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INITIAL PROJECT INFORMATION DOCUMENT (PID)

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Implementing Agency: Ministry of Finance
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Country Background

Tanzania is one of the poorest countries of the world. Per capita income is estimated at about \$280 per year. Covering an area of 945,000 square kilometers, it has a population of about 33 million growing at about 2.4 percent a year. The economy is heavily dependent on agriculture (primarily, coffee, cotton, tea, cashew nuts, sisal, maize, rice, wheat, cassava, and tobacco), which accounts for about 50 percent of GDP, provides 85 percent of exports, and is by far the largest employer. Industry accounts for some 15 percent of GDP and is mainly limited to processing agricultural products and light consumer goods. The mining sector has good potential, but has yet to be fully developed. Tourism is one of Tanzania's dynamic sectors and has shown significant growth in recent years. The service sector and the informal sector are an increasingly important source of employment.

Tanzania's macroeconomic performance has continued to improve in recent years. The annual growth rate increased from 4.9 percent in 2000 to 6.2 percent in 2002, and is projected at 5.5 percent in 2003 despite adverse weather conditions affecting agricultural production negatively. Conservative fiscal policies, supported by a cautious monetary policy, contributed to a decline in inflation from 7 percent at end-1999 to some 4.6 percent by the middle of 2003. The current account deficit (before grants) of the balance of payments declined from 12 percent of GDP in 1999 to about 7.4 percent in 2002, reflecting in particular the coming on stream of gold exports.

Although Tanzania experienced economic difficulties and worsening poverty in the early 1990s the benefits of the more recent growth have reversed the trend. During the past decade, food poverty has declined from 21.6 percent to 18.7 percent while basic needs poverty is from 38.6 percent to 35.7 percent.

Tanzania has embarked on comprehensive structural reforms to improve economic governance, enhance public service delivery, and create an enabling environment for private sector activities. Reforms in the area of public financial management include the implementation of an integrated financial management system, the adoption of an inclusive Public Expenditure Review/Medium Term Expenditure Framework process, and the revision of the public finance management and the public procurement acts. The first phase of Civil Service Reform involving downsizing of the

civil service and bringing the wage bill under control has been completed. Reforms are now entering their second phase and will increasingly focus on public sector performance. A Local Government Reform Program aims at strengthening capacities of the local authorities which bear the primary responsibility for basic service delivery in priority sectors such as basic education, primary health, water, and rural roads. A national action plan for the control of corruption as well as sector specific anti-corruption plans are being implemented. Progress in reducing corruption is partly mirrored by the improvement in Tanzania's relative position on the Transparency International corruption perception index. The share of countries receiving a poorer rating than Tanzania increased from 6 percent in 1999 to 31 percent in 2003.

In addition to the overall measures to improve economic governance, public service delivery is being enhanced by establishing sector development programs for key sectors such as health, education, agriculture, and roads and by according them priority during budget formulation and implementation.

Government has shown a strong commitment to withdraw from commercial activities and to define its role as an enabler of private sector activities. Key achievements in this area include the privatization of a large number of parastatals. This includes the privatization of the fixed net telephone operator with a parallel liberalization of the wireless telephone market, which resulted in a rapid increase in the number of subscribers. Similarly, government has disinvested its interests in and liberalized the banking sector, which has experienced a sharp increase in the number of private sector banks to 23 now operating in the country.

A key government strategy is to improve the investment climate in order to stimulate a more rapid expansion of local and foreign private investment. A notable success in this area is the setup of a policy framework for mining activities in the mid 1990s, which has since experienced two-digit growth rates. Other important measures include the revision of legislation, including the company law, and the liberalization of capital markets.

Tanzania developed through a broad-based participation process including the poor, civil society, NGOs, and various other stakeholders a poverty reduction strategy paper (PRSP) in 2000 and progress reports in 2001 and 2003. The poverty reduction strategy (PRS) focuses on three main areas of outcomes and actions for realizing them. The first is **reduction in the breadth and depth of income poverty**. The outcome targets include reduction of basic needs poverty and food poverty with a particular focus on rural areas, where poverty is most prevalent. The second area is that of **improving the quality of life and social-well being**. More specifically this entails improving human capabilities, enhanced longevity of survival, social well being (social inclusion and personal security), improved nutrition and containing extreme vulnerability (mainly through safety nets). The third broad area is **sustained conducive development environment**. The environment encompasses macroeconomic stability and good governance. The PRSP has also become an important instrument for coordination within government to ensure coherence of the various sectoral and cross sectoral reform efforts in support of poverty reduction.

PRSC2 Objectives and Description

The Poverty Reduction Support Credit (PRSC) will support the implementation of Tanzania's PRS. The financial support provided through the PRSC will close the gap between the cost of implementing key elements of the PRS and resources available from government's own domestic revenue and other donor support. A policy dialogue and performance assessment framework

under the PRSC will focus on the following cross-cutting and institutional actions which will facilitate progress towards the PRS objectives.

(i) Sustaining and accelerating growth and broadening its impact: Reducing income poverty is one of the key focus areas of the PRS. Private sector and rural development are the two areas where reforms are expected to have the biggest impact on reducing income poverty in Tanzania. Reforms in the areas of agricultural and rural development are intended to raise agricultural productivity and thus enhance the incomes of the population in rural areas, where poverty is most widespread and most deeply entrenched. Measures include enhancement of the profitability of agriculture broadly and export products of rural origin in particular, through better quality higher productivity, reduced marketing cost and improved access to markets and to credit; removal of institutional constraints remaining on rural activities; and correcting the incentives provided by the overall tax regime. With respect to private sector development, the focus will be on strengthening of the business environment, in particular for SMEs, and legal and administrative reforms to enhance the functioning of land, credit, and labor markets.

(ii) Support results orientation of public service delivery: The second area of impact is through monitoring and leveraging progress in the implementation of sectoral programs to reduce poverty, covering the priority sectors identified in the PRS, i.e., primary education, basic health, water, rural roads, agricultural research and extension, the judiciary, and HIV/AIDS. The PRSC policy dialogue focuses on the establishment of a robust monitoring and evaluation system that allows an assessment of the impact and results of sectoral programs. The information derived from the monitoring and evaluation system will then feed into the assessment of progress towards the PRS objective, on which future PRSC support will be contingent. Finally, the resources provided through the PRSC complement government and other donor resources in financing priority programs for poverty reduction. The well developed participatory PER-MTEF process provides a mechanism for the monitoring of the use of resources.

(iii) Enhance public sector performance: Measures in this area will have a direct impact on poverty reduction as they enhance public sector capacity to implement poverty reduction programs in the priority sectors and generate additional funds for poverty reduction by reducing leakages in the form of low allocative or operational efficiency of public expenditures. Key areas of reform include strengthening of financial management through the implementation of the public financial management reform program, strengthening of the national audit office, implementation of pay reform coupled with improved performance management in the public sector, procurement reform, the implementation of anti-corruption strategies, and enhanced efficiency in the use of development assistance.

(iv) Strengthen environmental management: Finally, the PRSC also supports government's efforts to enhance environmental sustainability of Tanzania's development program. The PRS identifies this as an important element of efforts to improve the quality of life and social well-being.

Financing

The proposed amount of IDA financing is US\$150 million equivalent, which will be released at credit effectiveness. This amount is considered necessary to finance the 2004/05 fiscal gap to support the implementation of the PRS.

Environmental Aspects

The environmental classification of the operation is to be determined. PRSC1 was classified as a Sectoral Adjustment Credit which is likely to have minimal or no adverse environmental impacts (Category C). PRSC2 is a macro economic and budget reform program. Environmental as well as social issues may arise from specific project activities in several sectors that are considered beyond the scope of this specific operation. Many of these activities are part of parallel Bank sponsored programs, as well as other donor supported initiatives, and there will be assurances made that provisions are in place for addressing any significant environmental and social issues in accordance with Bank safeguard policies. A permanent environmental specialist has recently been assigned to the country office in Dar es Salaam assuring appropriate safeguard adherence by the Bank.

Although PRSC2 has no potential large scale, significant, and/or irreversible impacts directly related to this operation, strengthening Tanzania's institutional capacity to carry out environmental assessments will be an objective during PRSC2 implementation to ensure that appropriate mechanisms are in place that will allow future PRSCs to address sectoral issues. Funding for such activities is provided through a PHRD grant as well as support from other donors such as UNDP in addition to government's own resources. Specific use of Strategic Environmental Assessments (SEA) will be made for sectors included in future PRSCs.

A continuing program by the donor community is supporting environmental management and regulation at the central government level as well as at several key sectors. The National Environment Management Council and the Department of Environment have been attempting to harmonize their respective roles and responsibilities. Environmental legislation is pending approval. EIA capacity building is supported through government, parastatal, NGO and donor involvement.

An Integrated Safeguards Data Sheet has been prepared and will be publicly available.

Benefits and Risks of the Program

Benefits: The PRSC2 is designed to help the government implement its homegrown PRS and reach the goals articulated in the strategy. The reforms supported under the program will help raise growth and strengthen the institutional infrastructure needed to improve the public sector's capacity to carry out its role more effectively, as envisioned in the PRS. A stable macroeconomic environment, improved budget execution, strong economic governance, an environment conducive to private sector and rural development (especially enhanced agricultural productivity and profitability), and a well-performing public sector offering the improved delivery of public services are essential if the government is to reach its goals for poverty reduction and improve the quality of life in Tanzania. A vital related element would be the effective monitoring and assessment of the progress and pitfalls related to the implementation of the PRS.

Risks and Efforts to Mitigate Them: There are several risks associated with PRSC2: (i) many of the reforms supported by the credit might encounter resistance from vested interests, but government has in the past shown determination to overcome such special interests; (ii) government tries to build broad consensus for reforms through consultative processes which sometimes tends to slow down the pace of reforms, however, the benefits of this approach clearly outweigh the risk; (iii) the utilization of PRSC funds is determined by the budget process and there is a risk that resource allocation is not fully consistent with the PRS, however, government

has adopted an open and participative budget process including an annual PER process which helps to align and monitor resource allocation and its consistency with the PRS; (iv) the CFAA and the CPAR identified significant fiduciary risk, which the proposed reform agenda is meant to address; and (v) capacity for program implementation and service delivery at both the central and district level is weak, however, in key areas programs are in place to strengthen capacity.

Program Objective Category (POC)

The operation falls under the poverty reduction POC.

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