

# POVERTY REDUCTION BUDGET SUPPORT TO TANZANIA FOR 2006/09

## PROGRAMME DOCUMENT

### Summary

1. This Programme Document describes a three-year rolling framework grant for Poverty Reduction Budget Support (PRBS) to Tanzania, covering the period 2006-2015. The first three years of this support will total £310 million (£90m in 2006/07, £105m in 2007/08, and £115m in 2008/09). Each November, after the annual budget support review, the programme will be rolled forward with the addition of a further year's allocation in line with the Tanzanian Government's three-year Medium Term Expenditure Framework (MTEF). The programme will be managed in accordance with the multilateral Partnership Memorandum Framework (PFM) annexed to this document.

2. Tanzania offers one of the most favourable environments in Africa for economic growth and poverty reduction. Over the last decade, the Government of Tanzania (GoT) has maintained macro-economic and political stability, increased GDP growth, improved budget planning and administration, and significantly increased funding of public services. Despite recent progress however, major challenges remain. Over 12 million people, or 36% of the population, were below the national basic needs poverty line when last assessed in 2001, and on present trends, most MDGs will not be met.

3. The PRBS grant will support the implementation of the GoT's second poverty reduction strategy (PRS), the five-year National Strategy for Growth and Reduction of Poverty, MKUKUTA. Launched in July 2005, MKUKUTA has three clusters of outcomes and goals: growth and income poverty reduction; quality of life and social well-being; and governance and accountability. This ambitious plan focuses on results, builds on the experience of the first PRS and is consistent with MDG targets. Whilst domestic revenue and aid flows have increased significantly in the last five years, the Government of Tanzania still faces a financing gap that impedes faster progress towards meeting the MDGs.

4. GoT stresses that budget support offers the best means for development partners to support its national development plans. This view is confirmed by the 2004 independent evaluation of PRBS. Our PRBS will be managed within the multi-donor PRBS programme which brings together 14 partners, both bilateral and multilateral, and grant and loan funds which totalled \$520 million for 2005/06. It will be managed in accordance with budget support principles proposed by GoT. These draw from the lessons of the independent evaluation and international best practice.

5. The **goal** of PRBS is to reduce poverty in Tanzania. Its **purpose** is to increase GoT's financial and institutional capacity to implement MKUKUTA and reach its poverty reduction and growth goals. The Performance Assessment Framework (PAF) against which progress will be measured is

based on MKUKUTA goals and specifically covers macro-economic stability, public financial management, and resource allocation. It will use existing national processes as a basis for assessment wherever possible.

6. The overall risk level is judged as **medium**. Fiduciary risks are also judged to be medium. Tanzania has performed well in terms of strengthening governance. The World Bank Institute's "Governance Matters" report assesses Tanzania as one of the few countries to have 'significantly improved' on most of its criteria. These comprise improving "voice" and accountability in terms of the level of public participation in politics and protection of human rights; improving government effectiveness; and controlling corruption.

### **Programme Details**

#### **Programme Description**

7. Tanzania is one of the poorest countries in Africa, with a GDP per person of \$290, compared with the average of Sub-Saharan Africa of \$450. However, it has good long-term prospects, and is making strong progress in tackling poverty. PRBS aims to support Tanzania to sustain and increase the rate of this progress by providing funds to implement MKUKUTA.

8. MKUKUTA identifies three clusters of outcomes: growth and the reduction of income poverty; improvement of quality of life and social well-being; and governance and accountability. It will last from 2005-2010 and sets goals and operational targets for each outcome, consistent with the internationally agreed MDGs. It was developed as a result of much analysis and discussion both within government, and by civil society and the private sector. It builds on and draws lessons from experience with Tanzania's first PRS.

9. Tanzania has demonstrated that it can use money effectively through the government system to make progress towards poverty reduction and growth. It has made big strides towards universal primary education, with net primary school enrolment rates increasing dramatically as a result of the abolition of fees in 2001. In 2005, around 95% of children aged 7-13 were enrolled in school. Child mortality rates remained stubbornly high throughout the 1990s, but improvements in areas such as malaria and immunisations are now beginning to feed through into falls in child mortality and improved nutrition indicators. Recent data shows that under-five mortality fell by almost a quarter in the last five years.

10. At the start of the 1990s, 39% of people lived below the national poverty line. There are no firm income poverty figures for the rest of the decade but it is likely that poverty levels first increased up to 1995, before starting to fall. By the time of the next survey in 2001 the proportion below the poverty line was down to 36%. More recent information suggests this falling trend has continued during the last four years. A new survey in 2006/07 will provide fuller information on these trends.

11. Although Tanzania has made very good progress in increasing the amount of money it raises from its taxpayers, and has been able to attract more aid and gain debt relief as a result of its good policies and strong performance, a wide financing gap still exists. This means that Tanzania does not have the funds it needs to implement MKUKUTA at the rate needed to meet the MDGs in 2015.

12. Development partners have developed strong relationships with GoT over a number of years and have agreed with Government ways in which Tanzania can use aid more effectively. This means partners work more closely with one another, and use government systems more than before. The increasing volume of aid going direct into the government system in the form of general budget support reflects this.

13. This programme will contribute £310 million as PRBS for the Tanzanian financial years 2006/07-2008/09. Future allocations will be determined in line with a ten-year bilateral Memorandum of Understanding (MoU) to be signed with the new government in early 2006 and by Tanzania's performance against its national growth and poverty reduction goals. Budget support will help Tanzania make faster progress towards the achievement of the MDG targets than would otherwise be possible. Our programme builds on six years of PRBS support from the UK between 2000 and 2006 (total £330 m).

14. All Tanzanians will benefit from increased public funding to services and increased public investment in infrastructure. The extent to which poor people benefit more than others will be determined by the way in which resources are allocated within the government budget. Tanzania has a strong track record of allocating funds to the services that matter to poor people, and has shown that it can produce good results in areas such as health and education.

15. Budget guidelines for the 2006/07 budget are being drawn up by the Government as part of its annual budget process and will draw from results from Public Expenditure Review processes. The 2005/06 budget maintained a strong emphasis on education, continued a trend of steadily increased shares to health and water, increased allocations for agriculture, and maintained the share on roads. GoT has made a major effort to link budget allocations to the achievement of MKUKUTA goals. The box below shows some of the ways in which increases in public spending have already resulted in improvements for poor people in Tanzania.

<b>BOX 1. SOCIAL SECTORS: CHANGES IN EXPENDITURE<sup>1</sup> AND OUTCOMES 2000-2005</b>	
<p><b>Education</b></p> <ul style="list-style-type: none"> <li>• Government expenditure more than doubled to \$560 million in the last five years.</li> <li>• Expenditure per person up from \$8.70 to \$15.90.</li> <li>• Represents 18% of the total budget.</li> </ul>	<ul style="list-style-type: none"> <li>○ 7.5 million children now in primary school – an increase of more than 3 million.</li> <li>○ Number of teachers up by a quarter; number of schools up by a fifth.</li> </ul>
<p><b>Health</b></p> <ul style="list-style-type: none"> <li>• Expenditure almost tripled to \$275 million.</li> <li>• Expenditure per person up from \$3 to \$7.30.</li> <li>• Represents 9% of the government budget, up from 7%.</li> </ul>	<ul style="list-style-type: none"> <li>○ Under-five mortality rates have fallen by almost a quarter to 112 deaths per live births.</li> <li>○ The proportion of under-fives experiencing fever in the last two weeks (a proxy for malaria) fell by a third to 23%.</li> <li>○ Vaccination of infants against measles has risen to 90% from 72%.</li> </ul>
<p><b>Water</b></p> <ul style="list-style-type: none"> <li>• Large increase in expenditure from \$17 million to \$120 million.</li> <li>• Expenditure per person up from \$0.50 to \$3.20.</li> <li>• Represents 4% of the government budget, up from 1%.</li> </ul>	<ul style="list-style-type: none"> <li>○ Rural water supply coverage increased from 50% to 53%</li> <li>○ Urban coverage increased from 70% to 73%. (There will be a time-lag before recent increases in expenditure feed through into improved coverage.)</li> </ul>

## Appraisal

16. The PRBS Annual Review of November 2005 and the PRBS Mid-Year Review of March 2005 summarise key appraisal and performance monitoring issues. Additional appraisal material is covered in the World Bank's programme document for Poverty Reduction Support Credit 3; the World Bank's Country Economic Memorandum; the IMF's Poverty Reduction and Growth Facility Review of July 2005; the multi-donor Public Expenditure and Financial Accountability Review (PEFAR); the GoT State of the Public Service Report 2004, and the Diagnostic Trade Integration Study 2005. All these documents are available for consultation.

## Background

17. Tanzania's development vision for poverty reduction is laid out in a series of documents. The longer-term development vision is described in Vision 2025, and medium-term plans in Tanzania's first PRS (2001-2004) and in MKUKUTA (2005-2010). GoT has described how it wants development partners to support implementation of these plans in the Tanzania Assistance Strategy of 2002, and in its recent draft Joint Assistance Strategy (JAS) which is expected to become operational in July 2006.

18. Both the latter documents state that general budget support is GoT's strongly preferred aid modality. The draft JAS proposes a medium-term

<sup>1</sup> All expenditure figures are in real terms (constant 2005 prices).

target of 70% of all development partner assistance as budget support. Our CAP addendum sets 70% as a minimum level for DFID. For 2006/07, a PRBS contribution of £90 million represents 82% of our bilateral aid framework for Tanzania. This would rise to 88% in 2008/09.

19. President Mkapa, his Ministers and senior GoT officials have repeatedly stressed that budget support offers the most efficient and effective means for donors to support national plans. Their views are confirmed by the 2004 independent evaluation of ten years of budget support in Tanzania, commissioned jointly by GoT and PRBS partners.

20. GoT acknowledges the role that sector and reform basket funds and directly funded projects have played in financing development expenditure. However, it also believes that these mechanisms frequently create parallel administrative, financial, human resource and staff remuneration systems that increase transaction costs and undermine the goal of building sustainable institutions. It therefore sees basket funds as transitional measures, and wishes to restrict directly funded projects to specific circumstances. DFID has a strong record of compliance with this preference: PRBS as a percentage of our bilateral aid framework is shown in Table 1.

**TABLE 1: DFID PRBS AS A PROPORTION OF AID FRAMEWORK**

Year	PRBS	As % of DFID bilateral aid framework
2000/01	40m	61%
2001/02	35 m	57%
2002/03	45 m	62%
2003/04	60 m	75%
2004/05	65 m	68%
2005/06	85 m	77%
2006/07 subject of this PM	90m	82%
2007/08 subject of this PM	105m	87.5%
2008/09 subject of this PM - figure based on provisional aid framework	115m	88%

21. The Secretary of State approved a project concept note in March 2005, authorising the design of a new budget support programme in conjunction with GoT and other partners. To meet our commitment to providing more predictable and timely PRBS, a separate submission for budget support for the financial year 2005/06 was made and approved by the Secretary of State in September 2005. The joint design work has now been completed and comprises a new five-year multilateral MoU for budget support (see annex) and an associated PAF. The five-year MoU synchronises our support with Tanzania's political cycle, and the prospect of two five-year terms from 2006-2015.

22. This PRBS proposal is fully aligned with our CAP Addendum for 2005 and contributes directly to DFID's PSA targets. It is consistent with policy and guidance notes on PRBS and with the UK conditionality policy. UK conditionality policy is reflected in the multilateral MoU and will be reinforced

by the proposed ten-year bilateral MoU. This proposal also conforms to the International Development Act 2002.

## **Approach**

23. The general case for budget support is set out in DFID's May 2004 PRBS Policy Paper. This paper states that we will use PRBS when:

- *A partner government's budget priorities support poverty reduction:*

This is true in Tanzania. The share of expenditure going to the PRS1 key sectors (including health, education and water) has shown a substantial and sustained increase over the last 5 years rising from 35% of expenditure in 1999/00 to 48% in the 2005/06 budget. In real terms, PRS1 key sector expenditure has increased by over 250% during the period. MTEF plans indicate that social sector expenditure is projected to rise from 23.5% of total expenditure in 2005/06 to 24.4% in 2007/08, while poverty focussed growth expenditure (including infrastructure) is projected to rise from 20% of total expenditure to 22.7%.

- *A partner government is committed to improving its administrative, technical and financial systems:*

This is true in Tanzania. Tanzania is implementing a comprehensive and credible set of reform programmes in the areas of Public Financial Management, Public Sector Reform, Local Government Reform and Tax Administration. Tanzania is one of the top rated low-income countries in Sub-Saharan Africa using the World Bank's "Country Policy and Institutional Assessment". It also has one of the best ratings of all HIPC countries in the IMF-WB poverty expenditure tracking assessment (with a satisfactory rating in eleven of the fifteen assessed aspects of public expenditure management in the 2004 update). The recent Public Expenditure and Financial Accountability Review, PEFA 30 indicator framework, and DFID 2005 fiduciary risk assessment, confirm this assessment. The trajectory of change is expected to remain positive.

- *The provision of budget support will produce significant benefits relative to other forms of aid delivery:*

The recent independent evaluation of budget support in Tanzania used a more rigorous set of benchmarks of success than has been applied to any other aid modality in Tanzania. The key findings of the evaluation are that the immediate effects of budget support have been strongly positive and that budget support helped Tanzania to: 1) stabilise its domestic debt; 2) achieve 10 years of good macroeconomic performance; 3) make consistent improvements in Public Financial Management and; 4) promote investment through improvements in the business environment. In addition, the evaluation concluded that budget support enabled a large expansion of education and health services.

The evaluation concludes that these important changes would not have been so effectively facilitated by any other aid modality.

24. The way in which we provide budget support is evolving. GoT produced a new budget support principles paper earlier in 2005. The starting point for this paper is the shared commitment between GoT and its development partners to eradicate poverty in Tanzania, and GoT's commitment to a) reduce poverty and achieve the MDGs, b) strengthen financial management and accountability (reducing the risk of funds being misused through weak administration or corruption) and c) good governance and accountability of the government to its citizens. This paper stresses the need to:

- Shift accountability more firmly to that between the Government and its citizens;
- Further reduce transaction costs for the Government and its development partners, especially in performance assessment;
- Encourage the development and use of Tanzania's own systems, rather than setting up and using parallel donor systems;
- Increase predictability to enable good budget planning and a stronger Medium Term Expenditure Framework; and
- Disburse in the first quarter of the financial year to improve budget execution

25. A new MoU has now been agreed as part of the Annual PRBS review which took place in October. It proposes:

- One Annual Review for PRBS to take place each October
- A streamlined PAF that stresses underlying national processes of assessment and includes outcome indicators to focus dialogue.
- Single tranche payments to be made in the first quarter of the FY
- Firm commitments for next FY to be made early in the budget cycle, that is, as soon as possible after the Annual Review.

26. The design of multi-donor PRBS has been the subject of intensive discussion amongst all PRBS partners and with GoT. GoT has carried out extensive internal consultations with MoF meeting with sector and line ministries to discuss budget support principles and the indicators to be included in the PAF. Other non-budget support partners have been kept informed of developments through the Development Partner Group. Civil society was involved in discussions particularly during the budget support evaluation and in government consultation on the JAS.

### **Economic Appraisal**

27. Tanzania has a strong and stable macroeconomic environment and has remained on-track with the IMF for a decade. Economic growth averaged 4% in the mid to late 1990s, rising to an average 5.8% since 2000, and reaching 6.7% in 2004. Tanzania's accelerated economic growth is supported by a comprehensive set of reforms that have yielded sustained macro-economic stability, a liberalized economy, and enhanced scope for the

private sector as the main agent of economic activity. Aid inflows have helped support Tanzania's reforms and contributed significantly to economic growth by both increasing government investment (aimed at easing supply side constraints) and by creating favorable demand conditions. Agriculture makes up around 45% of the economy and is the main economic activity for over 62% of the working population. By virtue of its size, agriculture, which grew by an average 4.8% each year between 2000 and 2004, made the largest sectoral contribution to overall growth. A key challenge for poverty reduction in Tanzania will be to sustain agricultural growth and continue to diversify and strengthen the export base.

28. Strong growth in exports of goods and services has contributed nearly 60% of overall GDP growth since 1990. However, traditional agricultural exports have been overtaken by tourism and especially gold, representing 47% of exports in 2004. As gold is import intensive and employs only 10,000 people, Tanzania needs to continue to diversify its export base especially in the labour intensive sectors likely to impact on poverty such as tourism and adding value to agricultural products. Increased public and private investment is needed if growth rates over 7% (needed to achieve the MDG income target) are to be sustained. Low levels of per capita income and consequent limited ability to raise resources domestically will mean that Tanzania will continue to need significant levels of ODA into the foreseeable future.

29. The last five years have seen a dramatic increase in government expenditure to around 28% of GDP in 2005/06. This has brought Tanzania back in line with the SSA average of 25% of GDP<sup>2</sup> and contrasts sharply with the 1990s when expenditure averaged only 17% of GDP. This increase in expenditure has been made possible by increases in both ODA (grants and concessional loans) and domestic revenue. ODA has risen from about 6% of GDP in 1999/00 to a budgeted level of 12% in 2005/06 and is now back up to levels experienced in the 1980s and early 1990s. Over the same period revenue has performed impressively, rising from 11% of GDP to over 14%<sup>3</sup>.

30. Whilst Tanzania remains committed to improving its revenue performance, the structure of its economy will mean that it will need increased levels of ODA (possibly up to 17 to 20% of GDP and in line with levels experienced in comparable countries such as Rwanda and Malawi) if it is to continue to make progress towards the MDGs. MKUKUTA plans and the Millennium Project Needs Assessment continue to show a significant financing gap. Taking into account existing aid levels, the Millennium Project estimates that an additional US\$45 per capita per annum (i.e. almost double present levels) is needed to reach the MDGs.

31. The growing importance of rural based growth, coupled with absorptive capacity constraints mean that increasing levels of aid need to be channelled

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<sup>2</sup> Source: World Bank World Development Indicators.

<sup>3</sup> These gains have been made through improvements in tax administration, reducing exemptions, and broadening the tax base. Nonetheless, revenue at 14% of GDP still remains low by international standards with the tax base hampered by a high share of subsistence agriculture in GDP.

into growth-related expenditure, and in particular infrastructure investment. Sustaining recent growth will also require a second generation of reforms to increase access to finance and to improve the investment climate. This anticipated shifting expenditure focus is in line with the CFA recommendations and recent World Bank CEM analysis, which identifies infrastructure as a pressing constraint to growth with a clear public sector role.

32. IMF analysis suggests that “Dutch disease” effects have not been significant in Tanzania so far. Exchange rates are aligned with economic fundamentals, and are not undermining the competitiveness of the economy. The IMF points out that if aid flows continue to be managed prudently with an increased focus on infrastructure, there is still absorptive capacity within the public sector and the economy as a whole, with the increased aid impacting positively in the medium term on competitiveness and growth.

33. Tanzania has a well-developed budget process, amongst the strongest and most transparent in Africa. The Public Finance Act 2001 and Public Finance Regulations 2001 define the roles, functions and responsibilities in management of revenue and expenditure. Expenditure is managed through a centrally-managed Integrated Financial Management System (IFMS) that ensures public monies are spent within the framework of the approved budget. At the strategic level, the Budget Guidelines and the MTEF for each sector guides resource allocation. This process is subject to wide stakeholder consultation (central and local government, donors and civil society) through the Public Expenditure Review process. Improvements to the budget process continue to be made, with the current cycle looking to create stronger links between policy and the budget through the introduction of a Strategic Budget Allocation System.

34. The medium-term fiscal outlook for Tanzania is positive, albeit dependent on sustained donor support. Tanzania runs a large current account deficit (11.4% of GDP in 2004/05), but this has been more than covered by official and private transfers and other capital inflows, allowing reserves to be maintained at a healthy six months of import cover. Tanzania’s debt outlook remains solid with the Net Present Value of external debt currently around 20% of GDP and 120% of exports, with debt service at 7% of exports. All these indicators remain below accepted critical threshold levels.

### **Social Appraisal**

35. Drawing from a range of analytical work, this appraisal highlights two key, interrelated challenges facing Tanzania in accelerating progress towards the MDGs. The first is how to maximise the distributional impact of growth in reducing poverty in rural areas, whilst mitigating increasing inequality. The second is how to promote inclusion through delivering better quality and equitable access to economic opportunities and social services.

36. Initial analytical work combining the Household Budget Survey (HBS) results with other routine surveys does indicate an overall trend of a falling poverty headcount, including in rural areas. However, declining poverty is

significant only in Dar es Salaam, being limited in other areas. With nine out of ten of Tanzania's poor people living in rural areas, the extent to which existing growth patterns (largely urban-oriented) can convert into reduced poverty in rural areas remains a critical challenge.

37. Income inequality in Tanzania remains relatively low, compared to many other countries in Africa. This is encouraging since low inequality can act to multiply the impact of growth on poverty levels. Results from the HBS 2000/1 however, do reveal a marginal increase in income inequality as measured by a rise in the Gini coefficient over ten years from 0.34 in to 0.35.

38. However, recent qualitative work also reveals a perception of increasing inequality in Tanzania on the basis of non-income indicators and against factors such as gender and age. Boys and girls from poorer households are more likely to drop out of primary school; and girls in particular often fail to stay in primary or progress to secondary. In health, the barriers to basic, life-saving services are significant. The lack of improvement in maternal health indicators shows that this is a particularly critical for women and girls. There remains an evident urban-rural disparity in water provision. Greater allocation of resources to low-cost rural water and sanitation supplies is a priority. Qualitative data on vulnerability from the Participatory Poverty Assessment shows how certain social groups are especially vulnerable to poverty, and the importance of specific action to protect and include those groups in growth promotion and service provision.

39. MKUKUTA is a product of a major consultation exercise involving civil society organisations, the private sector (including the informal sector) and district-level discussions across local government. It represents a broader-based, more nationally-owned plan than PRS1. It provides the framework for GoT with the support of development partners to meet the challenges set out above.

40. In terms of improving the distributional impact of growth, particularly in favour of rural areas, MKUKUTA identifies a range of policy measures to increase individual and household incomes, including improving food availability & accessibility, extending provision of affordable energy, strengthening access to microfinance, diversification of agriculture and off-farm activities, and formal employment promotion. More work, however, is planned on general growth promotion: this needs to identify more clearly specific sources of pro-poor growth, and will also need to address inequalities in access to productive assets that can exclude groups such as women farmers from increasing productivity.

41. MKUKUTA incorporates a stronger focus on cross cutting issues, such as vulnerability and gender, in its analysis, actions and outcomes. It focuses on strengthening human development through ongoing support to social sector reforms, but also incorporates specific policy measures to include poorer, vulnerable groups in economic activity and service provision. It addresses equity considerations in social service provision, for example, and seeks to develop and pilot new social protection policy.

Mkukuta therefore provide a promising framework for promoting social inclusion in economic opportunities and service provision as a fundamental part of overall poverty reduction. The challenge ahead for GoT, and development partners, including DFID, is to translate these policy commitments into stronger policy action.

### **Institutional Appraisal**

42. Delivering Vision 2025 and MKUKUTA requires efficient, transparent and accountable public service institutions. Reforming the public service is a long-standing priority for GoT. In the early 1990s, the Tanzanian public service was in crisis. The wage bill and other public expenditures were out of control, and ministries could not produce reliable accounts on a timely basis. In response, GoT introduced a major restructuring of the public service, leading among other things to a reduction of the number of departments by a quarter, and of the number of public service employees from 355,000 in 1992 to 264,000 by the end of 1998. Pay levels were increased, and public personnel management became more meritocratic. An integrated financial management system was introduced, expenditures controlled and accounting improved.

43. The four core institutional reforms launched since 2000 have built on these achievements. The lead reform – Public Service Reform Programme – addresses broader qualitative aspects of the public service: a medium-term pay policy; strategic plans for all ministries; and establishing executive agencies, merit-based recruitment procedures, and Client Service Charters. The Local Government Reform Programme has started to improve service delivery and accountability at the local level; Public Financial Management Reforms have led to more efficient and transparent allocation and utilisation of resources; and Legal Sector Reform Programme aims to provide access to justice for all Tanzanians. Other ongoing reforms tackle corruption, the business environment and service delivery in the sectors.

44. The public sector reform agenda in Tanzania is therefore broad and comprehensive, and GoT is clearly committed to improving the institutional environment for poverty reduction. Nevertheless, a number of critical challenges remain. Capacity remains weak across government, and significant technical and skills shortages exist, especially in remote rural areas. With only around 15,000 school children completing secondary education each year, this is likely to remain a problem in the medium-term. Public sector pay, although up 12-15% per year since 2000, remains too low to recruit and retain the highest-quality candidates, and provides incentives for corruption.

45. Multiple government planning processes exist and are insufficiently coordinated. A high level task force has been convened to look at options for harmonising planning processes and restructuring some of the “centre of government” institutions under the new administration. The linkage between core reforms and sector reforms is also being recognised as a key challenge.

46. Insufficient capacity within MoF to challenge sector ministries hampers contestability of resource allocation and means MoF is unable properly to fulfil its role in pushing for more efficient public expenditure. This issue was highlighted in the budget support evaluation which found that PRBS had funded expansion of services, but that the efficiency of spending remained low. The new PRBS design seeks to address this by strengthening the incentives for strong sector performance review processes and providing an opportunity for high-level dialogue on these issues. We should not underestimate however, the difficulties faced by all governments in achieving efficiency gains when overall resources are increasing.

47. Strong public institutions are critical to increasing the impact of our PRBS. DFID, working together with other development partners, has therefore provided around £30 million to support the design, implementation and evaluation of these reforms since 2000.

### **Political Appraisal**

48. Tanzania is a rare example of political stability in Africa. President Mkapa stood down this year after two five-year terms in which Chama Cha Mapinduzi (CCM), the ruling party since independence, has held power with absolute majorities. He has been instrumental in maintaining the pace and focus of economic liberalisation and efforts to reduce poverty. He has also shown strong leadership in improving aid effectiveness.

49. Presidential, parliamentary and local elections were due to be held on October 30<sup>th</sup> 2005 both for the Union Government including Zanzibar and mainland Tanzania and for Zanzibar alone. The death of a vice-presidential candidate on the eve of polling day meant that the Union elections had to be postponed. The Zanzibar elections went ahead as planned. President Karume of CCM was re-elected for a second term, with 53% of the vote. CCM also maintained its majority in the Zanzibar House of Representatives with 31 of the constituency seats available against 19 for the main opposition party, the Civic United Front (CUF). The conduct of the elections was a significant improvement on 2000, with the process seen as largely free and fair though marred in a few constituencies by irregularities, serious flaws and violence. CUF continue to denounce these irregularities and to declare the election invalid. Nonetheless, CUF MPs have taken up their seats in the House of Representatives.

50. Rescheduled Union elections were held in the mainland and Zanzibar on 14 December. Despite predictions that the Opposition would increase their share of the vote, CCM won a landslide. Former foreign minister Jakaya Kikwete, won 80% of the Presidential vote and on 21 December was sworn in as Tanzania's fourth President since independence. CCM took 206 out of 232 seats in the Union parliament. Early reports from international observers judge the elections to be largely free and fair, with isolated incidents of violence in parts of the country. The increased swing to the ruling party may be attributed to a combination of factors, including CCM's control of state resources and institutions, a weak and divided opposition, improved living

standards, and a desire for stability. Whilst the new administration's programme is not yet known, the CCM manifesto is broadly consistent with MKUKUTA. The general direction of reform is likely to be maintained.

51. Development partners have commissioned analytical work as part of their "drivers of change" analysis. Work on the budget process confirms that the formal institutions of democracy are still relatively weak. In many ways however, the PRS period has been marked by a significant opening up of government processes to increased public debate, and greater engagement by civil society in policy and budget allocations. From a low base, Parliament is developing a more active parliamentary committee system which, together with an intake of younger MPs, should mean that Parliament starts to play its oversight role more effectively. A recently published government survey on the state of the public service was an impressive attempt to look critically at how citizens perceive government and rate service delivery. This has been openly and widely discussed.

52. In addition to support for the supply-side reforms, DFID provides complementary support to stimulate the demand for accountability and to strengthen the capacity of Parliament, civil society and citizens to hold the government to account. Public access to information is a critical part of this work. More information is being made available all the time (from MoF, from local government and through the poverty monitoring system) but the capacity of citizens and the media to utilise this information is still weak. DFID and other partners are exploring how to support further improvements to public access and use of information.

53. The design of the budget support instrument seeks to address the issues of domestic accountability raised in the budget support evaluation. It does this by building the performance assessment framework around national processes that provide opportunities for parliament, civil society and the private sector to engage in government policy discussions and the monitoring of performance. Utilising and strengthening these national processes should mitigate the risk that government's accountability to donors displaces its accountability to citizens.

### **Environmental Appraisal**

54. In terms of mainstreaming environment within government policy, MKUKUTA is seen as a step forward. One specific goal relates to increasing access to "a safe and sustainable environment". Studies are under way to establish a core list of environmental indicators to be tracked within the Poverty Monitoring System.

55. To meet DFID requirements for environmental appraisal, we will draw from analysis by the World Bank which provides the lead amongst PRBS partners on environment. Environmental issues will be dealt with through the underlying processes identified in the PAF and which among others include reference to Agricultural and Water Sector Reviews. The World Bank has a specialist adviser for environment based in Tanzania following these issues.

## **Lessons and Evaluation**

56. The independent evaluation of ten years of budget support in Tanzania in 2004 was the first study to use the evaluability framework now being used by the multi-country OECD DAC study.

57. The evaluation highlighted the potential to improve the effectiveness of PRBS in Tanzania further by redesigning the instrument - in particular, the need to modify the performance assessment framework to strengthen national processes, and to ensure greater predictability in donor financing. Key recommendations have been taken up in discussions on the new PAF and MoU and are referred to throughout the text. The process of carrying out the evaluation was also valuable in enabling government and its development partners to reflect on experience and to discuss the basis and principles of the budget support relationship.

## **Implementation**

### **Management Arrangements**

58. The PRBS programme was initially designed in 2001 to harmonise bilateral and EC donor budget support in support of the first PRS. During its first year, the PAF was expanded to include the PRSC of the World Bank. Fourteen partners now use this common instrument. These partners all took part in detailed discussions with one another and with GoT to agree a new PAF and a new MoU during the Annual Review in October 2005.

59. Individual disbursement decisions remain the responsibility of each partner in discussion with GoT. However all partners use a common process to assess progress, and agree a common judgement on the level of progress achieved.

60. The Project Officer will be the A2 PRS group Programme Manager, currently Andrew Felton, and Ian Shapiro from January 2006. The A2 Governance Adviser, currently Annabel Gerry, is responsible for the assessment of Fiduciary Risk. All advisers and senior programme management staff in the office contribute to the analysis and engage with the national processes that underpin our assessment of government systems.

61. In recognition of the central role of budget support in the development relationship in Tanzania and to ensure adequate political engagement and sufficiently high-level leadership, PRBS partners have restructured the group to increase the direct involvement of Heads of Cooperation. Chairing of the PRBS group rotates to a rolling timetable between partners, and is currently chaired by Sweden, with troika support from Norway, Switzerland and the World Bank.

62. To ensure effective day-to-day operation of the joint PRBS instrument, partners have established a PRBS Secretariat to manage interaction with GoT

and act as a central clearing-house of information. To cover all the underlying processes that contribute to performance assessment, PRBS partners agree lead and supporting responsibilities for specific areas of work. The Secretariat currently comprises a junior economist and an administrative assistant. During the course of this PRBS programme, we will explore the possibility of expanding the services provided by the Secretariat through, for example, the addition of governance advice, poverty monitoring expertise and more senior economist inputs. The creation of a more comprehensive collective resource could reduce duplication across the development partner community, further reducing transaction costs for government and enabling agencies to manage budget support professionally without needing exclusive in-house capacity.

## **Timing**

63. Within the context of a proposed 10-year bilateral agreement with Tanzania, this programme describes a three-year rolling framework of PRBS contributions. The three year framework, currently for 2006/07, 2007/08 and 2008/09, will be rolled forward annually in line with Tanzania's MTEF. At the beginning of each financial year a single payment will be made to cover activities within that financial year. In line with the UK conditionality guidelines, the three year rolling framework will consist of core and indicative components. The core component will only be reduced if the underlying principles agreed in the PRBS MoU are broken.

64. The Annual Review of budget support each October will provide the main mechanism for assessing performance. The Annual Review is timed to fit into Tanzania's budget process, allowing budget support commitments to be firmed up early in the budget cycle for effective planning and resource allocation. The review represents the culmination of discussions with government throughout the year, drawing on information produced by national processes identified in the PAF. A review considered to be 'satisfactory' or better overall will trigger the movement of the Year 1 indicative commitment to the status of core commitment, and the addition of a new figure for the new outer Year 3. Final budget support amounts for the three-year rolling framework will be communicated to GoT after approval of a submission by the Secretary of State in November each year. We will seek authorisation for subsequent disbursement at the start of the following financial year from the Secretary of State each June, after confirming that Tanzania is not in breach of the partnership conditions described in the MoU.

65. Since Tanzania has a stable track record with minimum forward risk, we propose the core component of the 3-year rolling framework to be 100% for Year 1, 95% for Year 2 and 90% for Year 3. This will result in the following core and indicative allocations (some figures being rounded) for the current MTEF period:

### **Table 2 : Allocations for PRBS by DFID 2006- 2009**

	<b>Core</b>	<b>Indicative</b>	<b>Total</b>
Year 1 – FY 06/07	£90 m	0	£90 m
Year 2 – FY 07/08	£100 m	£5 m	£105 m
Year 3 – FY 08/09	£105 m	£10 m	£115 m

## Funding

66. The PRBS instrument brings together all development partner budget support contributions. Expected contributions for 2006/07 are given below.

**TABLE 3: PRBS CONTRIBUTIONS 2006/07 BY DEVELOPMENT PARTNER (ESTIMATED):**

<b>Donor</b>	<b>PRBS contribution 2006/7</b>	
	<b>Amount (US\$ million)</b>	<b>As % of agency framework</b>
African Development Bank	73	44%
Canada	17	32%
Denmark	14	20%
EC	38	48%
Finland	10	51%
Germany	12	25%
Ireland	14	48%
Japan	5	10%
Netherlands	12	22%
Norway	24	40%
Sweden	15	25%
Switzerland	5	17%
UK	156	82%
World Bank	200	33%
<b>Total</b>	<b>595</b>	

The proposed DFID contribution is £90 million of PRBS for the Tanzanian FY 2006/07, rising to £105m in 2007/08 and £115m in 2008/09. These funds represent 82% of the total DFID bilateral aid framework for 2006/07 rising to 88% in 2008/09. The allocations for 2006/07 and 2007/08 can be accommodated within the aid framework. The figure for 2008/09 is based on a provisional aid framework of £130 million.

67. Each year's PRBS contribution will be disbursed as a single payment within the first quarter of the Tanzanian financial year. This is in line with the UK's conditionality policy and the practice of most PRBS partners including the World Bank. Even the EC, with its variable and fixed components, disburses these together as a single payment. A single tranche reflects Tanzania's good performance and its relatively low levels of political and

fiduciary risk. Disbursing a single payment in the first quarter of the financial year increases predictability, facilitates budget execution and reduces transaction costs. These funds will be provided as general budget support and are not earmarked.

### **Contracting and Procurement**

68. All procurement from the grant will be done by GoT, in accordance with its own procurement legislation and procedures. Assessment of GoT's procurement systems takes place within the context of overall fiduciary risk assessment within the Public Expenditure and Financial Accountability Review. Support to government procurement forms part of the Public Financial Management Reform Programme.

### **Accounting / Audit**

69. Upon the Secretary of State's approval to disburse, Crown Agents Bank will make the payment into a PRBS account established by GoT for subsequent transfer into the Consolidated Fund. MoF will provide to DFID documentary evidence of the amount and date of the foreign exchange payment received under this Grant, and of the amount and date of receipt of each transfer under this Grant from this account into the Consolidated Fund.

70. The National Audit Office (NAO) carries out an independent annual external audit of the Government Accounts. The Auditor General is required by law to produce his/her annual report to Parliament on the Public Accounts within 9 months of the financial year-end. GoT will provide all PRBS partners with the annual audit report as soon as it is presented to Parliament.

71. If the NAO determines that the general audit report is unlikely to be available within the specified time it may commission a financial or performance audit by a qualified and recognised independent auditor to audit selected components or samples from the National Budget to assess compliance with financial management regulations or value for money. The selection of auditors and approval of the audit contract would be endorsed by GoT.

72. Internal audits of the PRBS account will also be undertaken. Contributing donors may undertake an independent external audit of the PRBS account at any time at their own cost.

### **Conditionality**

73. The new multilateral Partnership Framework Memorandum (PFM) sets out the way budget support will operate in Tanzania (see annex). The PFM is fully consistent with the UK conditionality guidelines and clearly identifies the underlying principles for PRBS support to Tanzania. These are:

- Continuing sound macroeconomic policies and management
- Commitment to achieving MKUKUTA objectives and Millennium

#### Development Goals

- Sound budgeting and public financial management system
- Continuing peace and respect for human rights, the rule of law, and the independence of the judiciary; and
- Good governance, accountability of the Government to the citizenry, and integrity in public life, including the active fight against corruption (in accordance with commitments of the signatories in the New Partnership for African Development and other agreements).

The PFM recognises that observance of these underlying principles is critical for the continuation of the budget support partnership. Concerns regarding non-compliance will be handled first through an incremental process of dialogue and discussion. If issues remain unresolved, a range of actions including diplomatic responses and a reduction or suspension in aid will be considered. The focus will be on understanding the likely impacts of any action, including on poor people, and seeking a response which is proportionate.

#### **Monitoring and Reporting**

74. GoT and PRBS Partners have just completed an intensive redesign of the budget support instrument in Tanzania. The new design builds on lessons from the recent joint evaluation of budget support and draws on experience of international best practice. The design addresses three issues in particular:

- Expanding PRBS review coverage across the full breadth of government activity to include social sectors, growth related sectors and the core governance reforms. The structure of the PAF now mirrors the structure of MKUKUTA.
- Reinforcing incentives for stronger national planning and budgeting processes by focusing attention on the links between inputs, outputs and outcomes. By linking sector reviews to budget support, the incentives for intra-government accountability will be strengthened.
- Using national processes which involve a range of domestic stakeholders to ensure that PRBS supports rather than undermines Tanzanian domestic accountability.

75. The new PAF moves away from a long list of actions towards a mix of process and outcome indicators that cover progress against MKUKUTA, resource allocation and budget consistency, public financial management and macroeconomic stability. The PAF has been designed multilaterally and thus covers assessment criteria necessary for all PRBS donors including the World Bank, EC and ADB. The PAF does this by using a mix underlying processes, outcome indicators and temporary process actions in a manner that is acceptable to all donors. For the majority of PRBS donors including the World Bank and DFID the most critical element in the PAF are the underlying processes. These underlying processes will form the basis for an overall assessment of progress and will be used by the PRSC as prior actions wherever possible. Where underlying processes are not yet functioning adequately, and particularly for the first year a series of specific temporary

process actions have been agreed with Government. It is anticipated that this section of the PAF will drop out after the first year.

76. The underlying processes will also be the main avenue for assessing poverty outcomes. The elements of a 'satisfactory underlying review process' are outlined in the PFM (para 14) and include an evaluation of progress towards sector outcomes. DFID and the majority of PRBS donors will make our assessments regarding outcomes at this underlying process level. However recognising the importance of specific outcome indicators for some PRBS donors, in particular the European Commission, a subset of outcome indicators have been identified and included in the PAF. The European Commission will use outcome indicators to determine the level of its variable component on an annual basis.

77. The underlying processes will form the main avenue for on-going dialogue, discussion and analysis. The completion of satisfactory review processes during the year is the principal means by which we will measure overall performance assessment at the annual review. This annual review will also provide the opportunity to bring together information and analysis from all these underlying processes, to facilitate high level discussion with Government on critical issues, and to come to a joint overall PRBS assessment. In the short term, performance assessed in this way will be complemented by an assessment of progress on specific actions identified in the PAF.

78. The commitment of both GoT and partners to utilise national systems is a strong principle of the PAF design. Tanzania has worked hard to develop its poverty monitoring system. A programme of household surveys has delivered up to date outcome indicators and there are efforts to improve data from routine administrative systems in sector ministries. The system has had notable successes and now regularly produces robust information. The strength of this system combined with the developing architecture of sector, core reform, and harmonised public financial management reviews enables us to move with confidence to a streamlined framework with fewer and less specified detailed conditions.

## **Risks**

79. Table 5 summarises the risk assessment including the headline fiduciary risks. The overall risk level is judged as medium.

80. The level of fiduciary risk is medium. The IMF and World Bank 2005 update on HIPC assessments, found Tanzania one of only two HIPC countries requiring 'little upgrading' to its public expenditure management systems. Table 4 gives a detailed assessment against the DFID benchmarks and shows a generally positive picture. The major weaknesses relate to consistency of budget outturn at vote and sub-vote level, corruption in procurement, and independent scrutiny of expenditure including effective sanctions and parliamentary oversight.

**TABLE 4: SUMMARY OF PRINCIPLES, BENCHMARKS AND RATINGS**

	<b>Principles</b>	<b>Benchmarks For Assessment</b>	<b>Rating 2005</b>	
<b>1.</b>	A clear set of rules governs the budget process	1. A budget law specifying fiscal management responsibilities is in operation.	<b>A</b>	↑
		2. Accounting policies and account code classifications are published and applied.	<b>A</b>	↑
<b>2</b>	The budget is comprehensive	3. All general government activities including those of State House and MoD are included in the budget.	<b>B</b>	↑
		4. Extra budgetary expenditure is not material	<b>A</b>	↑
<b>3.</b>	The budget supports pro-poor strategies	5. Budget allocations are broadly consistent with any medium term expenditure plans for the sector or for the overall budget.	<b>A</b>	↑
<b>4.</b>	The budget is a reliable guide to actual expenditure	6. Budget outturn shows a high level of consistency with the budget.	<b>B</b>	↔
<b>5.</b>	Expenditure within the year is controlled	7. In-year reporting of actual expenditure.	<b>B+</b>	↑
		8. Systems are operating to control virement, commitments and arrears.	<b>B+</b>	↑
<b>6.</b>	Government carries out procurement in line with principles of value for money and transparency	9. Appropriate use of competitive tendering rules and decision-making is recorded and auditable	<b>B</b>	↑
		10. Effective action is taken to identify and eliminate corruption.	<b>B</b>	↑
<b>7.</b>	Reporting of expenditure is timely and accurate.	11. Reconciliation of fiscal and bank records is carried out on a routine basis.	<b>A</b>	↔
		12. Audited annual accounts are submitted to parliament within the statutory period.	<b>B</b>	↑
<b>8.</b>	There is effective independent scrutiny of government expenditure	13. Government accounts are independently audited.	<b>B+</b>	↔
		14. Government agencies are held to account for mismanagement.	<b>C</b>	↔
		15. Observations, criticisms and recommendations made by the auditors are followed up.	<b>C+</b>	↔

81. The risk of corruption is judged to be medium. The WBI 'Governance Matters' data rates Tanzania as significantly improved between 1996-2004 on corruption. The Transparency International Corruption Perception Index shows consistent improvement for Tanzania over a similar period. Remaining corruption risks relate closely to the major weaknesses identified above.

82. Fiduciary risks will be monitored jointly with other donors based on the assessment of the PFM-PMF. This analysis will feed into the PRBS Annual Review. Monitoring of other risks will also take place in ongoing processes feeding into the Annual Review.

83. There is a credible programme of reform to improve public financial management and accountability. The key programme is the Public Financial Management Reform Programme. Reforms designed specifically to tackle corruption are generally less credible, but other reforms, including

procurement and tax administration, are expected to make progress in tackling corruption. The reforms will not fully address the weaknesses in the two benchmarks rated high risk – both of which also relate to corruption. Improving accountability for mismanagement (Benchmark 14) will require significant progress in legal sector reforms, implementation of proposed anti-corruption legislation that is expected to come before parliament in 2006, and a credible review of the National Anti-Corruption Strategy and Action Plan, also proposed for 2006. No additional short-term safeguards are proposed at this stage. Increased follow up of audit reports (Benchmark 15), may be facilitated by presentational improvements planned for the current year. If not, the issue will need to be given greater prominence in the Performance Assessment Framework, and weak parliamentary oversight addressed through joint donor support to parliament. Further detail on key developments and weaknesses, the risk of corruption, and the reforms is covered in the FRA.

**TABLE 5: RISK ASSESSMENT**

<b>Risk</b>	<b>Probability</b>	<b>Impact</b>	<b>Assessment / Mitigation Measures</b>
External shocks (adverse weather patterns, terms of trade and other global developments) cannot be effectively managed	Low	Medium	Tanzanian economy has shown increasing robustness to external shocks. Bank of Tanzania has shown high capacity to manage macroeconomic fundamentals. Reserve levels stand at 6 month import cover.
Budget priorities are not maintained throughout the financial year following the change in government	Low	Medium	Well developed budget process. Budget approved in Parliament. Coherence between MKUKUTA and political manifesto.
Institutional capacity constrains effective planning, prioritisation and delivery of pro-poor public policies	Medium	Medium	The ongoing set of public sector reforms are tackling capacity issues. These enjoy broad political support and are likely to be continued post-elections. A high level task force has been convened to look at harmonisation of planning architecture and capacity for effective sector budgeting, planning and monitoring.
Reduced political commitment to PFMRP and other PFMA reforms.	Low	Medium	Implementation of reforms will be monitored collectively in the annual PRBS review (October). Analysis of political economy looking at opportunities with the new administration will be considered, or follow-up to the DFID "Drivers of Change" budget study.
Insufficient independence of NAO, and lack of follow-up on its recommendations limit effectiveness of external audit	Low	Medium	MoF does not exploit NAO's lack of independence. NAO has developed a reform agenda, secured PFMRP funding and begun to address its capacity needs as well as building the capacity of the parliamentary public finance committee to carry out their scrutiny role. Discussions on independence of the NAO will not be prioritized unless more evidence emerges on problems with the current legal framework.
Weak accountability	Medium	Medium	The GoT anti-corruption strategy is being reviewed

in enforcing procedures rules and regulations, and investigation and punishment of corruption.			by GoT. PCB has prepared strengthened corruption legislation. Donors are following this closely, but the lead must be with GoT if change is to be meaningful. The oversight role of parliament needs to be strengthened, the willingness of parliament will be gauged after the elections.
GoT unable to recruit and retain skilled/experienced staff to manage existing systems and implement reforms.	Medium	Medium	In the short term there will be a need for expensive continuous training programmes. In the medium term, pay reform will be key, with a long-term objective of reducing use of TA.
Continued corruption in public procurement	High	Medium	Full implementation of the new Public Procurement Act that came into force in mid April 2005 will contribute to addressing the issues. But there will be a time lag, probably until FY 2006/7, before progress will be measurable. A detailed review of procurement is envisaged for future years as part of the PEFAR.

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