In reply please quote:

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February 14, 2014

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

RE: LETTER OF DEVELOPMENT POLICY

1. On behalf of the Government of the United Republic of Tanzania, I hereby write to request approval of the Eleventh Poverty Reduction Support Credit (PRSC-11) in the amount of USD 85 million (SDR equivalent). This credit will assist in the implementation of the National Strategy for Growth and Reduction of Poverty II (MKUKUTA II), the First Five-Year Development Plan and support the implementation of the ongoing Government reforms aiming at maintaining macroeconomic stability, facilitating private sector participation in the economy, rural development, infrastructure, energy, education, and water sectors, strengthening the public financial management, improvement in public service delivery, enhancing governance, and ensuring environmental sustainability.

BACKGROUND AND RECENT DEVELOPMENTS

A. MACROECONOMIC PERFORMANCE

2. 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.

3. 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%).

4. 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.

5. 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.

6. 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.

7. 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.
8. 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.

9. 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.

10. 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.

11. 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.

12. 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

13. 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.

14. 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. DESCRIPTION OF POLICY AREAS

• ENHANCED EFFICIENCY AND TRANSPARENCY IN DOMESTIC REVENUE MOBILIZATION

15. The Government recognizes the importance of increasing revenue collections from non-tax sources to expand the country's fiscal space for growth and sustainability in the long run. The importance of strengthening domestic revenue collection, especially from natural resources in a transparent and accountable manner, is well recognized in both MKUKUTA and FYDP. The Government has made solid progress in improving revenue transparency through EITI and succeeded in obtaining EITI compliance status in December 2012 and launching of the third EITI reconciliation report. The Government is working towards institutionalizing the EITI operations by establishing a governing legal framework.

16. The Government has actively continued to modernize the tax administration over the past few years to improve efficiency in tax revenue mobilization. The Government has prepared a bill for enacting the Tax Administration Act, which will further modernize tax administration by
establishing a common tax procedure code that consolidates and harmonizes administrative procedures from different tax laws, such as income tax and VAT. The Act is expected to substantially simplify the revenue collection system, both from collector and payers’ perspectives, thereby improving efficiency in revenue collection.

**PRSC-11 Prior Actions:**

- Domestic legislation institutionalizing Extractive Industries Transparency Initiative (EITI) and providing a sound framework for EITI’s operation is drafted and stakeholder consultations are completed.

- A bill to enact the Tax Administration Act for the purpose of establishing common tax procedures for different taxes collected by Tanzania Revenue Authority is approved by the Cabinet and finalized by the Attorney General’s Chamber.

**SOUND PUBLIC INVESTMENT MANAGEMENT, INCLUDING PPPs**

17. The Government has taken initiative to strengthen public investment management and PPPs, with a view to maximize growth benefits from the projects with less fiscal burden to the Government’s budget. This emphasis on public investment management is aligned with the Government’s effort to close existing infrastructure gaps and is expected to grow in importance over time, given the perspective of future domestic revenue derived from gas production.

18. The Government has launched Big Results Now (BRN) initiative with the objective of strengthening implementation of the FYDP I. While the POPC remains the main custodian and leader of the planning framework of public investments in the country, Presidential Delivery Bureau (PDB) has been established to oversee implementation of the programs and projects identified under the six National Key Results Areas (NKRAs) of the BRN. In order to enhance its effectiveness in public investment management, the Government is amending the Planning Commission Act of 1989 to clearly define the role of POPC in Public Investment Management (PIM) among other objectives. In view of new developments in Tanzania such as the creation of the PDB and PPP units at PMO and MoF. The Government is also preparing the PIM operational manual (PIM_OP) to guide MDAs and LGAs in preparing public investment projects, including proper economic and financial assessments of those public investment projects.

19. In line with the recommendations of the Resource Mobilization Lab of the BRN initiative, the Government has approved amendments to the PPP Act of 2010 (*PRSC-11 prior action*). The amendments include among other: (i) streamline the number of approvals for PPP projects; (ii) create PPP facilitation fund; (iii) establish rules for unsolicited proposals; (iv) establish procurement rules for PPP projects under the PPP Act (and not under the Procurement Act);
(v) clarifying the management of contingent liabilities resulting from PPP projects; and (vi) combining the two current PPP Units in TIC and MoF into a single PPP unit in the MoF. Merging of the two PPP units will simplify and speed up approval process of PPP projects while ensuring more focused ownership within Government.

**PRCS-11 Prior Actions:**

- The Government: (a) drafts a bill to amend the Planning Commission Act of 1989; and (b) initiates development of a public investment operational manual to provide guidance for the ministries, departments, and agencies and the local government authorities to carry out economic and financial analysis of public investment projects.

- The Government approves amendments to the PPP Act (2010) to: (i) streamline the number of approvals; (ii) create the PPP facilitation fund; and (iii) establish rules for unsolicited proposals.

- **IMPROVED QUALITY OF BUDGETS AND A STRONGER PUBLIC FINANCIAL MANAGEMENT (PFM) SYSTEM**

20. The Government has successfully implemented PFM reforms over the past two decades. Significant improvements have been achieved in overall compliance to public finance legal requirements including procurement regulation, timely auditing and budget transparency. The number of qualified opinion has also improved. While this is an improvement, the need for a stronger PFM system remains, notably in the areas of debt management and prioritization of government expenditure as the country anticipates a significant growth in revenues from the natural gas sector in coming years.

21. The Government is taking measures to strengthen audit functions including through rolling out risk-based internal auditing to all MDAs and LGAS as well as Government Business Entities (GBEs). The Internal Auditor General (IAG) has developed public sector audit committee guidelines. These guidelines will help to improve follow-up of audit recommendations by enhancing audit committees in MDAs and LGAs as well as Government Business Entities (GBEs) which receive subventions from the general budget. The Government has also facilitated implementation of the Procedures Manual for the Quality Assurance Improvement Program and the Guidelines for Developing Institutional Risk Management Framework in the Public Sector.

22. Recognizing the huge infrastructure gap and limited financing from domestic revenue and concessional sources, Government has continued to access funding from non-concessional borrowing and PPP. Intendam, the government has strengthened monitoring of debt evolution and fiscal and quasi-fiscal risks associated with PPPs.
23. The Government continues to implement measures designed to improve transparency including publication and dissemination of budget information in line with its commitment to Open Government Partnership (OGP). In this regard, the Government published on the MoF website budget books (both as submitted and as approved by Parliament), citizen’s budget and budget execution reports. As a result, Tanzania improved its score on Open Budget Index (OBI) to 47 in 2012 from 45 in 2010. Moreover, in 2013 the Government submitted to the IMF the 2009/10-2011/12 fiscal accounts for the first time in the GFSM2011 format for publication in the 2012 Government Financial Statistics Yearbook. The ongoing dialogue between the Government and the Bank will lead to further improvement in this area. As agreed with the Bank the Government has completed implementation of the following prior actions for PRSC.

**PRSC-11 Prior Actions:**

- The Internal Auditor General (a) formulates public sector audit committee guidelines to improve effectiveness of audit committees in ministries, departments, and agencies (MDAs) and local government authorities (LGAs); and (b) facilitates implementation of the Procedures Manual for the Quality Assurance Improvement Program (QAIP) and the Guidelines for Developing Institutional Risk Management Framework (IRMF) in Public Sector, issued by the Internal Auditor General.

- The Government: (i) completes and publishes the Medium Term Debt Strategy (MTDS), which recognizes as central government debt off-budget liabilities, including from pensions and parastatals; and (ii) submits to Cabinet proposed amendments to the Government Loans, Grant and Guarantee (GLGG) Act (2004).

- The Government ensures publication of the budget with: (a) guidelines for the preparation of the annual plan and budget for 2013/14 published on the MoF website by December 2012; (b) the executive budget proposal as submitted to the Parliament published on MoF website by June 2013; (c) the approved budget for 2013/14 published on MoF website by September 2013; (d) the citizens’ budget for 2013/14 published on MoF website by November 2013; and (e) year-end report on preliminary budget outturn published on MoF website by November 2013.

- **EFFECTIVE INSTITUTIONS FOR PROMOTING AND REGULATING SPECIAL ECONOMIC ZONES (SEZs)**

24. The Government is committed to strengthening the SEZs regime with a view to promote investments and ensure we have in place an improved investment climate by integrating the Export Promotion Zones (EPZs) program
into the SEZs. Consolidation of EPZs into the SEZs framework would provide incentives to individual exporting enterprises as opposed to the current regime which is based on fiscal incentives. To ensure effective operation of SEZs, the Government has established a one-stop services center for SEZ investors at the Benjamin William Mkapa (BWM) SEZ while also building capacity for managing PPP contracts as stipulated in the regulations. Implementation of a one-stop services center for SEZ-based enterprises is expected to streamline administrative procedures in those zones (notably in the areas of licenses, taxes, customs, work permits, visas, and residence permits) as the Government continues with effort to simplify existing procedures. The Government has also developed and issued the operational guidelines for PPP arrangements in the SEZs.

PRCS-11 Prior Action:

- The Government establishes a single one-stop services center of key ministries, departments, and agencies (MDAs) for special economic zones (SEZs) investors and develops operational guidelines for public private partnership (PPP) arrangements for SEZs.

**IMPROVED INVESTMENT CLIMATE AS A REGIONAL TRANSIT HUB**

25. The Government recognizes the need to leverage the country's geographical advantage as a coastal country bordering eight other countries, including six that are landlocked. With the support of the World Bank through the PRSC series, the Government has taken measures to improve investment climate in order to leverage its geographical advantage to promote regional transit trade. Towards this end, the Government has developed and widely disseminated a guide for clearance of cargo across Tanzania borders and at the port of Dar es Salaam. The guide helps to increase awareness of required procedures for trading and clearing goods across the borders and at the port of Dar es Salaam by collecting together information of all relevant border-related procedures such as customs and immigration.

26. Moreover, the Government is taking further steps to improve the efficiency of the port of Dar es Salaam which is also critical in strengthening the investment climate as well as increasing the volume of regional transit trade in the country. Towards that end the following measures have been implemented: (i) strengthened implementation of custom regulations which require manifest to be lodged electronically 24 hours before arrival of the vessel by effecting penalties for non-compliance; (ii) started implementing the Action Plan to move Tanzania Port Authority (TPA) to landlord status, including completion and adoption of feasibility study for berths one to seven with options for public private partnerships (PPPs); and (iii) developed and implemented action plan to merge cargo management and clearance under the new automated custom system (TANCIS). In addition, the accountability in the port of Dar es Salaam was upgraded by appointing a new Board and
Management of TPA, which have begun to generate momentum for change. Nevertheless, the government will continue with efforts to further improve port efficiency.

**PRSC-11 Prior Action:**

- The Government develops an operational manual for border trade and starts disseminating the manual for traders to increase their awareness of required procedures for trading across the border.

To improve port efficiency, the Government has: (i) strengthened implementation of custom regulations which require manifest to lodged electronically 24 hours before arrival of the vessel by effecting penalties for non-compliance; system; (ii) started to implementing the Action Plan to move Tanzania Port Authority (TPA) to landlord status, including completion and adoption of feasibility study for berths one to seven with options for public private partnerships (PPPs); and (iii) developed and implemented action plan to merge cargo management and clearance under the new automated custom system (TANCIS).

**D. REFORMS TO IMPROVE AID EFFECTIVENESS**

27. External Resources (ODA) continues to be an important component of the Government Budget. During FY 2012/13, ODA constituted 21 percent of the Budget and 47 percent of the Development Budget. For FY 2012/13, the share of ODA is 21 percent.

28. Given this significance, the Government is committed to continue with the implementation of reforms aimed at enhancing the development impact of ODA in Tanzania. These reforms focus on strengthening Government ability to own and lead the development process, including allocation of aid resources to national priorities and account for its use. A key Government Strategy towards this objective is to encourage development partners to channel their resources through General Budget Support (GBS). In 2012/13, the Government of Tanzania and the Budget Support Partners conducted a joint independent evaluation on GBS. The outcome of the evaluation forms a strong basis for future reforms of the GBS modality to ensure aid effectiveness.

29. The Government prefers the GBS aid delivery modality because of its advantages over project and basket funding modalities in terms of enhanced Government ownership over resource allocation and the full integration of aid resources into the National Budget, Public Financial Management and Accountability Systems. Currently, the Development Partner’s GBS Group is made up of 12 Development Partners that are providing part of their ODA
through General Budget Support. The World Bank is one of these 12 Development Partners that provide General Budget Support.

30. The implementation of General Budget Support in Tanzania is guided by the Partnership Framework Memorandum (PFM) that was signed in May 2011. Under the PFM, the Government and Development Partners have committed to implement a set of Principles and Commitments designed to improve overall performance of the Government, including Governance and accountability, improved service delivery, and enhanced anti-corruption efforts. In collaboration with development Partners, the Government will continue to monitor progress in the implementation of all agreed commitments through sector and the main GBS Annual Reviews, using agreed performance indicators on the PAF.

31. During the 2013 Annual Review, overall PAF implementation performance was rated satisfactory. One important outcome of the 2013 Annual Review is to slim further the PAF and focus on high impact interventions. Consequently the PAF 2014 has been slimmed down to no more than 17 indicators. The Government and development partners agreed to enhance dialogue on results. The key focus for dialogue in coming years between Government and development partners will be on sustainable growth (energy and agriculture), quality of social services at local government level, and public financial management and transparency.

E. CONCLUSION

32. Recognizing that PRSC-11 is the last operation of the series, the Government welcomes the next development policy operation (general budget support) series on Open Government Initiative and public financial management (OGP-PFM) which will help strengthen the achievement made in the area of PFM reforms while supporting the open government agenda. The Government stands ready to advance the dialogue that has been initiated by the Bank on the next series of development policy operations with the aim of disbursing the funds in the first quarter of FY2014/15 after successful completion of all agreed prior actions.

33. The Government remains committed to focusing on sustaining macroeconomic stability, increasing domestic resource mobilisation, promoting pro poor economic growth, and increased investment in core social services such as education, health and water. The Government is confident that various reforms pursued under the PRSCs and others in the PAF will further improve service delivery in the public sector. Further, the Government recognises that the support by the Bank and other development partners will complement government's efforts to ensuring adequate funding of MKUKUTA interventions, a key to sustainable growth and poverty reduction. Thus, the Government requests the World Bank to approve the provision of USD 85 million to
complement the Government’s efforts in implementation of MKUKUTA and reforms, thereby fostering and sustaining macroeconomic stability.

Thank you for your continued cooperation and support.

Yours sincerely,

Dr. Servacius B. Likwelile
PERMANENT SECRETARY
AND PAYMASTER GENERAL