September 12, 2008
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 08/48-1

10:00 a.m., May 30, 2008

1. United Republic of Tanzania—Report on Breach of Obligations Under Article VIII, Section 5 of the Articles of Agreement; Third Review Under the Policy Support Instrument

Documents: BUFF/08/69; BUFF/08/74; EBS/08/55 and Correction 1, and Supplement 1, and Supplement 2; EBS/08/59 and Correction 1

Staff: Nord, AFR; Hadjimichael, PDR

Length: 1 hour, 1 minute

Executive Board Attendance

M. Portugal, Acting Chair

Executive Directors	Alternate Executive Directors
P. Gakunu (AE)	
	K. Assimaidou (AF)
	D. Vogel (AG), Temporary
	Y. Ha (AU), Temporary
	S. Rottier (BE), Temporary
	K. Florestal (BR), Temporary
	J. Yang (CC), Temporary
	J. Pineda (CE), Temporary
	P. Charleton (CO)
	G. Collange (FF), Temporary
	F. Haupt (GR), Temporary
	S. Krishnan (IN), Temporary
	M. Xafa (IT)
	H.Yamaoka (JA)
	J. Kwakye (MD), Temporary
	H. Caracalla (MI), Temporary
A. Bakker (NE)	
	J. Bergo (NO)
	A. Shabunina (RU), Temporary
	S. Alnefaee (SA), Temporary
	S. Mathema (ST), Temporary
T. Moser (SZ)	
	D. Heath (UA)
	V. Pillai (UK), Temporary

S. Anjaria, Secretary
T. Orav, Assistant

Also Present
IBRD: K. Funk, J. Suarez. African Department: M. Atingi-Ego, H. Bredenkamp, B.V. Christensen, D. Dunn, S. Maziad, J. Mueller, D. Nellor, R. Nord, Y. Sobolev. Fiscal Affairs Department: A. Simone. Finance Department: I. Goodwin, C. Hemus. Legal Department: N. Rendak. Monetary and Capital Markets: B. Radzewicz-Bak. Policy Development and Review Department: M. Hadjimichael, N. Hobdari. Secretary's Department: P. Ramlogan, M. Yslas. Senior Advisors to Executive Directors: R. Gesami (AE), A. Ndyeshobola (AE), C. Roos Isaksson (NO). Advisors to Executive Directors: S. Cerovic (NE), A. Maciá (BR), G. Tesfamichael (AE), E. Uanguta (AE).

1. UNITED REPUBLIC OF TANZANIA—REPORT ON BREACH OF OBLIGATIONS UNDER ARTICLE VIII, SECTION 5 OF THE ARTICLES OF AGREEMENT; THIRD REVIEW UNDER THE POLICY SUPPORT INSTRUMENT

The Acting Chair (Mr. Portugal) suggested the Board take up the Managing Director's Report on the Breach of Obligation under Article VIII, Section 5, of the Articles of Agreement. Upon finishing that discussion, it would continue with the discussion on the third review under the Policy Support Instrument.

Mr. Gakunu informed the Board of the recent passing of a former Governor of the Bank of Tanzania.

Mr. Rottier associated himself with the concerns and positions expressed by Mr. Moser with regard to the instance of misreporting.

Mr. Haupt made the following statement:

> We regret the incorrect provision of data that gave rise to a breach of obligations under the Articles of Agreement. We are under the impression that this is another incident underscoring the importance of the ongoing efforts to strengthen the operations and the governance of the Bank of Tanzania. We share many of the concerns of Mr. Moser in this context and we look forward to the staff's answers to his questions. That being said, we are prepared to support the proposed decisions in view of the remedial measures taken.

The staff representative from the African Department (Mr. Nord), in response to Directors' questions and comments, made the following statement:

> First, let me say that we regret the late circulation of the paper, which was due to two considerations. First, it was felt that this issue should be discussed by the Board together with the third review. Second, and more substantively, before we put the paper on agenda, we wanted to wait for confirmation that one of the key remedial measures, namely, an already ongoing audit of the Bank of Tanzania's foreign exchange reserves, did not reveal any other major discrepancies. We received confirmation to that effect only last Monday. Had we not received that confirmation, we would not have put this paper on the agenda.
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> Why did the staff only discover the misreporting in early 2008, when the correct data were included in the Bank of Tanzania's (BoT)

audited statements in October 2007? We could indeed have discovered it earlier, but let me note that the misreporting of reserves dates back to 2005, and that the format of reporting to the Fund differs from the format in the BoT's Annual Report, so the differences are not immediately apparent. In fact, it was in connection with the other side of the transaction, the bond issued by the Ministry of Finance, that we saw that this was not included in the domestic debt report that we used for the Fund-supported program, which ultimately gave rise to our inquiries about the level of reserves.

On the transaction itself, we understand, as also noted in the letter from the Minister, that the government instructed the BoT to settle a liability of a company that was partly state-owned. There was no guarantee involved, but, nevertheless, the government instructed the BoT to settle this liability. In our assessment, this does not represent a breach of a performance criterion under the PRGF-supported program. There was no debt incurred; there was no guarantee. It was the government settling a liability that it felt it needed to settle.

Mr. Moser made the following statement:

On the late circulation period, I would have clearly preferred to have this discussion at a later stage. I recognize the convenience of having both items on the same day, but I think this case would have clearly deserved some more thorough exploration by the staff as well as the Board. I take note of the reasons, but I still regret the late circulation of the report. In future such cases, it would be clearly worthwhile to have two separate discussions.

I still feel very uncomfortable with the explanations given in the staff report. The report could have been more specific about these events. I understand now, after some extensive Google research, that the then-Governor was a former IMF Mission Chief, which makes it even more difficult to believe that the bank had difficulties in correctly booking these transactions. Also, I think the circumstances of this transaction are very dubious. I compared this case to an instance related to Tajikistan in my constituency and I have to say that it is the same level, but the standards applied and the thoroughness of the investigation are clearly not.

> Thus, given the short circulation period, and given also that I still have a lot questions regarding this transaction, which I understand was a payment to a foreign bank—again, information obtained through Google research and not from the staff report—I feel very uncomfortable with this decision. I would like to be recorded as abstaining from the decision on misreporting. I also would like to note that this has nothing to do with the current authorities of Tanzania; rather, it is an issue I have with the staff report on this case of misreporting. Thank you.

Mr. Krishnan, noting the recently obtained information on the audit of foreign reserves, wondered whether this was a separate audit from that of the external payment arrears account, which was mentioned in the staff's report on the Policy Support Instrument.

Mr. Bakker recalled that the breaches in question were intensively discussed with the authorities, including the new Central Bank Governor and the new Finance Minister, in the context of Executive Directors' group travel to Tanzania. At that time, he was persuaded that the authorities were taking the appropriate actions. Staff properly waited on the outcome of the audit to ensure there were no other irregularities. As such, he fully supported the Managing Director's recommendation.

Mr. Moser asked whether Mr. Bakker could clarify if the authorities had discussed with Directors both the new case of misreporting as well as special audit of the external payments arrears account.

Mr. Bakker recollected that both issues were intensively discussed.

Ms. Xafa said she also participated in the group travel and confirmed that both issues were discussed at that time. In fact, Directors had commended the authorities for their forthright pursuit of the matter, which included public disclosure of the audit.

Mr. Gakunu made the following statement:

> Mr. Chairman, I am very grateful to the very incisive questions raised by Mr. Moser. I think that shows the importance of the Board in terms of ensuring that issues are properly addressed. I am very grateful for that, frankly, because I would have raised the same questions myself.
>
> I can confirm what Mr. Bakker and Ms. Xafa just said. In fact, when we arrived in Dar es Salaam, we were met at the airport by the

Governor and he accompanied us to our hotel. Even before we checked into our rooms, he took us to a conference room that they reserved for us and they took us through not only this issue, but also the external payments arrears issue. On this particular point, I recollect clearly that, when we looked at the balance sheet report of the Bank of Tanzania, this issue was always recorded in their statement, but because there was this problem that the Ministry of Finance had not yet decided on how it should be recorded, the matter was never really brought to the attention of the Fund. The Governor told us that, upon taking the office, when he saw this issue, the first thing he did was to ask the Ministry of Finance for clarification, and then he informed the Fund.

Given that we are looking at this also in the context of the overall governance issues at the Bank of Tanzania, I would take this opportunity, Mr. Chairman, also to indicate that the new Governor has enacted significant internal reforms. Incidentally, the rules that were applied in the Bank of Tanzania came basically on the basis of the advice that this Board itself had given, including the new Act of the Bank of Tanzania. Upon taking office, the Governor realized that some of the measures that had been put in place, for example the Audit Committee, were not very transparent. He thought that it would be good for him to be excused from chairing the Internal Audit Committee of the bank. Five 7BoT personnel who were involved with this case have been suspended and they are being investigated for possible prosecution. I believe this reflects the fact that the new Governor, as well as the authorities themselves, including the President, take the issue of governance at the Bank of Tanzania very seriously. They feel that the credibility of the institution has seriously been affected as a result of these misappropriations that have been picked up in the various audits.

I thought I should make this extensive explanation of this point to assure those Executive Directors who still have reservations on this matter. If it would help, I am even willing to follow-up these explanations with the proper assurances in writing from my authorities on the actions that have been taken. I thank you, Mr. Chairman.

Mr. Rottier, in light of the information provided by Directors and the staff, agreed to the proposed decision. That said, he concurred with Mr. Moser that separate Board meetings should be held if information is made available on such short notice.

The staff representative from the African Department (Mr. Nord), in response to Directors' questions and comments, made the following statement:

> I can confirm that we are talking about two separate audits. The special audit of the external payments arrears account, which has been previously discussed in this Board, was completed in December, 2007, and we will discuss shortly the action plan that the authorities have put in place.
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> On this issue, when the staff became aware that there was a discrepancy and that reserves had been inaccurately reported, we asked for a corrected series. The corrected series of data showed in fact that the discrepancy was due to this single transaction. However, to be certain that this was the only transaction of concern the central bank commissioned a separate audit of its foreign exchange reserves by an external auditor. That audit started in April/May. The final report is being delivered as we speak. We saw a draft on Monday, which confirms that there are no other hidden skeletons. This audit went beyond what was strictly necessary in the sense that in addition to correcting the data, it looked at the level and composition of reserves to make sure there were no other hidden issues.
>
> One additional point that I should have mentioned before as regards Mr. Moser's question on the underlying transaction. We have focused here on the reporting to the Fund; I think that is appropriate under Article VIII, Section 5. We have not investigated the underlying transaction. However, the underlying transaction is under investigation, as are a number of other cases in Tanzania, by the anti-corruption office. I think it is appropriate to separate the two issues. If there is a problem regarding the underlying transaction and its legitimacy, it certainly needs to be investigated, but it needs to be investigated by the appropriate authorities.

Mr. Moser appreciated the additional explanation. He considered that the specifics of the underlying transaction were relevant for judging whether there was a breach under the previous PRGF-supported program, i.e. whether debt was incurred by the government. Staff had concluded there was no legal basis for the payment, and therefore is could not be viewed as a guarantee that the government was obligated to fulfill. Thus, it was simply a payment out of central bank reserves, which led to underreporting of on an indicative target, but not a performance criterion. However, more information was needed to determine clearly whether this was debt, or, if not, what was the basis was for the payment. Moreover, in the case of Tajikistan, where unlike the Tanzanian case central bank reserves were merely used as collateral and not for actual payments to a foreign bank, the special audit that the Fund had requested had been much broader than the special audit that was being requested from the Bank of Tanzania.

The staff representative from the Policy Development and Review Department (Mr. Hadjimichael), in response to Directors' questions and comments, made the following statement:

> I should clarify that this is the first case that comes to the Board as a breach of Article VIII, Section 5, on a stand-alone basis. All the other cases of misreporting we had discussed in the Board involved misreporting in the noncompliance with performance criteria. So, in a sense, this is a case where the staff in the Legal Department have investigated as to whether or not any performance criteria were breached, and we have come to the conclusion that none of them have, even though there may be other reasons of governance to investigate some of the underlying transactions.
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> Here is a case where the government pays in cash a claim by a supplier or some other party in a venture that the government is a 50 percent joint owner. The reporting of this transaction on the credit to government and under reserves was erroneous, and the new administration came quickly to that conclusion, which they subsequently corrected.
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> We were faced with an issue of how to present this to the Board, since all the corrective actions that we could have thought of have already been implemented. The new administration has all the goodwill to proceed forward. Having a meeting that avoids having a separate press release, as required by the Transparency Guidelines, also helps the new authorities to put the issue in the right perspective.
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> I can assure Mr. Moser that the Legal Department and all the other departments have investigated the underlying causes on whether or not we have a breach of performance criteria, and we are reasonably satisfied that this is not the case.

Mr. Gakunu clarified that, following the emergence of issues with respect to the external payments arrears (EPA) account, the President of the Republic of Tanzania created a task force for the purpose of not only investigating the EPA account, but all other related governance matters. The task force would soon submit its report to the President, and a responsible Minister will be charged with developing concrete recommendations for actions to be taken. As such, the matter is far from a closed, and further action are to be taken.

With regard to the special audit of the EPA account, the Board had earlier been informed that it would not receive the actual report from the auditors, Mr. Gakunu continued. The Controller had supplied a qualified report on that audit, because some of the particulars needed to be kept confidential if there were to be submitted as evidence for prosecution.

Mr. Moser thanked Directors for their patience. He reiterated that his chair had no issue with the authorities or the current Governor. The authorities were to be commended for the actions taken in follow-up to the issues that had arisen on the external payments arrears account. Rather, the issue related to staff's report on the instance of misreporting, given that he had not been given sufficient time or information to render a decision.

The Acting Chair (Mr. Portugal) took note of Mr. Moser's suggestions. He concluded that the Board had approved the proposed decision on the breach of obligations, with one abstention. The Board's public statement on the matter would be appended to the end of the statement to be issued for the third review of the Policy Support Instrument.

The Executive Board took the following decision, with one abstention from Mr. Moser (SZ):

United Republic of Tanzania—Breach of Obligations

The Fund has reviewed the report of the Managing Director set forth in EBS/08/59 (5/27/08) on the provision of inaccurate information by the United Republic of Tanzania on the international reserves of the Bank of Tanzania and on the stock of debt of the central government, and finds that the United Republic of Tanzania has breached its obligations under Article VIII, Section 5 of the Articles of Agreement to report accurate information to the Fund. The Fund determines that, on the basis of the corrective action undertaken by the United Republic of Tanzania, no further action is required.

Decision No. -14120(08/48), adopted
May 30, 2008

The Acting Chair (Mr. Portugal) then invited Executive Directors to consider the third review under the PSI.

Mr. Gakunu and Mr. Ndyeshobola submitted the following statement:

Introduction

The Tanzanian authorities are committed to sustaining prudent macroeconomic policies and deepening structural reforms. Economic growth exceeded 7 percent in 2007 and medium-term prospects are strong. They are thankful to the Fund for the constructive engagement and support, and are appreciative to staff for the forthright policy dialogue and advice under the program.

The authorities remain resolute in implementing the PSI-supported economic program. All end-December 2007 quantitative assessment criteria were observed. Implementation of all structural assessment criteria and benchmarks were on track, and program targets for the remainder of 2007/08 will be maintained. In view of the strong and good economic performance under the program the authorities request Directors' support for the completion of the third review of the PSI. They broadly agree with the thrust of the assessment in the well balanced staff report on the third review of the PSI, and will respond appropriately to the policy actions recommended.

Recent Economic Developments

Tanzania's impressive economic performance has been uninterruptedly sustained over the past decade, reflective of the sustained economic reforms; broad-based growth; and consistency in taking advantage of the favorable external environment. Real GDP growth is estimated at 7.3 percent in 2007 on account of good performance by transport and communications, mining, construction, tourism and trade, and manufacturing sectors, as well as stability in agricultural performance. Inflation remained within the single digit range, with headline inflation at 6.4 percent by end-December 2007, slightly above the authorities' objectives. Inflationary pressures intensified during the second half of 2007 due mainly to a surge in high oil and food prices. The authorities recognize the enormous challenges and implications of the protracted increases in the prices of these commodities on the external account and price stability in the near to medium term. Nonetheless, they are of the view that in response to measures taken to ease food shortages as well as sustained prudent fiscal and monetary policies, the inflationary spike should ease in the coming months. The authorities also call on the Fund to be more understanding by providing fiscal space and greater and timely access to the appropriate Fund facilities to enable them address the challenges of unprecedented high oil and food prices.

The fiscal position improved substantially during the first half of 2007/08, owing to strong revenue performance of up to 2 percent of GDP, higher than the program projections, and better than projected external financing for project and basket loans. However, major recurrent expenditure categories were below projections during the July-December 2007 period, mainly on account of slow procurement and recruitment processes. Significant savings on the budget in terms of interest costs were realized on account of a substantial fall in Treasury yields. Development expenditure benefited from accelerated disbursement of foreign project financing, to close above program projections.

The Bank of Tanzania (BoT) revised its monetary strategy in October 2007 by introducing a better mix of monetary policy instruments and broadening monetary policy transparency. Treasury bills have since been complemented with frequent sales of small amounts of foreign exchange in the market and more use of the repo instruments. As a result, reserve money growth has remained on track, and the Treasury bills yields have fallen sharply from 17.1 percent in June 2007 to 7.4 percent in March 2008. Despite the tighter monetary policy stance, the banking system continued to meet the strong demand of private sector credit in line with the accelerating economic growth.

External developments during the first half of 2007/08 were broadly in line with program targets on account of an 18 percent export growth, reflecting a strong performance in manufacturing and a recovery of traditional exports. Also, inflows of official foreign exchange and foreign direct investment (FDI) have remained strong. As a result, despite a rapid growth in imports that accounted for the widening of the current account deficit, the foreign exchange reserves level improved to 4.5 months of imports. In the same period, the nominal exchange rate of the shilling to the U.S. Dollar appreciated.

Outlook and Policies for 2008/09 and in the Medium-Term

Tanzania's economic performance is expected to remain strong in 2008/09 and the medium term, with real GDP growth projected to reach 7.8 percent in 2008 and 8.0 percent in 2009. Strong performance is expected to continue in the communication, construction, financial intermediation, manufacturing, and agriculture sectors. Accelerating the rate of growth and poverty reduction in the medium to long term will continue to be central in the authorities' program design and implementation. A new household survey to be completed in mid-2008 is expected to show a tangible improvement in poverty indicators. These build on the MKUKUTA (PRSP) Annual Implementation Report (MAIR) of November 2007 that showed strong progress in the achievement of some MDGs performance indicators, particularly in education and health. Notwithstanding such impressive developments, the authorities concur with staff assessment that the country faces three main challenges in the near term: maintaining fiscal stability in the face of uncertain financing; dealing with inflationary pressures; and addressing governance weaknesses and strengthening public accountability.

Among the authorities' main priorities, are consolidating fiscal stability, supported by continued robust revenue performance, while accommodating substantive increases in development expenditure for social and productivity-enhancing investments and strengthening the external position. The authorities are confident that these, coupled with tighter monetary policy of the BoT and the accelerated growth performance would relieve pressure on food prices and allow inflation to subside to the 5 percent target. The strong economic performance and favorable outlook notwithstanding, the authorities are conscious that they will have to consolidate macroeconomic stability to mitigate the immediate risks to their economic outlook, including inflation and revenue shortfalls; address infrastructure bottlenecks; and deepen implementation of structural reforms to sustain the high economic growth necessary to increase per capita income and reduce poverty substantially. In this connection, the authorities are determined to step up implementation of the MKUKUTA and Tanzania Vision 2025, which offers an appropriate framework for further diversification of the sources of production and exports, improvements in public finance management, and better integration in the regional and global economy.

Fiscal Policy

The authorities' objective is to sustain fiscal stability in the medium- to long-term. In this connection, the 2008/09 budget aims at raising revenue performance to 16.2 percent of GDP, on the basis of broadening of the tax base, strengthening of tax and customs administration, controlling tax exemptions, and improving the customs processes. Other near-term revenue reforms and measures include reforming the mining sector's fiscal and regulatory regimes; indexing specific excise duty rates; and adjusting forestry and hunting fees, the fuel levy and road user charges. The authorities are determined to further increase the revenue collection to 20 percent of GDP in the medium term mainly through measures to broaden the tax base and enhance tax collection. On the expenditure side, the authorities are taking a cautious stance due to the uncertainty of foreign financing. To this end, total expenditure is forecast at 26.5 per cent of GDP as compared to the 27.3 percent outturn expected for 2007/08. Consistent with the MKUKUTA strategies, priority continues to be placed on growth promoting expenditure, education and health.

Raising productivity and long-term growth through, inter alia, public infrastructure development remain a central policy objective of the authorities. The planned capital expenditure includes investments in infrastructure and social sectors, with increased allocation for infrastructure financed by the Millennium Challenge Account (MCA) and other financing options including issuing sovereign bonds and public-private partnerships (PPPs). Recurrent expenditure as a percentage of GDP is projected to remain broadly at the 2007/08 level. While the authorities are determined to maintain a zero net domestic financing (NDF) of the budget, the projected shortfall in external financing may require a readjustment of this policy stance thereby raising up to 1.0 percent of GDP from domestic sources. NDF would be adjusted in the course of the fiscal year in response to the level of available foreign financing. The Government would also adjust spending should external budget support fall short of the budget figures. However, the Government recognizes that safeguarding such NDF objective is challenging, as it is subject to risks of revenue shortfalls. The authorities, therefore, intend to execute the budget on the basis of a prioritized expenditure plan, enabling protection of priority spending linked to increasing productivity and the achievement of the MDGs, coupled with the implementation of required internal reallocations. The authorities have made strong progress in implementing the public finance management (PFM) reform, and the Phase II of the PFM will increase ownership of the reforms by the various tiers of Government beyond the Ministry of Finance and Economic Affairs (MOFEA) to line ministries. To this end, strategic allocation of resources in accordance with government priorities and along the MKUKUTA clusters, ensuring aggregate fiscal discipline and accountability, and strengthening of expenditure tracking will enhance ownership of the PFM reform agenda.

Monetary and Financial Sector Policies

The BoT is committed to continue anchoring its prudent monetary policy on maintaining low and stable inflation. To this end, it has reaffirmed its determination to further bolster its open market operations, maintain a flexible exchange rate policy, rely substantially on foreign exchange sales for sterilization of liquidity, and continue to improve liquidity forecasting. In this connection, the BoT's monetary policy for 2008/09 will aim to reduce M3 growth and monitor reserve money growth. The BoT is also committed to enhance transparency of its policy stance and promote orderly financial markets. Coordination between fiscal and monetary policies will be further strengthened to increase absorption of public funds, while adequately preventing pressures on interest and exchange rates, as well as on domestic prices. In this regard, the joint Cash Management Committee (CMC) is strengthening its operations. Private sector credit is projected to continue its robust expansion to support the authorities' growth objectives. The BoT is also reviewing the existing regulatory framework governing capital account transactions with a view to adapting it to the needs of the country's economy. To consolidate progress attained on the predictability of the monetary policy stance, the BoT will continue to inform the market players and the general public, on a regular basis, on recent economic developments, and the objectives and rationale underlying the adopted monetary policy stance.

The authorities are committed to strengthen implementation of the second generation financial sector reforms with a view to deepening and broadening financial intermediation. To this end, they have enacted the Social Security Bill that creates a single regulator for the pension sector and assigned to the BoT the responsibility of establishing investment guidelines. The BoT has in turn made commitment to expeditiously assess the financial health of the pension funds in preparation of the investment guidelines. The BoT will also continue to strengthen banking supervision, particularly by enhancing its capacity for risk-based assessment of bank soundness through stress testing and periodic reporting to its Board. To this end, the BoT plans to expand its staff complement and seek Fund technical assistance and staff training.

Structural Reforms

The authorities are determined to consolidate the gains achieved on reforms, PFM, public accountability and macroeconomic stability. They are equally determined to continue improving the overall investment climate that will further facilitate private sector development, attract and retain FDI, boost domestic entrepreneurship and sustain high economic growth. In addition to vigorously pursuing prudent macroeconomic and financial policies, the authorities are resolved to deepen implementation of the reform program. Moreover, steps will be taken to strengthen the fiscal risk management practices arising from public private partnerships (PPPs), the recommendations of the special audit of the external payments arrears (EPA) account including a verification and settlement of the remaining EPA claims, and the power sector reform agenda that has been enhanced by the new Electricity Act paving the way for competition and private investment in the sector.

The BoT is also undertaking a fundamental review of its functions, with a view to developing and implementing a strategy for refocusing its operations in the near term. In this regard, the authorities intend to clarify the relationship between the MOFEA and the BoT regarding some of the tasks that the BoT conducts on behalf of the MOFEA, including the management of the EPA account, and cost sharing of monetary policy operations. The authorities also plan to review the regulatory framework for preventing money laundering based on an assessment by the regional body, the Eastern and Southern African Anti-Money Laundering Group. They are grateful for the Fund’s timely response to their voluntary request for a safeguard’s assessment and other areas of technical assistance. The Fund’s technical assistance packages have enabled the authorities to make considerable progress on its reform agenda. My authorities feel that going forward they will need a wide range of technical assistance from the Fund to enable them implement more ambitious economic policies to spearhead further growth. To this end, they call on the Fund to ensure that in its implementation of its current policy on technical assistance special attention is taken to safeguard the development objectives of the country.

The authorities together with their East African partners are steadfast in strengthening the regional integration agenda. In this regard, they have initiated negotiations toward the establishment of an East African Common Market as a follow up to the existing East African Customs Union. The interim trade agreement with the European Union in the context of economic partnership agreements will continue to provide full duty free and quota free access for EAC goods exports to the EU markets. Nevertheless, the reciprocal nature of this agreement signifies that in the long-term the revenue implications should be carefully assessed in the context of maintaining the country's fiscal stability and the overall program objectives. The authorities will also continue to work closely with the regional partners to formulate a coordinated approach to participate actively in the multilateral effort for a rapid and successful conclusion of the Doha Development Round.

Conclusion

The authorities' continued commitment to strong policies under the program has yielded strong economic results, with substantial progress on all fronts. They are aware of the need for further reforms to consolidate the progress made in order to meet the challenges posed by the current surge of inflationary pressures. In the near term, the authorities are determined to ensure that the program focuses on sustaining macroeconomic stability, increasing domestic resource mobilization, promoting pro-poor growth, and increasing investment in infrastructure and core social services like education and health. In line with MKUKUTA objectives and Tanzania Vision 2025, the authorities are determined to ensure that the sustained macroeconomic stability and deepened structural reforms for a broad-based growth provides a sound basis for poverty reduction and attainment of the MDGs. They are confident that going forward, continued engagement with the Fund and the support of the development partners through increased financing support and policy advice will enable them achieve their development goals particularly the large investment needs in infrastructure, energy, water and education.

Mr. El-Khouri and Ms. Caracalla submitted the following statement:

Tanzania's strong economic performance over the past several years continued well into 2007, supported by the pursuit of prudent macroeconomic policies, the steady implementation of reforms, and donor assistance. This is well reflected in strong growth, moderate inflation, and a relatively comfortable reserve position. Moreover, the PSI-supported program remains on track, attesting to the authorities' resolve to persevere in the implementation of sound policies and market-oriented reforms. Against this background, we support the completion of the third review under the PSI.

The clear and well-written staff report appropriately centers on the key immediate challenges facing Tanzania, namely addressing inflationary pressures, maintaining fiscal stability in the face of uncertain financing, and improving governance and strengthening public accountability. In particular, the focus on policies needed to put back inflation on a downward trajectory is well founded. We are in agreement with the broad thrust of the staff's recommendations. In what follows, we shall offer some observations for emphasis and clarification.

The authorities should be commended for their prudent monetary policy that helped maintain inflation at moderate levels in the past years. Not surprisingly, as is the case with many other countries, developments in global food and fuel prices have led to inflationary pressures in recent months, pushing inflation to 9 percent in the first quarter of 2008. We note that year-on-year inflation is targeted to fall to 7 percent and 5–5½ percent by June 2008 and mid-2009 respectively. Given recent trends in international food and fuel prices and the fact that the expansion in economic activity and private sector credit is expected to remain robust in 2008, we find these objectives to be somewhat ambitious. Moreover, the government's decision to adjust the minimum wage level upward for civil service employees in 2008/09 might have a similar impact on the private sector pay scale, thus exerting further pressures on prices, especially in an environment of increasing supply bottlenecks. Staff comments are welcome.

We appreciate the authorities' continued sound fiscal policy, reflected in a better-than-projected fiscal outturn for the first half of 2007/08, and highlighted by Messrs. Gakunu and Ndyeshobola in their insightful buff statement. It is encouraging that the 2008/09 budget aims at preserving the fiscal sustainability in the face of large spending needs and uncertain financing, by targeting a further decline in the overall budget deficit (before grants). It is unfortunate, however, that the approved budget framework provides for a lower level of development spending, reflecting uncertainty regarding the availability of foreign financing related to donor's concern with governance issues. Given that the continuity of the public expenditure program remains critical for Tanzania's development, we understand the authorities' temporary and limited recourse to domestic financing. Nevertheless, since the country's domestic debt burden remains relatively high, we encourage them to substitute domestic for foreign financing only sparingly.

We welcome the progress made so far in addressing governance weaknesses and encourage the authorities to persevere with their efforts in this regard, as this would help restore confidence of both development partners and private investors. In this connection, we appreciate the various governance and accountability enhancing measures planned for 2008 and identified in paragraph 37 of the MEFP. Is it the staff's understanding that the full implementation of these measures will be sufficient to address donors' concern and allow for the timely resumption of foreign financing?

With these remarks, we commend the authorities for the economy's strong performance and wish them continued success.

Ms. Xafa and Mr. Crispolti submitted the following statement:

We thank staff for the concise paper, and Mr. Gakunu and Mr. Ndyeshobola for their insightful buff statement. Tanzania's economic performance under the PSI-supported program has been strong. Real GDP growth recorded one of the highest rates among regional peers, MDGs performance indicators improved, revenues outperformed, while a pick-up in inflation reflected temporary factors - notably higher fuel and food prices. Against this background, all end-December 2007 assessment criteria and benchmarks were met. Going forward, the authorities are committed to addressing Tanzania's developmental challenges by implementing sound macroeconomic policies and deepening structural reforms. In view of this progress, we support the conclusion of the third review under the PSI. We share the thrust of the staff's appraisal and limit our comments to three key areas.

Fiscal Policy

We commend the authorities for the progress made in strengthening Tanzania's fiscal position in recent years. The remarkable increase in revenues recorded since FY2002/03 is indeed a testament of their commitment to maintain fiscal stability while mobilizing additional resources to meet the country's pressing development needs. However, these efforts are hampered by continued uncertainty on the availability of foreign financing, reflecting donors' concerns with governance issues. We thus welcome the authorities' determined efforts to tackle these issues, and understand the need for limited recourse to net domestic financing if necessary to avoid disrupting the public expenditure program. Longer-term, there is a need to reduce heavy reliance on donor financing by tapping domestic revenue sources. We thus fully support the authorities' ambitious medium-term strategy to increase the revenue-to-GDP ratio to 20 percent by broadening the tax base and strengthening tax collection. On the expenditure side, an effective use of Fund's TA would be instrumental to prioritize spending while improving its effectiveness.

Monetary Policy

We support the monetary authorities' prudent policy aimed at returning inflation to a downward path, relying on better liquidity forecasts and on foreign exchange sales to sterilize liquidity. Like Mr. El-Khouri and Ms. Caracalla, we find the targeted reduction in inflation to 7 percent by mid-2008 and 5.3 percent by mid-2009 somewhat optimistic, given soaring commodity prices and robust credit growth. Strengthening the central bank's communication framework to explain the extraordinary nature of the inflation spike would be helpful in providing a firm anchor to inflation expectations. In this regard, we welcome the introduction by the BoT of regular meetings with commercial banks to solicit feedback on monetary policy performance, as well as quarterly press conferences to inform the public on economic developments (MEFP ¶14).

With respect to the serious governance shortfall at the Bank of Tanzania, we take note of the external audit's findings and urge the authorities to steadfastly implement the action plan based on its recommendations. This is crucial not only for the credibility of the authorities' commitment to effectively address governance weaknesses, but also for ensuring the availability of badly-needed financial support from development partners. A rapid conclusion of the proceedings against all parties responsible of misconduct would represent an important signal of the authorities' determination to tackle this issue. In this regard, the authorities' request for an updated safeguard assessment to strengthen the central bank's internal controls and governance, as well as the AML/CFT framework, is most welcome.

Structural Reforms

We welcome the authorities' progress in implementing the structural reform agenda, particularly in the financial sector and public financial management. However, we agree with staff that more remains to be done to foster private sector development, sustain rapid economic growth, and reduce poverty. In particular, improving the country's physical infrastructure is essential in order to boost FDI and domestic entrepreneurship. Yet careful consideration must be given to the financing of infrastructure so as to maintain high standards of transparency and safeguard debt sustainability. We wonder how the authorities' plans to issue sovereign bonds in international capital markets square with their commitment to avoid contracting external debt on non-concessional terms. In order to remove long-standing bottlenecks to economic development, an effective resolution of problems in the power sector is also necessary. In this regard, we would welcome staff's assessment of the new Electricity Act (MEFP ¶38).

With these remarks, we wish the authorities success in their reform efforts.

Mr. Mojarrad and Mr. Kwakye submitted the following statement:

We thank the staff for the well-written report and Mr. Gakunu and Mr. Ndyeshobola for their comprehensive statement. The authorities' prudent macroeconomic management and strong reforms have supported Tanzania's remarkable economic performance in the last several years. Strong and steady growth, together with low inflation, has been achieved. The external debt burden has substantially eased, thanks to HIPC and MDRI relief, and a measurable level of reserves has been accumulated, thereby reducing external vulnerabilities. Performance under the PSI program remains satisfactory with all assessment criteria and benchmarks met for this review, while the reform program continues to be broadly on track. The authorities' commitment to their high-quality program going forward remains strong. We are, therefore, pleased to support completion of the third PSI review. As generally recognized, Tanzania still faces major challenges ahead, particularly the need to raise productivity to achieve higher growth, maintain a sustainable fiscal program, keep inflation under control, and address lingering governance issues. The discussions appropriately focused on these challenges, and on the authorities elaborate measures for addressing them in their LOI.

The challenge facing fiscal policy is providing a macroeconomic anchor in the face of new spending pressures and uncertain foreign financing. To this end, total expenditure (as a percentage of GDP) is being reduced in 2008/09, with development expenditure bearing the brunt, while recurrent expenditure level is maintained to accommodate an increase in wage spending. Anticipating lower foreign financing, the budget provides for domestic financing as a temporary departure from the policy of zero domestic financing that is designed to help reduce domestic debt and prevent the crowding out of the private sector. However, given uncertainties in foreign financing, would it not be beneficial to actively develop the domestic capital market to provide alternative sources of less-volatile financing? Staff may wish to comment.

PFM needs to be strengthened to reinforce control and improve efficiency of spending. The LOI details measures to this end under Phase III of the Public Financial Management Reform Program (PFMRP). We support Fund and AFRITAC technical assistance for this task. The revenue/GDP ratio increases by a remarkable 5 percentage points during 2002/03-2008/9, although at 16.2 percent in 2008/09 Tanzania's revenue effort still lags that of its peers. If the high external dependency and associated vulnerability are to be reduced, domestic revenue mobilization will have to be reinforced. Mr. Gakunu and Mr. Ndyeshobola highlight measures planned by the authorities to strengthen tax and customs administration and broaden the tax base that need to be vigorously followed through if the target of 20 percent of GDP for revenue collection is to be attained.

Inflation has been successfully contained in the last few years, and the recent rise is largely the result of surging oil and food prices. As planned, it may be necessary to accommodate some of the increase, should the pressure from the supply-shocks persist. It will also be prudent for monetary policy to respond to contain second-round effects. In the process, in order not to stifle credit to the private sector, close collaboration with the fiscal authorities will be essential. Mr. Gakunu and Mr. Ndyeshobola assure us of such collaboration under the oversight of the Cash Management Committee. The Bank of Tanzania (BoT) should continue to broaden and improve its mix of instruments to enhance the effectiveness of monetary policy. The intent to strengthen monetary policy communication will boost policy predictability and credibility. The flexible exchange rate regime supports monetary management and increases the flexibility to respond to shocks. The authorities' commitment to maintain the regime is, therefore, well-advised. Further strengthening of the financial sector, as contemplated, is necessary to deepen intermediation and broaden access to financial services. Reforms to the pension fund system should reinforce its viability and reduce fiscal risks. The BoT is appropriately building its oversight capacity, with Fund and AFRITAC technical assistance, including in the important area of risk-based assessment.

While Tanzania has achieved an enviable growth record, the authorities recognize that making faster progress toward the MDGs would require higher growth and, to this end, they are committed to reinforcing second-generation reforms to increase productivity and remove obstacles to private sector activity. Public infrastructure development is high on their agenda, to be funded by a possible issue of sovereign bonds and use of PPPs. Safeguarding long-term debt sustainability calls for selecting high-return projects while PPPs should meet high standards of transparency and accountability. In this regard, capacity building for assessment and management of fiscal risks is well-considered. Reliable electricity supply is inevitable for growth. It is vital, therefore, to strengthen TANESCO by reinforcing its management and operational efficiency in tandem with movement to a cost-recovery tariff regime. Financial sector strengthening, noted above, should also support growth. Initiatives on regional integration and renewal of trade links with the EU, as highlighted by Mr. Gakunu and Mr. Ndyeshobola, will be beneficial to the Tanzanian economy in terms of fostering trade and growth.

Welcome steps are being taken to improve governance and increase public accountability so as to restore donor and investor confidence. In this connection, we commend the authorities for their decisive actions so far to address the governance weaknesses at the BoT (as detailed in Box 1). Their request for the Fund's safeguards assessment will help to strengthen the BoT's internal controls and governance. Also noteworthy are initiatives in public procurement, corruption prevention, and public audits, all of which signify the authorities' commitment to improvement of economic governance in Tanzania.

Mr. Rutayisire submitted the following statement:

We would like to thank staff for a well-written paper and Mr. Gakunu and Mr. Ndyeshobola for their helpful buff statement.

Sound macroeconomic policies and market-oriented reforms implemented by the Tanzanian authorities have helped the economy to perform well over the recent years. Economic growth exceeded 7 percent in 2007 and inflation remained moderate despite the recent soaring in oil and food prices which has pushed inflation to 9 percent in the first quarter of 2008. The government's restraint on the use of domestic financing helped to ease inflationary pressures and provided room for expansion of credit to private sector. Rapid export growth, in addition to the substantial debt relief under HIPC and MDRI has helped to build up of a comfortable level of international reserves.

The medium-term prospects for the Tanzanian economy remain strong. In order to sustain the progress made so far, the authorities will need to focus their policies in the short-term on maintaining fiscal stability, easing inflationary pressures and addressing governance weaknesses. We are reassured by their strong commitment to preserve sound policy implementation and good performance under the PSI program aiming at further enhancing confidence and raising Tanzania's growth potential.

The authorities' fiscal policy remained focused on macroeconomic stability. In the face of uncertainty related to the availability of foreign financing, there is a need to further expand the revenue base and achieve greater efficiency in spending. In this respect, we welcome the ongoing efforts to strengthen tax administration, help raise the revenue/GDP ratio and promote transparency and accountability in the management of public resources. The strengthening of the Joint Cash Management Committee to improve coordination in fiscal and monetary policy implementation is also welcome. The plan of action designed to transfer government deposits in banks to the central bank is a move in the right direction. The reviews of policies in the mining sector as well the finalization of the Tanzanian Revenue Authority new 5-year business plan are key steps toward raising revenues. In order to enhance efficiency on the public expenditure side, we encourage the authorities to speed up the implementation of the Public Financial Management Reform Program. We also support the Fund technical assistance through East AFRITAC with a view to improve capacity building in the areas of cash-flow projections and budget monitoring and reporting.

In the monetary area, the pursuit of prudent policy aims to gradually achieve the objective of low and stable inflation set out for the medium-term. The recent rise in inflation is mainly due to the pass-through of global oil and food prices. With regard to the exchange rate we note that the flexible exchange policy has served the economy well. We commend the authorities for their efforts to broaden the transparency of monetary policy, strengthen the management of liquidity and communications with the financial sector and general public. These efforts have started to pay off including by encouraging more competition. Growth of monetary aggregates has been kept on track and demand for credit from the private sector has also been in line with economic growth. The authorities have made progress in addressing the governance issues with a view to restore and enhance the transparency and credibility of the Bank of Tanzania. We see merit in the authorities' request to update safeguards assessment of the central bank, enhance internal controls and review the regulatory framework governing the capital transactions and for AML/CFT. This improvement will help the central bank to adapt to the evolving needs of the economy and regional integration. In the same vein, there is a need to strengthen banking supervision owing to the rapid expansion of credit. We support the Fund's technical assistance to reinforce the capacity of the central bank in the area of risk-based supervision and issuing quarterly reports on financial stability.

Sustaining continued high growth rates depends crucially on deepening structural reforms, investing further in infrastructure sector and resolving the energy problem. These efforts will help enhance the business climate and improve governance. As infrastructure development remains a priority in the 2008/09 budget, we support the authorities' intention to widen options for infrastructure financing including the issuance of sovereign bonds denominated in foreign currencies and the establishment of public-private partnerships. In this context, infrastructure projects should ensure that debt sustainability is preserved, and PPPs should necessarily meet high standards of transparency and accountability. With regard to the energy problem, we share the view that improving efficiency and finances of the electricity company together with implementing a strategic plan aiming at attracting private investment will help to establish a reliable electricity provision which is key element to economic growth.

In addition, further promoting the diversification and deepening of the financial sector as well as significant improvement in the business environment are key factors in order to further attract not only foreign direct investment but also spur domestic entrepreneurship development.

As regards regional integration, we welcome the negotiations within the East African Community to establish a common market. The interim trade agreement recently signed with the European Union which will not imply loss of fiscal revenue in the short run will enable EAC members to consolidate their trade and increase their insertion in the global market.

In the statistics area, we commend the authorities for their continued efforts to improve the statistic base and encourage them to take all necessary measures needed to the subscription to the IMF Special Data Dissemination Standard (SDDS).

We wish the Tanzanian authorities further success in their future endeavors.

Mr. Silva-Ruete and Mr. Vogel submitted the following statement:

Tanzania's economic performance over recent years is encouraging, which includes robust GDP growth and a sound implementation of the PSI program. We are pleased to read that all assessment criteria for this review were met and the structural reform program remains broadly on track. However, the country will face significant challenges over the short and medium term, associated with the need to reinforce macroeconomic stability, mitigate and decrease poverty conditions, and address governance issues, all of which are strongly related.

We welcome the substantial increase in revenues, although they seem to be still low relative to regional and international standards. In this regard, additional efforts, including the ongoing reform of tax administration, are key to minimizing the uncertainty related to foreign financing and donors. We are encouraged by the authorities' commitment to increase investment in infrastructure and core social services, as noted in Mr. Gakunu and Mr. Ndyeshobola's helpful statement. We also agree with the staff on the need to achieve greater efficiency and effectiveness of government spending.

Empirical evidence clearly shows that a country enjoying good governance has stronger possibilities to achieve a higher and sustainable growth. In Tanzania's case, even though some governance indicators (such as the one published by Transparency International) have improved over the past years, it is clear that they are still low and that much more remains to be done in this area. In this regard, we are encouraged by the authorities' awareness of the importance of this factor and their efforts to address it, including their request to the Fund to undertake a voluntary safeguards assessment of the Bank of Tanzania to assist in strengthening its governance.

With these remarks, we support the proposed decision, and wish the authorities every success in their future endeavors.

Mr. Murray and Mr. Ha submitted the following statement:

We thank staff for the report and Messrs. Gakunu and Ndyeshobola for their comprehensive buff statement.

We commend the Tanzanian authorities for their continued strong progress under the PSI program, which has underpinned an extended period of robust economic performance. We support the completion of the third review and agree that no further action be taken by the authorities with respect to the misreporting of data in light of their corrective actions.

The authorities face significant challenges with respect to budget planning and execution, owing in large part to a small, but growing, revenue base and significant recurrent and development spending needs. Furthermore, with recurrent expenditures representing over 100 percent of tax revenues, the authorities' development plans are dependant on external aid flows. The staff report notes the uncertainty with regard to donor financing for the 2008/09 budget, and we agree that the authorities' short-term actions are appropriate, focusing on rationalizing expenditures and recourse to limited domestic financing. The authorities are rightly addressing longer-term fiscal challenges through broadening the tax base and strengthening tax and customs administration.

We welcome continued enhancements to the monetary policy framework, including using a better mix of instruments for liquidity management, and improved transparency and communication with market participants. Nevertheless, the monetary authorities must remain vigilant, given the significant inflation pressures from rising food and energy prices and strong private sector credit growth.

We commend the authorities for actions to improve governance and address corruption. In this regard, the upcoming safeguards assessment for the Bank of Tanzania is welcome. We also stress the importance for continuing to enhance the legal and regulatory framework in preparation for the potential scaling up of public-private-partnerships in the area of infrastructure development.

With these brief remarks, we wish the authorities success.

Mr. Yamaoka and Mr. Harada submitted the following statement:

We thank the staff for their concise paper, and Mr. Gakunu and Mr. Ndyeshobola for his informative statement.

We regret the consecutive misconduct of the Bank of Tanzania (BoT), including the misreporting informed to us on May 27, just three days before the board meeting. Recognizing that the authorities took remedial action, we urge the authorities to thoroughly review the BOT's overall organizational procedures and implement measures to prevent a recurrence of such misconduct. Additionally, given that one month has passed since the staff received the letter from the Tanzanian authorities on April 22, it would have been more desirable if the board members had shared such important information a bit earlier. Having said this, we welcome Tanzania's strong economic performance and support the completion of the third review of the PSI, reiterating the importance of strengthening governance, including that of the BoT.

Inflationary Pressure[1]

Apparently, at this juncture, the major challenge for Tanzania's macroeconomic policies is inflationary pressure, since the current inflation is as high as around 10 percent. Recently, headline inflation has been accelerating and core inflation has also been gradually increasing, not only in Tanzania but also in many countries.

Textbooks on macroeconomics state that monetary policy shall accommodate one-time shocks while containing second-round effects. However, identifying "one-time shocks" and "second-round effects" is not always an easy job, and it is not certain whether the current rise in commodity prices is really a "one time shock" or not. If the current rise in commodity prices is driven by persistent demand growth lead by emerging economies whose energy efficiency is relatively low, the situation should not be called a "one time shock," in an exact sense, since it reflects continuous changes in relative prices, and the accommodative monetary policy to such changes may lead to a rise in overall inflation. In Tanzania's case, a lack of vigilance against the current level of inflation might deteriorate confidence in the medium-term inflation objective of 5 percent.

In the current global inflation environment, the Fund should be extremely cautious in its external communications so as not to give the impression that the Fund lacks due vigilance against inflationary pressures. Otherwise, we might lose the benefits of price stability obtained during the "disinflationary period" since the 1990s, and we

[1] With regard to necessary macroeconomic policy conduct against inflationary pressures, we maintain the opinions expressed in our Gray statement on Tanzania on December 21, 2007, as follows:

"In considering the strong demand growth and Tanzania's above-target inflation rate, both monetary and fiscal policies should be sufficiently vigilant against upside risks concerning prices, especially when inflationary pressures have intensified due to high inflation expectations. In order to reduce inflation expectations, it is critical for the authorities to conduct their macroeconomic policies in line with the inflation target, without overly relying on future exogenous downward pressures."

"inflation targeting schemes may work effectively only in the following circumstances and when: 1) the credibility, accountability and transparency of monetary policy are maintained, and 2) the actual policy conduct is in line with the target."

may be criticized for having overlooked inflationary risks at an early stage. In this regard, it might be risky to overly stress the idea that "monetary policy will need to accommodate one-time shocks" at this juncture. Although such a statement is a textbook dogma, it may not necessarily be wise as a communication strategy especially when commodity price rises bring about upward pressures on general prices.

Criteria on Reserve Money

Inflation has increased in spite of the fact that the Tanzanian authorities met the quantitative assessment criteria on reserve money. This fact evidences that reserve money targeting is not always effective in containing inflation. In fact, the BoT has recently revised its inflation target, from 4.5 percent to 6 percent, and then to 7 percent, and thus the BoT's policy stance toward price stability shall be examined within the context of the inflation target and the actual inflation. Although the appropriateness of such frequent changes in the inflation target could be an issue, the setting of short-term inflation targets inevitably questions the "raison d'être" of reserve money targets. In addition, in the second review of this PSI program, the Tanzanian authorities requested a waiver of the criteria on reserve money. These facts question the necessity of the criteria on reserve money.

Moreover, paragraph 17 of the Operational Guidance on the 2002 Conditionality Guidelines, states that "outcomes-based conditionality should be designed to minimize the risk of situations in which targeted outcomes are achieved by means of policies that would undermine the achievement of program goals" and, basically, this idea should also be applicable to the PSI. In this regard, although reserve money is totally under the control of the authorities, a discretionary decrease in net foreign assets or net domestic assets can jeopardize macroeconomic policies. In viewing the frequent request for waivers on reserve money by program countries, we believe that the criteria on reserve money should maintain sufficient flexibility, especially when various capital flows affect the demand for reserve money.

With these remarks, we wish the authorities every success in their future endeavors.

Mr. Kishore and Mr. Krishnan submitted the following statement:

We thank staff for their concise paper on Tanzania and Mr. Gakunu and Mr. Ndyeshobola for an informative and helpful buff statement. We congratulate the Tanzanian authorities on the continued strong performance of the economy. We are in broad agreement with the staff's assessment and confine ourselves to the following observations:

- On the fiscal front, we commend the authorities on their efforts which have resulted in the 5 per cent increase in the tax: GDP ratio since 2002-03 and on their commitment to reach 20 per cent of the GDP.

- We would also urge the authorities to display expenditure restraint in the face of the uncertainties surrounding aid flows. It would be more prudent to enhance credibility with donors through appropriate measures on the governance front. In this context, like Mr. El-Khouri and Ms Caracalla, while appreciating the measures outlined in paragraph 37 of the MEFP, we seek Staff's views on whether they consider these measures adequate to enhance credibility in the eyes of donors.

- Fiscal restraint coupled with a stead fast monetary policy are important in the context of the upward pressures on inflation, which it is now clear will be above the targeted path.

- The text box explaining the program conditionalities is user friendly and a good model to follow.

- We note from Mr. Gakunu's and Mr. Ndyeshobola's the expectation that Tanzania will continue to have access to technical assistance (TA) from the Fund to sustain its reform efforts. We expect that this request would be appropriately addressed within the new framework for technical assistance recently discussed by the Board.

With these comments we wish the authorities well in their future endeavors.

Mr. Ge and Ms. Yang Fang submitted the following statement:

We thank staff for the well-balanced reports and Mr. Gakunu and Mr. Ndyeshobola for their buff statement. As we agree with the thrust of staff's appraisal, the following comments are for emphasis.

Tanzania has sustained uninterrupted growth over the past decade. Growing at 7 percent, economic performance was broad based and robust in 2007 and medium-term prospects are strong.

Implementation of the PSI program has been satisfactory and is on track in large part due to the authorities' strong ownership and commitment. We support staff's proposal to complete the third review under the current PSI program.

Tanzania's fiscal position has improved substantially with higher-than-projected revenue and better-than-expected foreign financing. The authorities have made significant progress in public finance management, with expenditures clearly prioritized and pro-growth.

While we commend the Tanzanian authorities' success in containing inflation, we are concerned about the second round and medium-term impact of surging oil and food prices. Given the current heightened concerns, we would appreciate an updated inflation estimate.

The authorities continue their efforts on the structural reform front. The infrastructure investment plan and initiatives are underway to improve the business environment and promote long-term growth.

Challenges to economic development and poverty reduction remain. Tanzania's future development and growth will call for the government's continued efforts together with sustained donor support.

We wish the authorities every success in their future endeavors.

Mr. Bergo, Mr. Claveranne, Mr. Bakker, and Mr. Gibbs submitted the following joint statement:

We would like to thank staff for a concise and balanced report, and Mr. Gakunu and Mr. Ndyeshobola for their informative statement.

We commend the authorities for the successful economic performance over the past years against the backdrop of sound macroeconomic policies.

In light of the overall positive developments, adherence to the assessment criteria under the PSI-supported program, and the authorities' efforts to address remaining growth impediments, we support the completion of the third review. We take note of the recent information about incorrect reporting of data by the Tanzanian authorities, and we can go along with the proposed decision in view of the authorities' remedial actions.

Furthermore, we agree that the outlook still seems favorable, at the same time as staff notes the many challenges that lie ahead. We broadly agree with the thrust of the staff appraisal, and we will, therefore, focus our comments on a few points for emphasis.

Governance Issues

We appreciate staff's focus on the governance shortfall in the central bank, and the detailed information on the special audit of the EPA account provided in Box 1. We also welcome the measures initiated by the authorities. We support the new Governor's efforts to refocus the Bank of Tanzania's work on its core business. We also deem staff's safeguard assessment as a contribution to these efforts as well as to the strengthening of internal controls. Staff rightfully argues that further implementation of the special audit's recommendations is crucial in restoring the credibility of the central bank and the confidence among investors and donors. Therefore, we urge for the audit report for fiscal year 2006 and 2007 to be released. Many donors have linked their disbursement of foreign financing on further reform steps addressing the governance issues.

Fiscal Policy

In view of high public investment needs and poverty reduction, the uncertain budget financing, thus, calls for strengthening public accountability as well as expanding the revenue base and enhancing the tax administration. In spite of the strong growth of tax revenues, the revenue-to-GDP ratio is still relatively low and we, therefore, encourage the authorities to continue with improving the efficiency of revenue administration. We would welcome an update on the ongoing business planning work in the Revenue Authority, and staff's comments on whether this could provide a good basis for a medium-term domestic revenue strategy? While recognizing the need for financing investment in infrastructure and core social services, we note that the authorities consider suspending the zero domestic financing norm in view of a shortfall in external financing. What will be the impact of this measure on demand, inflation developments and the banking sector?

In sum, we think that improving revenue collection and prioritizing expenditures, while strengthening governance, are crucial at this point in time to cushion the impact of financing uncertainty. Moreover, a sound and transparent fiscal policy should help attract continued donor support and improve aid predictability. Could staff comment on the likelihood of higher than projected grant volumes in 2008-09 and beyond?

Monetary Policy and Food Prices

Since the recent rise in inflation is stemming from higher food and energy prices, we agree with Mr. Gakunu and Mr. Ndyeshobola that the inflationary spike will most certainly dwindle. Nevertheless, we see room for a tight monetary policy stance to avoid a build-up of inflation expectations in an environment of high credit growth, and to prevent second-round-effects. In the context of higher food and energy prices, we are interested to know what measures the authorities have taken to protect the poorer groups of the population. We note that the government has temporarily reduced import tariffs on maize to ease food shortages. What is the impact of this measure on projected budget revenues?

We welcome the measures taken by the central bank for strengthening the monetary policy framework as explained in Mr. Gakunu's and Mr. Ndyeshobola's statement. We also appreciate forthcoming action in the area of money laundering.

Structural Reforms

On the structural side, and in view of rapidly expanding credit activity, we believe that it is important to strengthen the legal framework for banking supervision and enhance the enforcement. In addition, we welcome the new Social Security Bill, which unifies the regulations of pension funds. It is important to underscore the independence of the new regulator. We are supportive of Fund assistance in this area.

Finally, we welcome the authorities' efforts to implement reforms in the energy sector, which includes the recent tariff increases and the adoption of new Electricity Act, and we encourage the authorities to implement key cost-reducing measures consistent with the Financial Recovery Plan. These measures could reduce the sizable losses and attract the much needed private investment in the sector.

Mr. Charleton submitted the following statement:

We thank the staff for a clear and concise report and Mr. Gakunu for his comprehensive statement. We also take the opportunity to thank the authorities for hosting the Executive Directors' Group travel earlier this year, which was very helpful to us in understanding the challenges facing Tanzania and better appreciating the efforts of the authorities in grappling with them. The report of that trip (EBAM/08/36) also provides some useful advice for the authorities. As one would expect for a PSI country, Tanzania is making steady progress and the parameters of their program are being fully adhered to. The proposed benchmarks going forward are balanced and appropriate and we can readily approve the proposed decision.

For several years Tanzania has been one of the most successful, non-oil producing, SSA countries with growth around 7 percent per annum and a broad continuation of this pattern is envisaged. Growth of this magnitude should permit steady, if not spectacular progress on poverty alleviation. Going forward, however, the global environment is likely to be less benign and coping with the impact of record high fuel prices and escalating food costs may prove quite challenging.

To maintain growth momentum, Tanzania depends heavily on aid flows and the dependence has been increasing. Notwithstanding a very commendable increase in the revenue ratio and good prospects that this can be further enhanced, about 50 percent of the budget is donor financed. Both current and capital expenditures are rising steadily on the basis of donor funds. This, in itself, is a vulnerability. Moreover, given the scale and diversity of aid it is not easy for the authorities to maintain effective control of all flows and we encourage them to strengthen central oversight of such funds. For the first time in 2008 there is a clear budget shortfall because of reduced aid flows. One hopes/presumes that this is a temporary phenomenon but, the misappropriation of EPA funds at the Central Bank last year was a serious setback which damaged the authorities' credibility. After a somewhat shaky start, the authorities have dealt with the issue comprehensively and definitively and put in place the systems and procedures to preclude any re-occurrence. We find these actions fully re-assuring but, once damaged, credibility can be slow to be regained. Is there a danger that aid flows could fall below expectations again next year? Moreover, with escalating food and fuel costs, is there a likelihood that a significant financing gap could emerge?

The report highlights the chronic need to upgrade infrastructure if the growth rate is to be maintained. These are endemic problems with respect to rail, roads, bridges, and ports, etc. and the authorities need to articulate a strategic capital investment plan, including its financing. Specifically, TANESCO and the dependability of the electricity supply has been a long-running chronic problem. Yet one does not sense that we are much closer to viability for this key sector. Notwithstanding the 22 percent price increase, it is still far from cost recovery. Cost cutting measures seem unlikely to resolve the problem and further price increases seem inevitable given global fuel price developments. It will be very difficult to attract private sector investment otherwise.

As in virtually all countries, the recent sharp upturn in inflation is attributed to rising food and fuel prices and is envisaged that inflation will fall back to around 5 percent in 2009. But the staff equally acknowledges that higher inflation may be somewhat more persistent. All counties need to be conscious that without an active policy response, inflation will not simply go away and in a country like Tanzania, with a large percentage of the population in poverty, inflation is a serious threat. At least the fact that the exchange rate is somewhat undervalued provides some scope to tighten monetary policy.

Also, in the context of longer-term growth and raising growth potential, we note the role being played by PPP's. These, however, are increasingly being seen as a source of fiscal risk with the possibility of significant contingent liabilities. In principle, however, PPP's are supposed to transfer risk to the private sector partner and we welcome the authorities' acknowledgement of the need to strengthen their capacity to manage PPP's.

We are struck by the fact that Tanzania is essentially a rural, agricultural society and yet there appears to be little emphasis on the role of raising agricultural productivity to promote growth. Perhaps there is more focus on this than is apparent but the current global food crisis suggests that this issue deserves a higher profile.

Finally, we take note of the breach of obligations under Article VIII, Section 5 in respect of data on government debt and international reserves. These data are of fundamental importance for surveillance but we acknowledge the nature of the breach and concur that no further action is required.

With these remarks, we wish the authorities every success in their endeavors.

Mrs. Sucharitakul and Mr. Waqabaca submitted the following statement:

We thank staff for the paper and Mr. Gakunu and Mr. Ndyeshobola for their helpful statement. Tanzania's growth has been strong averaging 7 percent during the 2001-7 period underpinned by rapid export growth and increased financial deepening. Extensive debt relief and buildup of international reserves have significantly helped reduce vulnerabilities. Whilst the medium term prospect remains favorable the main challenges going forward include maintaining macroeconomic stability, addressing governance issues and strengthening public accountability. The authorities' performance under the PSI program is commendable having met all the assessment criteria for the third review and the structural reform program broadly on track. Hence, we support completion of the third PSI review. We broadly agree with staff assessment and limit our comments to the following for emphasis.

The authorities have rightly mapped out the strategy of consolidating fiscal stability, enhancing investments and strengthening the external position. The strategy, along with tightening monetary policy will address the challenges, accelerate growth, relieve the pressure of increasing food and fuel prices and lower inflation to the

5 percent target. The implementation of the MUKUKUTA (PRSP) and Tanzania Vision 2025 will lay the strong foundation for growth.

Tanzania's performance ranks among the highest for non-oil exporting countries in sub-Saharan Africa. We support the authorities' budget focus of maintaining fiscal stability through further strengthening of tax administration, consolidation of past revenue gains and cautious expenditure stance, influenced by uncertainty in donor financing. Such an approach should fulfill the achievement of a revenue/GDP ratio of 16.2 percent initially and increased further to 20 percent as intended and, consistent with the MUKUKUTA strategies. We look forward to the outcome of the review of mining sector policies and Tanzania Revenue Authority's 5-year business plan, which should yield significant revenue raising measures in the medium term. At the same time, we welcome the agreement between the authorities and development partners on a strengthened Public Financial Management Reform Program and the assistance of the East AFRITAC through TA to strengthen budget monitoring and reporting, and introduction of a GFS functional classification of expenditure.

We commend the authorities' commitment to anchoring prudent monetary policy by maintaining low and stable inflation. In this regard, we support the tightening stance adopted to reduce M3 growth and monitor reserve money growth to bring inflation down to its medium-term objective of 5 percent. Given the continued increase in commodity prices, the April inflation rate at 9.7 percent and the rapid private sector credit growth, and noting the aim to bring inflation down to 7 percent by mid-2008 and 5.3 percent by mid 2009, what additional tools do the authorities have at their disposal other than a monetary tightening? Would some temporary import liberalization help? Staff comments would be welcome. Likewise, given the uncertainty in accessing foreign financing, development of domestic capital market will help improve the intermediation process and source of financing. . As such, we welcome the indication in Mr. Gakunu and Mr. Ndyeshobola's assurance of closer coordination between monetary and fiscal policies to increase absorption of public funds and prevent pressures on the interest and exchange rates, and domestic prices.

Establishing good governance at the BOT is crucial to maintain its credibility and public accountability. We therefore, urge the authorities to intensify efforts to prevent a repeat of such shortfall and strengthen corporate governance of BOT. In this regard, we support the Fund assistance to prepare the updated safeguards assessment to assist in strengthening the BOT's internal controls and governance.

While persistent application of monetary policy will enhance its effectiveness, we observe that the increased reliance on foreign exchange sales for sterilization purposes has affected T-bills yield to decline (17.1 percent in June 2007 to 7.4 percent in March 2008) and contributed to a steepening of the yield curve warranting that in the wake of tighter global liquidity, this may bring reversal process of portfolio capital flows in future. While we are assured that there is minimum chances of real appreciation of the shilling at present, we welcome the intention of the BOT to review the existing regulatory framework governing capital transactions to ensure its appropriateness in the changing environment of the regional integration. This is important in the wake of negotiations being under way within the East African Community (EAC) toward establishment of a common market and the signing of an interim trade agreement with the EU by five members of the EAC.

Strengthening of TANESCO is critical not only to ensure reliable supply of electricity but to support the revenue generating efforts for facilitating growth. We welcome the authorities' intention to table a new Public Audit Bill to parliament in June which will help safeguard public accountability and strengthen the legal framework.

We concur with staff and authorities that enhancement of infrastructure development and the strengthening public services in health and education are crucial in the long term to reducing poverty and reaching the Millennium Development Goals (MDGs).

We wish the authorities well in their policy endeavors.

Mr. Alazzaz submitted the following statement:

I thank the staff for the comprehensive paper and Mr. Gakunu and Mr. Ndyeshobola for their helpful statement. The Tanzanian authorities continue to make good progress in their adjustment and reform efforts under the PSI-supported program. As the staff reports, all end-December 2007 quantitative assessment criteria were met and the structural reform program remains broadly on track. I also note that end-March 2008 indicative targets for net domestic financing, average reserve money, and net international reserves were all met by comfortable margins. This sustained pursuit of prudent policies is reflected in robust growth, reasonable price stability, and a buildup in international reserves. In light of these positive developments, I support the completion of the third review.

On the fiscal front, I welcome the continued strong domestic revenue performance in FY 2007/08 with tax revenue projected to be better than programmed. Looking ahead, it is encouraging that, in the face of uncertain donor financing, the 2008/09 budget provides flexibility to substitute domestic for foreign financing to ensure the continuity of critical public expenditure programs. On the revenue side, the ongoing efforts to strengthen tax and customs administration should help consolidate the progress made in increasing the revenue to GDP ratio in recent years. On the expenditure front, I am reassured by the authorities' plan to give priority to growth promoting expenditures, including investment in economic infrastructure, education and health in line with the poverty reduction strategy (MKUKUTA). In addition, the adoption of a strengthened Public Financial Management Reform Program is encouraging.

Turning to monetary policy, the increased inflationary pressures, which primarily reflects developments in commodity prices, underscore the challenge ahead. In addition, the staff notes that there are risks that these pressures could spread in an environment of rapid credit expansion and increasingly binding growth bottlenecks. In this regard, the focus in the program for 2008/09 on a gradual tightening of the monetary stance while providing sufficient room for continued private sector credit expansion seems appropriate. On financial sector policies, I am reassured that the authorities plan to continue implementation of reforms aimed at deepening financial intermediation and broadening access to financial services. It is also encouraging that the Bank of Tanzania will continue to build its capacity for banking supervision in 2008/09.

On other structural reforms, it is essential to further advance reforms in order to enhance productivity and long-term growth potential. In this context, the passage of the new Electricity Act is a welcome development that should promote competition and attract greater private investment. I am also encouraged that the authorities are working on the development of a framework for the deployment of Public-Private Partnerships (PPPs) as part of plans to improve public infrastructure. In this regard, it will be important to carefully assess the potential risks to the budget arising from PPP projects.

Finally, on the reporting of inaccurate data on government domestic debt and official international reserves between December 2005 and January 2008, I can go along with the Managing Director's recommendation and support the proposed decision.

With these remarks, I wish the authorities further success.

Mr. Kiekens and Mr. Rottier submitted the following statement:

Tanzania's economic performance has been strong since the last PSI review. We support the completion of the third review. Since we broadly agree with the staff appraisal, we will only make a few specific comments for emphasis.

We support the objectives for the PSI program in 2008/2009. The staff rightly stresses the importance of increasing productivity and maintaining fiscal stability.

Inflation in Tanzania has been relatively high for the past several years. And, given the recent surge in global food and oil prices, the staff notes that it is unlikely that the program target of 7 percent for June 2008 can be achieved. We understand that the staff has advised that monetary policy should accommodate these higher prices and that the authorities should focus on containing the second-round effects. How does this affect the path and timing of the medium-term objective of 5 percent?

We welcome the fact that Tanzania is largely self-sufficient in staple food crops and that food prices should not have a significant impact on the country's balance of payments. We agree with the staff that the ban on cereals exports should be lifted or at least reduced, as soon as possible. At the same time, it is important that access to food is guaranteed for everybody. In this regard, have the authorities taken any measures or has the staff provided any specific advice?

The medium-term fiscal revenue target of 20 percent of GDP is commendable. We note the measures described by Messrs. Gakunu and Ndyeshobola in their insightful statement—in particular the reduction of tax exemptions and the reform of the mining sector.

However, we urge the authorities to form a more specific timetable for the implementation of these measures. We regret that the full implementation of measures to obtain a sustainable solution for the financing of TANESCO have again been postponed. We share the concerns by Mr. Bakker et al. on the possible suspension of the zero domestic financing norm.

The approved budget still reflects the uncertainty regarding the availability of donor financing. The authorities should accelerate measures which will restore the credibility and convince donors. Many donors are still using the wait-and-see approach with regard to the implementation of governance reforms, in particular at the Bank of Tanzania. Does the staff consider the authorities' action plan to be sufficient?

The authorities are undertaking good initiatives to foster trade, particularly at the regional level. We hope that the strong performances of the Tanzanian economy will have a positive impact on the neighboring economies.

Lastly, we support the longer-term objectives of MKUKUTA so to strengthen growth and reduce poverty.

Ms. Agudelo and Ms. Florestal submitted the following statement:

We thank staff for a set of helpful papers and the update on recent developments. We also wish to thank Mr. Gakunu and Mr. Ndyeshobola for their informative buff statement. We particularly welcome the emphasis put on the MKUKUTA. We join them in inviting the Fund to be increasingly responsive to countries' needs in facing the challenges posed by the global increase in food and energy prices.

The Tanzanian authorities need to be commended for their continued commitment to prudent macroeconomic management and for achieving good progress in implementing reforms, particularly those pertaining to the governance of the BoT. All assessment criteria for end-December 2007 under the PSI were met and the structural reform program remains on track. Thus, we support the completion of the third review of the PSI.

On the Breach of Obligations, we support the MD's recommendation that the Board take no further action because of two factors: (i) the correct data would not have given rise to the nonobservance of any performance or assessment criteria in effect under the PRGF or PSI during the period in question and (ii) corrective action taken to provide accurate historical data and ensure accurate reporting in the future.

Staff's assertion about the need for Tanzania "to restore credibility and increase public accountability" in order to garner donors' support raises doubts about the effectiveness of the PSI in being a signaling device. Moreover, the fact that under the PSI performance on the structural front has so far been on track, and that donors are still hesitant to provide financial support to Tanzania because they are still looking "to the government to undertake agreed steps to address governance issues" leads us to inquire if the structural agenda under the PSI was deficient . The uncertainty relative to the availability of external support for the FY09 budget is also puzzling given that we are told that, during the period under review, "development expenditure benefited from accelerated disbursement of foreign project financing" (MEFP Par.4) and "external financing of the budget during the period benefited from higher than projected program, project and basket loans" (MEFP Par.5). We would appreciate staff's comments.

As projected during the Board discussion of the previous review of the PSI, a substantial tariff increase has been approved by EWURA, the independent regulator of TANESCO. However, contrary to what was anticipated at the time of the last Board discussion, this increase is considered to fall short of the cost recovery level requested and another tariff increase is being considered for later this year. We were under the impression that a cost of service study was being prepared by foreign experts at the time of the tariff increase request last year. EWURA's request that TANESCO completes a cost of service study before it considers another tariff increase seems to imply that the increase granted was discretionary and not based on objective criteria. The adoption of all feasible cost-cutting measures, particularly those pertaining to nontechnical losses should constitute a prerequisite to any tariff increase and be one of the key components of TANESCO'S strategy to achieve financial viability.

The appreciation of the shilling helped dampen inflationary pressures in the short term. At the same time the current account deficit widened, driven by the rising fuel costs and the increase in other imports notwithstanding a large increase in exports. With gross official reserves representing more than four months of imports, the BoT does have ample room to continue for some time with large sales of foreign exchange as a means to sterilize liquidity. Nevertheless, caution is warranted as Tanzania may suffer from high volatility of capital inflows, undermining its external financing in the medium term. On the monetary front, we agree with staff's recommendation to tighten the policy stance in the short run. However, we would appreciate additional information on how staff sees the authorities being able to accommodate a continuous global rise in food prices while focusing on containing second-round effects.

The Government is steadfastly addressing governance issues and should be commended for progress made on many fronts. The measures taken to redress the improprieties of the EPA account are particularly noteworthy. We encourage timely implementation of the Public Audit Bill, which will strengthen the independence of the National Audit Office, and the prompt resolution of the cases brought to the public prosecutor by the PCCB.

Mr. Heath and Mr. Wood submitted the following statement:

The Tanzanian economy continues to show strength, with rapid growth in exports and progress on financial deepening. We are pleased to see that all assessment criteria for the third review were met and that the structural reform program remains broadly on track.

Thus, we support the completion of the third review of the PSI.

We are concerned by the revelation that the authorities provided inaccurate information to the Fund on public debt and official international reserves, but we are encouraged by the steps taken to correct the data and to strengthen reporting procedures. The latest revelation underscores the need for increased public accountability. We appreciate the authorities' efforts, including the special audit, to address the previous governance shortfalls at the BoT, and we encourage the decisive implementation of the plan to further strengthen governance. Such action would improve the credibility of government policy and help to restore confidence of donors and private investors.

We welcome the authorities’ commitment to maintaining the progress made toward fiscal stability. We encourage their focus on containing current spending amid uncertainty about the level of foreign donor financing. Over the longer term, we agree with Ms. Xafa and Mr. Crispolti that the authorities would be best served by broadening the tax base and strengthening tax collection in order to reduce reliance on donor financing. In addition, we believe it is important to achieve financial viability for the state-owned electricity company, TANESCO, in order to reduce the long-term drain on government finances and to ensure a reliable supply of electricity. Thus, we commend the approval by the independent regulator of a substantial tariff increase, although we note that it fell short of the cost recovery level that was requested. We also support the staff’s suggestion that improvement in the business environment and regulatory regime to boost entrepreneurship and foreign direct investment is vital to Tanzania’s growth.

The recent spike in inflation owes mostly to higher global prices for food and energy, but we believe that monetary policy should be sufficiently tight to dampen inflation expectations so that inflation does not end up at a permanently higher level. To that end, we support the BoT’s efforts to sterilize reserve increases and its intention to improve communications with the financial sector and the general public, including the emphasis that it has no predetermined path for the exchange rate.

Mr. Moser submitted the following statement:

I commend the authorities for the performance under the PSI and note with satisfaction that this is the first review without a request for a waiver. I will first comment on the PSI and then on the misreporting.

Third Review Under the PSI

As experienced by other countries, inflation and inflationary pressures have sharply increased in recent months owing, among others, to a surge in global food and fuel prices. However, inflation has been on a upward trend in Tanzania over the last years. I encourage the authorities to take decisive action before higher inflationary expectations become entrenched. Does the staff agree that some further currency appreciation would help alleviate inflation pressures?

Regarding the ban on cereals exports, I support the staff's call on the authorities to lift the ban as soon as possible. Moreover, I understand that Zanzibar has introduced its own administrative measures in an attempt to preserve food security. Could the staff comment?

I very much welcome the revenue gains made in recent years and the authorities determination to further increase revenue collection to 20 percent of GDP in the medium term, as conveyed in Mr. Gakunu and Mr. Ndyeshobola's buff statement. Currently, total revenue falls even short of recurrent expenditure, and the overall balance before grants is projected to stay around 10 percent of GDP over the entire program period. Without a significant overperformance on the revenue side, the PSI will not achieve its goal of reducing Tanzania's aid dependency.

However, I would also like to reiterate my concern about the very high level of public spending. Wages and salaries are rising fast and the public sector still seems to have a significant problem with ghost workers. Expenditure reforms are clearly called for.

Given the high level of public expenditure and donor support, I am concerned about the authorities' intention to explore the issuance of sovereign bonds denominated in foreign currency and the establishment of public-private partnerships. It is my understanding that such bond issuance would breach the continues performance criterion on nonconcessional loans under the current PSI. I note that the Ministry of Finance and Economic Affairs "aims to strengthen its capacity to assess and mange fiscal risks." What concrete measures are planed?

Could the staff inform about the size of the wage arrears owned to teachers, and inform whether these arrears are included in the public debt figures?

The challenges and uncertainties facing the 2008/09 budget also provide lessons regarding the need to ensure accountability in the use of public resources. I gladly note efforts being made to further improve public financial management and accountability. I welcome the government's plan to enact the new Public Audit Bill, which will hopefully strengthen the mandate of the National Auditor's office. I also commend the authorities for the efforts being undertaken to improve compliance of procuring entities with National Procurement Procedures and for the ongoing investigations into alleged grand corruption cases.

On structural reforms, I concur that the authorities need to appropriately prioritize and implement reforms to address domestic capacity constraints in order to keep up with growing domestic demand. Apart from addressing infrastructure problems (especially in the transport and energy sectors) and improving the education and health sectors, future growth potential will also crucially depend on the promotion of private-sector growth. Reforms of infrastructure financing and of TANESCO are welcome steps. But there needs to be further improvements if the fiscal cost is to be minimized. Further, in the agriculture sector, progress has been slow, with the Land Bank still not operational.

I join others in encouraging the authorities to follow up on the special audit of the Bank of Tanzania (BoT) and support the authorities' request for a new safeguards assessment. In this context, it is important to clean up with the investments and guarantee schemes operated by the bank. The BoT needs to operate in the right institutional environment to be able to fully focus on its mandate.

I welcome efforts of the authorities to improve statistics, especially with respect to government finance statistics and the implementation of a functional classification of expenditures consistent with GFSM 2001.

Misreporting

It is regrettable that the data on government domestic debt and official international reserves were inaccurately reported to the Fund. I would further like to complain about the unacceptably short circulation period of the respective staff paper. Moreover, the explanation given by staff is far from satisfactory. Without further explanation I am not in a position to approve the proposed decision.

First, given that the relevant data was accurately reported in the BoT's audited financial statements for 2005/06 it is difficult to understand why the authorities were not able to correctly report the same data to the Fund. It is also difficult to understand why the authorities did not consult with the Fund on this issue, given that they were not certain how to record the transaction.

Second, given that the relevant audited statements have already been published in October 2007, it is also difficult to understand why the staff only learned about it recently. Could the staff elaborate on how they learned about the misreporting.

Third, I would like to ask the staff to elaborate on the circumstances of the transaction itself, and why the government's instruction to the BoT to settle creditor's claims on the company did not breach the performance criterion of noncontracting or nonguaranteeing external debt under the PRGF arrangement.

Mr. Haupt made the following statement:

We thank the staff for an excellent set of papers and Mr. Gakunu and Mr. Ndyeshobola for their informative buff statement. We welcome Tanzania's continued strong economic performance and the overall satisfactory implementation of the PSI-supported program. As we broadly concur with the staff's analysis, I shall limit myself to the following four points:

Inflation in food and energy prices poses a considerable challenge, as highlighted by the information provided in the staff's buff statement. Negative real interest rates, increasing capacity constraints, and rapid credit expansion make for an environment putting additional upward pressure on prices. Against this background, we have some doubts whether the gradual tightening of the monetary stance implied by the program is sufficiently strong.

On public accountability, we are encouraged by the follow-up measures the authorities have started to implement based on the recommendations of the special audit of the Bank of Tanzania. Like several other Directors, we reiterate that further expeditious and comprehensive steps to implement the related action plan are crucial to restore confidence of development partners and to pave the way for further donor support to come forward.

On a related point, we strongly welcome the upcoming safeguards assessment of the BoT. However, like Messrs. Bakker, Gibbs, Bergo, and Claveranne, we are concerned that the regular BoT audit report for FY 2006/07 has yet to be published eleven months after the close of the fiscal year.

Finally, we appreciate the vigilance expressed in Mr. Gakunu’s buff as regards the budgetary risks arising from uncertain donor financing. Like Mr. El-Khouri and Ms. Caracalla, we urge the authorities to resort to net domestic financing only sparingly.

The staff representative from the African Department (Mr. Nord), in response to Directors’ questions and comments, made the following statement:

I would like to thank Executive Directors for their incisive statements and questions. I am going to try to address most of them here. Some of the specific ones we will follow-up bilaterally.

Despite the difficult global environment, Tanzania’s economy has continued to perform strongly, but there are some clouds in the sky and the wind is picking up. To ensure smooth sailing in the period ahead, both the seaworthiness of the vessel and the skills of the skipper will be critical.

Our written statement addresses the impact of the global surge in food and fuel prices. In sum, Tanzania is more affected by high oil prices, at least as far as the balance of payments is concerned, and we estimate that the impact could be about 1.8 percent of GDP in 2008-09, which is about 15 percent of reserves. This is not negligible, but, at the same time, Tanzania’s ample cushion of reserves and its flexible exchange rate policy will facilitate dealing with such a terms of trade shock.

On the food side, the balance of payments impact is not expected to be significant, but domestic food prices are also rising, reflecting both what is happening on world markets and domestic transportation costs. The authorities have taken some steps, including some direct distribution of food to those most affected, but the scale so far remains limited.

I should note that in a longer-term perspective, Tanzania has large amounts of underutilized land, and could, if the supply response is forthcoming, use higher food prices as a driver for income generation in the rural areas, where poverty is the most pronounced.

In our discussions in Dar es Salaam and in the period since then, we have focused on the risk of rising inflation. While driven mainly by fuel, power, and food price increases, the continued rapid credit expansion also poses risks. As noted by many Directors, the 7 percent target for end-June no longer seems within reach.

What is the appropriate policy response under these circumstances? Regarding the exogenous component, the challenge is to accommodate while limiting any second-round price effects. This is not an easy task, as noted by some Directors, in particular, at a time when money demand is undergoing structural change in the context of rapid financial deepening. In our view, the slight tightening envisaged for 2008-09, with broad money growth coming down from an expected 24 percent this year to 18 percent next year, and the medium-term target of 5 percent, remain appropriate. But I agree with those Directors who emphasized that the communication strategy of the central bank will be critical in tempering inflation expectations during this period.

Concerned about the risk of excess liquidity, the Bank of Tanzania (BoT) has recently extended reserve requirements to cover government deposits with commercial banks, which is the practice in most countries, and it stands ready to tighten monetary policy further if required. Do reserve money targets remain appropriate for countries like Tanzania? We would certainly agree that sufficient flexibility needs to be exercised, e.g. in the case of rapid sudden surges in capital inflows. The Tanzanian authorities are interested in shifting eventually to an inflation targeting regime. We organized a seminar at the BoT while we were there to discuss the experience in Africa with modeling inflation, which is a critical ingredient of any inflation targeting framework.

Let me turn to fiscal policy. As noted in the staff report, uncertainty about the availability and timing of foreign assistance has complicated budget preparations, which are ongoing as we speak. Normally, development partners confirm the level of their budget support in December following an annual review, well in time to be integrated in the budget preparation cycle. Responding to the question from one Director, this explains why disbursements this year were high. They were based on commitments made in late 2006. This year, reacting to a series of governance revelations, development partners were reluctant to commit until reassurance was provided that identified governance issues were being addressed, and I will return to those issues in a moment. Consequently, the authorities prepared a conservative budget framework. The program for 2008-09 shows a corresponding cutback in development spending, despite providing for up to 1 percent in domestic financing. The signs are that foreign financing could in fact be higher than expected if donors are satisfied with progress on the governance front, and that domestic revenue, which has continued to outperform expectations, could in fact be higher. So, there will be probably some more room for public investment next year.

Some Directors asked if the program could have provided for even more domestic financing, or at least rely more systematically on domestic rather than foreign financing. In the staff's view, which is also shared by the authorities, a zero net domestic financing rule has served Tanzania well, and it remains a valuable anchor for macroeconomic stability in a context where domestic capital markets are still small and the risk of crowding out is correspondingly high.

Let me turn to a topic raised by several Directors and an important topic in Tanzania, namely, that of public-private partnerships, fiscal risks, and infrastructure investment. During the mission, we also organized a seminar for government officials on public-private partnerships, including lessons learned and pitfalls to avoid in Tanzania. There is a tremendous need for infrastructure investment. With debt levels low, there are foreign investors willing to provide financing. The current global slowdown does not seem to have reduced investor appetite. Our Debt Sustainability Analysis suggests that indeed Tanzania does have the capacity to carry more debt. That said, given past experience and current levels of income, the first best source of financing for Tanzania remains concessional financing, preferably on a grant basis. This is also government policy, as we understand it. Under the appropriate circumstances, this should not preclude recourse to commercial financing. High-return projects can justify more expensive financing, but it does underline the importance of having a robust institutional framework, strong public financial management to ensure efficient public spending, including procedures to assess investment projects, and effective debt management and handling of fiscal risk.

On the latter, the government is currently preparing a public-private partnership (PPP) policy framework in coordination with development partners. This document will outline Tanzania's policy objectives and lay out the development of a PPP program, including legislation in line with this policy. There is also under discussion the establishment of a central PPP unit. The functions of this unit would include risk management, scrutinizing quality, affordability, expected costs of PPPs and assessment of contracts, capacity-building, and a standardization of PPP-related procedures. The staff thinks that this is a good idea, and we have encouraged the authorities to proceed in consultation with us and other development partners with expertise in this area.

Finally, let me say a few words about the various governance issues that Tanzania has faced and how they are being addressed. The action plan formulated by the authorities following the special audit of the BoT's external payments arrears (EPA) account represents, in our view, a good basis for progress. Indeed, we have integrated several of the measures into the PSI-supported program, notably the Memorandum of Understanding between the Ministry of Finance and the BoT, and the divestiture of the BoT's non-core activities, including guarantee schemes and certain gold operations.

The safeguards assessment mission that will visit Tanzania in a few weeks' time also represents an opportunity for the BoT to further strengthen its systems and processes to ensure that what happened in 2005-06 cannot happen again.

Beyond the action plan, which is centered on the BoT's EPA account, the authorities are also taking steps to strengthen public accountability more broadly. The PCCB, the anti-corruption office, is moving forward on several cases and has, we understand, already concluded its investigations into four alleged cases of grand corruption and passed the files to the public prosecutor.

The BoT has commissioned a value-for-money audit on the construction of its Twin Towers Headquarters, which will allow it to respond to questions about cost effectiveness.

The new public audit bill, as cited by several Directors, which is on the agenda for the next parliamentary session, further strengthens the national audit office, which is a key institution for maintaining the integrity of public spending in Tanzania.

Several Directors asked whether the measures under preparation are sufficient to address the concerns of development partners and ensure a resumption of budget support. I cannot respond on their behalf, but progress in the areas that I mentioned, including the completion of the safeguards assessment mission by the Fund, will be critical in their assessment. In sum, I believe the authorities are responding appropriately to the governance challenges that they have faced.

Looking forward, it will be important to maintain momentum and put in place durable structures at the BoT and elsewhere that guard against future incidents. The challenge is also an opportunity; it is the opportunity to take decisive steps to improve governance, which is the foundation for long-term investment, sustainable growth, and poverty reduction in Tanzania. The staff will do its best to help the authorities in these efforts.

Mr. Moser wondered whether (i) a more general debt management strategy was under consideration; and (ii) if staff could provide an update on the issue of wage arrears to teachers, particularly whether it had been taken into account in the budget or in the debt figures of the authorities.

The staff representative from the African Department (Mr. Nord), in further response to Directors' questions and comments, made the following statement:

On debt management, the Ministry of Finance has a Debt Management Unit. We have in the past provided some assistance to this Debt Management Unit. However, there is certainly scope for improving its effectiveness. Part of the reason for establishing a clear Memorandum of Understanding between the Bank of Tanzania and the Ministry of Finance goes to the issue of debt management. The Bank of Tanzania issues treasury bills for monetary policy purposes, and there needs to be a good understanding between the Bank of Tanzania and the Ministry of Finance on the sharing of the cost burden. In that context, I think the Ministry of Finance needs to strengthen its capacity to manage debt more broadly beyond the debt currently issued purely for monetary policy purposes, because, as we have said, the government's policy is a zero net domestic financing policy. Should Tanzania advance in its discussions on the financing of large infrastructure projects, whether through public-private partnerships or through the issuing of debt, strengthening its debt management capacity is certainly a prerequisite.

On the issue of wage arrears, this is being picked up by a couple of newspaper articles that are reporting currently on a strike threat from teachers. The Minister of Finance, in our understanding, insists there are no wage arrears, and we do have a zero target in that regard under the Fund-supported program. There would appear to be delays in payments of certain nonwage components, e.g. travel expenses, medical hardship allowances, and sitting fees for training courses. It is not clear to us at this point whether that is due to the lack of financial resources, delays in processing paperwork, or unjustified claims or expectations. We will follow-up, and I can assure Mr. Moser that we will keep him informed of this should we get information that goes beyond what I just said.

Mr. Gakunu made the following concluding statement:

On behalf of my Tanzanian authorities I express my appreciation to you and to the Directors for the constructive discussions on Tanzania, and for supporting the completion of the third review under the PSI. I consider Directors' advice and observations very important and valuable and will promptly transmit them to the authorities to assist them in achieving their development goals and in forging greater engagement with the Fund going forward. Let me also thank Fund management and staff, in particular the mission Chief, Mr. Nord and his team for high quality and purposeful dialogue with the authorities, and for thorough responses to the issues raised by Executive Directors in their Grays and during the discussions this morning.

The issues raised by Directors deserve closer attention in a forward-looking context. I have noted Director's guidance on the need to maintain prudent fiscal framework and sustain the revenue effort; vigilance on inflation in the wake of global commodity price surge; improving the effectiveness of monetary policy; strengthening governance and public accountability; continuing to reduce pervasive poverty while recognizing the need to maintaining macro-stability and debt sustainability; and the challenges posed by the need to address the infrastructure deficit. I fully agree with Directors that while the authorities have comprehensively and effectively addressed alleged corruption cases as they have unfolded, this has damaged credibility. The challenge now is how to quickly regain this credibility, given the country's heavy dependence on donor funding.

Mr. Chairman,

Let me reiterate that the authorities have been unwavering in their commitment to effective implementation of reforms under the program because these reform measures are in the best interest of the country. The President, the Prime Minister and the Economic Team during the Executive Directors' Group and the Managing Director's visit to Tanzania last February reaffirmed the authorities' commitment to sustain the reform effort, and to take this commitment to greater heights. In this context, I thank the Board for the visit of the Directors to Tanzania and for the unwavering encouragement given to the authorities to sustain their reform effort.

Mr. Chairman,

On the issue of non-concessional financing of investments in infrastructure, my Tanzanian authorities have reaffirmed their commitment to continue to prioritize broad based growth through investment in productive infrastructure and social services, as the necessary basis for sustained poverty reduction. This in realization of the fact that like some Directors have said, Tanzania is essentially a rural, agricultural society with huge potential but with serious infrastructural bottlenecks.

The President of Tanzania during his December 2007 visit to the Fund informed the Managing Director of his administration's plans to scale-up investments in infrastructure to enable the country exploit its full economic potential and effectively address the huge infrastructural deficit as a means of addressing rural poverty. Directors who visited Tanzania in February this year will recall similar statements of resolve by the Prime Minister and the Economic Team. The Minister for Finance and Economic Affairs was very specific by pointing out to the Directors that as part of scaling up the development tempo, the Government was intending to increase spending and investments in infrastructure, while being mindful of the requirement to maintain debt sustainability, high standards of transparency and accountability. Recourse to non-concessional financing of infrastructure investments is in recognition of the fact that concessional resources would not be adequate to address this challenge.

In this regard, Mr. Chairman, the Fund needs to respond favorably to the invitation of the authorities to support their policy framework on this issue both with technical and policy advice on how best they can achieve their stated goals. The dialogue that the Mission Chief has referred to in his remarks, in particular the workshops they held with the authorities on this and other issues during the last mission is an initiative in the right direction and should be continued going forward.

As regards the temporary ban on the export of maize and other cereals in response to the unfolding global food price surge, my authorities have been quite explicit that this measure is temporary in mature. The measure was necessitated by the need to avert the occurrence of severe food shortages with serious balance of payments implications and consequences for the poor. At the same time, the authorities want to use the available foreign exchange resources to finance the improvement of productivity in agriculture. It is rather paradoxical therefore to urge the authorities to immediately lift this ban at a time when the concern is of ensuring that food security in the country is guaranteed. Nonetheless, the authorities intend to address this issue during the budget statement on June 12, 2008.

The Acting Chair (Mr. Portugal) made the following summing up:

Executive Directors commended the Tanzanian authorities for implementing sound macroeconomic policies that have sustained robust economic growth. While noting the challenges posed by high global fuel and food prices, Directors considered that Tanzania's flexible exchange rate policy, ample stock of international reserves, and favorable near-term agricultural outlook should facilitate Tanzania's adjustment to the ongoing terms of trade shock. Directors acknowledged, however, the downside risks to Tanzania's economic growth should high petroleum prices persist and world economic growth dampen further.

Directors commended the authorities for the strong implementation of the 2007/08 budget based on the achievement of a further impressive revenue performance, and welcomed their commitment to maintaining fiscal stability going forward. They noted that uncertainty about donor assistance has complicated the preparation of the 2008/09 budget. While welcoming the authorities' determination to continue to maintain a zero net domestic financing target over the medium term, most Directors saw scope for temporary and limited domestic financing in the year ahead, if needed to ensure continuity of critical public expenditures. Restraint on current spending will be essential, however, in the event that aid flows fall short of projections. Directors welcomed the authorities' plans to broaden the tax base and strengthen tax collection further and to increase the efficiency of public spending.

Directors welcomed the strengthened framework for the conduct of monetary policy and foreign exchange operations that uses a better mix of instruments for liquidity management and improves transparency and communication with market participants. This will contribute to the predictability of monetary policy, contain inflation expectations, and lower yields on government securities. Directors emphasized that monetary policy will need to be vigilant to contain the second-round effects of rising fuel and food prices, while providing sufficient room for continued expansion of credit to the private sector.

Directors supported the government's focus on improving infrastructure as well as health and education services to raise Tanzania's growth potential, while ensuring long-term debt sustainability. They saw scope for increased reliance on public-private partnerships, provided that high standards of transparency and accountability are in place to guard against fiscal risks associated with contingent liabilities. They stressed the importance of energy sector reform, including by strengthening the efficiency and finances of the electricity company. Directors also stressed the importance of financial sector development and improvements in the business environment and the regulatory regime to encourage investment and entrepreneurship.

Directors welcomed the steps being taken to strengthen governance, address corruption, and enhance public accountability as essential for bolstering the confidence of investors and donors. They encouraged the authorities to implement decisively the action plan to follow up on the recommendations of the special audit of the Bank of Tanzania. Directors welcomed the authorities' decision to request a voluntary safeguards assessment of the central bank and to review the legislative framework for combating money laundering and terrorism financing.

The Executive Board took the following decision:

United Republic of Tanzania—Policy Support Instrument—Review

1. Pursuant to paragraph 8 of Decision No. 13561-(05/85), 10/05/05 and paragraph 1(b) of the Policy Support Instrument for the United Republic of Tanzania (EBS/06/149, Supplement 1, 2/8/07) ("PSI"), the Fund has conducted the third review to assess program implementation.

2. The letter dated May 3, 2008 from the Minister for Finance and Economic Affairs of the United Republic of Tanzania (the "May 2008 Letter"), together with its Memorandum of Economic and Financial Policies (the "May 2008 Memorandum") and the Technical Memorandum of Understanding (the "May 2008 TMU"), shall be attached to the PSI for the United Republic of Tanzania, and the letters from the Minister for Finance dated November 20, 2006, February 8, 2007, June 12, 2007 and December 7, 2007, together with their attachments, shall be read as supplemented and modified by the May 2008 Letter and its attachments.

3. Accordingly, the PSI shall be amended as follows:

A. The following provision shall be added to paragraph 1(b):

"The fifth review is scheduled to be completed by April 30, 2009 as specified in paragraph 6 of the May 2008 Letter."

B. In paragraph 2.E references to "Table 1 of the December 2007 Letter" and "December 2007 TMU" shall be replaced, respectively, with "Table 1 of the May 2008 MEFP" and "May 2008 TMU".

C. The following subparagraph shall be added after subparagraph 2.E(1):

"; or (2) by September 30, 2008, a memorandum of understanding has not been established between the Bank of Tanzania and the Ministry of Finance and Economic Affairs as specified in Table 3 and paragraph 37 of the May 2008 MEFP."

D. New subparagraph 2.F shall be added after paragraph 2.E to read as follows:

"F. with respect to the fifth review:

(1) the data as of end-December 2008 indicate that any of the floors and ceilings referred to in paragraph 2.B(1)(i) through (iii) of the PSI, and as set out in Table 1 of the May 2008 Letter and further specified in the May 2008 TMU, has not been observed;"

E. The following provision shall be added to paragraph 3:

"Completion of the fourth review will be subject to assessment criteria having been established for the fifth and sixth reviews. Completion of the fifth review will be subject to assessment criteria having been established for the sixth and seventh reviews."

4. The Fund completes the third scheduled review specified in paragraph 1(b) of the PSI on the condition that information provided by the United Republic of Tanzania on its performance under the assessment criteria related to this review is accurate.

Decision No. -14119(08/48), adopted
May 30, 2008

APPROVAL: September 19, 2008

SHAILENDRA J. ANJARIA
Secretary