
Singida			0	0	0	0	0	0	307
IPP Incremental		0	414	87	-127	-73	-75	-891	307
Import - GWh	**48**	**31**	**176**	**270**	**78**	**78**	**139**	**152**	**167**
Hydro Import from Ethiopia - GWh	**0**	**0**	**0**	0	0	0	0	0	0
Other Import -GWh	48	31	176	270	78	78	139	152	167
Total Dispatch - GWh	**5,322**	**5,200**	**5,631**	**5,994**	**6,327**	**6,812**	**7,765**	**8,636**	**9,403**
Technical and Commercial Loss	1,245	1,113	1,188	1,245	1,230	1,267	1,418	1,549	1,655
Sales - GWh	**4,077**	**4,087**	**4,443**	**4,749**	**5,098**	**5,545**	**6,347**	**7,087**	**7,748**
Revenues - US$ m	**316**	**346**	**518**	**593**	**847**	**891**	**990**	**1074**	**1141**
Other Revenue	31	26	84	27	72	72	72	72	72
Weighted Average Tariff - TSh/kWh	**114**	**136**	**185**	**198**	**276**	**276**	**276**	**276**	**276**
Weighted Average Tariff - $c/kWh	0.08	0.09	0.12	0.12	0.17	0.16	0.16	0.15	0.15
Cost - US$ m	**386**	**554**	**849**	**837**	**939**	**927**	**954**	**1059**	**1156**
IPP Capacity Charge					190	147	134	169	169
IPP Energy Charge				577	203	170	145	44	85
Tanesco Owned Plant Fuel Charge					121	150	155	256	281
Import Cost					64	76	94	105	117
Operating Cost				162	207	219	235	258	271
Depreciation				54	64	69	96	131	138
Financing Cost				33	70	76	76	74	71
Bad Debt Provision				11	20	20	19	22	24
Unit Cost - Tsh/kWh	**139**	**214**	**304**	**285**	**308**	**289**	**268**	**274**	**281**
Unit Cost - $c/kWh	0.09	0.14	0.19	0.18	0.18	0.17	0.15	0.15	0.15
Before Government Subsidy - US$m	**-39**	**-182**	**-247**	**-217**	**-20**	**36**	**107**	**86**	**56**
Tanesco Losses before Government Subsidy - US$m									
Government Grant	31	125	119	53					
Profit/Loss - $m	**-8**	**-57**	**-127**	**-164**	**-20**	**36**	**107**	**86**	**56**
Financial Gap Financing - US$m									
Government Loans				200					
Remaining Surplus/Losses	-8	-57	-127	36	-20	36	107	86	56

Tanesco Financial Obligations - US$m				
Trade and Other Payables	205	299	443	450
Borrowing*	344	339	463	747

* Borrowing includes both long term and short term debt

Source: World Bank staff in collaboration with MEM/TANESCO

Notes: The forecast is income statement based and not cash flow based. Therefore, this is a financial loss projection and not cash requirement forecast. In order to estimate cash needs, we also need to incorporate arrears, debt repayments, capital investment, working capital and financing plans, which are difficult to present in the same table. Following assumptions are made for the model: (i) Forecasting period: 2014-2018; (ii) Demand growth: Assumed at 10% p.a. in 2014-2015, 15% p.a. in 2016-2018; (iii) Hydro power availability: *Base Case*- same as 2013 actual, *Upside Case-a*verage 2011-2013, *Downside Case*-10% lower than average 2011-2013; (iv) Gas Availability and price: Assumed sufficient supply after Q1 2015 and Gas price at $6.5/mmbtu; (v)Tariff: Average yield Tsh276/kWh and Flat in Tanzania Shielings after 2013; (vi) Emergency Power Plant Usage: Dispatched if needed; (vii) Cost of Emergency Plant: Based on the information provided by MEM/ TANESCO; (viii) TANESCO Operating Cost: Based on TANESCO budget numbers and Increase generally in line with inflation; (ix) Grid losses: Based on TANESCO budgeting plan; 19.4% in 2014, 18.6% in 2015 and 0.3% loss reduction annually after 2015; (x) Other Revenue: Three year average $72 million; (xi) New Power Plant Commercial Operation Date (COD): *Base Case/Upside Case*- Mwanza HFO Q1 2014, Kinyerezi Gas I Q1 2015, Kinyerezi Gas II Q1 2016, Singida Wind Q1 2018, Kinyerezi Gas III Q1 2017, Kilwa Energy Q1 2017, Ethiopia Import Hydro Q4 2018, *Downside case*- Mwanza HFO Q1 2014, Kinyerezi Gas I Q3 2015, Kinyerezi Gas II Q3 2016, Singida Wind Q1 2018, Kinyerezi Gas III Q1 2017, Kilwa Energy Q1 2017. 2013, Ethiopia Import Hydro Q4 2018. The numbers are estimates, since they are not audited numbers.

ANNEX 5: NEPAD FRAMEWORK OF NATURAL RESOURCE CHARTER

Precept 1: The development of a country's natural resources should be designed to secure the greatest social and economic benefit for its people. This requires a comprehensive approach in which every stage of the decision chain is understood and addressed.

Precept 2: Successful natural resource management requires government accountability to an informed public.

Precept 3: Fiscal policies and contractual terms should ensure that the country gets full benefit from the resource, subject to attracting the investment necessary to realize that benefit. The long-term nature of resource extraction requires policies and contracts that are robust to changing and uncertain circumstances.

Precept 4: Competition in the award of contracts and development rights can be an effective mechanism to secure value and integrity.

Precept 5: Resource projects can have significant positive or negative local economic, environmental and social effects which should be identified, explored, accounted for, mitigated or compensated for at all stages of the project cycle. The decision to extract should be considered carefully.

Precept 6: Nationally owned resource companies should operate transparently with the objective of being commercially viable in a competitive environment.

Precept 7: Resource revenues should be used primarily to promote sustained, inclusive economic development through enabling and maintaining high levels of investment in the country.

Precept 8: Effective utilization of resource revenues requires that domestic expenditure and investment be built up gradually and be smoothed to take account of revenue volatility.

Precept 9: Government should use resource wealth as an opportunity to increase the efficiency and equity of public spending and enable the private sector to respond to structural changes in the economy.

Precept 10: Government should facilitate private sector investments at the national and local level for the purposes of diversification, as well as for exploiting the opportunities for domestic value added.

Precept 11: The home governments of extractive companies and international capital centers should require and enforce best practice.

Precept 12: All extraction companies should follow best practice in contracting, operations and payments.

Annex 6 discusses in more detail how the operation and specific precepts will lead to poverty reduction and shared prosperity, specifically mentioning precepts 1 & 7.

ANNEX 6: EXPECTED IMPACT OF THE PGSDPO SERIES ON ECONOMIC GROWTH AND POVERTY REDUCTION

Background

Tanzania is power starved. With an installed generation capacity of only 1583 MW as of 2013, annual electric power consumption stands at less than 136 kilowatt-hours (kWh) per capita, just enough to power one 60W light bulb per person for six hours every day. Access to modern energy has still only reached 24 percent of the total households.[30] Based on the latest Household Budget Survey (HBS) 2011/12 data, 16 percent of the population has access to energy.

Tanzania has access rates that are higher than Malawi and Uganda (9 percent) but lower than Kenya and Zambia (over 20 percent) and far lower than from developing countries of East Asia (more than 90 percent coverage) and South Asia (62 percent). Access to the national grid is very limited in rural areas. According to HBS 2011/12, only 1.1 percent of the lowest-income quintile in the rural area have access to electricity.

The Government's objective is to increase access to electricity at affordable costs by implementing an ambitious investment program that will increase energy supply in the next few years. During the period 2013-16, the Government's strategy is to use existing near-shore gas reserves to supply new gas power plants through the construction of a new pipeline. In the longer term, the authorities also plan to invest in renewable resources and possibly coal and hydro-energy. The development of offshore massive gas reserves is at the top of the Government's agenda, but the expected impact on economic growth and poverty will occur only when production starts in about 7–10 years. Such a strategy will not only increase power capacity but will also reduce significant current production costs by lowering the reliance of the energy network on very expensive fuel power plants. It will also help diversify the risks associated with climatic shocks and variations in fuel prices on international markets. The DPO series is supporting this medium-term vision.

This Annex sets out the channels through which the DPO series will deliver results for the lowest-income households/population. It also discusses the impact associated with the means used by the Government to close the financial gap in TANESCO in the next few years, before the new power plants become operational. Ensuring the financial viability of TANESCO is urgent as it is a precondition to the financing of future investments and the well-functioning of the energy sector. The impact on economic growth and poverty is however influenced by the choice of means to close the gap.

Growth and Poverty Reduction Channels

There are four potential channels through which the DPO series will support growth and poverty reduction:

- Accelerate growth by removing energy constraints;
- Diversify the power supply mix to strengthen the resilience of Tanzania's power supply;
- Enhance energy access through strengthening the power sector;
- Facilitate the good management of natural gas revenues and develop institutional structures to promote shared prosperity and increased development spending.

[30] Based on the latest data (2013) from the Government (Ministry of Energy and Minerals).

(1) Accelerate growth by removing energy constraints

At a theoretical level, the relationship between electricity, economic growth and the elimination of deep poverty is obvious—no country has achieved a high level of per capita income and welfare without a functioning electricity system.[31] However, an increase in electricity supply, access and reliability will lead to economic growth only if other factors, including policies, are supportive of such growth—i.e. only if electricity is one of the key binding constraints on growth.

The growth diagnostic case study completed in 2005 by the World Bank (and confirmed in 2011 by the USAID study)[32] suggests that poor infrastructure, especially power and transport, is a key constraint to growth in Tanzania.[33] Evidence from the World Bank Enterprise Survey also supports this.[34] When managers of firms in Tanzania are asked directly about the most serious problems they face in conducting business, electricity comes out as their number one concern. Almost 75 percent of Tanzanian enterprises consider routine load shedding and power outages to be the most serious constraint to doing business, while another 15 percent mention it as a significant problem. According to the World Bank's Investment Climate Assessments, power has become less reliable over time and the number of outages per month has grown from 2.5 in 2002, to 8 in 2005 to 25 in 2006. The lack of access to cheap and reliable energy is viewed as a major constraint by firms operating in Tanzania, costing them as much as 5 percent of sales, and as much as 18 percent for manufacturing firms.[35] This scale is consistent with other reports in Africa which suggest that power outages result in significant losses equivalent to 6–16 percent of turnover.[36] Overall the poor state of power infrastructure is estimated to reduce growth rates in Africa by an average of 2.1 percent per year.

Improving the reliability of on-grid electricity increases economic growth in the local, regional or national economy through increasing the productivity of both labor and capital by allowing the use of electricity-using technologies, enabling extended working hours after dark, and reducing the costs of production. The results of unreliable power supply is that production volumes, manufacturing costs and output quality are all adversely affected; firms invest less or in less efficient technologies and have lower productivity growth (Alby, Dethier, and Straub, 2010).[37] Unreliable power supply can "drive up firms' direct and indirect costs and bias their technological choices away from energy intensive ones, which in turn increases the overall costs relative to competitors in other regions" (Alby, Dethier, and Straub, 2010). Where electricity grids are unreliable, firms often have to resort to diesel generators, which are both

[31] There is a strong log-linear aggregate cross-sectional relationship between per capita commercial energy consumption and per capita GDP. Modi et al 2005: '*Energy Services for the Millennium Development Goal'*. Energy Sector Management Assistance Programme, United Nations Development Programme, UN Millennium Project, and World Bank.

[32] USAID, Tanzania Growth Diagnostic, Partnership for Growth, 2011.

[33] http://siteresources.worldbank.org/INTPREMNET/Resources/489836-1123682017954/Tanzania_UtzPresentation.pdf

[34] World Bank. Investment Climate Assessment, 2009.

[35] Source: Tanzania Manufacturing Association, 2011

[36] At the macro level, Morimoto & Hope, (The impact of electricity supply on economic growth in Sri Lanka, 2004) demonstrate that increased energy generation is associated with increased future economic output and estimate, for the example of Sri Lanka, that a 1 MWh increase in electricity supply is associated with extra economic output of 88000 to 137000 Rupees (approximately US$1120–1740). Research on Bangladesh over the period 1973-2006 also found similar evidence that increased energy generation is associated with increased economic output (Sarker, A., & Alam, K. (2010). *Nexus between Electricity Generation and Economic Growth in Bangladesh* (Asian Social Science, 6(12), 16-22)).

[37] Alby, P., Dethier, J.-J., & Straub, S. (2010). *Firms Operating under Infrastructure and Credit Constraints in Developing Countries*. World Bank.

costly and polluting. This reduces their overall investment capacity and drives up costs—in Africa, own-generated electricity is on average 313 percent more expensive than electricity from the grid (Foster & Steinbuks, 2009). [38] This may lead firms to prefer higher tariffs with reliable supply.

All these factors point to the need for significant additional investment in the power sector in Tanzania. The expected increase in power supply, as supported by this proposed operation, should in the medium-term reduce operating costs of firms, leading to accelerated growth and job creation both directly and indirectly, especially in urban areas and locations where the liquefied natural gas (LNG) plant are located.

(2) Diversify the power supply mix to strengthen the resilience of Tanzania

At present, 36 percent of Tanzania's installed capacity is in hydropower plants. The DPO series aims to diversify the power supply mix in Tanzania by facilitating the development of natural gas. This in turn will reduce the power supply's vulnerability to climatic conditions and make Tanzania more resilient to hydro shocks and variations in fuel prices on international market. The fuel import bill has been growing very quickly over the past few years, accounting for approximately one-third of total exports in 2011/12. Less vulnerability to exogenous shocks will help improve the management of the sector, including tariff setting and investment programs.

The power supply will become more reliable and spending on expensive emergency power will decrease. However, it should be noted that clean energy solutions are also key to improving resilience through reducing emissions and long-term climate change.

(3) Enhance energy access through strengthening the power sector

The reforms supported by the DPO series support energy access by increasing generation capacity that is necessary (but not sufficient) to improve access. It should be recognized that progress also has to be achieved in transmission and distribution for increased generation to translate into better access. The DPO also series aims to promote an affordable cost-reflective electricity tariff for households and firms—once the new power plants become fully operational.

The current access to electricity is still limited. There are however significant variations depending on the level of income and location of households (Table A-1). Low-income households have only at a negligible level of access to electricity, while the wealthiest quintile report an access rate equal to 47 percent. Significant differences also exist between rural (3.8 percent) and urban areas (48.3percent).

Table A-1: Access to Electricity for Households and Population by Location and Income Quintile

	Households			Population		
	Rural	**Urban**	**Tanzania**	**Rural**	**Urban**	**Tanzania**
Lowest	1.1%	12.0%	2.8%	1.5%	9.4%	2.7%
Q2	2.0%	25.6%	6.6%	1.7%	22.9%	5.5%
Middle	2.5%	40.3%	12.6%	2.7%	37.8%	10.4%
Q4	5.9%	47.8%	22.4%	4.3%	48.1%	19.2%
Highest	12.5%	68.9%	47.4%	10.4%	68.4%	42.1%
Tanzania	3.8%	48.3%	18.4%	3.5%	46.9%	16.0%

Source: GoT Natural Bureau of Statistics, Household Budget Survey 2011/12.
Notes: Left panel based on household quintiles, right panel based on population quintiles. National quintiles (even for rural and urban percentages).

[38] Foster, V. and J. Steinbuks. 2008. *Paying the Price for Unreliable Power Supplies: In-House Generation of Electricity by Firms in Africa*. AICD, World Bank, Washington, DC.

Improved energy access is key for meeting development objectives and the DPO series provides a necessary first step towards this goal. The Commission for Sustainable Development (2001) said that "access to affordable energy services is a prerequisite" to achieving the first Millennium Development Goal (MDG) of halving the number of people living on less than US$1.25 a day. Limited access to energy has a direct impact on achievement of the MDGs by limiting the provision of basic services, by directly affecting health and the time available for education, and by constraining the potential for economic development and improved livelihoods. Important public service facilities such as maternity wards cannot operate safely at night without electric lights and many medicines cannot be stored without refrigeration. Women and children are particularly affected by the absence of modern energy services. They can gain significant benefits from improved household lighting (creating opportunities for productive activities and education) and new economic opportunities.

The electricity tariff structure in Tanzania has been designed to provide benefits to low-income households with a subsidized rate available for low-usage customers (D1 customers). Also, there is no service charge for the customer group with lowest usage. The new tariff schedule introduced from 2014 includes several changes. In addition to changes in rates, they also shifted the threshold for subsidized rate for D1 customers. This means for the quantity between 50kWh and 75kWh, the effective tariff rate is in fact reduced by 49 percent. Using the latest Household Budget Survey 2011/12 data, average electricity expense has been estimated for 2012-13 and 2014 by income quintile (Table A-2). Since the majority of households with access to electricity, including those who are in low-income groups, consume more than 50 kWh per month, the above-mentioned threshold shift under the 2014 tariff schedule appears to moderate the impact of the rate adjustments among low-income households. This analysis is only for those households with electricity access. Once the households without electricity, which are more prevalent among lower-income households, are added to the base, the average negative direct impact of the tariff increase on low-income households is expected to be reduced further. Nonetheless, the overall impact will depend on the second-round effects through prices, particularly energy-intensive products such as cement and fertilizer, which need to be monitored in coming months. Tanzania also has an effective social protection program, called Tanzania Social Action Fund (TASAF), which provides targeted social protection measures such as conditional cash transfers for the people/households under extreme poverty and protect the vulnerable groups from economic shocks.

Table A-2: Mean Projected Monthly Electricity Expense by Household Income Group

	Estimated Expense 2012-2013	Estimated Expense 2014	Simulated Change: 2012 to 2014
Lowest	5,388	5,384	-0.1%
Q2	10,985	11,504	4.7%
Middle	12,780	13,455	5.3%
Q4	14,308	15,169	6.0%
Highest	21,363	23,955	12.1%
Tanzania	17,204	18,882	9.8%

Source: Household Budget Survey 2011/12.
Note: All households are assumed to be in D1 category. The numbers are averages among those who have access to electricity (from TANESCO).

The Government has committed to improving electricity access among the Tanzanian population. TANESCO's connection charge in the rural areas is substantially lower than in urban areas to accommodate stronger need to expand energy access among rural communities. Through the Tanzania Energy Development and Access Project (TEDAP), the Government is addressing the need for alternative electrification solutions for rural areas unserved by the national grid, and home to the majority of Tanzanians. The project revealed that Tanzania has abundant but largely untapped renewable energy resources, including small hydro, wind, solar, and biomass, which could be harnessed for power

generation and access expansion.

4) Facilitate the good management of natural gas resources

The DPO series aims to support the implementation of a gas sector strategy to ensure sound governance, policies and investment planning. Strong institutions are essential to optimize the benefits of the new resources for all. Tax revenues from the gas sector need to be maximized to ensure higher development spending that optimizes results for the lowest-income group and ensures shared prosperity. The DPO policy dialogue will support this process and complements the Government's action plan that is under preparation. The World Bank, in close coordination with partners, is ready to assist the authorities in their effort through detailed analytical work and the forthcoming capacity building project.

In the short-term, sizable FDI inflows will be necessary to finance infrastructure. While a large fraction of this will be used to finance imports, the construction work will create additional jobs and opportunities for local suppliers. According to the World Bank estimate, inflationary pressure may emerge such as the price of housing and food that may require targeted actions for vulnerable groups in these local communities. This will need to be carefully managed.

In the longer term, the management of fiscal revenues derived from gas production as well as the linkage opportunities with the local economy will produce potential significant effects on economic growth and poverty levels. The revenues can also be used nationally. A recent paper by Devarajan and Giugale (2013)[39]suggests that if Tanzania were able to redistribute 10 percent of the revenues derived from natural gas to the lowest-income households/population, this would amount to US$15 per household per year, or 26 percent of the average poverty gap. If Tanzania were to bring all of its low-income group to the poverty line using cash transfers, this would absorb about 40 percent of the natural resource fiscal revenue.

Strong institutions are essential to ensure additional prosperity is shared at the national level through promoting investment in infrastructure, building more human capital and developing a local private sector. Civil society also has a role to play to ensure access to information and improve the accountability of both Government and the private sector. Initial developments in the institutional framework are encouraging, although this trajectory must continue. An institutional mechanism for inter-sectoral coordination on natural gas has been set up, the gas policy was adopted by Cabinet in October 2013 and the Gas Act is being drafted. Tanzania's commitment to the Natural Resource Charter will encourage shared prosperity. Specifically, precept 1 is to 'secure the greatest economic and social benefits for its people', whilst precept 7 encourages '*sustained, inclusive economic development* through enabling and maintaining *high levels of investment* in the country'. In December 2013, the Government of Tanzania launched an expert panel charged with overseeing the benchmarking exercise of the Tanzania Natural Resource Charter in Dar es Salaam. The benchmarking exercise aims to help the government diagnose gaps and opportunities along the decision chain for natural resource management, from extraction to investing the financial proceeds. The results will be used to build an action plan and national vision to guide a program of activities to improve the governance and economic management of natural resource wealth.

It is important that the macroeconomic impacts of the projected increase in exports are well managed in terms of balance of payments and real exchange rate so as to maintain the competiveness of the non-gas sector. Properly managing the fiscal revenues received from gas producers will also be a priority both in

[39] Devarajan, Shantayanan and Marcelo Giugale. 2013. 'The Case for Direct Transfers of Resource Revenues in Africa' Center for Global Development Working Paper.

the short and longer terms. This necessitates strengthening capacity to manage public debt (so as to avoid excessive advance borrowing) and public investment in terms of sectors and geographical allocation. Lastly, the authorities will have to maximize the synergies between the gas operators and the local economy through the development of joint infrastructure projects and backward as well as forward linkages, including through training programs and technology transfers. The magnitude of these effects will greatly depend on the Government's capacity to manage them along with the production and commercialization of gas. Not only is this series of operations aimed at supporting these efforts, but also the World Bank's parallel capacity building project should help the authorities to build technical expertise at the various stages of the process. The operation is being complemented by a set of World Bank analytical projects. These include a study to estimate the potential medium-term growth impacts of the development of the natural gas sector in Tanzania—both onshore and offshore—through a macroeconomic modeling exercise; local content analytical work to examine how to maximize local private sector involvement in offshore exploitation and natural gas plant construction and thereby help the economy generate employment and opportunities for sustainable enterprises and investments; a study looking at international experiences in institutional arrangements for the natural gas sector; and one examining the role of urbanization in the successful long-term planning of natural resource use.

ANNEX 7: ENERGY SECTOR CAPACITY BUILDING PROJECT (ESCBP)

Background/Scope: Recent discoveries of massive natural reserves (currently estimated between 33 and 38 Tcf with exploration activities ongoing) require a further strengthening of Tanzania's strategic, legal and institutional framework around the gas sector. The ESCBP project will assist the Government in strengthening its capacity to develop (i) its natural gas sector and (ii) PPPs for the power generation sector. The project scope has been closely aligned with the Power and Gas Sector DPO to maximize the World Bank's assistance program to the energy sector in Tanzania.

Components: The project has four components, each with multiple sub-components, which are briefly summarized below:

Component A focuses on the Government's priority of implementing a comprehensive, clear and workable policy and regulatory framework to maximize value arising from natural gas development (financial, social, and environmental) in Tanzania. The proposed component supports the following specific activities: (1) update of the Petroleum Policy and Strategy to maximize value arising from natural gas development (financial, social, and environmental); and (2) the development of a legal and regulatory framework for the Gas sector to reflect the Government´s policies and strategies for the sector and to attract foreign and local investments to the sector.

Component B aims at strengthening the capacity of the major institutions (Ministry of Energy and Minerals (MEM), Energy and Water Regulatory Authority (EWURA), Tanzania Petroleum Development Corporation (TPDC), the National Environmental Management Council (NEMC), the Occupational Safety and Health Authority (OSHA) and the Extractive Industries Transparency Initiative (EITI)) that deal with the oil and gas sector as well as the power generation sector to allow them to execute their mandates in a way that is conducive to investments and ensures that all safeguards and safety standards are met to international standards. The proposed support is grouped into four sub-components: (1) Strengthening Sector Coordination and Governance; (2) Enhancing Organizational Capacity; (3) Environmental and Social Management; and (4) Health and Safety Management. The support includes preparation of a Strategic Environmental and Social Impact Assessment (SESIA) that will provide guidance to NEMC, the Vice-President's Office (VPO), and MEM on systematically integrating environmental and socio-economic concerns in project development, operations and maintenance of future oil and gas sector activities.

Component C focuses on enhancing technical skills in the sector through support to the Vocational Education Training Authority (VETA). Activities being financed include (1) support to VETA to develop and implement an Educational Development Plan; (2) the purchase of equipment, tools and consumables necessary for executing the Educational Development Plan; and (3) administrative and logistics support for the Training Center including coordination and supervision missions from a Training Advisor until the end of the project, as well as additional training of new instructors.

Component D will increase the capacity of the Government and its institutions to attract and develop power generation projects with private sector sponsors/financing. The proposed support under this component of the project is grouped into two sub-components: (1) MEM PPP Node Support; (2) TANESCO PPP Node Support.

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TANZANIA

SELECTED CITIES AND TOWNS
PROVINCE CAPITALS
NATIONAL CAPITAL
RIVERS
MAIN ROADS
RAILROADS
PROVINCE BOUNDARIES
INTERNATIONAL BOUNDARIES

JUNE 2013