**Rapid Budget Analysis 2013**

**Synoptic Note**

DRAFT

**November 15, 2013**

The Rapid Budget Analysis is a programmatic feature of Tanzania’s budget calendar and one of the traditional outputs for the PER Working Group. It is produced by PER-Macro group involving close donor-Ministry of Finance collaboration. The RBA utilizes the detailed approved data for 2013/14 and detailed pre-audited actual spending data for 2012/13, all provided promptly by the Ministry of Finance. The Synoptic Note was produced by World Bank staff, with inputs from IMF, while the background notes were produced by staff and consultants from Japan, Norway, Sweden, UN, EC, Denmark, Belgium, Canada, KfW, AfDB, USAID, Ireland, UK, and the World Bank. The RBA 2013 is among the traditional outputs of the PER process; and will be discussed with the Budget Guidelines committee chaired jointly by the MoF and the POPC will constitute key input for dialogue with stakeholders during the GBS Annual Review 2013.

**Main messages**

2012/13 Executed Budget

* With stable GDP growth and declining inflation, the Government managed to achieve an impressive macro performance during 2012/13 but missed its fiscal target by 0.7 percent of GDP. The overall fiscal deficit is now estimated at 6.2 percent of GDP against the anticipated 5.5 percent. This is a significant deterioration compared to 2011/12.
* The Government collected lower than expected domestic revenues mainly as a result of reduced non-tax revenues and under-performing VAT and duty collection. On the positive side, the level of exemptions granted by customs and TRA went down by 0.8 percent of GDP between 2011/12 and 2012/13.
* Public spending increased by 0.7 percent of GDP compared to 2011/12, with an increase in recurrent spending (from 64 percent to 68 percent of total expenditure) and a decline in development spending from 36 percent to 32 percent. This can be attributed to inadequate planning and poor execution of foreign financed projects. A notable development in this regard was the significant reallocation of resources throughout the year in favor of locally-funded development projects and TANESCO. The resultant cuts significantly affected non-priority recurrent spending.
* The financing sources of the budget shifted toward more non-concessional borrowing which rose by 3.0 percent of GDP in 2012/13 (excluding on lending to public enterprises). Official aid, which remained constant in absolute value, accounted for only 5.2 percent of GDP against 10 percent in 2007/8. The main decline was recorded in grants.

2013/14 Approved Budget

* The objective of the 2013/14 approved budget is to reduce the overall fiscal deficit to five percent of GDP. It is expected that this would be achieved through an unprecedented increase in tax and nontax revenues (including LGAs own revenues) up by 3.1 percent of GDP when compared to 2012/13 actual outturn. The expected gains would then go towards financing the considerable increase in public expenditures which is projected to rise by 2.5 percent of GDP.
* By exceeding 30 percent of GDP, total expenditures will reach a new record level. This new level is explained by an increase in both recurrent and development expenditures. The wage bill (including parastatal PE, pension and allowances) will rise by 2.1 percent of GDP (driven by higher wages and recruitment); while development expenditures are expected to increase by 1.1 percent of GDP under the Government’s plan to promote investment projects in priority sectors.
* The spending allocation of the approved 2013/14 budget appears well aligned with the strategic priorities of recent national strategies, but remains insufficient to finance the Big Results Now initiative whose aim is to accelerate the achievement of results in six priority sectors. Furthermore, against the traditionally inconsistent execution of the development budget it can be expected that resources allocated towards infrastructure sectors will be reduced during the course of the year. Similarly, while the allocated budget to the LGAs is higher than that of 2012/13, these usually suffer from irregular implementation of those transfers each year.
* The combination of new taxes, higher tax rates, and improved collection efforts are expected to lead to an increase in domestic revenues (including LGAs own revenue) by 3.1 percent of GDP between 2012/13 and 2013/14. However, with tax collection almost 10 percent off target during the first quarter, the ambitious annual target may have to be revised downwards.
* The stock of public debt is projected to reach 48 percent of GDP at the end 2013/14, while the debt service (excluding amortization of domestic debt) should be as high as 2.5 percent of GDP (up from 1.8 percent in 2012/13) driven largely by foreign debt service. These figures point to a relatively rapid decline in Government’s fiscal space.

Emerging messages from sectors

* Education: In 2012/13, the execution rate accelerated from 79 percent to 94 percent, but the disparity in the funds allocation across districts remains high, perpetrating unequal sector performance as well as a sense of inequity among districts. The share of budget allocations to the education sector declines to around 19.6 in 2013/14, equivalent to 5,9 percent of GDP – still a relatively high allocation for a low income country. Transfers to local governments should intensify, from 65 percent to 70 percent of total sector expenditures, driven by an increased wage bill and development spending.
* Health: Unlike 2011/12, the execution of the health budget was strong, reaching almost 90 percent in 2012/13. The 2013/14 approved budget of 8.7 percent of total expenditures for the health sector represents a significant decline compared to 2012/13. The share of local (including GBS) funding to the sector is also expected to decline from approximately 8 percent in FY 11/12 to 6 percent in FY 12/13. Geographic inequality in health block grant distribution amongst LGAs remains substantial.
* Water: In 2012/13 water sector experienced a very low budget execution rate, at 56 percent. The low execution rate together with already a small share in the total budget of round 4.4 percent means that limited fund were spent on water and hence poor quality of service, including access and reliability. The share of public resources going to the sector in the approved total budget in 2013/14 is projected to decline further to 4.3 in 2013/14. However, LGAs water projects and programs are prioritized with projected increase in water budgets in LGAs.
* Agriculture: The execution of the budget in the agriculture sector declined from 78.5 percent to 69.6 percent between 2011/12 and 2012/13 due to the non-release of all budgeted funds. In 2013/14, this sector’s share of total budget has declined to 3 percent from 4 percent in 2012/13. A large portion of the sector budget is allocated to input subsidy programs and the National Food Reserve Agency, leaving limited resources for other programs such as land use and planning, animal disease control and seeds breeding.
* Energy: In 2012/13, when adjusting for transfers to TANESCO, recurrent expenditures were 370 percent higher than the approved budget while development expenditures were 53 percent lower than approved budget. In 2013/14, spending in the energy sector is set to increase further driven by both the costly EEP (including clearance of arrears) and the need to scale up investment in the energy sector.
* Transport: In 2012/13, the transport sector recorded overspending by more than 50 percent (or about Sh350 billion) of the approved budget. Most of this went towards clearing arrears in the roads subsector. Despite these efforts, outstanding payments at the end of June 2013 amounted to Sh376 billion, after a net increase of Tsh 221 billion in arrears in 2012/13. Furthermore, physical execution of roads projects remained low due to diversion of funds towards the clearance of arrears and the suspension or slow execution of works by numerous contractors whose invoices remained unpaid. In 2013/14, there is a significant increase in allocation for the transport sector, both for road and non-road subsectors. However, this increase may still not impact on the physical execution of projects as a considerable portion of funds will be used to clear arrears in roads subsectors.
* Gender: There is limited information to capture gender dimensions in the budget and this makes it difficult to assess and monitor gender aspects in budget allocations and spending. Reversing this situation requires Government commitment and one way to achieve this would be by developing a standardized format for a ’gender budget statement’ which government agencies would use to report on the gender implications of budgets and spending.

Fiscal risks

* A key risk is linked to the ambitious target for revenue collection, which in the 2013/2014 budget is set to increase by 3.1 percent of GDP. Given the delay in implementing the new taxes on financial and communication services, this target will require a significant effort to achieve, including further reduction of tax exemptions. Any deviation in revenues will have to be offset by lower spending, unless the Government decides to give up altogether on its objective of reducing the overall fiscal deficit to five percent of GDP.
* Another risk area is the financial deterioration of several parastatals and public agencies. Of particular concern is the public utility TANESCO which accumulated an operational deficit of USD270 million and arrears of USD276 million at the end of 2012. While TANESCO's financial state improved marginally during 2013, the fact remains that the cost of producing electricity is lower than the revenues derived from its sale. To date, the gap between costs and revenues has been partially met by transfers from the central Government and commercial borrowing by TANESCO.
* On its part, the Central Government too has accumulated significant arrears, notably within the road sector and its commitments under the public pension scheme. At the end of 2012, the estimated total value of the government arrears with PSPF amounted to USD700 million.
* In the coming years, the Government will have to manage well the public spending in order to preserve fiscal and debt sustainability. Although at present Tanzania has a relatively low public debt to GDP ratio (at slightly more than 40 percent) the fiscal space is closing rapidly, at least as long as revenues derived from natural gas production are not yet available.

1. **Introduction**
2. **This synoptic note presents key findings and messages from the Rapid Budget Analysis (RBA) 2013**. On top of a general assessment of the budget, the RBA 2013 covered six sectors namely education, health, water, agriculture, transport, energy and three thematic areas which are aggregate, wage bill and local government. The analysis uses the preliminary actual expenditures for 2012/13 and the approved budget data for 2013/14. The actual expenditure data for 2012/13 is generated from the IFMS by the Ministry of Finance after September 30, 2013, which is the cut-off date for closing the final financial accounts. The approved budget data was generated end August 2013 by the MoF after incorporating all changes proposed by the Parliament.

1. **The main focus of the note is to assess the consistency of the budget and actual public spending with government key policy priority objectives**. The Government priority objectives have been outlined in several key documents, such as the MKUKUTA which is the National Growth and Poverty Reduction Strategy of Tanzania, Five Year Development Plan (FYDP), Big Results Now Initiative, and specific sectors policy documents, such as Strategic Plans. Alignment of approved budgets and actual spending with policies is critically important for its effective implementation in order to achieve intended results. Therefore, the main question which this RBA is trying to answer is: “to what extent is the national budget an effective financial instrument to implement the policies and achieve the objectives outlined in the Government’s plans?”
2. **The remaining part of the note is organized into four sections.** The first section assesses the recent macroeconomic performance and outlook since this is a critical pre-condition for achieving the strategic objectives of economic growth and poverty reduction as outlined in the MKUKUTA and FYDP. In this respect, the note discusses the impact of the budget on key macroeconomic variables such as the inflation rate, the GDP growth rate, and the internal and external balances. The second section reviews strategic allocations and public spending among priority objectives as stated in MKUKUTA, FYDP and BRN. The appropriate composition of the budget allocation and public spending across sectors and economic categories is critical for ensuring the optimal provision of economic and social services in the country. Therefore the note discusses allocation and spending among MKUKUTA clusters, major sectors and in terms of the economic nature of spending such as wages, mainte*n*ance, infrastructure investment, and local government. The third section emphasizes some issues emerging from the analysis of the budget allocations and spending within the major sectors. The note ends by pointing out some potential fiscal risk issues, both in the medium and longer term.
3. **It is worth noting that the Government made an important change in the budget cycle, which was incorporated during the preparation and adoption of the 2013/14 budget.** The new budget cycle was justified on the basis to broaden the participation in the budget preparation, including by Parliament, and allow its execution to start on July 1. Therefore, sector budgets, which include MDAs, regions, and local government authorities (LGAs), were presented and debated by the Parliament from April to June, and the overall budget framework was approved by end June. There is room to further improve the process to preserve macro-fiscal control, in particular to seek endorsement by the Parliament of the overall budget framework before the individual expenditure votes are debated.
4. **Macro-Fiscal Framework and Outlook**
5. **Macroeconomic Context**
6. **Tanzania continues to register relatively high GDP growth rates.** Real GDP growth is estimated to have reached seven percent in 2012/13 on account of fast-growing sectors, such as communication, financial services, construction, manufacturing, and retail trade (Table 1 and Figure 1). The industrial and construction activities continue to expand steadily, partly driven by the improved electricity supply which has impacted positively on the manufacturing and construction sectors. Concurrently, the services sector has continued to experience the highest growth driven by the expansion in communication, financial services, and retail trade. The communications sector enjoyed impressive growth of more than 20 percent per annum during the decade. Additionally, the steady and rapid economic growth was supported by domestic consumption as the result of fast population growth and urbanization. However, the agriculture sector which employs the majority of people has continued to experience limited growth which also translated into limited progress in reducing poverty.It should be noted that when adjusted by the rapid population growth of 2.7 percent, the income per capita growth appears more modest at 3.6 percent over the period 2008-12.

Table 1: Key macroeconomic indicators



Source: Tanzania authorities, IMF, and World Bank preliminary estimates

1. **Inflation continues to steadily decelerate due to favorable food and energy prices in addition to the tight monetary policy implemented by the Central Bank.** The headline inflation declined to 6.3 percent in October 2013 (Figure 2). Global energy prices have also declined, impacting on local energy prices, while local food prices have also decreased by a cumulative 6 percent since early 2012, thanks to better domestic harvest, higher level of food imports, and lower international food prices. The decline in the inflation rate has allowed stabilizing the real exchange rate, which had appreciated by over 20 percent in 2012.

Figure 1: Real GDP growth trends Figure 2: Inflation trends

 

Source: Tanzania authorities and World Bank preliminary estimates

1. **Monetary policy remained tight although there was increased growth of extended broad money supply towards the end of FY2012/13**. Broad monetary expansion (M3) which has fallen less than 13 percent in June 2012 rose to more than 17 percent by July 2013 due to increased net credit to the Government, which amounted to Tsh 1,240 billion (equivalent to about 2.6 percent of GDP). But this declined again in August and September 2013 although overdraft increased towards the end of October 2013. The growth of net credit to the private sector slowed down during the same period, declining to 15 percent in September 2013 from 20 percent in July 2012, on account of a sustained fall in holdings of NFAs of banks as well as of rising real interest rates.
2. **External imbalance improved as the current account deficit declined to 13.9 percent of GDP by June 2013.** The overall balance of payment recorded a surplus of about USD 450 million, which led to an increase in gross official reserves to about USD 4,350 million. The current account deficit narrowed by 2.2 percent of GDP to around 14 percent as the result of the good performance in exports and slower import growth. The volume of gold export declined by about 10 percent while the unit price of gold exports declined 3.6 percent by June 2013 compared to June 2012. However, in recent months exports have declined, hence the need for close monitoring in the coming months.
3. **As discussed in fuller details in the next section, the fiscal deficit expanded significantly to 6.2 percent of GDP in 2012/13, almost the same level as just after Global Financial Crisis (GFC and surpassing the IMF target of 5.5)**.

***Macroeconomic Outlook***

1. **Tanzania’s economic growth is projected to remain stable at around 7 percent in the medium term.** The main drivers of growth are expected to remain the same as in recent years accompanied by an increase in public investment (as part of the “Big Results, Now” initiative). Sectors, such as communication, financial, retail trade and construction should continue to benefit from sustained increases in domestic demand resulting from technological changes and urbanization. Preliminary data shows real GDP grew by 7.5 percent during the first quarter of 2013.
2. **Inflation is expected to decline to around 5 percent over the medium term.** The decline in inflation assumes favorable energy and food prices accompanied by prudent monetary policy with a moderate rate of M3 growth consistent with low and stable inflation.
3. **The overall external balance is expected to remain stable but with a relatively high current account deficit**. A significant growth in resource-related FDI (especially natural gas) and the induced imports related to such investment will expand the current account deficit before improving significantly in the medium term after domestic natural gas replaces liquid fuel as the main source of thermal power generation. The gross official reserves are also projected to be stable at around 4 months of imports of goods and service (excluding FDI related imports).

**B. Fiscal-frame and outlook**

***Recent fiscal developments***

1. ***Fiscal deficit:* The estimated 2012/13 fiscal deficit exceeds the IMF target, by 0.7 percent of GDP.** The preliminary data estimates the fiscal deficit to be around 6.2 percent of GDP in 2012/13, up from 5.0 percent of GDP in 2011/12 (Table 2 and Figure 3). A combination of a shortfall in domestic revenue collection and higher than planned domestically financed expenditures resulted in expanded fiscal deficit.

Table 2: Fiscal trends (in percent of GDP)



Source: Ministry of Finance, IMF and World Bank

1. **Deterioration of key indicators measuring the strength of fiscal accounts accompanied the widened fiscal deficit in 2012/13.** The ratios of both domestic revenue to current expenditures and current expenditures to development expenditures, significantly deteriorated in 2012/13. Domestic revenues were only able to cover 97 percent of current expenditures while current expenditures were more than twice the development expenditures (Figure 4). These new figures represent a reversal in fiscal policy trends which had improved significantly in 2011/12.

Figure 3: Fiscal deficit drivers (in % of GDP) Figure 4: Indicators sound fiscal management



Source: Tanzania authorities, IMF, and World Bank preliminary estimates

1. ***Public Expenditures:* Overall the public expenditure to GDP ratio increased to 27.8 percent in 2012/13, about 1.5 percent higher than in 2011/12**. The increased public spending was mostly directed to recurrent spending which increased its share to 71 percent, 2 percent higher than in 2011/12. Conversely development spending witnessed its share declining to 29 percent, down by 2 percent compared to 2011/12. These new trends conflict with the Government commitment of increasing development spending, especially in infrastructure and social services, through the FYDP and the BRN.
2. **It is worth noting that there is significant variation in the public expenditure data obtained from different reports produced by the MoF.** For example, data from the CGO report shows higher level of public spending compared to the data generated from the IFMS by around one percent of GDP (Table 3). The major variations between these two data sources is on locally funded expenditures (both recurrent and development), which amounts to 1.2 percent of GDP worth of public spending. It is not clear what explains this variation in locally funded development. Moreover, these variations suggest that a significant share of public spending is unrecorded in the IFMS. There is an urgent need for improving the ability of the IFMS to capture all public spending.

Table 3: Variations in public spending by MoF different sources



Source: Ministry of Finance and World Bank estimates

1. ***Recurrent expenditures*: Recurrent spending was two percent of GDP higher in 2012/13 than in 2011/12. T**he share of recurrent spending in total public spending increased to 71 percent, up from 69 percent in 2011/12 due to increased spending on wages and salaries as well as interest payment on domestic debt. The increased spending on wages and salaries is due to higher than anticipated recruitment of teachers, security and health staff, in addition to an unbudgeted salary increment of national service staff which was implemented during the year.
2. **Re-allocation was a common feature during the implementation of the 2012/13 recurrent budget**. As a result, almost ½ all spending agencies (MDAs and regions/LGAs) experienced under spending of their recurrent budget that ranges from 10 to 57 percent. By contrast, only 9 out of 85 spending agencies (MDAs and regions/LGAs) over executed their recurrent budget by 10 to 132 percent. The notable under-spenders[[1]](#footnote-1) included the key MKUKUTA MDAs such as MoHSW (Tsh 29 billion), MAFSC (Tsh 24 billion), MNRT (Tsh 22 billion), MEVT (Tsh 18 billion) and Regions (including LGAs) such Dar es Salaam (Tsh 58 billion), Geita (Tsh 52 billion), Mbeya (Tsh 18 billion), Kagera (Tsh 18 billion). Most of the under spending was made through expenditure cuts in non-priority current spending items under goods and services categories. Notable over-spenders included MDAs such as Defense (Tsh 90 billion), MFAIC (Tsh 45 billion), National Service (Tsh 34 billion) and Police (Tsh 16 billion). Most of the overspending was made through higher wages and salaries.
3. **The cuts in non-priority current spending (non-salary expenditures) through re-allocation led to lower transfers to regions and LGAs.** By the end of FY 2012/13 only 59 percent of non-salary funds budgeted for the Regions and LGAs were released. The significant shortfalls in disbursement of non-salary recurrent funds (which was mostly directed at capitation grants, school meals, general purpose grant, and leave and moving expenses) may have disrupted service delivery in LGAs especially in education and health sectors. In MDAs, overall release of non-salary recurrent funds performed well with 98 percent of all budgeted funds being released by the end of the FY, with 81 percent of funds being released by end of Q3 of the FY. There have been, however, significant variations across MDAs.
4. ***Development expenditure*: Development expenditures were lower than budgeted despite significant re-allocation from recurrent to development spending during the year.** Lower than anticipated disbursement of foreign financed projects, together with delays in recording foreign direct spending to project funds accounted for lower than budgeted development spending. The locally funded development expenditures were up by 1.3 percent of GDP. As a result the share of domestically funded development budget increased to around 59 percent in 2012/13, significantly higher than around 50 percent recorded in 2011/12 (Table 4). At this stage, the share of foreign funded development may be underestimated due to delays in reporting the direct spending to project funds (D-Funds) and may increase when final adjustments will be recorded in the system.

Table 4: Funding of development spending



Source: Ministry of Finance

Figure 5: Trends in release of funds (as percent of approved budget) in 2012/13



1. **Development budget execution improved in 2012/13 but the usual delays in the release of development funds persisted.** Overall development execution rates increased to 79 percent from 70 percent in 2011/12, driven largely by good performance in disbursement of local funds, with an execution rate of 89 percent (Figure 5). Nevertheless, the large share of development funds was released during the last quarter of FY, about 47 percent, while less than 15 percent were released during the first quarter. In terms of release of development funds, performance was much better in the Regions and LGAs than MDAs, with more than 83 percent of all budgeted development funds being released by end of the FY; and 87 percent of the release arriving by Q3 of the FY. The delays in releasing local development funds were mostly driven by the late disbursement of non-concessional external loans, which were mostly executed during the last month of Q3 of the FY. Additional delays in the release of foreign funds were on account of slow project implementation (limited absorption capacity), including the length of procurement process.
2. **PAF 2013 indicator:** Overall the release of both non-salary recurrent and development funds to the Regions and LGAs through the end of FY was **70 percent**, with **87 percent** of released funds arriving by Q3, up from 60 percent in 2011/12.
3. ***Domestic revenues*: Domestic revenue collection in 2012/13 was below the target set up in the budget by almost 1 percent of GDP** (Table 5). While tax revenues increased by 0.4 percent of GDP between 2011/12 and 2012/13, non-tax revenues declined by 0.2 percent of GDP. The relatively good performance in tax revenue collection was driven by the collection of domestic taxes especially corporate income taxes and withholding taxes which grew by 33 percent and 37 percent, respectively, between 2012/13 and 2011/12. These improvements are explained by intensification of tax audits, recovery of tax arrears, increasing transactions that attract withholding taxes (dividend payment to shareholders by companies), and enforcement on the use of Electronic Fiscal Devices (EFDs).

Table 5: Domestic revenue trends (in percent of GDP)



Source: Ministry of Finance

1. **In contrast to the good performance in collection of direct taxes, domestic VAT, excise, PAYE, and international taxes underperformed in 2012/13**. Slower construction and manufacturing activities together with huge VAT refunds to TANESCO accounted for about 10 percent and 17 percent shortfalls in VAT and excise tax collections, respectively. Non implementation of salary adjustment by many private companies, following the pay rise by the public sector in 2012/13, and significant increase in employment tax refunds resulting from retrenchments in some public enterprises accounted for a shortfall of about 3 percent in PAYE collection. Decline in volumes and shift in composition of imports from consumer goods to intermediate goods accounted for underperformance in international tax collection.
2. **Non-tax revenue collection was significantly lower than targeted in 2012/13, a shortfall of about 30 percent**. Delays in application of new rates of land rents passed by Parliament in August 2012, together with delays in payment of dividends by some parastatals and non-remittance of 10 percent of gross incomes of regulatory authorities to consolidate fund partly accounted for the shortfall.
3. **The lower than expected domestic revenues was recorded in spite of a significant effort to reduce tax exemptions in 2012/13.** Preliminary data shows that tax exemptions as a percentage of GDP declined to **3.1 percent in 2012/13 (PAF 2013 indicator),** from 3.9 percent of GDP in 2011/12 (Table 6). Both customs and domestic revenue departments recorded a decline in tax exemptions. That said, tax exemptions as percent of GDP remain relatively high, accounted for largely by exemptions of VAT and custom duties to private companies and individuals, particularly mining companies, and TIC registered companies.

Table 6: Tax exemptions trends



Source: Tanzania authorities and World Bank estimates

1. ***Grant and non-concessional external financing***: **Although overall aid disbursement in absolute value remained relatively stable, as share of GDP it continued to fall in 2012/13**. The level of aid was equal to 5.7 percent of GDP, or 20 percent of total public spending, against 6.4 percent and 24 percent, respectively in 2011/12. Those levels were as high as 10.3 percent of GDP and 45 percent of total public spending in 2007/8. Program aid, which includes general budget support and basket funds (loans and grants), declined faster as a share of GDP than project aid (Figure 6).

Figure 6: Aid and non-concession external financing trends (a & b; in percent of GDP)



1. **Non-concessional external borrowing is increasingly replacing foreign aid as the new source of financing the budget**. In 2010/11, non-concessional borrowing was equivalent to about 0.2 percent of GDP, while total grants and concessional loans were equivalent to 8 percent of GDP. Two years later, in 2012/13, the level of non-concessional loans increased to 3 percent of GDP and total grants as well as concessional loans declined to about 5.7 percent of GDP. In 2012/13 alone, the Government contracted about 3 percent of GDP in non-concessional loans with about one half disbursed through the budget while other half was disbursed direct to Tanzania Petroleum Development Corporation (TPDC), as on-lending. However, some of the contracted loans will be disbursed over several years.
2. ***Net domestic borrowing*: Net domestic borrowing exceeded the target agreed in the IMF program by 1.3 percent of GDP in 2012/13.** The net domestic financing through domestic borrowing amounted to Tsh. 1,087 trillion, equivalent to 2.3 percent of GDP above the target and IMF ceiling of 1 percent of GDP. The increased domestic borrowing was partly used to compensate for shortfalls in disbursement of non-concessional borrowing and domestic revenue collections.
3. **Debt service has consistent increased with the increased non concessional borrowing reducing the fiscal space.** Debt service (excluding amortization of domestic debt) increased to 1.8 percent of GDP, (equivalent to 6.5 percent of total public spending) in 2012/13 from just 1 percent of GDP (equivalent to 3.6 percent of total public spending) in 2009/10. As the share of debt service in the total public spending continues to increase the available fiscal space is reduced hence limiting the resources for infrastructure and social services provision.

***Fiscal Outlook***

1. ***Fiscal deficit*: The 2013/14 budget anticipates bringing fiscal deficit down to 5.0 percent of GDP.** To achieve this fiscal deficit target it will require significant strides in increasing revenue collections and containing expenditures while ensuring that the priority activities and programs in infrastructure and social services are fully funded. On the revenue side, low tax collection during the first quarter of 2013/14 (about 10 percent lower than targeted) will require a significant turnaround in the remainder of the fiscal year.The level of total expenditure is projected to reach over 30 percent of GDP in 2013/14 -its highest level in recent history. This increase followed the Government’s willingness, as illustrated by the recent BRN initiative, to finance key development projects in six priority sectors. It also reflects a relatively sharp projected increase in recurrent spending, especially in the public wage bill.
2. **Recurrent spending is projected to increase significantly in 2013/14 reaching 20.7 percent of GDP, driven largely by an increase in the wage bill.** The increased wage bill is the result of the Government decision to raise the minimum wage of civil servants together with anticipated new hires, including in the education and health sectors. In addition to the wage bill, non-salary recurrent spending is allocated for finalizing the Constitutional review process, to issue citizen identity cards, analyze population and housing census data, and to prepare for 2015 General Elections. Payment of domestic and foreign debt services as well as verified arrears and claims by various suppliers and employees is included among the current priority spending areas.
3. **The increase in minimum pay of civil servants and new hires means that the wage bill[[2]](#footnote-2) will consume about 40 percent of the budget in 2013/14.** The Government decided to increase the minimum salary of civil servants starting July 2013 to provide motivation for quality public service delivery while keeping up with the rising cost of living. Concurrently, the Government has decided to hire new staff in education, health and agriculture sectors with the aim of improving the quality of service delivery consistent with BRN objectives. While the need for improving quality of public service delivery through providing right incentives to civil servants and new hires is welcome, there is a need to have a right balance between the wage bill and other components of the budget, including development spending.

Table 7: Trends in wage bill components (in percent of total budget)



Source: Ministry of Finance and World Bank estimates

1. **Despite the increase in wage bill the share of allowances in the budget slightly declines reflecting the Government policy of limiting the use of allowances to compensate for low pay.** Spending on allowances is projected to declineboth as the share of total budget and in percentage of GDP to 3.8 percent and 1.1 percent respectively. These allowances include both remunerative consuming 40 percent and duty facilitating consuming 60 percent of total allowances.
2. **As in recent years, infrastructure maintenance is a low priority of the 2013/14 budget.** The overall share of the budget allocated for infrastructure maintenance declines to less than 3 percent in 2013/14. Inadequate allocation for infrastructure maintenance, especially in sectors such as energy, water and roads sectors, has undoubtedly resulted in unreliable and low access to electricity, water and rural roads. This problem hinders Tanzania’s potential for higher growth and the reduction of poverty. Some backlogs and additional new infrastructure investment require increased allocation for maintenance to avoid huge rehabilitation or reconstruction costs in the future.
3. ***Development spending:* Development expenditures are projected to increase significantly in 2013/14, largely as the result of the BRN action plans and other priority projects under FYDP.** Development spending is projected to increase by 26 percent in real terms reaching 10.3 percent of GDP, up from 8.9 percent of GDP in 2012/13 approved budget. The Government projects to spend Tsh 2, 289 billion (equivalent to 4.1 percent of GDP) on strategic projects under the BRN initiative and Tsh. 3,386 billion (equivalent to 6.2 percent of GDP) on other priority projects geared towards promoting economic growth and poverty reduction (see more details in next section).

Table 8: Trends in current and capital spending (in percent of approved total budget)



Source: Ministry of Finance and World Bank estimates

1. **Development spending will continue to privilege the purchase of consumption goods but the share of capital goods is on the rise.** Driven by increased spending on energy, transport and water public investments, the share of capital spending in the in the total budget is expected to reach 21 percent, significantly higher than in 2012/13 but lower than in 2011/12 approved budget.
2. ***Domestic revenue***: **The domestic revenue collection target in 2013/14 is highly ambitious at 20.9 percent of GDP.** Both tax and non-tax revenue collections are projected to increase significantly driven by strengthened tax policy and administration measures. The Government is implementing some of the recommendations from the Resource Mobilization Lab under the BRN aimed at increasing revenue collections from both tax and non-tax sources. These recommendations include auctioning forestry and hunting blocks together with better assessment and collection of land and property taxes. The Government has also introduced some new taxes and raised rates applicable to existing excise taxes, and continues to reduce tax exemptions especially those associated with VAT. Moreover, the Government continues to strengthening tax administration through training and the use of technology in assessing and collecting taxes by TRA, including use of the EFDs and establishment of Revenue Gateway in July 2013.
3. **Projected increase in domestic revenue collection is supported by tax policy measures but some have proved difficult to implement.** Taxes on the SIM card and the bank transfer have not been implemented pending the ruling of the court case. In addition, the proposed increase in fuel level was not fully approved by the Parliament. As a result significant short falls in domestic revenue collections were observed during the first quarter of 2013/14 (almost 10 percent lower than targets). The carry-over of the revenue shortfall from 2012/13 also partly explaining the shortfall observed during the first quarter of 2013/14.
4. ***Aid and financing***: **Grants, concessional and non-concessional loans from both external and domestic sources are projected to reach 10.7 percent of GDP in 2013/14**. The Government expects to borrow Tsh. 1,469 billion (equivalent to 2.6 percent of GDP) on concessional terms and Tsh 1,156 billion (equivalent to 2.1 percent of GDP) on non-concessional terms from external sources. Moreover, Tsh 552 billion, equivalent to 1.0 percent of GDP, is expected to be borrowed from domestic sources. The non-concessional borrowing targets are consistent with the IMF Standby Credit Facility (SCF) and all these funds will be directed into infrastructure investment projects, especially in energy and roads.
5. ***Public debt and debt service*: Total public debt and debt service have been growing fast and are set to grow further owing to increased non-concessional borrowing**. Total debt was equivalent to 43 percent of GDP by March 2013, up from 42 percent of GDP in March 2012 External debt accounted for 77 percent of total debt. The total public debt is set to increase by 5 percent of GDP in 2013/14, reaching 47-48 percent of GDP at the end of the FY. The total debt service on external debt (interest and amortization payments) is projected to increase to 2.5 percent of GDP (up from 1.8 percent in 2012/13) equivalent to 8.3 of projected total public spending.
6. **Despite the increasing levels, total as well as external public debt remains sustainable in both the short and medium term but fiscal consolidation becomes imperative**. The risk of debt distress remains relatively low as long as the Government will be able to contain its overall fiscal deficit and sustain high growth in the coming years. This assumes that the authorities will be able to manage the expenditure pressures associated with infrastructure needs and growing pension liabilities within a sound fiscal policy framework. The Government is in the process of establishing the Debt Management Department in the MoF, including reviewing the policy and legal framework and capacity building for better manage and monitor the public debt.
7. **Strategic Allocation of Expenditures and LGA transfers**
8. **Strategic Allocation of Expenditures**
9. **The share of budget allocated to strategic priorities defined in the MKUKUTA and FYDP should reach 73 percent in** 2013/14, up from 71 percent in 2012/13 (Table 9). This increase is the result of higher allocations for infrastructure investment in energy and roads. In addition, significant budgetary allocations for social sectors continue to be with the objective to increase the quality of service delivery.

Table 9: Trends in approved budget allocations to MKUKUTA and non-MKUKUTA



Source: Ministry of Finance and World Bank estimates

1. **Despite the increased share of the budget allocated for MKUKUTA and FYDP priority programs and projects, BRN action plans remain significantly underfunded**. Overall, the program and projects that are identified under the BRN remains significantly underfunded, with only 42 percent of the required funds being included in the 2013/14 budget (Table 10). The projects and programs under the BRN are supposed to be implemented over three years starting from 2013/14 to 2015/16. Inadequate funding will definitely delay implementation of those programs and projects. As a result, part of the resource required for the BRN implementation will have to come from the private sector. However it remains unclear when and how much resources can accessed from the private sector since the legal and institutional frameworks for privates sector participation, especially through PPPs, is currently under review.

Table 10: Resource requirements and budget gaps for implementing BRN NKRAs (in Tsh billions)



Source: Tanzania authorities

Table 11: Trends in approved budget allocations to MKUKUTA clusters



Source: Ministry of Finance and World Bank estimates

1. **The continued focus on infrastructure investment has seen a significant increase in the share of budget allocations going to cluster 1 (economic growth and reduction of poverty) in 2013/14 compared to 2012/13 but remains lower than in 2011/12 and 2012/13[[3]](#footnote-3).** Cluster 1 is now consuming about 41 percent of all MKUKUTA allocations, well above the cluster 2 (social wellbeing), and up from 33 percent in 2007/8 (Table 12). Such a development is consistent with FYDP; which considers increased infrastructure investment, especially in energy and transport, as critical for unlocking growth potentials in Tanzania. The increased share of cluster 1 is largely driven by increased allocations to energy, roads, and railways sectors. Nonetheless, the increase may not bring new investments or improved maintenance as part of such increase will be used to clear arrears.
2. **Improved budget execution will guarantee the credibility of increased budget allocations in favor of priorities of the MKUKUTA and FYDP**. Budget execution remains weak especially in sectors which have large share of capital investment and this may have impact in changing MKUKUTA shares in the executed budget. For example, in 2012/13, the overall budget was under executed by 10 percent, with the development budget being under-executed by 22 percent while recurrent budgets being under-executed by 6 percent. Figure 7 indicates that key MDAs and Regions (including LGAs) which are the main implementers of MKUKUTA and FYDP priority programs significantly under-executed their budgets while some of non-MKUKUTA and non-FYDP significantly over-executed their budget in 2012/13. Not only does this under-execution puts serious concern on the credibility of budget allocations but also on the implementation of related programs and projects. Unless this challenge is fully addressed it will not be a surprise to see some of the action plans under BRN facing implementation difficulties.

Figure 7: Budget execution trends in selected MDAs & Regions in 2012/13



Source: Ministry of Finance and World Bank estimates

1. **There is a significant reduction in share of allocations to non**-**MKUKUTA spending agencies in 2013/14**. This reflects the Government commitment of reducing spending in these areas in order to create budget space for spending on priority programs and projects. Despite the decline in overall allocations for non-MKUKUTA spending areas, share of allocations for debt service continue to rise consistent with increase non –concessional borrowing.
2. **PAF 2013 indicator: Therefore,** despite a large share of the 2013/14 budget being allocated for MKUKUTA and FYDP policy priorities it is **weakly aligned with policy objectives** due to unreliability in execution of the resource envelope in addition to significant underfunding of BRN action plans.
3. ***Local government authorities* (LGAs)**
4. **The fiscal decentralization efforts are being sustained through steadily increasing budget allocations toward LGAs but low execution rates are taming these efforts**. The positive trend of fiscal decentralization in the budget allocation is sustained in 2013/14 with LGAs projected to receive 28.6 percent of the total budget resources, up from 26.4 percent in 2012/13. In absolute terms, this amounted to Tsh 3.8 trillion and represented an increase of 15.9 percent over the previous year’s allocation. The increased allocations for LGAs are driven by increased allocation for salary and wages and development spending, mostly directed to education and water sectors. Nonetheless, in recent years, efforts in budget decentralization have not being matched on the grounds. For example by end of FY 2012/13, only 68 percent of funds budgeted for development and non-salary activities in LGAs were released by the Treasury. Non-salary funds performed poorly with only 58 percent of the budgeted funds being released to the LGAs. This affects service delivery in the LGAs, with severe implication for the population.

Figure 8: Trends in budget allocations and release of funds to LGAs



1. **Inequity in recurrent budget allocations across LGAs remains a big challenge as it explains regional disparities in social service delivery**. Some LGAs will receive more than four times more recurrent funds (adjusted per capita) than others. Since those funds are used to cover salary and non-salary expenses, they explain discrepancy in the numbers of staff and the likely variations in the quality of service delivery. Government has recognized this problem and the PMORALG and the MoF are reviewing the formula-based allocation system under PFMRP IV in an effort to make the system more transparent and equitable. The system will also be examined in detail in the upcoming fiscal inequities public expenditure review, which will look in more detail at implementation problems and possible solutions to improve actual allocations and hence service delivery.
2. **Own-source revenues are increasing becoming an important source of funding LGAs projects and programs**. LGA own revenues are projected to grow by 6 percent in 2013/14 compared to 2012/13, thereby contributing about 10 percent of the total resource envelope of LGAs. Further consideration should be given to how to develop LGAs ability to generate their own resources and using them in a more effective and accountable way.

Figure 9: Recurrent Spending Allocation Per Capita in Different District Councils (Tsh)[[4]](#footnote-4)

1. **Emerging messages from sector budgets**

**Overall**

1. **About two thirds of the discretionary public spending was spent on the six Mkukuta priority sectors in 2012/13.** This is equivalent to an increase of more than 3 percent (or 0.2 percent of GDP) of spending compared to the previous year (Table 12). The increase in actual spending in 2012/13 compared to 2011/12 was largely driven by the energy, water, health and education sectors, which saw their shares, increase significantly to off-set the decrease in roads, and agriculture. The most notable increase is in the energy sector which saw its total spending rising by 2.3 percent. This is partly explained by the increased transfers to TANESCO which aim to close the parastatals financial gap.
2. **Despite the need for the implementation of the BRN action plans the share of total spending of the six Mkukuta priority sectors in the 2013/14 budget declines compared to the approved budget in 2012/13**[[5]](#footnote-5)**.** This partly reflects the fact that the BRN action plans are significantly underfunded. The six Mkukuta priority sectors are set to consume 64.6 percent of the 2013/14 budget (excluding CFS) compared 65.5 percent in 2012/13 (Table 12). As a share of GDP, allocations to the six priority sectors increased between 2012/13 and 2013/14 by 0.8 percent. The main drivers of increased allocations to priority sectors are water, energy and roads, which saw significant increases in the 2013/14 budget. The sectors which are included in the National Key Results Areas (NKRAs) under BRN are education, water, agriculture, transport/roads, and energy. There is also a revenue mobilization priority.
3. **PAF 2013 indicator:** The share of actual total public expenditure (excluding CFS) devoted to education, health, water, agriculture, roads, and energy increased to **62.5 percent** in 2012/13 from 59.2 percent in 2011/12. It is further anticipated to reach 64.6 percent in the 2013/14 budget. However budget execution is a serious challenge especially for development spending and the infrastructure sector.

Table 12: Trends in priority sectors spending



Source: Ministry of Finance and World Bank estimates

1. **Education**

*2012/13 actual expenditure*

1. **Budget execution in the education sector has improved**. The education sector saw a continued improvement in the centralized budget execution in 2012/13with 94 percent of approved funds released (97 percent of the recurrent budget and 80 percent of the development budget) and almost all money being spent. This is a substantial improvement on the previous year where 79 percent of approved funds were spent (96 percent and 25 percent respectively for recurrent and development budgets).
2. **There were some variations in overall sub-sector budget execution rates in 2012/13, ranging from 84 percent for TVET and Adult[[6]](#footnote-6) to 98 percent for Higher education level**. For recurrent expenditure there was slightly more variation (78 percent for TVET to near 100 percent for Higher) and there was high variation in development budget execution, with Adult only achieving 30 percent, Secondary only achieving 44 percent whilst TVET achieved 99 percent. Whilst this variation in development budget execution rates is less extreme than in 2011/12, the low execution rates at secondary level continue to hint at on-going issues of absorption/implementation capacity for construction activities which were raised in both the 2011 and 2012 education sector RBAs.
3. **The regions (including LGAs) have an overall execution rate of 94.3 percent in 2012/13**. Most regions have an execution rate above 85 percent, with a reported 100 percent in Kigoma and virtually 100 percent in three other regions. Geita is an outlier with just 39 percent execution. There was no Regional outturn data. However, using PMO-RALG data, we can see that there was a wide variation in the education budget execution rates for individual districts ranging from a low of 21.6 percent in Bahi District to a high of 121.4 percent in Lushoto District[[7]](#footnote-7). The Government should investigate reasons for the large geographical inequality in regional spending per student and prioritise greater equity in resource allocation.[[8]](#footnote-8)

*2013/14 approved budget*

1. **The education sector budget is broadly in line with sector policy priorities**: Education remains the largest spending sector but its share of total government budget has reduced to 19.6 percent in 2013/14 budget, down from 21.2 percent in total Government budget in 2012/13.
2. **Education sector spending as a share of GDP remains relatively high for a developing country at 5.9 percent**, but budget execution needs to continue improving to ensure results on the ground.
3. **An increasing share of the education sector budget is being decentralized.** Around 70 percent of the education sector budget in 2013/14 will be decentralized, up from 65 percent in the 2012/13 budget. This demonstrates an on-going commitment to spend more of the education budget at the district level to improve the quality of primary and secondary education.
4. **There is high volatility in the decentralized development budget for education** – the 902 percent rise this year follows a 97 percent drop from 2010/11 to 2011/12. This seems to be due to its substitutability with LGAs development expenditure, with rises and falls largely offset there. It might also be a reward for improvements in execution, 67 percent in 2011/12 compared to 26 percent in 2010/11. The decentralized development budget constitutes 21 percent of the total education development budget this year.
5. **The total wage bill (including allowances) has continued to increase** **mainly on account of a rise in the minimum pay and due to the anticipated new hire of teachers for secondary and primary schools**. As a share of the total education budget wage bill stands at 64 percent of the 2013/14 budget. Basic salaries, or PE, accounts for 97 percent of total wage costs, the vast majority of which is at decentralized level (i.e. for Basic and Secondary)[[9]](#footnote-9). As execution of PE tends to be higher than other types of spending (97 percent in FY 2012/13 compared to 90 percent for the sector overall) this figure is likely to rise with implementation, which would make relative wage spend in 2013/14 higher than in any other year for which data was available. The Government needs to ensure that sufficient budget is allocated for non-salary quality improvement inputs.
6. **Estimates of nominal unit cost for basic education have increased but nominal unit cost estimates for secondary and higher education have decreased**. This could represent on-going rationalization of the Higher education budget. However, at the Secondary level, where the unit cost has decreased by Tsh 40,000, it raises concern given that increasing the quality of secondary education is a core priority given the low examination pass rates.[[10]](#footnote-10)
7. **There is significant wastage in the education system which undermines value-for-money.** This is due to high repetition rates in the early grades of primary education and a low examination pass rates at the end of the primary and lower secondary cycles. Basic analyses on unit costs per student suggest that around half of the basic education budget is spent on students who are repeating and/or fail to graduate.
8. **Health**

*2012/13 actual expenditure*

1. **The budget execution in the health sector has improved**. The health sector budget execution for 2012/13 was a strong 89.4 percent of the budgeted amount. Unlike 2011/12, execution of the 2012/13 budget was consistently strong across both foreign (88.3 percent) and local (89.9 percent) health spending. This is a welcome improvement from 2011/12 where more than 90 percent of GoT discretionary budget was executed but less than 40 percent of the foreign budget was executed. This was potentially linked to low execution of GFATM resources.

*2013/14 approved budget*

1. **The share of the health sector budget in the total approved budget continues to decline, at 8.7 percent in 2013/14 down from 9.6 percent in 2012/13.** Despite the decline in share the health sector budget has increased in nominal, real and per capita terms between 2012/13 and 2013/14. However, the share is significantly below the Abuja target of 15 percent of total public expenditures.
2. **Non-basket foreign funding is expected to reverse the decline in previous years**. The increase in non-basket foreign funding is particularly prominent in the area of medicines. However, the increase in non-basket foreign funding to the health sector masks the absolute and real term declines in the health basket funds and local resources to the health sector. In 2012/13 the health sector received 8 percent of local resources; but this is projected to decline to 6 percent in 2013/14. Declining shares of Government own discretionary resources to the health sector suggest a lower priority given to this sector, as indicated by its exclusion in the first round of BRN ‘labs’. Financial sustainability therefore remains a concern, particularly because non-pooled donor funding (which is not necessarily predictable or system strengthening focused) appears to be replacing local and pooled donor funding to invest in the health system.
3. **The decline in the foreign health basket and GoT local (including GBS)** resources to the health sector could potentially have a negative impact on budget execution in 2013/14. This must be carefully monitored.
4. **Geographic inequality in the health block grant (OC&PE) distribution amongst LGAs** remains substantial. This causes disparities in quality of health service delivery across districts. This needs to be addressed as a matter of urgency.
5. **Water**

*2012/13 actual expenditure*

1. **Budget execution rates in the water sector remain very low.** While there is some improvement in 2012/13 compared to 2011/12, a water budget execution rate was only 56%. Significant efforts are needed especially for successful implementation of the BRN action plan on water. In addition to the low execution rate, the share of the water sector budget in the total Government actual expenditure has remained below 3 percent (on average) in the past three years.

*2013/14 approved budget*

1. **The share of public resources to the water sector is projected to decline from 4.5 percent of total approved budget in 2012/13 to 4.3 percent in 2013/14.** This will be driven by a decline in foreign financing to the sector. Nevertheless, local financing of water sector is projected to significantly increase in 2013/14, directed to projects and programs in rural areas. This illustrates the Government’s commitment to improve access to water services to the majority of Tanzanians.
2. **There is also an increased budget allocation for water programs and projects in LGAs**. After declining for the past three years, spending on water programs and projects in the regions and LGAs is anticipated to increase by 5 percent in 2013/14 compared to 2012/13. This illustrates a positive commitment to decentralization and is largely driven by the increase in the development budget through the rural water and sanitation program. The water sector budget directed to rural water development programs has increased significantly in 2013/14 to 49 percent from 15 percent in 2012/13, thereby altering the urban bias seen in the 2012/13 budget.
3. **The water sector budget is broadly aligned to sector policy priorities but the delays in disbursement of development funds to LGA are set to persist.** Analysis has indicated a reasonable alignment of the sector approved budget with key strategic objectives and projects in the sector as set out in the WSDP, MKUKUTA and BRN. However, the Lower Ruvu water project remains significantly underfunded. There is also a significant funding gap implementing the BRN Initiative in water (44 percent gap). Furthermore, there is concern about the timely availability of funds to implementing units to carry out development projects in rural areas. This trend seems to continue because until the end of the first quarter of 2013/14 there are no funds disbursed to LGAs implementing water sector development programs and projects under the BRN.
4. **There is also limited attention to allocations for infrastructure maintenance**. The inadequate budget allocation for the maintenance of sector facilities is another area which requires immediate improvement. The maintenance budget allocation remains low at 0.2 percent of the total sector budget in 2013/14. Whereas construction of new infrastructure is critical, maintenance of existing facilities is essential to ensure existing facilities remain functional. This has been articulated in the BRN but not backed with finance in the budget.
5. **Agriculture**

*2012/13 actual expenditure*

1. **There have been significantly lower levels of budget execution in 2012/13 than the past four years**. The executed agriculture budget for the financial year 2012/2013 reached Tsh 431.7 billion, showing a worrying execution rate of 69.6 percent. This is a significant decrease compared to 78.5 percent in 2011/12 and the lowest execution rate the sector has experienced for the last four years. It poses a clear problem of budget credibility within the sector. Low release of budgeted funds, at 70 percent, mainly contributed to low execution rate in the sector. As a result it translated into failure to pay farmers supplying grain to the NFRA, failure to pay input dealers supplying seed and fertilizer to the input subsidy program, and many other delays. Moreover, this contributed to higher input costs and lower incentives to expand production.
2. **But there is an increased absorption capacity**: On a more positive note, the utilization rate of funds received is encouraging with nearly 100 percent of funds received by MDAs and LGAs being spent in 2012/13. This is an improvement compared to previous years where significant amounts of resources were carried over to subsequent years. This is particularly observed at LGA level, where allocations have been reduced, and as a consequence of resource scarcity, execution ratios are very good.
3. **The increased number of extension staff may be linked with a decline in the quality of service.** The sector hired an additional 3000 extension workers, tutors and researchers in 2012/13; this is reflected in the 12.1 percent increase of the 2013/14 wage bill. While hiring of additional extension officers, tutors and researchers is good, it will be important for this investment to be accompanied by supplemental funding for equipment, transportation and training. At the moment the increased budget for hiring more agriculture staff is not accompanied by increased non-salary (operational) budget. And there may well be a continuing decline in non-salary budgets for extension in the future as the ASDP budgets for LGAs declines.

*2013/14 approved budget*

1. **Despite the agriculture sector being recognized as one of the priority sectors, its share in the total Government budget is projected to decline.** The share of agriculture sector budget in the total Government approved budget is around 3 percent in 2013/14, down from 4 percent in 2012/13. Not only does the agriculture sector budget decline as the share of total Government but it also declines in absolute terms, from Tsh 560 billion to Tsh 543 billion between 2012/13 and 2013/14.
2. **There are stable allocations for development spending**: The share of development expenditures remains stable compared to previous years although there is a continued dependency on foreign funding for development expenditures. Capital investments remain low, representing 12 percent of the overall agriculture budget and 27.3 percent of development expenditures, but shares have improved two years in a row. However, the picture is different at the local level where capital spending is only 4.2 percent of allocations to regions and LGAs.
3. **The agriculture budget reveals a shift of expenditure in favor of public goods**. However core public goods such as seeds breeding, policy and planning, plant health and protection, land use and planning, and animal disease control receive low priority. Nearly 50 percent of the sector budget is allocated to two items for subsidization of crop production and operation of the National Food Reserve Agency (NFRA), including clearance of arrears of grain purchased in 2012/13 but not yet paid, with possible risks for disrupting development of the grain market. To improve prioritization of sector strategies and MKUKUTA II, there should be a reduction on single items such as the NFRA. Priority should be given to other core public goods. Contrary to the decentralization policy, the share of LGA transfers of the sector budget decreased from 15.6 percent in 2012/13 to only 11.4 percent of the sector budget in 2013/14. The decline is attributed to a decline in commitments to the ASDP Budget Fund as the program closes. Despite this decline, ASDP still receives 10 percent of the sector budget, with SAGCOT receiving only 4 percent. The closure of ASDP will lead to uncertainties in future funding of sector investments particularly at the local level. With the completion of the ASDP, it is paramount to ensure that transfers to LGAs are increased or restored to the previous year’s levels to sustain critical investments at this level, in line with the decentralization policy.
4. **Future funding of the sector could be through the Big Results Now (BRN)** initiative whose implementation starts in 2013/14. The BRN initiative will initially be implemented for two years with the initial budget of Tsh. 1.78 trillion to be financed by the Government and DPs. However, this analysis could not identify specific funds tagged to this program for this financial year. The level and modality of funding BRN activities are not yet clear for both national and local levels.
5. **Transport**

*2012/13 Actual expenditure*

1. **There was over spending of the development budget but this was linked to the clearance of arrears**: Actual development expenditures for trunk and regional roads under TANROADS exceeded the approved budget by around 50 percent, equivalent to about Tsh 350 billion. It is under stood that additional funds were reallocated to the Ministry of Works for clearance of arrears in TANROAD but the exact amount of funds disbursed is not clearly shown. It is, however, not less than Tsh 352 billion, which would be the imputed amount used for clearance of arrears assuming a full utilization of the approved budget for regular project related expenditures.
2. **The outstanding payments at the end of June 2013 totaled Tsh 376 billion.** This translates into a net increase of Tsh 221 billion in outstanding payments in 2012/13 when compared to Tsh 155 billion as of the end of June 2012. Despite substantial payments made to clear arrears the outstanding amounts are not diminishing due to the emergence of new arrears.
3. **Physical execution of roads projects remained low despite high financial execution**: The physical execution ratio remained lower than normal due to the diversion of funds for clearance of arrears and suspension or slow execution of works by numerous contractors whose invoices remained unpaid.

*2013/14 approved budget*

1. **The share of public resources going to the transport sector is projected to increase significantly from 11.6 percent to 12.9 percent of total approved budget between 2012/13 and 2013/14.** The increase in both the road subsector and the non-road subsectors are consistent with the need for scaled up transport infrastructure development and the intermodal approach at the core of FYDP and National Transport Policy. However, there are two serious uncertainties. First, a significant part of the increased road subsector budget will be used to clear arrears. And second, the approved budget for the non-road subsectors may not be executed in full as in the past since the execution rate was only 44 percent in 2012/13.
2. **Moreover, the increased 2013/14 budget for the transport sector still does not meet the funding requirements for TSIP Phase II and the BRN Initiatives**. The underfunding of the BRN could partly be explained by the mismatch between the timing of the budget process and launch of the BRN initiative. Despite the large financing gap, however, there is some broad realignment of development expenditures in line with FYDP, TSIP II, and BRN Initiatives evident in the increased allocations for the non-road subsectors in the current budget, especially for rail.
3. **There is inadequate direct funding in the current budget for LGTP Phase II** that is now in its second year of implementation. This is a serious issue in contravention with the top MKUKUTA II priority of poverty reduction and shared growth.
4. In order to improve the performance of the transport sector it is important the Government: (i) adopt a comprehensive approach as proposed in the RBA Sector Background Note – Transport to clearance of arrears; (ii) develop strategic policies and investments to catalyze private investments under PPPs; and (iii) provides direct budgetary allocations to LGTP Phase II matching dollar for dollar the rising donor assistance in this area in 2014/15 and beyond.
5. **Energy**

2012/13 actual expenditure

1. **This sector witnessed a large increase in actual expenditures compared to the approved budget in 2012/13**. The increased expenditure was driven by increased transfers to TANESCO to close the financial gap. Through mid-year budget reallocations, recurrent expenditure was 370 percent higher than the approved budget while development expenditure was 53 percent lower than budgeted, after adjusting for transfers to TANESCO from development budget to recurrent budget.

2013/14 approved budget

1. **Spending on the energy sector is anticipated to increase further.**  While containing the growth of the recurrent budget, the approved budget for 2013/14 has increased substantially the allocations for development expenditure, particularly foreign funded expenditure. The funding source for increased development expenditure is partly from the budget support by the World Bank and the African Development Bank, which the Government has budgeted for in transfers to TANESCO. However, these trends are not expected to finance capital goods but assist TANESCO to clear arrears.
2. **The continued increase in spending is driven by both the costly EEP and the need for scaling up investment in the energy sector**. In the short term, the growth in sector spending is driven by the costly Emergency Power Program (EPP) introduced in August 2011 in response to the power shortage due to poor rainfalls in late 2010. The medium term trend corroborates with the Government’s intention to scale up public investments in the energy sector in line with MKUKUTA II, FYDP, and more recently by the BRN initiative. Going forward, the Government is committed to scale up the investment program under the BRN Energy KRA. One key challenge is how to ensure timely and fiscally sound implementation of the program. If implemented successfully, the program would lead to transformation of the sector to a lower-cost structure using cheaper gas-based power generation.
3. **The energy sector remains in financial distress**. TANESCO continues to face financial difficulty and, as shown in the size of transfers from the Government budget, it carries a substantial financial burden and risks for the Government’s fiscal framework. Before the GoT transfers, TANESCO made about $240 million operational losses in 2012 and is projected to have slightly higher losses in 2013 based on the preliminary estimation by the World Bank. The Government’s transfers were used to finance about half of the operational loss in 2012. TANESCO has also borrowed commercially to finance the loss, which adds burden to its financial sustainability in the long run. On the other hand, there are some signs of improvements as reflected in the reduction in the size of arrears from $276 million at the end of December 2012 to $167 million at the end of September 2013. The data from the first eight months of 2013 show an improvement in revenue collection compared to 2012, which is driven by efficiency improvements rather than a tariff increase.
4. **Gender**
5. **There is limited information on gender dimensions in the budget**. The available data from the 2013/14 budget does not provided sufficient information to track gender dimensions. Not only is there limited information on how the transfers to local government authorities (accounting for around 20 percent of the total budget) are used but for central government allocations to sectors, gender information can only be inferred. For example, it might be suggested that the large allocation for National Food Security is potentially positive from a gender perspective to the extent that women are more likely than men to be poor and thus food-insecure, and because women tend to bear more responsibility for ensuring that their families are fed than men. Apart from this, the analysis reveals that extremely small amounts are allocated specifically for “gender” or “women” within the Government budget.
6. **There is a need for better capturing and monitoring of gender dimensions in the budget allocation and spending**. One way of doing this is to develop a standardised format for a “gender budget statement” that government agencies then use to report on the gender implications of their budgets and spending. However, this needs the Government commitment to inform gender budgeting and reporting.
7. **CONCLUSIONS AND POTENTIAL FISCAL RISKS**
8. **The slippage in fiscal policy management in 2012/13 was significantly high; with the fiscal deficit rising to 6.2 percent of GDP while surpassing the NDF ceiling by 1.3 percent of GDP**. It is important that the Government take steps to consolidate their fiscal accounts, with a target of achieving fiscal deficit of 5.0 percent of GDP and staying within the NDF ceiling of not more than 1 percent of GDP. While it is important to strengthen the fiscal accounts, there are significant fiscal risks on the horizon.
9. **The first short term risk to the fiscal stance relates to shortfalls in revenue collection coupled with the implementation of action plans related to the BRN initiative**. The 2013/14 budget is based on ambitious new tax measures which may prove difficult to fully implement. In this regard, if revenue collections are less than anticipated, the Government will need to reduce non-priority spending to achieve the targeted level of deficit. Furthermore, implementation of the BRN initiative action plans may require reallocation of spending or finding new sources of revenue. However, this will be very unlikely in the current fiscal year given the fact that significant will be necessary to achieve the fiscal deficit target of 5 percent of GDP with substantial shortfall in domestic revenue collections already observed in first quarter of 2012/13.
10. **Financial distress within the energy sector, especially TANECO, presents a second short term risk to the fiscal stance**. In the management of TANESCO’s financial difficulties, the Government is facing two inherent uncertainties. First, the magnitude of the projected gap in TANESCO, the value of which will amount to approximately USD 300 million every year over the next few years, will require decisive actions that might not be popular, including possible new tariff increases or budget reallocations involving significant cuts in other areas. Second, the size of the TANESCO deficit is itself sensitive to a number of factors outside of the Government’s control. For example, an increase in world oil prices will automatically lead to higher production costs and therefore to a higher TANESCO deficit. A combination of bad luck and delays in the implementation of the TANESCO action plan would add significant pressure to the Government’s fiscal accounts.
11. **The third short term risk to the fiscal stance relates to the accumulation of arrears by the central Government, estimated to be around 0.7 percent of GDP as of end June 2013**. To some extent debt and arrears are similar, as both are aimed at saving time by postponing payments. However, their burden is different, since debt is repaid by future taxpayers, while the brunt of the burden of arrears is borne by suppliers. As described earlier, the value of Government’s arrears has grown substantially during 2012/13, reaching almost Tanzania Shilling 650 billion at the end of December 2012. The high and growing level of government arrears described above fails to incorporate important categories of delayed payment by the State, in particular to pension funds. The value of these arrears is estimated to be in the region of Tanzania Shilling 1,200 billion as of December 2012. This is already significant, at equivalent to about 3 percent of GDP. However, the figure is expected to increase rapidly if the Government fails to act, underscoring the need for urgent reforms.
12. **The fourth and final risk to the fiscal stance is linked to the government’s level of debt, the value of which stood at around 43 percent of GDP by June 2013**. At first sight, this level appears acceptable by international standards, with a number of OECD countries having debt-to-GDP ratios in excess of 100 percent. However, the acceptable level of debt is determined by a country’s capacity to repay its accumulated debt over time. This capacity is limited for most developing countries, including Tanzania, because of the difficulty of refinancing its debt on financial markets at affordable cost and because of fiscal constraints. For this reason, a relatively prudent fiscal policy is justified for the near future. The Government is forecast to borrow externally on a non-concessional basis around USD 1.3 billion during the next two fiscal years, a sum sufficient to finance a number of new investment projects, while at the same time keeping its debt level to a sustainable level of 46.8 percent of GDP by the end of 2014/15.
13. **However, keeping the level of debt to a manageable level requires close attention from the authorities**. Indeed, Tanzania’s infrastructure needs are so great that the Government might be tempted to borrow more to finance those projects, especially if the authorities fail to meet their ambitious revenue target in 2013/14 and 2014/15. This temptation might be exacerbated by pressures related to the forthcoming general elections and by the prospect of collecting additional revenues from natural gas in the future (which might be used in advance to guarantee commercial debt). The trade-off between prudent debt management and sustained public investment will have to be closely monitored in the coming years to ensure fiscal sustainability. The best means of achieving sound fiscal policy is through ensuring fiscal transparency. The Tanzanian Government should move toward a consolidated presentation of their financial accounts, including those of the main parastatal agencies operating in the energy and mining sectors.
14. **The economic prospects are also subject to external risks**. While the Tanzanian economy is not overexposed to global market volatility, it is not completely immune. Major fluctuations in commodity prices, notably gold and oil, will affect its trade balance. The magnitude and timing of anticipated FDI inflows in the natural gas sectors will also impact the local economy, especially in geographical areas where those investments will take place. The new investments are expected to be in the region of USD 4-5 billion per year. Even if the majority of these funds are used to purchase imported goods, as is likely, their magnitude will modify the current equilibrium in the domestic financial markets and possibly have an impact on exchange rates. These potential impacts will have to be carefully managed by the authorities.

1. Under-spending and over-spending is measured by comparing expenditure outturn and original approved budget. [↑](#footnote-ref-1)
2. Wage bill here uses the broad definition which includes allowances and parastatal PE. [↑](#footnote-ref-2)
3. The comparison with 2012/13 is biased because the gas pipeline was not incorporated in the central government expenditures. If this project is included, the share of cluster 1 was equal to 40.4 percent of total approved budget in 2012/13. [↑](#footnote-ref-3)
4. Health sector is currently not included in the BRN National Key Results Areas. [↑](#footnote-ref-4)
5. Note the Adult sub-sector also includes Non-formal education, Community Colleges and Folk training. [↑](#footnote-ref-5)
6. Note the Adult sub-sector also includes Non-formal education, Community Colleges and Folk training. [↑](#footnote-ref-6)
7. Dar es Salaam City Council register zero recurrent education spending, but this is assumed to be a mistake in reporting. Fourteen other Districts had no data available. [↑](#footnote-ref-7)
8. It must be noted that this analysis has been done without access to the regional budget allocation formulas. However, there is an apparent variation of 400% from the lowest spending region to the highest which seems unlikely to be explained by contextual factors only. [↑](#footnote-ref-8)
9. A full breakdown including per diems was not attempted as this would involve analyzing by 6D\_GFS which contains nearly 200 codes and, in any case, is only possible at MDA level, which accounts for just 4% of wage costs. [↑](#footnote-ref-9)
10. It must be noted that these estimates are dependent on our assumptions of relative spend at the decentralised level as PE has not been assigned to sub-sectors. [↑](#footnote-ref-10)