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Investment Policy Review
The United Republic of Tanzania

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PREFACE

The UNCTAD Investment Policy Reviews are intended to help countries improve their investment policies and to familiarize Governments and the international private sector with an individual country's investment environment. The reviews are considered at the UNCTAD Commission on Investment, Technology and Related Financial Issues.

The Investment Policy Review of the United Republic of Tanzania was initiated at the request of the Government. In preparing the Review, UNCTAD received the full support and cooperation of the Tanzania Investment Centre, the Zanzibar Investment Promotion Agency, the Ministry of Science, Technology and Higher Education and other Government ministries and agencies. The views and experiences of the private sector, both foreign and domestic, as well as those of the international donor community and the development agencies represented in the country, were taken into consideration in the preparation of this Review.

The report was prepared by a team, led by Khalil Hamdani and comprising Tafferre Tesfachew, Zbigniew Zimny, Joseph Mathews and Menelea Masin, project officer. UNIDO members of the team were Mithat Kulur and Felix Ugbor. Experts from outside the United Nations included John Firn and Stephen Young. Roland Brown, Jagadeesan Jegathesan, Erich Supper and Marcel Namfua also provided inputs. Dinh Lang provided research assistance and Deborah Wolde-Berhan provided production assistance.

This Review was undertaken within the context of the Joint UNCTAD/UNIDO Programme on Investment Promotion and Enterprise Development in Africa, with the financial support of UNIDO and the United Nations Development Programme.

It is hoped that the analysis and recommendations of this review will contribute to an improvement of policies, promote awareness of investment opportunities and serve as a catalyst for increased investment into Tanzania.

Geneva, December 2001

The United Republic of Tanzania

The United Republic of Tanzania is a union of Tanganyika and Zanzibar, both of which became independent from the United Kingdom administered UN trusteeship in 1961 and 1963, respectively. The whole country is generally referred to as Tanzania, Tanganyika as "mainland Tanzania" and the islands of Zanzibar and Pemba as "Zanzibar." This union remains the only case in Africa of previously sovereign states uniting into a new country and surviving as one entity up to the present.



Key economic and social indicators

Indicator	1998	1999
Population (million)	32.1	32.9
Gross domestic product (billions of dollars)	5.7	6.5
Annual GDP growth rate (per cent)	4.0	4.7
Inflation (per cent) ^a	12.8	7.9
GNP per capita (dollars) ^b	240	260
GDP by sector (per cent):	100.0	100.0
Agriculture	45.7	44.8
Industry, of which	14.9	15.4
manufacturing	7.2	7.4
Services	39.4	39.8
FDI inflows (millions of dollars)	172.2	183.4
Exports of goods and services (per cent of GDP)	13.3	13.5
Imports of goods and services (per cent of GDP)	27.4	25.5
Gross domestic investment (per cent of GDP)	15.0	17.0
Poverty line (per cent) ^c	..	51.1
Human development index ranking ^d	156	140
Adult literacy rate (per cent)	73.6	74.7

Sources: World Bank, UNCTAD, and UNDP.

^a Consumer prices; ^b Comparative 1999 figures are \$490 for Sub-Saharan Africa and \$420 for low-income countries;

^c Per cent of population below poverty income line in 1991; ^d Out of 174 countries in 1998 and 162 in 1999.

Table of contents

	<u>Pages</u>
PREFACE	i
INTRODUCTION	1
CHAPTER I. FOREIGN DIRECT INVESTMENT: TRENDS AND IMPACT.....	3
A. Trends	3
1. FDI size and growth.....	3
2. Forms of FDI.....	5
3. Distribution by sector, industry and country of origin.....	5
4. Relative importance of FDI in the economy.....	8
5. Explanatory factors	9
B. Impact	11
1. Sectoral impact.....	11
a. Mining	11
b. Banking	14
c. Privatized enterprise sector	16
2. Technology transfer and diffusion	17
3. Trade	23
4. Overall impact.....	25
C. Assessment	27
CHAPTER II. THE INVESTMENT FRAMEWORK	29
A. Evolution of the investment framework.....	29
B. Specific FDI measures.....	31
1. Entry and establishment.....	31
2. Investment restrictions and requirements	32
3. Treatment of FDI	33
a. Standards of treatment.....	33
b. Repatriation of profits and capital.....	34
c. Expatriate and immigrant labour	34
4. Protection of FDI	35
C. General investment measures and conditions.....	35

1.	Commercial legislation and the rule of law	35
2.	Settlement of disputes	36
3.	Labour market legislation	37
4.	Land issues	38
5.	Taxation and investment incentives	39
6.	Export processing zones.....	43
7.	Technology in the new investment policy	44
8.	Protection of intellectual property.....	44
9.	Environment protection.....	45
10.	Capital and financial markets.....	45
11.	Foreign exchange regulations	45
12.	Sectoral investment regimes	46
a.	Gemstone and mineral mining	46
b.	Petroleum and gas	46
c.	Tourism and hotels	46
13.	International agreements.....	47
D.	Role of the Investment Centre	47
E.	Assessment and recommendations	49
CHAPTER III.: ENHANCING THE ROLE OF FDI IN DEVELOPMENT		53
A.	Tanzania’s FDI potential.....	53
1.	Tanzania’s comparative international position.....	53
2.	FDI potential at the country level	54
3.	Potential at the sector and industry levels	56
a.	Mining and natural resources	57
b.	Agriculture and agribusiness	59
c.	Tourism	61
d.	Manufacturing	61
e.	Other sectors.....	62
4.	Potential at the firm level.....	62
5.	Overall assessment	63
B.	Policies and actions to realize potential.....	64
1.	Building a market economy	64
2.	Privatization programme.....	66
	Recommendations	68
3.	Infrastructure development	68
	Recommendations	69
4.	Human resources.....	69
	Recommendations	70
5.	Regional integration, trade policy and FDI.....	71
	Recommendations	73

6.	Policy coherence, consistency and coordination.....	74
	Recommendations	76
CHAPTER IV. ENHANCING THE TECHNOLOGICAL IMPACT OF FDI		79
A.	Tanzania’s technology policy framework	79
B.	The direction of policy reforms required.....	81
C.	Conclusions and recommendations	83
	1. Technology development and policy framework.....	83
	2. Technology infrastructure	84
CHAPTER V. CONCLUSIONS AND RECOMMENDATIONS		89
REFERENCES		95

Boxes

Box I.1.	FDI impact in mining: Kahama Mining Corporation	12
Box I.2.	The foreign banks: a role in developing human resources	15
Box I.3.	Transfer of technology: Standard Chartered Bank	18
Box I.4.	Transfer of technology: Mtibwa Sugar Company	19
Box I.5.	Transfer of technology: Wonder Foods (T) Ltd.	21
Box II.1.	The evolution of investment priorities	30
Box II.2.	Investment framework in Tanzania: principal acts.....	31
Box II.3.	Application and authorisation procedures.....	32
Box II.4.	The Investor Roadmap	36
Box II.5.	Local taxes and levies	40
Box II.6.	Other investment incentives	41
Box II.7.	Incentives for petroleum exploration and development	42
Box II.8.	Investment incentives in Zanzibar	42
Box III.1.	Investors’ perceptions of Tanzania versus Kenya	56
Box III.2.	National Development Corporation: FDI through strategic alliances	58
Box III.3.	CDC Group PLC: the evolving role of a long established UK investor...	59
Box III.4.	The BEST Programme	65
Box III.5.	The Tanzanian National Business Council	66
Box III.6.	Major public sector institutions involved in FDI.....	76
Box III.7.	National Investment Steering Committee	77
Box IV.1	Technology support institutions.....	81
Box V.1.	The Multi-Facility Economic Zone Concept	92

Figures

Figure I.1.	FDI inflows into the United Republic of Tanzania, Kenya and Uganda (1970-2000)	3
Figure I.2.	Share of Tanzania in FDI inflows into LDCs and Sub-Saharan Africa .	4
Figure I.3.	Number of approved foreign affiliates in Tanzania, by industry (1990-2000)	7
Figure I.4.	Employment of approved foreign affiliates in Tanzania, by industry (1990-2000)	8
Figure I.5.	Number of approved foreign affiliates in Tanzania, by country of origin (1990-2000)	8
Figure I.6.	GDP growth and inflation (1991-2000).....	10
Figure I.7.	Total net resources flows to Tanzania, by type (1988-1998).....	26
Figure I.8.	Tanzania: FDI inflows vs. profit remittances, 1990-1999.....	27
Figure IV.1. National System of Innovation of Tanzania	85

Tables

Table I.1.	Tanzania's FDI performance compared to selected countries during the 1990s	5
Table I.2.	Major foreign affiliates in Tanzania, 2001	6
Table I.3.	Growth of FDI and the economy, 1993-2000.....	9
Table II.1.	Comparison of fiscal regimes in selected countries	39
Table II.2.	Taxation.....	41
Table II.3.	International agreements.....	47
Table II.4.	Tanzania's bilateral investment treaties (BITs) and double-taxation treaties (DTTs), as of January 2001	48
Table III.1.	East African comparisons: selected indicators, 1999	53
Table III.2.	East African comparisons: national competitiveness 2000	54
Table III.3.	African countries ranked according to FDI attractiveness and business environment improvement	54
Table III.4.	East African Comparisons: competitiveness factors	55
Table III.5.	Number of privatized enterprises, by year.....	63
Table III.6.	FDI potential in Tanzania: strengths and weaknesses	64
Table III.7.	Student enrolments for degree programmes in public and private universities	70

INTRODUCTION

The United Republic of Tanzania is fast becoming a foreign direct investment (FDI) frontrunner in Africa. As market reforms reached critical mass, Tanzania received a billion dollars of investment inflows in 1995-2000 compared to only \$90 million during the preceding six years. This is a commendable performance for one of the least developed countries of the world and an economy that was centrally planned and closed to FDI not long ago.

Tanzania is still a new entrant in the FDI field. Improvements in the investment framework are recent and institutions for FDI promotion are new. The FDI so far has only trickled in just one sector, mining, but the lesson is clear: when locational assets are packaged in “the best of its kind” investment regime, investors will come. Unexploited potential for further investment extends from mining through the services sector, to agriculture and small-scale manufacturing. The challenge now is to push FDI to new frontiers, achieving higher levels of investment inflows and increasing the scale and scope of benefits from FDI. What the Government can do to take up this challenge is the central focus of this report.

Tanzania has made tangible progress towards establishing an open and increasingly transparent and consistent legal framework for FDI. At the same time, the continuing process of policy change has made the 1997 Investment Act increasingly dysfunctional and it needs replacing by a new, modern act reflecting current conditions inside and outside Tanzania. Other areas needing attention include: commercial and contract law; labour laws; competition law and the review and improvement of the incentives system. Updating regulations in sectors such as fishing and tourism could facilitate FDI. The Mining Act of 1998 and accompanying incentives are an example of what good regulation can do to encourage increased FDI inflows as well as their beneficial effects.

As a short-term strategy, the Government should continue to focus on immediate FDI potential in mining, utilities and tourism. Current exploration in non-gold mineral reserves indicates that FDI will continue in mining, while FDI in utilities and other infrastructure services will depend on the follow through of privatization efforts. Major FDI inflows in tourism are constrained by infrastructure but there are short-term opportunities nonetheless. Focused targeting of investors by both TIC and ZIPA would help realize this potential.

At the same time, the Government should address the long-term challenge of making Tanzania an attractive location for FDI in Eastern and Southern Africa. The internal market, though rapidly growing, is small. Infrastructure is meagre. The labour force is unskilled, and its competitiveness threatened by relatively high wages and HIV. The private domestic enterprise sector is fragile. Overcoming these weaknesses will require continued support of the international community through bilateral and multilateral ODA. Debt relief from multilateral sources such as HIPC, for which Tanzania has become eligible, or bilateral sources, will also help. The broad types of actions to develop Tanzania’s locational advantages include the following:

- Completing the privatization programme, especially in the area of utilities and other infrastructure. This will bring additional FDI and, if implemented properly, should improve infrastructure and reduce the cost of doing business.

- Improving infrastructure. In addition to privatization, new investments should be encouraged in infrastructure through financial instruments such as concessions and BOTs; this will require appropriate legislative framework. The successful experience gained with Kilimanjaro International Airport should be applied more widely. Consideration could also be given to the creation of industrial parks and multi-facility economic zones.
- Expanding and consolidating international market access, including through regional integration within EAC and SADC. Exploitation of the SADC market would require improvements in the transport infrastructure in the southern part of the country. New preferential market access opportunities, especially under the EBA and AGOA schemes, should be explored as to their potential to attract export-oriented FDI into manufacturing and agriculture.
- Enhancing competitiveness of human resources. Maintaining competitive skill/wage ratios requires attention to worker productivity and training, and adapting labour laws and the education system to the needs of the market economy, thereby addressing the high cost of labour and deficit of skills at all levels.
- Building a dynamic private enterprise sector by redirecting the focus of technology policy and institutions to the needs of enterprises. These are essential conditions for enhancing the long-term technological impact of FDI, including through linkages and technological learning. The restructuring and strengthening of existing technology support institutions is a priority.

In the short term, these challenges can be partly overcome through carefully packaged strategic thrusts in select areas of investment opportunity.

CHAPTER I. FOREIGN DIRECT INVESTMENT: TRENDS AND IMPACT

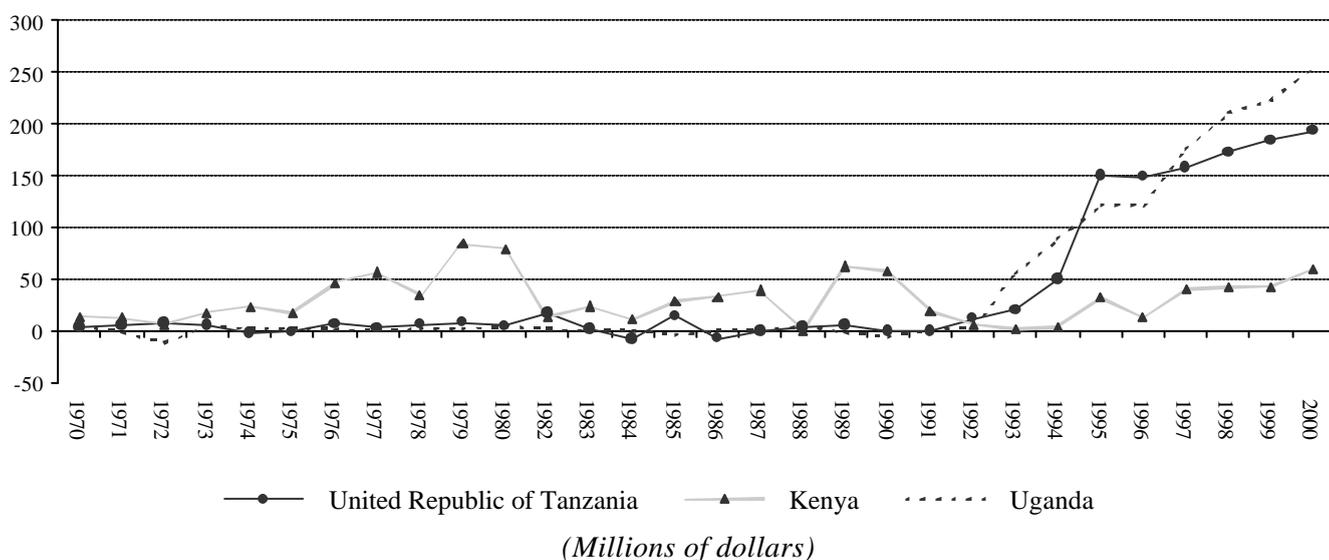
Foreign direct investment (FDI) is on an upward trend in Tanzania, as the reforms initiated in 1985 appear to have begun to firmly take hold. Positive impacts from the initial investment inflows are also beginning to be felt. On a sure footing at last, Tanzania should now keep pace with the FDI frontrunners of Africa.

A. Trends

1. FDI size and growth

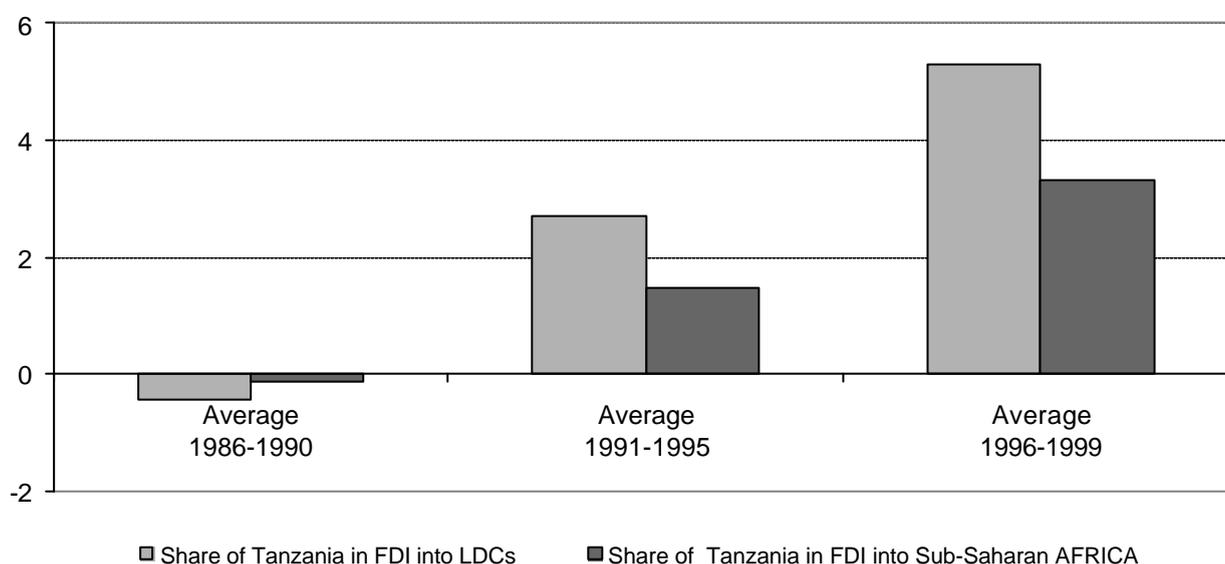
Tanzania is a new entrant in the FDI field. Its efforts to increase the role of foreign direct investment in its development nominally date back to 1985 when Tanzania decided to initiate the process of transition from a centrally-planned economy to a market-based economy. The process focussed initially on the liberalization of the trade regime within the Structural Adjustment Programme. However, for a number of years reforms were rather slow. In addition, in the early 1990s growth was sluggish and inflation was high. Only in the second half of the 1990s, when the economic situation improved, the privatization programme began in earnest, market-oriented reforms reached critical mass and sound foundations for an enabling framework for FDI were put in place, did foreign investors respond. During 1995-2000 Tanzania received a total of \$1 billion of FDI compared to less than \$2 million during 1986-1991. On an annual basis, from 1992 on, when the inflows increased to \$12 million, they began to rise fast, to \$50 million in 1994 and to above \$150 million in 1995. In 1996, FDI inflows stabilized at the high level of \$150 million and continued to grow, although at a slower pace, reaching the level of \$193 million in 2000 (figure I.1). This is a remarkable acceleration, for a country that was receiving zero inflows just ten years ago.

Figure I.1. FDI inflows into the United Republic of Tanzania, Kenya and Uganda, 1970-2000



The acceleration of inflows between 1992 and 1996 improved considerably Tanzania's FDI performance relative to other countries, including to neighbouring countries with which Tanzania may compete for certain kinds of FDI. Tanzania's share of FDI inflows into least developed countries (LDCs) doubled from 2.7 per cent in 1991-1995 to 5.3 per cent in 1996-1999 and that of inflows into Sub-Saharan Africa more than doubled, from 1.5 to 3.3 per cent in the same period (figure I.2). After 1996, although growing in absolute terms, inflows into Tanzania did not keep pace with the inflows into LDCs or Sub-Saharan Africa and Tanzania lost some of its position achieved in the mid-1990s. On an annual basis, these shares were the highest in 1995 and decreased slightly by 1999.

Figure I. 2. Share of Tanzania in FDI inflows into LDCs and Sub-Saharan Africa
(Per cent, average for five-year periods)



Comparisons of Tanzania with Kenya and Uganda, the other members of the East African Community (EAC), show a very differentiated picture over time. From 1970 until 1991 the EAC countries received some \$757 million of total inflows, 90 per cent of which went into Kenya. Nearly 10 per cent went into Tanzania while Uganda hardly received any inflows. The picture changed during the 1990s with an improving performance of Tanzania and Uganda and a deteriorating performance of Kenya (figure I.1). Uganda – slightly ahead of Tanzania – was found by the World Investment Report (WIR) 1998 to be one of the 7 best performing countries for FDI in Africa (during the mid-1990s).¹ Keeping pace with Uganda, placed Tanzania close to the African FDI frontrunners. By 2000, both Tanzania and Uganda outperformed Kenya in terms of FDI stock.

In relative terms, accounting for differences in size of countries in terms of population and GDP, Tanzania's performance also improved considerably between the first and second halves of the 1990s, in some measures even more than in absolute terms. In 1991-1995 Tanzania's inflows were comparable

¹ Frontrunners were defined as countries having four FDI indicators higher than the average for developing countries. These indicators included absolute FDI inflows and inflows relative to GDP, GFCF and population for 1992-1996 compared with 1987-1991 (UNCTAD 1998, pp. 178-179).

to the average for LDC in terms of inflows per \$1000 of GDP and were much below the LDC average in terms of inflows per capita and as per cent of gross fixed capital formation. In the second half of the 1990s, on all these measures Tanzania's performance was superior to that of an average LDC (table I.1). On all measures, it did not exceed the average for all developing countries. Within the EAC, Tanzania has caught up with Kenya's head start on FDI stock. However, relative inflows indicators for Tanzania are still below those of Uganda, Mozambique and Zambia.

Table I.1. Tanzania's FDI performance compared to selected countries during the 1990s
(Dollars and percentage)

Country	ABSOLUTE PERFORMANCE					RELATIVE PERFORMANCE													
	FDI inflows per year		FDI stock			FDI inflows per capita		FDI inflows						FDI stock (Dollars)					
	Millions of dollars					Dollars		Per \$1000 GDP (Dollars)		As per cent of GECE				Per capita			Per \$1000 GDP		
	1991-1995	1996-1999	1990	1995	1999	1991-1995	1996-1999	1991-1995	1996-1999	1991-1995	1996-1999	1991-1995	1996-1999	1999	1990	1995	1999	1990	1995
United Republic of Tanzania	46	165	93	325	987	1.6	5.2	9.8	22.5	4.4	13.6	13.8	3.6	10.9	30.1	22.0	65.5	112.4	
Kenya	13	34	673	736	873	0.5	1.2	1.5	3.2	0.8	1.9	2.6	28.6	27.0	29.5	78.9	81.3	83.2	
Uganda	54	182	4	272	1'000	2.9	8.9	1.2	2.8	6.9	18.0	22.1	0.3	14.4	47.3	1.0	47.3	157.6	
Mozambique	32	184	42	202	936	2.0	9.7	14.3	48.6	7.3	25.7	55.5	2.9	11.6	48.5	16.6	84.2	231.9	
Zambia	54	171	987	1'256	1'941	6.8	19.7	16.0	49.1	10.3	12.4	11.7	136.4	153.3	216.2	300.3	361.9	583.6	
East-African Community	98	400	719	1'210	2'809	1.6	5.9	7.1	19.3	3.7	11.5	19.6	13.3	19.0	40.1	46.8	70.4	134.6	
LDCs	1'748	3'570	8'273	17'014	30'580	3.2	5.8	10.2	17.3	6.0	6.4	7.9	16.1	29.3	47.9	50.0	95.0	142.0	
Developing countries	80'789	187'557	487'694	849'376	1'740'380	18.5	40.2	17.3	30.4	6.2	11.4	13.8	118.9	189.8	364.8	126.2	153.6	275.2	

Source: UNCTAD, FDI/TNC database.

2. Forms of FDI

Since 1993, FDI inflows into Tanzania took predominantly the form of greenfield investment in spite of some participation of foreign investors in Tanzania's privatization programme and a few cases of acquisitions of foreign affiliates by foreign investors. But foreign acquisitions gave an initial push to increased FDI inflows. For example, in 1993 the total value of these acquisitions was higher than annual FDI inflows while in 1994, the third year of FDI growth, it was still one quarter.² After that, the share fluctuated between 1 and 14 per cent annually. Overall, during 1993-1998, the share of foreign acquisitions in FDI inflows was above one tenth. But it could increase when large privatizations of utilities such as telecommunications take place.

3. Distribution by sector, industry and country of origin

Systematic data on the industry and home country breakdown of FDI in Tanzania do not exist. Available information, including the list of major foreign affiliates in 2001, the data on FDI projects approved by the Tanzanian Investment Centre (TIC) during 1990-2000, and FDI deals during 1997-2000 give some indication on where the investment goes and by whom it is undertaken.

² Source: UNCTAD 2001, p. 123.

The largest sector for FDI is mining and the largest single industry is gold. At the end of 1998, total cumulative FDI in mining was estimated at \$370 million.³ This suggests a share of mining in total cumulated inflows of above 50 per cent. Although sectoral and industry distributions by value of investment projects and FDI flows or stocks are unavailable on a systematic basis, the picture is somewhat illustrated by *total investment*⁴ of major foreign affiliates, most of which were established during 1997-2000 (table I.2). The sectoral composition of the largest projects, based on total value is: mining (65 per cent), services (19 per cent) and manufacturing (16 per cent). This data underestimates the share of the services sector, because it does not include several large foreign banks present in Tanzania (box I.2). Thus, services are the second largest sector for FDI in Tanzania, most likely, much more ahead of the manufacturing sector than it appears from table I.2.

Table I.2. Major foreign affiliates in Tanzania, 2001

(Total investment, millions of dollars)

Company name	Home country	Total investment	FDI form and industry
Kahama Mining	Canada	610	New, gold mining
Geita	Ghana/ South Africa	400	M&A, gold mining
Tanzanian Telecommunications Company	Netherlands/ France	120	Privatization, jv, ^a telecommunication
Voda Com	United States/South Africa	120	New, telecommunication
Tanzania Breweries	South Africa	120	Privatization, jv, manufacturing
Tanzania Cigarette Company	Japan	80	Privatization, jv, manufacturing
Golden Pride	Australia	77	New, gold mining
Africa Mashariki	..	72	New, gold mining
Mtibawa Sugar	Mauritius	48	Privatization, jv, manufacturing
Kilombero Sugar Co.	United Kingdom/ South Africa	40	Privatization, manufacturing
Serena Hotels	International	33	New, tourism
Mic Tanzania	United Kingdom	27	New, telecommunication, jv
Merelani	..	20	New, mining
National Bank of Commerce	South Africa	15	Privatization, banking
Indian Ocean Hotels	United Kingdom	15	New, jv, tourism
Holiday Inn	South Africa	13	New, tourism

Source: UNCTAD, based on information received from TIC and on *Business Map*, 2000, p. 39.

^a "jv" means joint venture

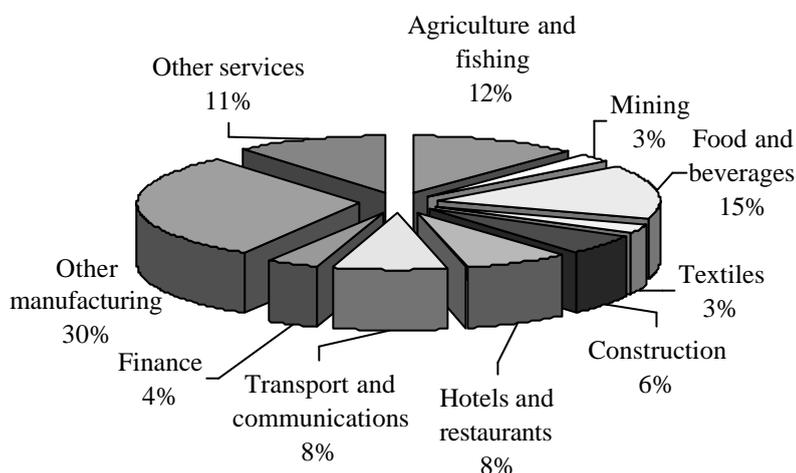
Data on *the number of approved foreign affiliates* indicates that almost half of the total approvals during 1990-2000 were in manufacturing. Even though most projects are small and many may never be implemented, their sheer number suggests that there is interest by foreign investors in, and

³ WTO, 2000, p. 94.

⁴ The total value of investment by foreign affiliates is not directly comparable with FDI flows which, first, encompass only the part of the total value financed by equity capital or loan from the parent company or re-invested earnings. The two correspond with one another especially in a country like Tanzania where financing of FDI projects from the domestic financial market is unlikely, due to limited savings and high interest rates. On the other hand, even for projects fully financed with FDI flows, the two measures would be identical only for completed projects, as FDI inflows measure expenses for a single year. In addition, total investment includes part of investment financed with loans from international financial markets, which are not included in FDI data.

potential for, FDI in manufacturing in Tanzania. The largest industry within manufacturing in terms of the number of approved affiliates is food and beverages, which is typical for countries with small markets such as Tanzania. The services sector is next in importance, with 38 per cent of the approvals, in such industries as transport and communications, hotels and restaurants, construction and financial services (figure I.3). The balance, 15 per cent, are accounted for by the primary sector. Only 3 per cent of approved affiliates are in mining but among those were a few large, capital-intensive projects. The picture changes if *planned employment of approved affiliates* is taken as a measure: the share of the primary sector is considerably higher at 38 per cent while the shares of both manufacturing and services are low. But the employment gain in the primary sector is in agriculture and fishing not in mining, where the share is even smaller than in the number of approved affiliates, a mere 1 per cent (figure I.4). However, the data for mining is only for 1990-1996 and thus this sector is underestimated by this data series.

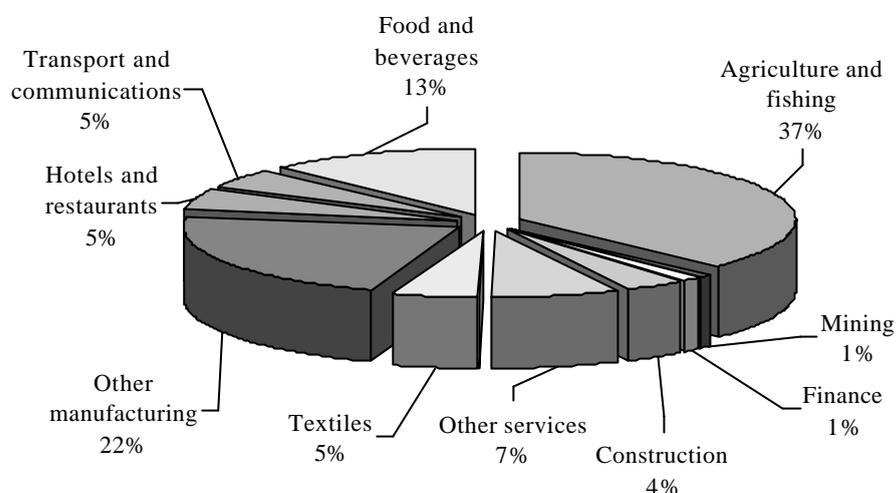
Figure I. 3. Number of approved foreign affiliates in Tanzania, by industry, 1990 - 2000
(Percentage)



Source: Tanzania Investment Centre.

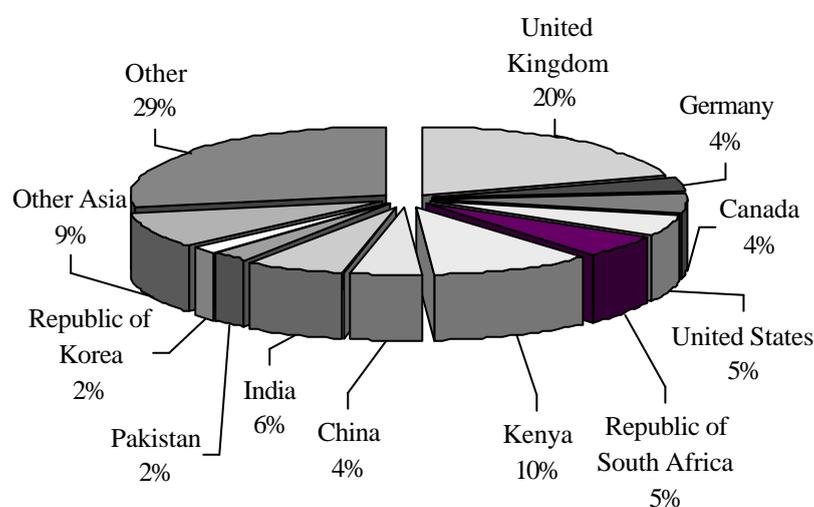
FDI in Tanzania originates from a wide range of countries from four continents. Based on *the number of approved foreign affiliates*, the leader is the United Kingdom with 20 per cent of affiliates, followed by Kenya with 10 per cent (figure I.5). India, the United States, South Africa, Canada, China and Germany each account for around 5 per cent of the number of approved affiliates. The picture changes somewhat if *total value of investment* is taken as a measure. Data based on value favours countries with FDI projects in capital-intensive mining and services such as banking, telecommunication and hotels. The United Kingdom remains the largest home country, with \$390 million of TIC estimated total value of investment by September 2001, followed by the United States (\$195 million), Ghana (\$153 million), South Africa (\$145 million) and Australia (\$119 million). Some FDI projects from South Africa are undertaken by foreign affiliates with headquarters in developed countries (e.g., Holiday Inn).

Figure I.4. Employment of approved foreign affiliates in Tanzania, by industry, 1990-2000
(Percentage)



Source: Tanzania Investment Centre.

Figure I.5. Number of approved foreign affiliates in Tanzania, by country of origin, 1990-2000
(Percentage)



Source: Tanzania Investment Centre.

4. Relative importance of FDI in the economy

FDI grew much faster than Tanzania's economy in the second half of the 1990 (table I.3). As a result, the role of FDI in Tanzania's economy increased considerably. Although not directly comparable, inward FDI stocks as a percentage of GDP gives an indication of the rate of this increase: they increased from 2.2 per cent in 1990 to 7 per cent in 1995 and 11 per cent in 1999. In spite of the fast increase, this share is still half of that for all developing countries and for Africa, showing potential for still greater role of FDI in Tanzania's economy.

Table I.3. Growth of FDI and the economy, 1993-2000
(Annual average rate of growth, per cent)

Variable	Growth
FDI flows	38.1
FDI stock	37.9
GDP (current prices, 1993-1999)	11.6
GFCF (1993-1999)	3.8
Exports (1993-1999)	3.5

Source: World Bank, 2001 and UNCTAD, FDI/TNC database.

The share of FDI inflows in total investment also increased, from 0.7 per cent in 1988-1993 to 4.5 per cent in 1994 and 14.6 per cent in 1995. After that year, the growth of FDI inflows kept pace with the growth of domestic investment and the share fluctuated around 13 per cent, at a level higher than the average for Africa, 7-9 per cent.

The importance of FDI by sector and industry varies considerably: as a result of the rapidly growing FDI in the mining sector (and especially in gold mining) and banking, it is high in these sectors, while in manufacturing and especially agriculture it is still insignificant.

5. Explanatory factors

Tanzania's FDI performance mirrors its economic performance. The transformation from a centrally-planned to an open, market-based economy has been impeded by a variety of internal and external factors and the Government acknowledges "the various reform programmes implemented since the 1980s could not achieve the targets set".⁵ It is therefore not surprising that the response from foreign investors came with almost a decade of delay. FDI inflows accelerated only by the mid-1990s and since then Tanzania joined the ranks of better performing FDI countries in Africa.

Tanzania's reforms were initiated in the late 1980s, but initially the reform process focussed on the liberalization of the trade regime through the Structural Adjustment Programme. Many of the reform measures were carried out and refined only in the 1990s. These reforms included financial sector and civil service reforms, the launching of a limited privatization programme in 1992, and the establishment of the Tanzania Revenue Authority in 1995. Reforms of the banking system began only in 1993 at which time there was not one private bank in the country. According to a widely held view, only after the elections of 1995 did "a genuine will to undertake economic reforms emerge"⁶ and the pace and intensity of reforms accelerated. Components of an enabling policy framework for FDI were also introduced gradually and only in the second half of the 1990s did a critical mass emerge. The first Investment Act aimed at encouraging FDI was introduced only in 1990, but it soon turned out that it was not attractive enough and was replaced by the Tanzania Investment Act of 1997, improving provisions and incentives for investment in areas designated as national priority. But more importantly,

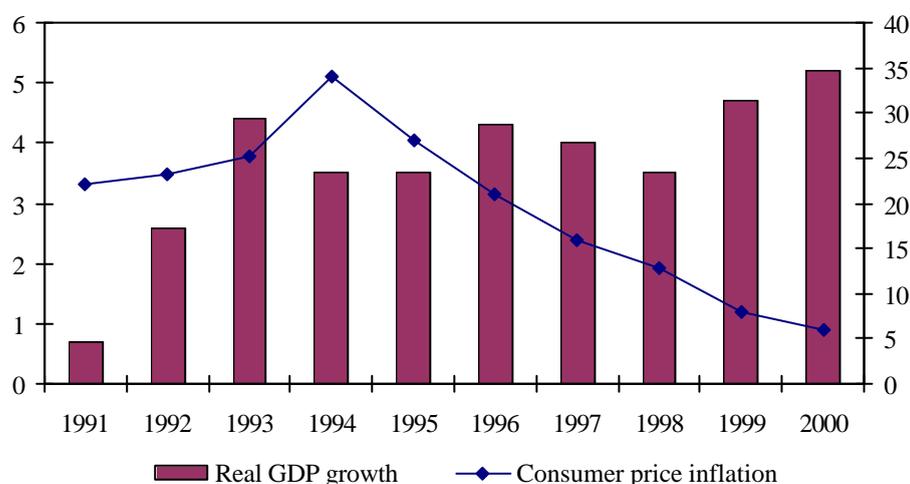
⁵ United Nations, 2001, p 4.

⁶ Lindahl, 2000.

only in 1998, did the Tanzanian Mining Act relax regulatory control over the mining sector – an area with strong FDI potential – and removed a number of barriers that previously limited foreign control of mineral exploitation enterprises.⁷ The external sector was also liberalized in steps. Early measures relaxing foreign exchange controls were consolidated into the Foreign Exchange Act of 1992, which eased controls of foreign trade. Market-determined exchange rate was introduced in 1993 but the liberalization of all current account transactions took place only in 1996. This, according to the report by the Government of Tanzania to WTO “was followed by a partial liberalization of the capital/financial account, which allowed foreigners to participate in direct investment activities in the country”.⁸

The macroeconomic environment, another pillar of the sound investment climate, deteriorated in the early 1990s. External shocks, prolonged drought and the El Niño floods disrupted economic activity and crippled infrastructure. During 1990-1995 growth was sluggish, 2.2 per cent annually, only half of the rate of growth achieved during the preceding five-year period.⁹ Inflation was nearing 40 per cent and budget deficit was 5 per cent. Towards the end of the 1990s Tanzania made significant progress in achieving macroeconomic stabilisation and resuming economic growth. In 2000, inflation was down to 6 per cent, the lowest level in nearly two decades, and GDP grew at a healthy rate of 5.2 per cent (figure I.6), with predictions for the acceleration of growth to 5.7 per cent in 2001 and 6.3 per cent in 2002.¹⁰ The budget deficit has turned into a surplus in 1999 and foreign exchange reserves have increased from about 1.5 months of merchandise imports to 4.5 months.¹¹

Figure I.6. GDP growth and inflation, 1991-2000
(Per cent)



All these, together with a long period of political stability, a relatively low crime rate among the countries of the region and other measures such as investment promotion and home country measures, have put Tanzania within the purview of foreign investors. They have also contributed to increased flows of FDI, albeit concentrated in the mining sector and in a number of service industries. Mining FDI is large and recent and will most likely fuel a high level of inflows for a few more years. However,

⁷ UNCTAD, 2001, p. 13.

⁸ WTO, 2000, p. 85.

⁹ UNCTAD, 2000, p. 300.

¹⁰ The Economist Intelligence Unit (EIU), 2001, p. 11.

¹¹ Lindhal, 2000, p. 9.

sustained inflows at higher levels, require not only a continuation of good macroeconomic performance but also the deepening and broadening of reforms, including further improvements of the investment framework as well as policies to open up new opportunities for FDI, particularly with respect to the development of human resources and infrastructure and encouragement of the private enterprise sector.

B. Impact

Before the mid-1990s, FDI in Tanzania was so small that its impact on the economy was minimal (and even negative in some respects as annual profit remittances exceeded inflows in the years before 1994). With the increasing inflows of FDI and rapidly growing presence of TNCs in certain sectors, it seems that an overall positive impact is emerging and, though still small, it is being felt in some sectors and areas such as the transfer of technology and skills.

1. Sectoral impact

The sectoral impact is concentrated in mining and banking, which have received most of the FDI inflows into Tanzania, and in privatized manufacturing enterprises.

(a) Mining

Thanks to an attractive sectoral investment policy and the response by FDI, especially in gold mining, since the mid-1990s, the mining sector has been the fastest growing sector of the Tanzanian economy, playing the role of not only an engine of growth but also of diversification, reducing the traditional dependence of Tanzania on agriculture. It is predicted that mining will grow in importance, accelerating the growth of the economy. In gold mining alone a foreign affiliate, "Resolute Tanzania, which started production at the end of 1998, is expected to have raised production to five tons of gold per year by the end of 1999. Ashanti Goldfields is anticipated to produce 15 tons per annum and Barrick Gold and Africa Mashariki Gold mines also should experience total production of nine tons of gold a year by 2001. Thus, the contribution of these large-scale mines is expected to add thirty tons of gold, worth about \$300 million, a year. In addition, depending on gold prices, five medium scale mines should also become operational, contributing another \$250 million worth of gold to total production".¹² If these plans materialize, the increased gold production would add 8 per cent to the annual GDP. Contribution of mining TNCs to the local economy is not limited to providing capital and undertaking investment but also includes increased employment, training and enhancement of skills, technology, linkages to local economy and contributions to the local community such as roads and hospitals (box I.1).

Tanzania has also reserves of many other minerals and ores such as gemstones, nickel, cobalt, coal, gas, phosphates, kaolin and tin. Exploitation of these minerals and ores will increase the impact of FDI on the Tanzanian economy. In recent years, Tanzania has attracted many companies, predominantly foreign ones in exploration activities in all these areas. In 1998 alone, there were more exploration activities in Tanzania than in any other country in Africa, including such traditional mining countries as South Africa and Ghana. Spending on exploration has increased to \$58 million per year.¹³

¹² World Economic Forum, 2000.

¹³ Temu and Due, 2000, p. 709.

Box I.1. FDI impact in mining: Kahama Mining Corporation

Encouraged by the Tanzania Mining Act (“the best of its kind”) and investment incentives and confident about the stability of the policy environment, Barrick Gold Corporation, a Canadian transnational corporation, entered Tanzania in 1999 acquiring a “junior” Canadian mining company, Sutton Resources, with assets in Tanzania, for \$280 million. With the purchase, Barrick became the owner of the Kahama Mining Corporation and the highly promising Bulyanhulu property in the Lake Victoria area. A \$25 million exploration programme, undertaken after the acquisition, has tripled estimated gold reserves at Bulyanhulu to 10 million ounces, with a corresponding rise in anticipated Government royalties over the life of the project. Gold production started in mid-2001. It is expected to rise to approximately 400,000 ounces a year in 2002 and to 500,000 ounces in the future. Operating costs are expected to average \$130 an ounce.

The development of the Bulyanhulu project has or will have in the future a number of positive impacts on the local community and Tanzania’s economy. They include the following:

Investment. For the development and construction of this \$280 million mining project, project financing of \$200 million has been provided by a consortium of international financial institutions. Beyond that initial capital expenditure, Kahama Mining is investing several more hundred million dollars in ongoing capital expenditures to sustain the mine’s operation, as well as in infrastructure and economic and social development programmes. According to TIC, a total of \$610 million has been invested by 2001. This represents one of the largest investments in Tanzania’s economy ever, contributing over the years to a considerable inflow of external financial resources into the country.

Infrastructure. Local infrastructure has already begun to improve considerably as a result of Kahama’s investment. These improvements include the building of a power line of 275 kva (\$15 million investment), the building of a road of 87.5 kilometers (\$5 million investment) and a 47-kilometer long water pipeline (\$3.4 million). This has brought benefits to local population. The power line brings a reliable electricity supply not only to the mine but also to the region. The roads have become bustling routes for farmers and local craftspeople taking their products to market in local towns. The pipeline has the capacity to meet the water needs of 30,000 villagers along its route.

Technology. Bulyanhulu is a modern trackless operation that uses state-of-the-art, safe and efficient methods to mine ore below ground and transport it to the processing plant on surface. Ore reserves are accessed through a 1,090-meter shaft, 6.4 meters in diameter, which is located at the centre of the ore body to hoist ore and waste. Three underground ramps provide access to all the main production levels. The mine has a total hoisting capacity of 5,000 tonnes per day. Modern equipment is used that maximizes safety and efficiency, including computerized mine design; high-tech drills load-haul-dumpers that can be operated by remote control in certain areas to increase safety. Trucks transport the ore to automated loading pockets for hoisting to the surface.

Employment. During construction Kahama employed more than 2,000 people. Presently the mine directly employs some 900 local men and women and 200 expatriate professionals, as well as an additional 600 people indirectly as contractors. In view of the salary, benefits and training positions at Kahama are among the most attractive in the country. Kahama estimates that about 7,500 additional indirect jobs will be created in the regional economy as a result of its operations. The number of expatriates is expected to be reduced to 30-50 over the next seven years. One of the tasks of expatriates is to train local employees: the success is measured by the time needed to train themselves out of their jobs.

Human resources development. Modern mining and processing gold is a highly mechanized and technologically sophisticated activity. Kahama requires geologists, mining, electrical and mechanical engineers, underground miners, processing plant technicians, as well as administration, finance and purchasing functions. It requires employees with skills and experience with equipment and technology on a scale that is not readily available in the immediate region. To meet the objective of having a workforce that is overwhelmingly Tanzanian, Kahama has already invested \$6.3 million in 147,000 hours of job training for Tanzanians. It has also provided training in the local communities for aspiring entrepreneurs who are creating new businesses such as mosquito net manufacturing, carpentry, pottery and craftwork.

/...

(Box I.1, continued)

Aware that education is key to sustainable communities, Kahama has signed a million-dollar partnership with CARE International to develop educational facilities in the communities around Bulyanhulu. Kahama's parent company, Barrick Gold Corporation, maintains a scholarship programme to provide significant financial support to children of all of its employees for post-secondary education. In recent years, Barrick and its subsidiaries have awarded 4,000 of these scholarships at a cost of some \$6.4 million. Kahama's management is presently evaluating the most culturally and socially appropriate application of this programme to the children of the Bulyanhulu employees.

Sourcing, processing and linkages. All heavy machinery needed at the mine had to be imported since it was not available within the country. There are now a number of distribution depots in Mwanza (the closest town to the mine site) for suppliers such as Caterpillar and Goodyear, to facilitate the importation of equipment from overseas. Approximately 40 per cent of the gold produced at Bulyanhulu is recovered from the ore on site in the form of doré bars. Each doré bar is composed of approximately 70 per cent of gold and 30 per cent of impurities, which cannot be efficiently removed in the on-site processing facilities. Consequently, all of the doré bars produced at the mine are shipped by air offshore to a specialized third party gold refiner where a pure gold product meeting strict international standards of purity is produced. The remainder of the gold produced at the mine is contained in a copper-gold concentrate. This copper-gold concentrate requires sophisticated and highly technical metallurgical treatment at specialized smelting facilities to extract the copper and gold values. Because only a small number of such smelters exist throughout the world, Kahama has entered into long term smelting contracts with Japanese and Korean smelters to perform this function for it. The copper-gold concentrate produced at Bulyanhulu is transported by road and rail to the port of Tanga and then on to Japan and the Republic of Korea by ship for processing. Local linkages include purchases of vegetables, timber and transportation services. For example, during construction Super Doll Forwarding of Dar-es-Salaam, a local trucking company, was involved in the transportation of 3,000 truckloads of material and equipment to the Kahama mine, including 1,000 tons of steel.

Social amenities and services. They include a \$6.4 million housing programme, which will provide interest free loans to employees in connection with the planned construction of up to 600 new houses. (Construction of the first 200 has already started). It is the first private-sector housing loan programme in Tanzania and is expected to have significant social benefits. The housing programme will also assist in providing funding for the construction of houses for the teaching staff and their families associated with the CARE program described above. Kahama has also opened one of the most up-to-date, well-equipped and staffed medical clinics in Tanzania – for the benefit of employees, their families and the surrounding communities. Kahama is also refurbishing the existing regional dispensary in nearby Bugarama and has partnered with the African Medical & Research Foundation (AMREF) to develop, fund, and staff public health educational programmes on a regional basis.

Environmental protection. Environmental protection is integral to all aspects of the Bulyanhulu operation. It is based on a plan, employing international best practices, including zero discharge policy, aimed to minimize impact on the air, water, flora and fauna around the mine during the mining and after, when the site will be reclaimed and restored to its natural condition. Wastes are recycled at the mine and water is conserved. A unique paste tailing process has been implemented that uses 50 per cent less water than traditional methods. 25 per cent of the tailings produced is mixed with waste rock and directed underground to fill and seal mined areas. Under an Environmental Management System, Kahama is providing environmental awareness training for employees. The mine has established a nursery to propagate native trees for landscaping and re-vegetation purposes. It has also created a wildlife refuge for monkeys, mongooses, Nile monitor lizards and small antelopes.

* * *

The mine has already helped to put Tanzania on the world mining map. As exploration continues, Bulyanhulu is envisioned as a hub for expanding mining activities in the region, contributing to the development of one of the most prospective gold regions in the world. The mine contributes about \$13 million a year in royalties and taxes to the Tanzanian economy. This amount will increase as production rises. Wages total another \$15 million a year on average.

/...

(Box I.1, concluded)

Pioneer investors in mining recognize their responsibility to contribute to Tanzania's development. For Barrick Gold Corporation and its affiliate Kahama Mining Corporation, Bulyanhulu mine is a model of operating excellence and corporate and environmental responsibility. As the Chairman of Sutton Resources, the owner of Kahama Mining before its take-over by Barrick, has put it, Kahama had to earn the trust and confidence of Tanzanians by "investing in infrastructure development, creating jobs, protecting the environment and paving the way for substantial foreign exchange earnings". On the other hand Kahama "also had to convince the Government that many more investors would follow if they were assured that business could be undertaken with transparency and free of bribes, that agreements would be honoured and that the rule of law would be meaningful in the event of disputes" (*Financial Times*, 24th May 2001).

Source: UNCTAD and Barrick Gold Corporation.

(b) Banking

Until liberalization and deregulation of the financial sector in the early 1990s, the banking system in Tanzania consisted mainly of three state-owned commercial banks. By 1998, 13 commercial banks were established, 6 of them foreign, accounting for close to 30 per cent of the total assets of the commercial banks.¹⁴ State-owned banks were successfully privatized, with the largest bank - National Bank of Commerce – restructured and sold to the South African Banking Group, ABSA, in 2000. This sale and the entry of Barclays Bank in Tanzania after 30 years of absence, increased the role of foreign banks in the financial sector.

The first steps in the liberalisation of the financial system are widely considered to have been satisfactory, creating foundations for establishing a healthy market-driven financial system, better suited to the needs of private sector and business community, local and foreign. Both local and foreign banks have contributed to this success in areas of their expertise and specialization. If problems occur, they are not confined to local banks only. For example, the Bank of Tanzania, recently had to close one of the foreign banks, the Greenland Bank, and had to find a buyer for an affiliate of the Trust Bank of Kenya.¹⁵

As the reform and rationalization of the banking system continues, however, foreign banks are likely to increase their contributions to the economy. One could even argue that without foreign banks, full transformation to a competitive banking industry would not be possible. Local banks, while providing useful and competitive services in certain areas, simply do not have the expertise to provide, for example, full range of corporate banking services required by foreign investors or fully service international transactions. As the experience of emerging markets indicates, foreign banks are typically more efficient than local banks.¹⁶ They help improve the availability of financial services by introducing new services, not available in the host country. They also improve the quality and pricing of existing services, either directly as providers of such services or indirectly through competitive pressures on domestic banks, forcing the latter to introduce improvements. As an example of three foreign banks that recently entered Tanzania shows, such improvements would not have been possible without a massive transfer of technology through bringing in skilled banking expatriate personnel, on-the-job training and sending local staff for training abroad at specialized training institutions (box I.2). These contributions do

¹⁴ Temu and Due, 2000, pp. 686-687.

¹⁵ EIU, 2000, p. 24.

¹⁶ IMF, 2000, p. 165.

not necessarily come automatically but are determined by government policy, including the establishment of the competitive environment on the one hand and strengthening existing institutions, reinforcing the regulatory system and putting in place an effective supervisory mechanism on the other hand.¹⁷

Box I.2. The foreign banks: a role in developing human resources

Foreign investors typically invest in training especially in countries where the relevant skills are in short supply, and, therefore, can have an important impact upon the level of skills and expertise in host economies. This box illustrates how the foreign banks, which have entered Tanzania, build their human capital resources for their own and the country's benefit.

Foreign banks present in Tanzania include Barclays Bank (United Kingdom), Citibank (United States), Standard Chartered (United Kingdom), International Bank of Malaysia and the National Bank of Commerce (NBC) (in which the Amalgamated Banks of South Africa (ABSA) took a majority stake after privatization).

Citibank entered Tanzania through the establishment of a greenfield branch in Dar-es-Salaam in 1995 and has since expanded to Mwanza, with plans to set up in Arusha later in 2001. Employment totals 100 people, with 75-80 professionals including 5 expatriates. The Citibank strategy is to build a pool of professionals with regional exposure by switching them around the 16 countries in which the group has a presence in Africa. Training is undertaken at three levels: in-country, by visiting personnel or expatriates; regional training, undertaken either in Nairobi or in South Africa; and international training at the corporate Training Centre in Istanbul. Aside from these three levels of training, the company also operates an internal mentoring and appraisal scheme. Citibank recruits from the University of Dar-es-Salaam (around 80 per cent) with the balance from the Institute of Finance and Management (IFM).

ABSA had a larger and different challenge following entry through acquisition. The South African company started with 1176 people after their majority purchase in 1999, a figure which is now down to 934. ABSA brought in 6 expatriates to introduce new priorities, systems and procedures, and this figure increased to 11 subsequently. The company used an industrial psychologist to obtain a profile of all the staff, and on this basis identified people they could use and in what capacity. Salaries were increased by 25 per cent in order to retain the best staff. In terms of new recruitment, ABSA has not attached excessive value to academic qualifications, but rather has focused on capabilities and trainability. The focus of training has been on two aspects: firstly, telephone etiquette (using ABSA's 'Golden Voice' training programme) and secondly, the new integrated computer system.

The International Bank of Malaysia commenced greenfield operations in Tanzania in February 1998. The small staff numbers 18, including one Malaysian. Almost all of the 8 professionals are graduates. Two of their staff studied at the International Islamic University of Malaysia and all the rest are from the University of Dar-es-Salaam, except one employee in IT. Recruitment at graduate level was followed by two to three months training in Malaysia. Training is also undertaken within the bank through the Association of Bankers, which has yearly specialist programmes on, for example, liability management and credit. Growth has been slow but gradual and the bank may establish other branches around Dar-es-Salaam with the aim of handling small- and medium-sized (mostly business) customers.

Source: UNCTAD.

¹⁷ Temu and Due, 2000, p. 691.

(c) *Privatized enterprise sector*

Of the 83 companies privatized until 30 June 1997 through the sale of shares or assets, 44 were sold to domestic and 22 to foreign investors. The privatized firms have yielded benefits to the economy in terms of improved efficiency and tax revenue, thus reversing the trend of draining government resources. While most companies bought by domestic buyers were “lower value” enterprises, those purchased by TNCs were large and potentially profitable companies, such as brewery and cigarette companies. But, as one study put it, “most of these [latter] firms were running below capacity and plants were in badly dilapidated condition. Privatization did not only entail handing over firms for a set price, but also required large investments in rehabilitation, new equipment, meeting outstanding debts, particularly for utility services, and training of personnel. Only international capital could afford this”.¹⁸ As Government has retained between 30 and 40 per cent of these companies, another benefit is increased direct revenue.

Evidence from individual firms also point to positive impact of foreign firms on privatized companies, regardless of whether the privatization took the form of direct purchase of these companies or non-equity arrangements between the Government and foreign investors. For example, the privatization and better management of Kilimanjaro International Airport, under concession to Mott MacDonald of the United Kingdom, has been a factor in its rapid growth and improved services. Similarly, the privatization of water agencies in Arusha and Moshi are reported to have led to substantial improvements in service provision and revenue collection.¹⁹ In the telecommunications sector, alongside the privatization of TTCL through FDI, there has been a boom in the supply of cellular services. So far the costs of telephone calls have not come down appreciably, but the completion rate of calls has improved substantially and fixed line installation delays have been largely eliminated (see section III.B.3 on this). The Tanzania Harbour Authority, operated under a performance contract,²⁰ has initiated a \$24 million modernization programme, and new machinery in the port of Dar-es-Salaam has reduced loading and unloading times significantly. In addition, the container terminal has recently come under the management, based on a 10-year lease agreement, of Tanzania International Container Terminal Services Inc. (TICTS), a foreign affiliate of a Philippine company, which is to invest heavily in information systems to speed-up procedures for loading/unloading, clearing and forwarding, and enable customers to track their shipments. In addition, a one-stop centre for inspection, clearing and forwarding is being built by the company.

As the privatization process continues, increased participation of FDI is quite likely, and this should lead to increased FDI impact on privatized companies in terms of not only injection of capital and new investment but more importantly technology, skills and improved management.

¹⁸ Temu and Due, 2000, p. 697.

¹⁹ “Privatisation” of water services in Arusha consists of the water supply kiosks built by the urban water supply department being rented out to ward development committees, which in turn rent them out to private individuals to operate. This system of privatising water supply system has been largely effected in unplanned settlements in Arusha. *Source: UNCHS website, Chapter 6: Privatizing Municipal Services in East Africa: The Experiences. Untitled document.*

²⁰ PPSRC Annual Review 1999/2000: Annex 1, Table 3 - no entry under “Buyer” for THA Performance Contract divestiture strategy; and PPSRC Privatisation in Tanzania: “Commercialisation of THA commenced in 1994 when the Government entered into a performance contract with THA,” (p.11).

2. Technology transfer and diffusion

FDI has traditionally been the most “packaged” form of knowledge transfer from external sources. It combines the provision of capital with technical know-how and the supply of technology. The transfer takes place either through equity involvement or joint ventures with local enterprises, licensing, turnkey projects, management contracts and subcontracting. In general, the following packages of technology transfer can be identified: (a) technology-embodied products such as machinery, equipment and tools; (b) technical skills such as management and organizational expertise, marketing, quality control and other production related skills; and (c) process-related technologies such as proprietary know-how, design and technical specifications and R&D capability. The latter are often transferred under licensing arrangements or to be used by foreign affiliates.

In Tanzania, the impact of FDI is, at present, confined to the transfer of technologies and skills falling under (a) and (b) above. Investigations conducted for this review show no evidence of transfer of technology and technical know-how that are included under (c) above. This is to be expected as most of the foreign investment entering the country has concentrated in resource-based industries where the need for proprietary technology is limited. But, this does not mean that the potential for technology diffusion and local technological learning will be restricted.

Basically, there are four channels through which technologies transferred by FDI can be diffused in the host country. They include:

- FDI establishing linkages with domestic enterprises – as suppliers (backward linkage) or users (forward linkage).
- Skills transfer through training, learning-by-doing, learning-by-interacting, and job-mobility.
- Demonstration effects as local firms copy or adapt new technologies, market channels and management techniques introduced by foreign investors. This can take place in activities that involve processing or manufacturing and also services.
- Strategic technology partnership between a foreign investor and a domestic partner in areas such as R&D.

At present, the scale of technology diffusion from foreign affiliates in Tanzania to domestic enterprises is limited, although, as shown below, there is evidence to suggest that FDI is contributing to skill formation. However, the potential exists for effective diffusion of technology and know-how from foreign affiliates to domestic enterprises.

Regarding technology transfer to Tanzania, there is no doubt that the recent surge in FDI inflows has increased the stock of technology, especially technology-embodied products such as machinery and equipment, available in the country. In some cases the technology transferred is new to the country, such as the Automated Teller Machines (ATM) introduced by the Standard Chartered Bank, a subsidiary of the United Kingdom banking group (box I.3). Other international banks have followed

suit. In other cases, the technologies transferred are diverse and large-scale and have the potential to generate backward linkages with local supplier firms.

Box I.3. Transfer of technology: Standard Chartered Bank

Standard Charter was the first international bank to open operations since the introduction of the financial sector reforms in the early 1990s. The first branch was opened in Dar es Salaam in 1993, followed by five additional branches: another two in Dar es Salaam and one each in Mwanza, Arusha and Moshi. By the end of 2000, the bank has built up a capital base of over \$220 million and a clientele including major international corporations in the country as well as local public and private enterprises.

In the last four years, the bank has introduced a number of innovative products and services previously not available in the country at a cost of over TZS 1 billion. Foremost among these is its Internet Services for corporate customers, the first such service in East Africa, which enables corporate customers in the region to access their accounts or conduct business through the Electronic Banking Service facility. Its Reuters Money 2000 provide bank customers with timely information on their foreign currency exposure. All 6 branches are fully computerized, satellite-linked, and equipped with Automated Teller Machines (ATMs). Other international banks have since followed suit.

Standard Charter has 190 employees, 5 of whom are expatriates including the Head of Finance who is Kenyan. The bank's training programme is closely linked to its strategy of maintaining and improving competitiveness through the use of cutting-edge technology and acquisition of marketing and management techniques. Three methods of training are used: 1) in-house training through learning by doing; 2) workshops on specific topic such as credit management, marketing and customer relations; and 3) training of technical staff in neighbouring countries, especially Zimbabwe and South Africa. The bank also sponsors management and technical staff for specialized training in the United Kingdom. Since 1998, the bank has spent over TZS 400 million in training.

Source: UNCTAD

One such case is the technologies imported by Kahama Mining Corporation (box I.1). Nearly 80 per cent of the total investment has been earmarked for acquisition of technologies and equipment and for installation purposes. At present, apart from semi-skilled labour, very little of the technological and technical skill needs of the company comes from local sources. But, mining machinery and equipment are complex products which require constant supply of parts and components, repair and maintenance, quality control and regular replacement of equipment. The potential for local engineering firms to emerge and develop the capability to supply some, if not most, of the parts and components currently imported from abroad is, therefore, great. Indeed, over time, the test of whether the presence of foreign companies such as the Kahama Mining Corporation in Tanzania has impact on local technological learning is the degree to which such companies continue to rely on imports for the supply of technology parts and components. The Kahama Mining Company has already generated some useful linkages in other areas such as transport, energy and construction. Efforts must be made to ensure that this success story is followed in other areas as well especially backward linkages with domestic producers of capital goods.

A typical policy approach traditionally used to encourage backward linkages with local supplier firms has been to impose domestic-content requirements on FDI. Although such a mandatory policy measure has been effective in some countries, it is not a viable option for Tanzania for at least two reasons. First, given the Government's commitment to maintain a liberal investment policy climate, imposing a mandatory requirement will give the wrong signal to potential investors as it is likely to be seen as an imposition on the freedom of foreign investors to acquire supplies from the source of their choice. Second, WTO ban on certain trade-related investment measures (TRIMs) makes it difficult to

apply local-content requirement, although as a least developed country, this does not apply to Tanzania at the moment.²¹ The challenge is how to exploit the technological learning potential of supplier relations without necessarily applying mandatory measures. In this respect, the special agreement that the Government of Tanzania has arranged with individual mining companies - in the context of Fiscal Stability Agreement - may provide an answer. For instance, the agreement signed with Barrick Gold of Canada, the owner of Kahama Mining Corporation, incorporates an understanding that the company will contribute to local development through investment in related activities such as road construction, power supply and training and by creating backward linkages to local suppliers. TIC should consider the possibilities of arranging similar non-mandatory understanding with other major foreign investors, covering broad areas including local purchase of technology-embodied products.

In the manufacturing sector, the impact of FDI on technology transfer and technological improvements has been significant in recently privatized enterprises. Tanzania has introduced a comprehensive privatization programme and the determination of the Government to implement its programme has attracted serious foreign investors that are willing to take long-term investment perspective including the technological upgrading of the newly acquired enterprises. Some examples include the Tanzania Cigarette Company, acquired by RJ Reynolds, the Tanzania Breweries, acquired by South African Breweries, and the sugar processing companies, in particular Mtibwa Sugar Company, which is now a private joint-venture company (box I.4). Prior to acquisitions by foreign investors, all of these companies operated in a protected domestic market environment and they suffered from problems related to over-employment, declining revenue, under-utilization of capacity and weak technological and management capabilities. Without exception, therefore, technical and managerial skills as well as new or additional technologies had to be introduced to make them fully operational, competitive and profitable.

Box I. 4. Transfer of technology: Mtibwa Sugar Company

Until recently, sugar production in Tanzania was controlled by three large state enterprises, one of which was the Mtibwa Sugar Company. The three have been privatized, with Mtibwa being bought by a local transport and trailers manufacturing firm jointly with investors from Mauritius. For the local company, the decision to diversify into sugar production posed both technical and skill challenges as it had no experience in food production, especially one that involved an integrated production system including managing sugarcane plantations. Converting the newly privatized plant into a viable and efficient commercial business required additional technologies and advanced management and marketing skills. The involvement of a foreign partner was critical in resolving these constraints.

The technical capability and management skills needed to bring the company to full production and to make it competitive were obtained from Mauritius, which is increasingly becoming an important source investment and managerial skills in East and Southern Africa. The involvement of the foreign partner has proved to be effective in the following areas: (a) Upgrading the technological capability of the newly privatized company by introducing new, as well as, second-hand sugar processing machines and equipment and heavy agricultural machinery for sugarcane production imported from Mauritius. Components for the manufacturing of boilers were also imported from Mauritius and assembled in Tanzania; (b) Improving efficiency and competitiveness through new management and marketing techniques arranged through a management contract; and (c) training of local technical staff to develop local capacity.

Source: UNCTAD

²¹ The current transition period expires at the end of 2002.

An interesting feature of technology transfer to Tanzania through FDI is the growing importance of South-South technology transfer in contrast to the traditional North-South flows. Since liberalization, Tanzania has attracted new investments from South Africa, Mauritius, Malaysia, China (mainly in small-scale pharmaceutical industries) and India involving the transfer of technology, technical know-how, and managerial skills and new working style and culture from the home countries. Whether this new form of foreign investment and the types of technologies and skills that it transfers will have a more positive impact – for example compared to technologies imported from developed countries - in terms of local technological learning and technological adaptation through linkages and spillover effects is to be seen. What is clear, however, is that the FDI from other developing countries tends to be attracted to small- (for example, the small-scale Chinese-owned pharmaceutical enterprises) to medium-scale (from South Africa, Mauritius, India) activities and they are generally labour-intensive and often rely more on local than expatriate personnel. The potential for backward and forward linkages and the diffusion of technologies and know-how that are more appropriate for the needs of Tanzanian enterprises is, therefore, higher. Indeed, in recognition of the importance of South-South technology cooperation, the government is actively encouraging interactions between Tanzanian and other enterprises in developing countries. For example, the Governments of India and Tanzania have recently signed, as part of a technical cooperation agreement, eleven letters of intent for technology transfer, technical and management expertise worth over \$ 4 million. The letters of intent, which were signed by TIC on behalf of the Government, were part of an integrated industrial development programme aimed at encouraging Indian investment in the Tanzanian economy, particularly in agro-business, especially food processing, pharmaceuticals, engineering and other small- to medium-scale manufacturing activities. The main attraction of the programme is its contributions to the transfer of technology and know-how through inter-firm partnerships between Indian and Tanzanian enterprises.

The liberal investment policy framework has also encouraged the transfer of technologies and production processes that are new to Tanzania. One such a case is the greenfield investment by a United Kingdom transnational corporation, Cow Bell International, which established in 1998, a milk powder packing, marketing and distribution company (box I.5). The main technologies used are packing machines that are designed to pack milk powder in small sachet of different sizes for mass production. At present, all the company's technical needs are provided from abroad. The parent company, Cow Bell International, has subsidiaries in 14 African countries with a regional office in South Africa. Technical support, including training, for affiliates which are located in countries where local technological capability is weak is currently coordinated through the regional office. However, for Tanzania, this company's investment and the transfer of specialized industrial technologies provide an opportunity in the following areas:

- Technological learning through the supply of parts and components. The advantage for local firms is that most of the capability required such as foundry work, machining and welding capacity, both in terms of equipment and skills, is not specific to particular products. For example, technological learning and capacity acquired from manufacturing parts and components for packing machines can be transferred to production of boilers for sugar industry or equipment for cement or food manufacturing.
- The introduction of specialized industrial technologies such as packing machines also provide the opportunity to learn new machine designs and for adaptation or even imitation through reverse engineering.

Box I. 5. Transfer of technology: Wonder Foods (T) Ltd.

Wonder Foods Tanzania Ltd, a subsidiary of Cow Bell International (United Kingdom), was established in 1998 as the first to pack, market and distribute milk powder in the country. It qualifies as a greenfield investment in that it introduced a new product to the Tanzanian market with the production capacity located within the country. It is the fifteenth African affiliate for the parent company, headquartered in South Africa. Wonder Foods (T) Ltd. has since expanded into tea processing, blending, packaging and distribution. It supplies at least 20 tons of tea per month, which is 15 per cent share of the domestic tea market. The company plans to add one item to its product line every year.

The technologies used by the company to process its products include packaging machines and blending equipment. The packaging machines are specially designed to pack small quantities of milk powder and/or tea in tins and paper sachets. The machines used are not automated nor are they complex. But all the machines as well as the simple metal hoops used to blend tea are imported from abroad. As the company expands its product line, it is likely that additional machinery and/or equipment will be acquired to increase capacity. This will be an opportunity for local engineering firms to supply equipment and even manufacture packing machines through reverse engineering. The skills and technologies needed to manufacture the basic equipment used by the company, such as metal hoops for blending, already exist in the country. For example, SuperDoll, trailers assembly company, manufactures boilers and large metal hoops for food processing enterprises, including its sister company, Mtibwa Sugar Ltd. Therefore, the hoops imported by Wonder Foods could have been manufactured within Tanzania and the foreign exchange used for this purpose invested locally.

The company provides training, both in-house and by sending technical staff for advanced training abroad. Since more than 70 per cent of the staff are in marketing and sales, most of the training undertaken by the firm is in marketing. The company coordinates training with its sister companies in the region.

Source: UNCTAD

The impact of the recent surge in FDI to Tanzania has been more prominent in the transfer of technical skills. In the last four decades, Tanzania has made considerable progress in human resource development having started at a very low initial level at independence. However, since the mid-1980s, there has been noticeable decline in education, especially technical training, due largely to the gradual reduction, initially as part of structural adjustment programme, of public resources allocated for education and the lack of alternative private sector investment in either technical training or education as a whole. As a result, the human capital base of Tanzania is small and, at present, almost all indices of skill formation indicate that Tanzania is lagging relative to countries in the region such as Kenya and Zimbabwe. The low output of skills, as indicated by formal enrolment, is exacerbated by the low quality of the technical skills available, including in management and marketing, which are essential in current increasingly skill driven and competitive national, regional and international market conditions.

The Government recognizes the constraints on economic growth and further investment created by the weak and stagnant skill base. As a result, it has begun to allocate more resources to basic social sectors, including education, as reflected in the guidelines for the preparation of the 6th Rolling Plan and Forward Budget for the period 1998/99 – 2000/01. Moreover, an action plan for decentralizing responsibility for the management of schools through block grant system has also been finalized. However, what is missing in the current government thinking on education reforms, in particular vocational training, is the role of the private sector in this process. Domestic private enterprises invest very little in employee training and there is no specific policy to encourage private operators to introduce systematic training programmes. For instance, there are no fiscal incentives in the current technology policy for enterprises that provide formal technical training or develop in-house R&D capability, which

is not even allowable as a tax-deductible expense. Given the shortage of technical skills and high-level of mobility among skilled workers, local enterprises are reluctant to take the investment risk involved in training staff.

In this respect, the experience of FDI has been somewhat different. All the foreign firms interviewed for the purpose of this review are contributing to skill formation and the expansion of the overall skill base of the country.

One way is to import skilled personnel to cope with the immediate shortage of technical skills in the country. All of the major foreign investors now rely on expatriate personnel for technical and managerial functions. In some cases, such as the Kahama Mining Corporation, the majority of the 200 skilled technical personnel are expatriates (box I.1). The company envisages that in seven to eight years, the number of expatriate staff will be reduced to between 20 to 30 which, should it happen as planned, will suggest that local technological learning and capacity building have taken place. In banking and food processing foreign companies, the imported skills tend to be dominant at the management and administration levels.

Training within the firm is another channel through which FDI is contributing to skill formation in Tanzania (boxes I.3, I.4 and I.5). In some cases, well-established affiliate firms in the region are used as training grounds. For foreign investors, especially medium- and small-scale foreign firms, one of the attractiveness of a developing country like Tanzania as an investment location is the low cost of labour, which helps to sustain competitiveness.²² If these firms have to continue to rely on expatriate technicians and managers, the competitive advantage of Tanzania as an investment location is lost because, at present, it costs from \$200,000 to \$250,000 a year to hire a manager from a developed country. Even if skilled staff were brought from other relatively more advanced developing countries such as Malaysia, the Philippines, South Africa, India, Turkey and others, the overall cost would still be much higher than locally recruited skilled personnel. Therefore, at present, firm-level training is a necessary strategy for foreign firms in Tanzania which require, and will continue to require, highly skilled technical and managerial staff.

Many of the new foreign investors have also introduced programmes where locally recruited staff is sponsored by the firms to obtain further training in formal learning institutions within Tanzania or abroad. For example, since 1998, the Standard Chartered Bank has spent \$5 million in training its locally recruited staff (box I.3) in Tanzania, in other countries in the region (Zimbabwe and South Africa), and in the United Kingdom. The bank believes that in order to maintain its current competitive position – in the face of intense competition from other international banks already in the country such as Citibank and Barclays -- investment in upgrading the skills of its Tanzanian staff and training them in modern technical and management skills is critical. Another example is the Kahama Mining corporation which has budgeted \$6 million for training in Tanzania and abroad.

Some of the foreign firms train their staff in the home country and often by parent company so that the trainees, while acquiring new skills, also gain better understanding of the working methods and culture of the company. For example, when the International Bank of Malaysia was establishing its

²² Although, as explained in Chapters II and III, the cost of labour in Tanzania is higher than other countries with the same level of economic development.

operations in Tanzania, it headhunted and recruited Tanzanians studying in Malaysia who were then given 3 to 4 months additional training by the parent company before returning to Tanzania. Mauritian and South African firms also conduct most of the advanced training of their staff in the home countries. This suggests that FDI is diffusing not only technical skills but also diverse management techniques and working cultures.

In short, although it is too early to assess the full impact of the recent FDI inflows to Tanzania on technology development, preliminary indications suggest that it has contributed to the expansion of the stock of technology and skills available in the country. A new and interesting trend emerging from the recent FDI inflow to Tanzania is the transfer of technology by FDI from other developing countries. Targeted investment promotion efforts may be necessary to continue to attract FDI from other developing countries in the region and beyond.

3. Trade

The shift from an inward oriented to an open market system has rapidly improved Tanzania's international trade at global and regional levels. During the first half of the 1990s, Tanzania's export were rising at rates of 15 per cent per annum, although in more recent years, some setbacks were experienced which together with continued import growth have exacerbated the balance of payments situation. Nevertheless, exports of goods and services amount to 20 per cent of GDP, as do imports of goods. The process of economic reforms is still ongoing, and a number of steps towards trade and tariff liberalization and improvement of conditions for exporting are still to be achieved. Not surprisingly, increasing exposure to global competition has become a major challenge for some sectors, particularly manufacturing enterprises, which had previously benefited from heavy protection. In this respect, the involvement of FDI through the privatization programme has been an effective instrument in reviving some of these enterprises and improving their competitiveness.

In the past little FDI was involved in the development of the foreign sector. FDI has recently started to make increasingly important contributions in that area. Various major FDI projects in gold mining for exports have taken place and the indications are that they are likely to be followed by other export-oriented investments for gold and other metals. FDI has also taken place in projects for the expansion and/or restructuring of plantation farming, such as sugar. FDI into major hotel projects have also the potential for boosting the tourism industry in the direction of high quality services, thereby widening the foreign exchange earning capacity of the country.

The development of the foreign trade sector will particularly benefit from FDI involvement in the improvement of transport, financial and other support services in the forms of management contracts for airports, rationalizing ports and foreign acquisition of domestic banks. The latter have direct impact on the transfer of technology and technical know-how and the provision of efficient and cheaper services for trade and investment financing.

Key to a future dynamic development of Tanzania's foreign trade sector will be the diversification and expansion of exports in goods and services and a considerable improvement of infrastructure for export-oriented production and foreign trade. Initial operations of foreign gold mining companies in Tanzania indicate (see, for example, box I.1) that FDI will play a critical role in this respect. In addition to capital flows, it is also contributing to the development of export-oriented

technological, management and international marketing capacities and the improvement and expansion of local physical infrastructure.

Enhancing further the impact of FDI on trade will require diversification of the export base, both horizontally and vertically, and ensuring that the country takes advantage of the various preferential market access offers. The new Cotonou Agreement with the European Union, for example, provides an opportunity for attracting export-oriented FDI. The Agreement provides for an investment fund, which offers support for the restructuring and promotion of joint venture arrangements with small and medium scale European investors. Tanzania should encourage domestic enterprises to develop their export capacity through linkages with potential European partners with the support of the investment fund.

Until the adoption of the recent Everything but Arms (EBA) initiative for LDCs by the European Union, the EU/ACP trade preferences offered major opportunities for diversifying exports into non-traditional exports, food processing and manufacturing. However, existing preferential opportunities have hardly been seized for developing exports to the European Union markets for processed products. There is also a pronounced lack of response in the area of manufactures, where only one single clothing product of cotton has taken advantage of the preferential market access provided by the European Union.

EBA has brought considerable improvement in market access for Tanzania's exports. This initiative enables immediate duty-quota-free access to the European Union market for all LDC products but arms and ammunitions, while for a limited number of very sensitive products, namely banana, rice and sugar, tariffs will be removed according to specific time schedules. For bananas, the duty will be reduced by 20 per cent per annum over the 2002-2006 period, whereas for rice and sugar the process of tariff liberalisation shall take place between 2006 and 2009. During the interim period, in order to provide effective market access, LDC rice and sugar will be allowed to enter the EC market duty-free within the limits of a tariff quota which will be gradually increased over time. In the case of sugar, such quotas for all LDCs will grow from 74,185 tons (white-sugar equivalent) in 2001/2002 to 197,355 tons in 2008/2009 (July to June marketing year). The 10,000 tons of sugar available to Tanzania under the EU/ACP sugar Protocol are excluded from the above quota to maintain the benefits of such Protocol²³.

The EBA goes far beyond the market access available to Tanzania exports through Cotonou/Lomé and previous EU GSP/LDCs preferences. First, unlike the previous preferences, EBA provides for more stability, as it is granted for an indefinite period of time. Second, EBA expands products coverage and duty-quota free access, including the elimination of all variable and specific duties to other products like beef and other meat; dairy products; fruit and vegetables; processed fruit

²³ At the time of writing, it is not yet clear how these tariff quotas are to be allocated among LDC beneficiaries (48 countries – Myanmar is temporarily excluded from the EC GSP). EC Regulation 1260/2001 lays down a list of possible methods that could be used to administer sugar quotas (article 26.2):

- "First come first served";
- "simultaneous examination method": based on distribution in proportion to the quantities requested when the applications are lodged;
- "traditional/new arrivals method": a method whereby traditional trade patterns are taken into account.

and vegetables; maize and other cereals; starch; oils; processed sugar products; cocoa products; pasta; and alcoholic beverages. A further improvement of the EBA would be to improve rules of origin²⁴.

Overall, the EBA provides better market access opportunities than the Cotonou Agreement in the EU for Tanzania products, possibly fostering exports and attracting FDI, particularly in those sectors whose competitors continue to face considerably high MFN tariffs when exporting in the EU.

The United States has also removed most of its duties relevant for Sub-Saharan Africa Countries under its new African Growth Opportunities Act (AGOA). While the current “normal” GSP programme of the United States expired in September 2001 and contains several limitations in terms of product coverage, the AGOA amends the GSP by providing duty-free treatment for a longer period of time and for a wider range of products. This includes, upon fulfilment of specific origin and customs requirements, certain textile and apparel articles that have been heretofore considered import-sensitive and thus statutorily excluded from the programme and continue to attract considerable high MFN duties. According to the United States Trade Representative’s calculations, the Act offers an average 17.5 per cent duty advantage on apparel imports in the United States market, thus providing beneficiary African countries with a significant competitive price advantage over many other major international suppliers. A special provision of AGOA encourages exports of apparel from Lesser Developed AGOA beneficiaries with more favourable rules of origin requirements over an initial four years period. Tanzania should undertake the necessary steps to benefit from this special initiative within AGOA²⁵.

Further, the “AGOA-enhanced” GSP benefits will be in place for a period of 8 years and this longer than usual period of time is expected to provide additional security to investors and traders in designated African countries. This element of security of the preferences is further strengthened by the decision by the Office of the United States Trade Representative responsible for GSP matters not to carry out the usual annual reviews of product coverage for AGOA products. With capital and management and marketing skills generated from FDI, Tanzania could easily expand its exports of cotton textiles to the United States.

The Tanzanian Government should encourage potential foreign investors to join in actively exploring possibilities for exploiting these duty-free and preferential market opportunities available in the European Union and United States markets. To that end, it may be necessary to launch an investment campaign which is focussed on a few priority sectors tailored to each target market, investment promotion missions to potential markets in European Union or United States, or Tanzanian investment round tables. This will help to identify potential foreign investment partners, while drawing attention to market access opportunities and Tanzanian comparative advantages. Tanzania should also make use of the various instruments provided by the European Union under the Cotonou Agreement for fostering FDI, joint ventures and industrial and marketing cooperation in all possible forms, including financial arrangements.

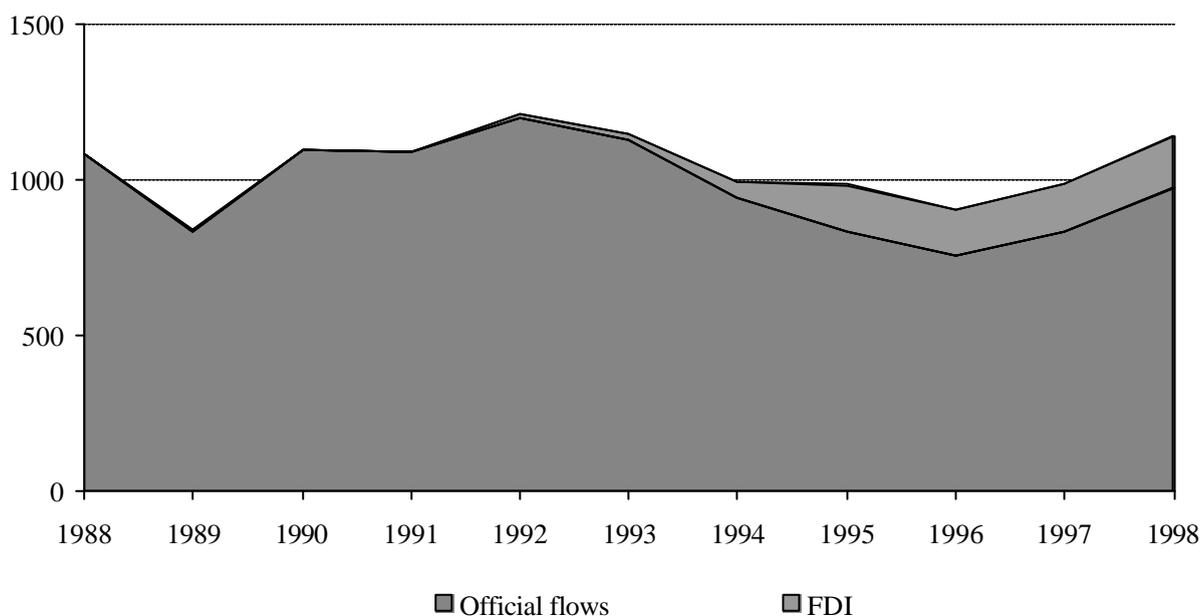
²⁴ Under the EBA/GSP, the cumulation provisions to comply with rules of origin requirements are more limited than under the rules of origin contained in the EU/ACP. While under Cotonou Agreement full cumulation is allowed among all ACP countries, in the case of the EU GSP scheme (and thus also for the EBA) diagonal cumulation is only allow to selected regional groupings. For further reading see UNCTAD/DITC/TNCD/4 (2 May 2001)

²⁵ At the time of writing Tanzania, although declared AGOA eligible, it has yet to be declared eligible for the apparel provision and for the special provision for lesser developed countries as it has not yet established an efficient visa system.

4. Overall impact

Although to date the benefits from FDI are strongest in industries where FDI is concentrated, such as gold mining and banking, the impact goes beyond these industries and is beginning to have implications for the entire economy. Increasing FDI flows are changing the structure of external financial flows into Tanzania (figure I.7). While official development assistance (ODA) remains the largest component of resource flows, it has been in decline in both absolute and relative terms. During 1995-1998 Tanzania received annually \$617 million of ODA, compared to \$876 million in 1990-1994. As a percentage of GNP, ODA declined from 28 per cent in 1990 to 13 per cent in 1998 and in dollars per capita from 46 to 31. At the same time, FDI inflows, net of profit remittances on FDI, increased from \$14 million to \$116 million annually, compensating for over half of the decline in ODA. While in 1990 the share of FDI in resource flows to Tanzania was zero, in 1998 it increased to 15 per cent.

Figure 1.7. Total net resource flows to Tanzania, by type, 1988-1998
(Millions of dollars)



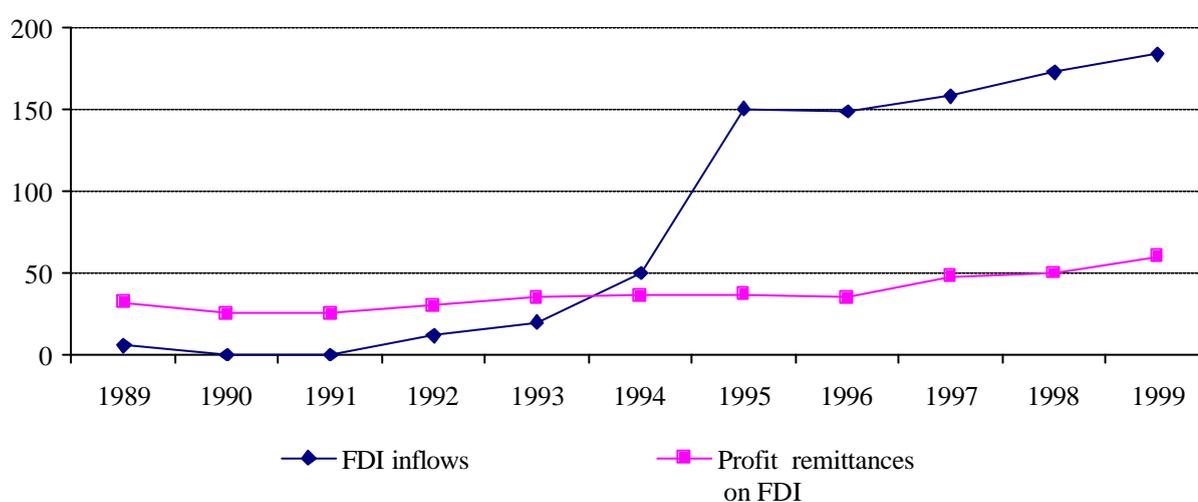
Increasing FDI inflows reversed also the negative impact of the two most important FDI-related financial flows on the balance of payments (BoP), which occurred in the first half of the 1990s (1990-1994) when profit remittances on FDI (\$151 million) exceeded FDI inflows (\$82 million) by a factor of two (figure I.8). In 1995-1998 inflows amounted to \$630 million while profit remittances were \$170 million. It is impossible to assess the full impact of FDI on BoP, because data on the transactions of foreign affiliates and the indirect impact of FDI on domestic firms and consumers is not available. But one can recognize the contribution of foreign affiliates in increasing gold exports as well as inflow of hard currency from tourism.

When discussing the implications of FDI for overall productivity, growth, employment, etc., one should bear in mind that the share of industries with FDI in the economy is still small. Mining sector's share in GDP, although growing rapidly, is still very small – over two per cent in 1999 (it is much smaller

in total employment). The share of financial services in GDP is only 4 per cent and that of tourism 7 per cent.

The ratio of FDI flows to capital formation, although much higher than ever before in Tanzania and higher than an average in LDCs, is around 14 per cent. If one assumes that all FDI is “GDP investment” (which is not the case) and that every dollar contributes equally to the GDP growth, out of 4.2 per cent of an annual GDP growth during 1996-1999, only 0.6 percentage point would be due to FDI. In countries such as Mozambique and Uganda this contribution is much higher with the ratio of FDI to capital formation, respectively 26 and 18 per cent (table I.1).

Figure I.8. Tanzania: FDI inflows vs. profit remittances, 1990 -1999
(Millions of dollars)



Source: UNCTAD

Tanzania remains a rural economy with the share of agriculture in GDP nearly at 50 per cent, which has hardly changed during the 1990s. FDI in this sector is very small. Perhaps as a result of the upcoming privatization of large state-owned farms this will begin to change. Another chance of increasing the impact of FDI on the entire economy is in attracting FDI into large scale privatizations of infrastructure services and into manufacturing. The latter sector accounts for only 8 per cent of GDP. FDI role in it, in spite of the increasing number of approved foreign affiliates, appears to be limited at present.

C. Assessment

Although Tanzania's efforts to increase the role of FDI in its development date nominally back to the mid-1980s, when Tanzania made a decision to begin the transition away from a centrally-planned economy to a market-based economy, these efforts were for many years rather timid. It took time to dismantle old institutions and mechanisms and to create new ones. Only in the second half of the 1990s market-oriented reforms reached critical mass. The economic situation also improved after sluggish growth and high inflation of the early 1990s and foundations for a sound FDI environment were established. Once some of the necessary conditions to attract FDI were in place, foreign investors' responded and FDI inflows increased significantly to reach the level of nearly \$200 million in 2000.

During 1995-2000 Tanzania received a total of \$1 billion of inflows, compared to \$90 billion during the preceding six years. This is commendable, given that Tanzania remains one of the poorest countries of the world and that it emerged from its socialist past not a long time ago.

The acceleration of inflows between 1992 and 1996 improved considerably Tanzania's FDI performance relative to other least developed countries which have also worked hard to receive more FDI, but with few exceptions, have not been very successful in this regard. Tanzania has also improved its position vis a vis neighbouring countries. Overall, during 1995-2000, Tanzania received inflows comparable to those of Uganda (\$1.1 billion) and Mozambique (\$0.8 billion), found by *World Investment Report 1998* to be among 7 frontrunners in Africa as regards FDI performance. After 1996, however, on an annual basis, although growing in absolute terms, inflows into Tanzania did not keep pace with the inflows into LDCs, sub-Saharan Africa or neighbouring countries (except for poorly performing Kenya) and Tanzania lost some of its relative position achieved in the mid-1990s.

Owing to increased FDI inflows, qualitative impact of FDI on the economy has also become noticeable, especially in the sectors where FDI is concentrated. In mining FDI has served as an engine of growth and increased gold exports. In banking it has contributed to the modernization of the sector. Foreign investors have restructured privatized enterprises, increasing their competitiveness. They have typically contributed to the transfer of technology and skills. Although FDI impact is strongest in industries where it is concentrated, it has implications for the entire economy. Noticeable overall impacts include: (a) a contribution of FDI to the external inflow of resources (15 per cent in 1998); (b) a change from a negative to a positive contribution of the balance between FDI inflows and profit remittances to the balance of payments; (c) the contribution of foreign affiliates in increasing overall exports and inflow of hard currency from tourism; (d) an increased share of FDI in capital formation and thus growth; and (e) the diversification of the economy away from agriculture towards mining and services.

These positive impacts which hardly existed until the mid-1990s or were negative (as the balance between transfer of profits and FDI inflows) go some way towards achieving Tanzania's objectives. The objective of FDI is, among others, "to increase the share of foreign direct investment in total external resource inflows..." and "to invest in export areas in which Tanzania has comparative advantage." However, the scale of these impacts is still small and a number of desired impacts are hardly taking place at all (such as linkages to local economy or the encouragement of local science and technology capacities²⁶).

Therefore, after the initial success with FDI, Tanzania's challenge is now to push FDI to new frontiers, achieving higher levels of FDI inflows than those received in the second half of the 1990s, and increasing the scale and scope of Tanzania's benefits from FDI.

²⁶ These objectives were stated in the 1996 National Investment Promotion Policy document.

CHAPTER II. THE INVESTMENT FRAMEWORK

Tanzania has an open investment environment with adequate standards of investor treatment and protection. This is, however, a characterization of policy and current conditions and practices, rather than the statutory regime. The investment code, introduced in 1990 and modernized in 1997, has not kept pace with the rapid changes in the country. There is need to overhaul the regulatory regime and enact new and modern legislation reflecting current conditions inside and outside Tanzania.

A. Evolution of the investment framework

Investment in Tanzania is a national and sub national concern. Zanzibar has separate legislation that governs investment promotion. However the regime established in Zanzibar is subject to the Constitution and has many features in common with the provisions applicable in the Union. It must also be remembered that many important fiscal incentives can only be granted in Zanzibar under, and in accordance with, Union legislation (e.g. legislation relating to Customs and Excise and Income Tax).

In Zanzibar, the basic legislation covering FDI is contained in the *Investment Promotion Act of 1986* passed by the Zanzibar House of Representatives, which was enacted during a period when, like mainland Tanzania, the local economy was centrally planned. In 1992, the so-called Zanzibar Declaration began the process of opening up and putting greater reliance on the private sector, both local and foreign. The Zanzibar Investment Promotion Agency (ZIPA) was established the same year. Subsequent legislation has established the Free Economic Zones and the Tourism Commission, which works closely with ZIPA to attract FDI to develop the tourism sector. In 1999, the Government of Zanzibar adopted a *Zanzibar Vision 2020*, which includes a commitment to building investment climate that will further encourage FDI. It is expected that the 1986 Act will shortly be revised.

On the mainland, the first market-oriented investment code was introduced in June 1990, applying to all private investments, local and foreign. It opened up some sectors of the economy to private investors and paved the way to the establishment of the Investment Promotion Centre (IPC) to encourage and manage both domestic investment and FDI. The limitations of this initial approach became apparent to the Government and ODA donors quite soon, during the early 1990s, as the response of private investors was very weak. Donors were especially concerned that economic development would continue to be too dependent on ODA and public investment, and that foreign investors were obviously avoiding Tanzania.

The Government launched the New Investment Policy of Tanzania in 1996, which shortly resulted in *The Tanzania Investment Act 1997*. The Act introduced five important changes to the investment framework. It:

- Established the Tanzania Investment Centre (TIC), giving it significantly expanded mandate compared to that of its predecessor, IPC.
- Identified investment priorities (box II.1).
- Introduced a new company registration process.
- Determined investment incentives and investors' rights.

Box II.1. The evolution of investment priorities

The Government of Tanzania designates for the purposes of investment promotion and investment incentives priorities in the form of lead and priority sectors, which are, in fact, a mixture of industries and activities. These sectors, formally defined in the Customs Tariff Act 1976, and amended by the Financial Laws (Miscellaneous Amendments) Act of 1997, provided the operational interpretation of the 1997 Tanzania Investment Act concerning investment priorities. They included:

- **Lead sectors:** mining; infrastructure (roads, bridges, airports, power, telecommunications, water and essential support services); and export processing zones.
- **Priority sectors:** agriculture including livestock; air aviation; commercial buildings; commercial, development and microfinance banks; export-oriented projects; export processing zones; geographical special development areas; human resources development; economic infrastructure (including construction of roads, bridges, railways, airports, installation of electricity, telecommunication, water services and like services); manufacturing; natural resources including fisheries; rehabilitation and expansion; tourism and tour operations; and radio and television broadcasting.

The designation of lead and priority sectors was criticized, among others, because they accounted for almost all of Tanzania's GDP and, as a result, there appeared to be very few "non-priority" sectors. In the 2001/2002 budget speech, the minister responsible for planning and investment has clarified that the current lead sectors are: agriculture and agro-industries, mining, tourism and economic infrastructure. Investors in these sectors can be given additional incentives (under section 20 of the 1997 Investment Act) beyond general rights and incentives provided to the holders of the Certificate of Incentives.

Zanzibar has identified its own, much more limited set of investment priorities. They currently include tourism, export processing, fishing and fish processing. However, with the exception of tourism which is being actively promoted through the Tourism Commission, no operational sector strategies or investment promotion programmes have been formulated by the Government of Zanzibar, although the formation of independent promotion agencies for the Export Processing Zone and Free Port will be followed by the preparation of strategies and business plans for both of these initiatives.

Although applying equally to all investors, this Act ("the 1997 Act") is the principal legal basis for Tanzania's present FDI framework. It includes a few specific references to foreign investors on some FDI-specific issues. Other laws affecting investment such as the laws on employment, taxation, and land acquisition as well as sector specific laws such as mining laws, together with the 1997 Act, constitute the FDI framework of the URT (box II.2).

The focus of this chapter is on the FDI environment at the Union level. Wherever there are significant differences between the mainland and Zanzibar, these are discussed in relation to specific issues.

Box II.2. Investment framework in Tanzania: principal acts

- Planning Commission, *Composite Development Goal for the Tanzania Development Vision 2025*, February 2001
- Government of Tanzania. *Programme for Business Strengthening for Tanzania Creating: an enabling environment for business: enhancing growth and reducing poverty*. December 2000
- Ministry of Finance & Economic Affairs, Zanzibar, *Zanzibar Vision 2020*, December 1999
- The Tanzania Investment Act 1997
- The Mining Act 1998
- The Petroleum Act 1980
- The Land Act 1999
- The Hotels Act 1963
- The Tourist Industry Licensing Act 1969
- The Zanzibar Investment Promotion Act 1986

B. Specific FDI measures

1. Entry and establishment

Foreign investors wishing to open and operate a commercial business venture in Tanzania must first be licensed as a business to meet the requirements of the Business Licensing Act 1972, administered by the Business Registration and Licensing Agency (BRELA) of the Ministry of Industry and Trade. In Zanzibar all FDI applications and advice are handled directly by ZIPA staff which liaises with relevant Union ministries where required. The licensing procedure and documentation requirements are fairly straightforward and is not overly onerous (box II.3).

On the completion of the registration process with TIC investors, both foreign and local, receive the Certificate of Incentives. However, after changes in fiscal legislation in recent years, the Certificate in most cases gives investors access to rights rather than privileges. These include investment guarantees contained in the 1997 Investment Act, access to land or the right to transfer funds abroad and employ up to 5 expatriates.

For an investor to qualify for the Certificate, the 1997 Tanzania Investment Act establishes minimum levels of investment capital. The minimum level for foreign investment projects, including wholly-owned affiliates and joint ventures, is \$300,000 and \$100,000 for local investors. The legislation is not clear on incentives and procedures for FDI projects below the threshold levels. It appears that FDI projects below this minimum level can still be registered with BRELA. They may be offered facilitation and support and help by TIC, but will not receive incentives available to projects above \$300,000 or \$100,000 as the case may be. This minimum level also applies in Zanzibar.

It is also unclear to what extent the Investment Centre is intended to have discretion in the issue of the Certificate of Incentives to an investor who is otherwise qualified in terms of the minimum level of capital investment. The language set out in subsection (2) of section 17 of the Investment Act is mandatory – “shall issue certificates in accordance with the provisions of this section” – and there is no reference in the section to approval of an investment. On the other hand the information required of an

applicant suggests that the Centre expects to exercise some

Box. II.3. Application and authorisation procedures

The FDI entry and establishment process for Tanzania is defined in the 1997 Act. It sets out the requirements and steps for new investors to apply for entry, approval and business registration, and thereby obtain access to the fiscal incentives available to investment projects meeting the FDI eligibility criteria. The procedure is relatively simple and clear. All applications are dealt with by TIC.

Three copies of the completed application and business plan for the investment project should be submitted to TIC. Other required formalities are (1) a foreign investor profile and (2) a non-refundable \$750 registration fee.

Once this process is done, a representative of the Ministry of Industry and Commerce will assess the business and issue a business certificate making the business eligible for investment incentives from TIC and then hand over the application to a TIC case officer. In Zanzibar all FDI applications and advice are handled directly by ZIPA staff which liaises with relevant Union ministries where required.

Enterprises seeking to invest in the mining or petroleum sectors require to obtain registration and approval within the separate legislation (Mining Act 1998 and the Petroleum Act 1980) administered by the Ministry of Energy and Minerals. Businesses in tourism and hotels have also to secure licences, both centrally and locally from the relevant ministries and local authorities.

Once FDI applications and the required associated documentation have been reviewed by the TIC case officers and the in-house ministerial and agency representatives, TIC registers the project. Normally, this process is a matter of days rather than weeks as was the case before. Copies of the project documentation of approved applications are sent to the Ministry of Industry and Commerce, the Ministry of Finance and to the Tanzania Revenue Authority. Copies are also sent to the relevant ministry with authority over specific sectors such as agriculture, banking and financial services, telecommunications, tourism, energy and minerals. In practice, very few registration applications are refused either in the mainland or Zanzibar.

TIC maintains a database, which is the main means of monitoring FDI project approvals in Tanzania. The database also contains the six-month progress reports required of all FDI projects. The records also include registration documents for technology transfer agreements and all certificates of approval issued to companies and their expatriate staff.

judgement about the merits of the proposed investment. The current practice is however relaxed and very few applications are refused. The Centre does not approve or monitor projects but helps register and facilitates them. This is but one example of a discrepancy between the reality and legislation, which should be dealt with when a new act is prepared.

2. Investment restrictions and requirements

The 1997 Investment Act practically eliminated the remaining FDI industry restrictions on the

mainland limiting them to the manufacturing and marketing of hazardous chemicals, armaments and explosives. In Zanzibar, industries reserved for local investors, and thus closed to FDI, include: retail and wholesale trading services; product brokerage; the operation of taxis; barber shops, hairdressing and beauty parlours; butcher shops; and ice-cream manufacture.

There are no ownership restrictions or requirements for a government equity holding in foreign investment projects, with only one exception. In the petroleum sector under the model production sharing agreement now used as a basis for negotiation with the oil companies in the event of a commercial discovery by the contractor Tanzania Petroleum Development Corporation is entitled to exercise an option to acquire, on a working interest basis, a participating share in the contract rights held by the investor. The amount of the participating share is determined by a sliding scale based on the volume of production and ranging from 5 per cent to 20 per cent.

The 1997 Tanzania Investment Act does not set performance requirements or any other quantitative or qualitative investment goals for investment projects either in a formal or an indicative sense. There is an expectation that the job creation, investment expenditure and business growth targets provided by investors in the business feasibility plans attached to their business registration application will be actively pursued.

The specific project information required from foreign investors in green-field, mergers and acquisitions or joint venture situations, is detailed in section 17 of the 1997 Act. This must be supported by evidence confirming that the investors have sufficient capital to complete the project.

One serious concern in relation to production targets in feasibility studies approved by TIC, namely that investors could find themselves required to pay corporate tax and some fiscal duties *in advance* of their being operational, based upon these *ex-ante* forecasts has been rectified by the Financial Act of 2001. This was a burden in relation to TRA assessments, especially where the subsequent performance of a company or investor did not match up to expectations and forecasts. While under-performance was expected to result in a reimbursement of the advance tax by TRA, there were delays, opportunities for bureaucratic inefficiency and occasionally corruption.

3. Treatment of FDI

(a) Standard of treatment

A policy priority in Tanzania is to treat foreign investors on a par with domestic investors. The Investment Act of 1997 seeks to achieve that result by making the provisions of the Act applicable to foreign and local investors without distinction, with the important qualification that the benefits and protection to be afforded by the Act to a foreign investor requires a minimum capital investment of \$300,000 but is extended to a local investor on a capital investment of \$100,000.

Local investors are granted certain benefits on a par with foreign investors even in cases where it is common to grant such benefits only to foreign investors. This includes a fiscal stability clause contained in Section 19(2), which provides that benefits accorded to a holder of the Certificate under applicable fiscal legislation will not “be amended or modified to the detriment of the investors enjoying those benefits”. Other examples include repatriation of funds and employment of expatriates. Section 21 guarantees to all Certificate holders the right to make transfer payments in freely convertible currency. Such payments

include transfers to service loans in foreign currencies, transfers of dividends or profits and proceeds of sale or liquidation. Under Section 24 of the Investment Act every Certificate holder is granted an initial automatic immigrant quota of up to five persons during the start up period.

(b) *Repatriation of profits and capital*

Under Section 21 of the Tanzanian Investment Act of 1997 FDI projects holding Certificates of Investment are guaranteed unconditional transferability of FDI payments abroad through any authorised dealer bank in freely convertible currency. This covers FDI remittances of net profits and dividends; service charges for foreign loans; royalties and technology transfer charges, the proceeds of FDI liquidations or sale of capital assets in Tanzania, and salary payments to expatriate staff employed in Tanzania by a registered foreign company. Tanzania is at present largely free of exchange control restrictions and the foreign exchange payment framework is held by most FDI executives to have operated relatively efficiently over the past five years, especially with the privatization of previously state-owned dealer banks. In this respect, Tanzania is approaching best practice within the region delivering a foreign exchange regime that is strongly supportive of FDI. This is probably the most important single factor contributing to the striking improvement in the investment climate that has taken place in recent years. However it should be kept in mind that in the mining and petroleum sectors where there are long-term projects with licences and agreements extending over twenty or thirty years major investors will seek contractual undertakings from Government which could give protection in the event that a more rigorous exchange control regime is reintroduced at some time in the future.

(c) *Expatriate and immigrant labour*

The basic legislation covering immigration to Tanzania is the Immigration Act of 1995 (which came into force in 1998) as modified by the Financial Laws Act of 1997, which gives the management and administration of expatriate employment policy to the Tanzania Investment Centre. A similar devolved allocation of responsibility for expatriate immigration exists within Zanzibar through ZIPA.

Under the 1997 Act, every incoming business enterprise having a Certificate of Incentives is entitled to an automatic initial immigrant quota of up to five non-Tanzanian persons during the start-up period of a business, which is deemed to continue for five years. TIC administers the requests for expatriate staff, and maintains records of expatriates granted entry under the Act. Investors may apply to TIC for approval to bring in additional expatriate employees beyond the initial five, which TIC then reviews with the on-site representative of the Immigration Department in relation to the availability of qualified Tanzanian nationals; the complexity of the technology involved in the incoming business; and earlier TIC agreements with the foreign investors concerned.

The present perception of private sector businesses and organisations is that this immigration policy framework is working well: decisions are normally reached with little delay; and the management expatriates now arriving in Tanzania are filling an important gap in the country's business base. Most large foreign companies also use their expatriate staff in a mentoring role to develop and bring on Tanzanian managers and skilled staff. Such expatriates will also play a lead role in achieving the changes in Tanzania's business culture that lie at the core of the BEST Programme. Further improvements are planned in the administration of work permits, and a Work Permit Customer Charter is to be introduced by the middle of 2002.

There are no limits or quotas applied to the number of expatriate managers and employees allowed to enter Tanzania for mining, natural gas or petroleum projects, as it is recognised that the technical skills required are not yet available in Tanzania. All requests to TIC for expatriate staff for these sectors, over

the basic five automatically allowed, have to be fully justified by the FDI company, and will have been identified as a priority in the initial feasibility study and business plan required under the 1997 Act.

4. Protection of FDI

The Tanzanian Government is aware of the long-term adverse effects of government expropriation or seizure of private sector corporate assets, and has specifically addressed this issue in the 1997 Act.

However Section 22 of the Act, which seeks to deal with the matter, is, in its present form, contradictory and confusing. Subsection (1) provides that no business enterprise shall be nationalised or expropriated by the Government, and no person who owns, whether wholly or in part, the capital of any business enterprise shall be compelled by law to cede his interest in the capital to any other person. That statement looks clear and unambiguous but is subjected to subsections (2) and (3) that say that the State may not acquire a business enterprise to which the Act applies unless the acquisition is under due process of law, and there is payment of fair, adequate and prompt compensation with the right of access to a court or arbitration in the event of a dispute. What most investors will expect is an undertaking that if their assets are compulsorily acquired that will be done for a public purpose under due process of law, adequate and prompt compensation will be paid, and disputes settled by reference to arbitration.

A revised version of Section 22 would help to sustain a favourable investment climate. However it is important to appreciate that major investors, particularly those hoping to raise limited resource project finance, may not be fully satisfied by a statutory provision of this kind. Parliament in Tanzania cannot bind its successors. Undertakings by Government, however carefully drafted, if not contained in the Constitution may be subsequently appealed or amended. For that reason major investors will look for contractual commitments by Government with submission to international arbitration in the event of a dispute.

C. General investment measures and conditions

1. Commercial legislation and the rule of law

The present framework of commercial and contract legislation and the current judicial system are regarded by foreign investors operating within Tanzania as a constraint to the establishment and profitable operation of new international business ventures in the country. Reforming the commercial legal system of Tanzania is thus a high national priority within the investment framework.

The existing laws governing commercial disputes and contract enforcement are outdated; many are in conflict with each other; and there are gaps in relation to modern business organisations, commercial practices and modern business systems and technology. This leads to confusion for investors and expense in legal and other fees. A more serious concern, identified as a priority for government action in the 1996 and 1999 Investor Roadmap surveys (box II.4), is the perceived lack of integrity in the Tanzanian court and justice system, which has been the subject of a continuing series of not always successful attempts at reform. This affects adversely settlement of disputes.

Box II.4. The Investor Roadmap

The Tanzania Investor Roadmap was first prepared in 1996. Tanzania was about ten years into market-oriented reforms and undergoing economic and policy instability. Investment applications had dropped from 365 in 1991 to 123 in 1995 and inquiries fell from a monthly average of 150 to 20. The Roadmap identified procedural and policy investment problems that deterred new foreign and domestic investment and impeded the expansion of existing enterprises. Based on Government's evaluation of problem areas, the Roadmap offered recommendations which became the basis for subsequent institutional, managerial and policy reforms. An assessment in 1999 showed that the Tanzanian Government has achieved considerable progress but that many challenges have remained in key areas of private firms' activities:

Employment

- Expatriate staff. Securing work permit was reduced from months to matter of weeks or less, but is still too long;
- local workforce. Recent changes in labour practices allowing for one and two-year contracts have eased concerns over what is considered excessively worker-protective labour laws. The cost and number of workers' benefits as well as the lack of skilled Tanzanian managers are still problems.

Locating

- Obtaining land lease still take months or even years, partly because few plots are surveyed and current tenants must be compensated and partly because several authorities are involved in the process: the local authorities, district level officials, three divisions within the Ministry of Lands and the TIC. Non-Tanzanians are not allowed to own land; developing land, from obtaining construction permits to actual construction, is still a very cumbersome, uncertain and expensive undertaking; and establishing utilities connections is comparatively more time-consuming and expensive than in neighbouring countries.

Reporting

- Instead of approving and regulating investment, the post-1997 Investment Act TIC has taken on the role of registering and facilitating it. It has cut time-lag for obtaining a Certificate of Incentives to weeks instead of months and has strengthened coordination with other government agencies, but there is still room for further improvement;
- the number and rates of taxes, as well as mode of collection, are a continued concern to investors. They are also serious deterrents for the formalization of the informal sector; and
- there are still too many licenses and overlapping regulatory mandates, with too many official agencies that lack the capacity to regulate, but extract licensing fees or taxes nonetheless.

Operating

- Customs clearance now takes 4-7 days from at least two weeks' time, but investors still consider the process overly time-consuming and complicated;
- certain improvement in import/export procedures, but still not at sufficient level; and
- acquisition of foreign exchange and repatriation of profits no longer problem areas.

Other broader non-procedural issues identified by the 1999 Roadmap exercise that need to be resolved to make Tanzania a top investment destination are the obsolete legal system, poor infrastructure, declining education and increasing health problems.

Source: The Services Group, 1999.

2. Settlement of disputes

The Investment Act of 1997 contains provisions (section 23) for the negotiation and settlement of disputes between both Tanzanian and foreign enterprises, the TIC and central government. Where the preferred amicable settlement via negotiation between the parties is not achieved, the parties may then seek agreement through the arbitration laws of Tanzania; through the International Centre for the

Settlement of Investment Disputes, or within appropriate bilateral or multilateral treaties. Zanzibar has similar provisions.

There are some ambiguities in the present legislation in relation to the settlement of disputes, but more importantly, there appears to be no defined statutory mechanism through which investors can ensure that progress is made in addressing concerns and disputes of investors that are less serious than full disputes. Should government or an agency not deliver upon its promised support or intervention to resolve a contractual dispute with Tanzanian parties (as has been the case with two investors known to the review team) there is currently no easy way to break the impasse. This is especially important in relation to investor disputes and negotiations with TRA in spite of the tax appeal mechanism established by the TRA Act which investors are encouraged to use.

The courts are widely regarded as slow, inefficient, capable of influence and (especially at lower levels) easily corruptible. As a result foreign affiliates are normally loath to take contract, debtor or employment disputes to court, and seek resolution outside the legal system. These concerns also apply to taking commercial disputes to the national court system and to using the non-court dispute resolution mechanisms available within various acts. Companies can thus feel vulnerable when doing business in Tanzania, and as corruption in the legal and court systems has not yet been prosecuted and punished, the image of Tanzania as an efficient, secure and profitable location for foreign investment has been affected. This is the prime area of weakness within the FDI operating framework.

Of equal concern is the difficulty in ensuring a fully transparent, efficient and timely resolution of commercial disputes within the present court system, especially in relation to enforcement of debt collection from Tanzanian customers of foreign affiliates. The dispute provisions within the 1997 Investment Act require to be both strengthened and incorporated in the relevant commercial contract law of Tanzania.

The organisation and authority of TIC is designed specifically to reduce foreign investor uncertainties and disputes through the secondment of executive staff from the TRA, the Ministry of Lands and Urban Settlements, the Ministry of Labour, the Immigration Service, and the Companies Registration section of the Ministry of Industry and Commerce into the TIC offices. They have small, dedicated offices in the TIC building to investigate and resolve investor problems. In practice their Ministries continue to make the key decisions. Whilst this has begun to create a genuine one-stop-shop for investors, there are remaining problems, especially with the TRA's interpretation of its sometimes conflicting roles in investment promotion and national revenue priorities.

Each of the TIC's staff members has a portfolio of private investors, both Tanzanian and foreign, for which they act as client representatives through six monthly meetings with each client investor. This is meant to identify and rapidly respond to any emerging disputes or regulatory problems as well as to review the progress with investments; but a shortage of TIC transport and budget makes such support difficult.

3. Labour market legislation

The employment and labour laws largely reflect the political priorities of the pre-1990 period. They were designed to support the public sector in a centrally-planned economy where issues such as security of employment or minimum wage were of paramount concern. Their current impact on investors is to make it relatively expensive for companies and employees to terminate or lay-off employees. This has the consequence of making companies wary about creating jobs and taking on employees on permanent contracts until employees have proved their suitability; and also of ensuring that the real cost of worker benefits is comparatively high to the companies, which tends to restrict basic wage levels.

The Government recognises that it does not yet have employment laws capable of fully supporting a modern private sector economy, and that they will appear onerous and complex to foreign companies used to operating in more flexible employment regimes. The Ministry of Labour, with the support of Denmark, has begun to reform labour laws through simplification of the existing legislation and processes (especially in relation to employee dismissal); to review and adjust the role of the Industrial Court; and to make the other changes to bring Tanzania in line with best practice standards in its competitor countries. This greater flexibility in employment is essential in the context of exports from Tanzania in cyclical global economy.

4. Land issues

Ownership of all land (urban and rural) within Tanzania and Zanzibar is vested in the Government, and is available only as leaseholds. Structures built on land can be wholly owned (although not the air rights). The Government is currently pursuing a major rationalisation and restatement of land law to remove the present uncertainties that have evolved over the course of the past 50 years. The Land Act and the Village Land Act 1999, which came into force in May 2001, both contain provisions to make land available to private sector investors on a leasehold basis with a secure title. A series of parallel administrative changes, which are seen as being especially important in attracting FDI, have been implemented recently.

Although normally the distribution of land is the responsibility of the Ministry of Land, under the 1999 Land Act, TIC has been empowered to provide land to investors as part of the one-stop-shop service. Hence the presence within TIC premises of a Principal Land Officer stationed at TIC by the Ministry of Land.

Under the 1999 Land Act, all districts are required to prepare “land use plans” which identify a specific area of land to be used for investment purposes. The Ministry then demarcates such land and announces its new status through the Government Official Gazette. Some of this land is subsequently transferred to the responsibility of TIC for distribution to potential investors.

Once an investor has made a decision to invest and has applied for land, TIC assists in identifying an appropriate size of land in areas suitable for the investors’ needs. TIC then grants land rights to the investor on a leasehold basis for a period ranging from 33 through 66 to 99 years.

This system of land provision does not apply in mining or the oil and natural gas sectors where mineral rights are granted by the Ministry of Mining and Energy.

While the recent changes in the administration of land allocation are encouraging, it is evident from

the responses of investors, especially local investors, that the system requires further improvements to meet the demands of a growing market economy. For instance, delays in obtaining land leases by foreign investors and the lack of transparency in the administration of applications for business uses needs improvement. Another indicator of the limitation of the present system is the reluctance by commercial banks to use land as collateral in giving loans to investors. The Government intends to amend the Act to meet the requirements of the banks.

5. Taxation and investment incentives

Tax reform has been an important component of Tanzania's reform programme. In the 1980s and the early 1990s the reform aimed at simplifying the tax system and enhancing the tax revenue collection. Despite the reforms, complicated tax structure still remains (Levin, 2001). Value added tax (VAT) was introduced in 1998 and replaced previous sales tax and part of stamp duty and entertainment taxes.

The general corporate tax rate in Tanzania is 30 per cent, which compares with the rates in other countries in the region (table II.1). It is less than in Ghana (35 per cent) but higher than in Zimbabwe (25 per cent). There is no withholding tax on interest, which compares favourably with such countries as South Africa (20 per cent) and Ghana (5 per cent). Withholding tax on dividends is 10 per cent, less than that in South Africa (12.5 per cent) and Zimbabwe (20 per cent). VAT on capital goods is zero, comparable to the rate in the countries mentioned. On non-capital goods and services, VAT is 20 per cent. Depreciation allowances for capital assets are also very liberal: 100 per cent of the value is allowed to be deducted. In *The Africa Competitiveness Report 2000/2001*, corporate and income taxes were listed among assets of Tanzania's business climate while employee payroll tax, tax evasion and import tariffs (including the average tariff rate) were among the liabilities (World Economic Forum, 2000, p. 219).

Table II.1. Comparison of fiscal regimes in selected countries
(Per cent)

Item	Tanzania	Zimbabwe	South Africa	Ghana	Peru
Royalty:					
Gold	3	0	0	3-12 ^a	0
Diamonds	5	0	0		0
Withholding tax on dividends ^b	10	20	12.5	3.5	None
Withholding tax on loan interest	None	None	20	5	None
Withholding tax on salaries and fees for foreign consultants	3	20	None	5	None
VAT on mining capital goods	None	None	None	None	None
Depreciation allowance	100	100	12.5 ^c	75	20

Source: Chamber of Mines, Tanzania

^a All minerals.

^b Remitted aboard.

^c Compounded.

There is also a plethora of local licences, permits, duties and levies throughout mainland Tanzania and Zanzibar which are significantly more numerous than in most countries and imposes additional transaction costs on investors (box II.5). The multiplicity of taxes and non-transparent procedures can not only act as a barrier to FDI but also can also prevent local investors from entering formal business and result in a significant informal sector. It is important that the Government fulfils the commitment made in the 2001/2002 budget to rationalize local and central government taxes.

All incentives have a fiscal base, and are delivered through a reduction in, or exclusion from, tax or duty payments to investors in lead and priority sectors with investment above \$300,000 in the case of foreign investors and above \$100,000 in the case of local investors (table II.2 and box II.6). As regards general incentives, until 1997, there were differences between lead and priority sectors on the one hand and other sectors on the other hand as regards corporation tax and between lead, priority and other sectors as regards import duty on capital goods (which was, respectively, 0, 5 and 10 per cent). The 1997 Investment Act and subsequent annual fiscal acts have harmonized fiscal incentives, eliminating these differences as well as differences concerning value added tax on capital goods and carrying forward of losses, eroding further the meaning of the Certificate of Incentives as a tool of giving privileges to investors in priority areas. The Certificate continues to serve as a tool of distinguishing investors according to the desired threshold levels determined by the 1997 Investment Act. There has been steady progress to making the award of investor benefits automatic.

Box II.5. Local taxes and levies collected by Ilala Municipal Commission: financial year 1999/2000

Development levy	Guest house levy
Guest house levy	Market levy
City service levy	Livestock keeping licence
Food licence application and fee	Small licence
Hotel registration application and licence fee	Daily levy
Registration fee of health care, dispensary, pharmacy, professional and laboratories	Sign and advertisement fee
Business licences under by-laws	Bus stand fee
Liquor import licence application	Road crossing fee (daladala)
Local liquor licence application	Site fencing levy
Taxi cab and vehicle registration fee	Motor vehicle levy
Scale levy	Oil levy
Up country business licence	Building tax
Profession licence	Fishing licence
Local liquor business licence	

Source: BEST Practice document, 2000, pp.28 and 29.

Table II.2. Taxation

Tax	Legislation	Year	Present level, per cent
A. CENTRAL GOVERNMENT			
Corporation tax	Income Tax Act	1973	30
Withholding tax on dividends	Income Tax Act	1973	10
Withholding tax on interest	Income Tax Act	1973	0
Payroll levy ^a	Payroll Levy Act	..	4
Value added tax on raw materials and traded products	Value Added Tax Act	1997	20
VAT on capital goods	.VAT Act	1997	Deferred
VAT on mining, tourism services and education	VAT Act	1997	0
Import duty on capital goods and raw materials	Customs Tariff Act	1976	0
Training levy ^b	Training Levy Act	1972	2
Stamp duty	Stamp Duty Act	1972	2-3
Capital gains tax	Income Tax Act	1993	10
B. LOCAL GOVERNMENT			
Development levy	Local Government Finance Act	1982	1.0 per cent of income
Property rate	Local Government Act	1982	0.15 per cent rateable value
City service levy	Local Government Finance Act	1982	0.3 per cent of turnover
Other local levies	Local Government Finance Act	1982	Various (box II.5)

Source: BEST Programme Document, Appendix 3 and TIC.

^a Per cent of gross wage bill.

^b Levied on gross payroll.

Box II.6. Other investment incentives

- VAT zero-rating on manufactured exports; and VAT deferment for new capital equipment assets purchased by VAT registered investors.
- 100 per cent investment allowances and deductions against Tanzanian corporate tax in the first year of income. A five-year carry-over of all business losses following start-up against future business profits.
- Automatic approval of the employment of up to 5 foreign nationals in any project granted a Certificate of Incentives.
- Access to land.

Sources: National Legislation including the Tanzanian Investment Act 1997; the Income Tax Act 1973; the Customs Tariff Act 1976; and the Sales Tax Act 1976.

Apart from general incentives linked to the Certificate of Incentives (which apply practically to almost all investors), the 1997 Investment Act (section 20) empowers the Minister of Planning and Privatization, in consultation with the Minister of Finance, to offer additional investment incentives or benefits over and above those specified in the Act, on a case-by-case basis, should an investment project

have a special national economic development importance. TIC has a defined role in the determination of the need for specific investment incentives through identifying and agreeing that a project has national strategic importance. Only two FDI cases, both in sugar growing and processing, have so far received such additional incentives; but it is possible that targeted incentives may be progressively introduced especially for agricultural and infrastructure projects which have been recently confirmed to be among the lead sectors (box II.1).

Special investment incentives are also available to domestic and FDI projects in petroleum exploration and development (box II.7); and Zanzibar has introduced its own set of incentives for its Free Economic Zone and Freeport areas (box II.8) which are designed to be no less attractive than incentives offered by island countries in the region such as Mauritius. There are some mainland concerns about these Zanzibar incentives, especially where they have export criteria, which is interpreted as “exporting” from Zanzibar to mainland Tanzania.

Box II. 7. Incentives for petroleum exploration and development

The general investment incentives listed in table II.1 and box II.6 are supplemented by the following sector specific allowances:

- The award of eleven year exploration and development concessions based on 4 initial exploration years with a 4 year extension; and a second 3 year extension to the point of production.
- Relatively large exploration licence area concessions up to a maximum of 60 blocks each of 5x5 minutes; and with RSA certificates being granted for more than one licence.
- Generous and negotiable work programmes covering oil recovery cost allowances and oil profit splits with government.
- No import duties on all equipment brought in for petroleum exploration.
- No signature or production bonus payment.
- Full allowance for unrecovered exploration costs incurred under earlier PSAs by the company in all its contract areas once it has made a discovery in a subsequent PSA, i.e. no ring-fencing.

Sources: Tanzania Investment Centre; Petroleum (Exploration and Production) Act, 1980; Tanzania Investment Act, 1997.

Box II.8. Investment incentives in Zanzibar

- ZAFREZA administered 10 year corporate tax holiday
- No withholding tax on dividends, interest and any other income accrued from business transactions during the tax holiday period*
- Free repatriation of dividends after taxation*
- 25 per cent investment allowance and 100 per cent ownership retention*
- Waiving of rent on leased property during the construction period
- Exemption from customs and import duties for:
 - Manufacturing equipment and capital goods during the construction period**
 - Raw materials for the manufacturing process utilised for trial purposes*
 - Raw material inputs used in production of finished goods destined for export markets*
 - Personal effects of expatriate personnel during the first six months of their business commencement*
- Generous terms of government land lease for 49 years which can be extended to 98 years

* Union investment incentives.

Sources: Zanzibar Free Economic Zone Authority and Zanzibar Freeport Authority, March 2001.

* * *

The present structure and level of fiscal incentives to foreign investors in Tanzania as presented in the 1997 Investment Act and updated in annual financial legislation is still unclear. With the exception of mining and petroleum, it appears to be currently no difference in the level or type of investment incentives available to eligible investors in the lead and priority sectors and investment prioritisation is thus promoted by other means. When reviewing the present incentives framework and levels, there is no reason to change incentives in mining, which have proved to be instrumental in attracting significant and beneficial FDI into this sector.

6. Export processing zones

In mainland Tanzania there have been moves to establish export-processing zones (EPZs) since the early 1990s when the African Development Bank was requested to conduct a study on EPZs. The study was completed in 1995 and recommended EPZs in Dar-es-Salaam, Kigoma, Tanga and any other suitable town. It estimated the cost of establishing a good EPZ, similar to EPZs in Malaysia and Mauritius, at \$29 million. The Government found the cost to be much too high to guarantee returns and decided to pursue alternative ways. As a result of another study completed in 2000, the National Development Corporation (NDC) was appointed as a body, which will supervise the establishment of EPZs (box III.2). The current thinking is that the first zone will be created in the proximity of Dar-es-Salaam, close to the main roads and with easy access to power supply. The Government will not develop the zone, but will make it available to private investors as an investment opportunity, providing land and the appropriate, attractive legislation. The necessary infrastructure is to be developed by private investors. The EPZ status is to be given to individual factories with the potential to export 80 per cent or more of their production. The expectation is that the cabinet will approve the establishment of EPZs in the early 2002, paving the way for an EPZ legislation and operationalization during 2002.

In Zanzibar a Free Economic Zone and a separate Freeport have been established under legislation

from the House of Representatives, and these have additional investment incentives for companies locating in these zones.

Zanzibar Free Economic Zones Authority (ZAFREZA) was established as an autonomous agency of the Government of Zanzibar. Free economic zones are currently being planned and funded at Fumba and Micheweni to complement the first zone at Amaan Industrial Park outside Zanzibar town. Preference is given to attracting manufacturing projects, which will be required to export a minimum of 80 per cent of their output from Zanzibar. The incentives to investors within the zone are summarised in box II.8.

Zanzibar Freeport Authority (ZFA) was created in 1998 as a public sector agency responsible for developing, managing and promoting a new bonded Freeport complex alongside the harbour in Zanzibar. This 39,000 square metre complex is designed to enable goods being transhipped or warehoused in Zanzibar to have minimal customs and administrative requirements and interference. Zanzibar, as a long-established entrepôt trading economy sees Free Economic Zones and Freeports as enabling it to better compete against Mauritius in attracting international manufacturing and trading companies seeking access to Central, East African and Gulf States markets.

There are concerns in mainland Tanzania regarding the special zones in Zanzibar, when goods from these zones, enjoying a number of benefits, are sold in mainland, putting businesses there at a competitive disadvantage. This is an internal Union matter, which requires attention.

7. Technology in the new investment policy

The Tanzanian Investment Act of 1997 has provisions facilitating transfer of technology into Tanzania. Foreign investors that meet the minimum investment requirement can import machinery, capital equipment, vehicles (especially investments in mining and agriculture), installation material and, in the case of mining, explosives, lubricants, and industrial items either free of import duty or at a rate not exceeding 5 per cent. Section 26 (1) removes all restrictions relating to technology transfer agreements with foreign suppliers of technology. It states that a person who has “established an enterprise may enter into such transfer of technology agreement as he considers appropriate for his enterprise.” Coupled with the guarantee of freedom of transfer in a freely convertible currency of royalties, fees and charges in respect of any technology transfer agreement and payment of emoluments and other benefits to foreign personnel employed in Tanzania investment projects, the 1997 Act goes a long way to bring technology to Tanzania. Moreover, in order to make the process easier, the 1997 Act has removed the need for separate application for transfer of technology agreement.

In contrast to the old and cumbersome work permit procedure, under the new investment regime, holders of Certificates of Incentive are entitled to an initial automatic work permits for up to five persons during the start up period. This has eliminated the concerns that the foreign companies often have about finding highly skilled managerial, supervisory and/or technical staff to oversee the establishment and operation stages of their investment. This new provision allows them to bring their own skilled personnel and it appears that most of the new foreign investment in the country has taken advantage of this regulation. In addition, if need for additional technical expertise can be demonstrated, TIC, in consultation with the Immigration Department can allow for such additional technical persons. There are no limits to the number of foreign experts or managers who can be brought to Tanzania in mining, natural gas and petroleum projects, as it is recognized that such expertise are not available in Tanzania at present.

Thus, the 1997 Act has proactive measures in encouraging technology transfer to Tanzania.

8. Protection of intellectual property

Intellectual property rights (IPR) is an important issue for FDI, especially in relation to the statutory and practical protection of brands, logos, technology and products, the loss of which has been a cause for concern in many capital exporting countries. Tanzania, through its Patent Act and the Trade Services Marks Act (both enacted in 1987) has the basic statutory framework for protecting IPR and settling IPR disputes. Government therefore does seek to ensure IPR protection for its investors, but as yet this has not been an active issue in that the indigenous SME sector has not yet evolved the manufacturing and marketing capability to cause concern to international investors in Tanzania. The 1997 Tanzania Investment Act requires that all technology transfer agreements by FDI and Tanzanian companies be registered with TIC as a means of monitoring technology and IPR flows.

Tanzania is a founder member of the World Trade Organisation (WTO); the African Regional Industrial Property Organisation (ARIPO); and the World Intellectual Property Organisation (WIPO). It is a signatory of the Paris and Berne Conventions, and the other key international protocols governing the creation, ownership, use and sale of IPR. However, there is currently a lack of effective statutory and administrative mechanisms to identify, pursue and punish infringements of IPR: this is currently being addressed by the Government.

9. Environmental protection

There is a growing national awareness of the environmental consequences of unplanned and unregulated economic and commercial developments, especially in sensitive coastal and rural areas of Tanzania important to Tanzania's growing tourism economy. The current regulation for environmental protection is the National Environment Act of 1983, administered by the Ministry of Parks and Natural Resources. This legislation needs to be revised. It is now standard practice for major FDI projects in Tanzania to undertake Environmental Impact Assessment studies in advance of their construction, and these are a pre-condition for construction and planning permits. MIGA guaranteed FDI projects must undertake EIAs to demonstrate that they do not damage the environment and are sustainable, especially for mining, oil and natural gas, and tourism projects in the wildlife parks and coastal areas.

The Tanzania Investment Centre and Zanzibar Investment Promotion Agency both seek to assess FDI projects against environmental benefit and impact criteria; and can require Environmental Impact Assessments to be undertaken in support of investment applications where significant capital projects are involved. Such impact assessments will be extended to domestic SMEs once the necessary resources and skills are available.

10. Capital and financial markets

The Capital Markets and Securities Act 1994 provides the legislative basis for establishing a Capital Markets and Securities Authority for Tanzania with the aim of promoting and facilitating the creation of an efficient, fair and transparent capital and securities market. The Act introduces a series of regulatory requirements for stockbrokers and securities dealers, and regulates these areas for foreign companies operating in these market areas within Tanzania. Banks and other financial enterprises are

separately regulated through the 1991 Banking and Financial Institutions Act. Commercial, development and microfinance banking are three of the priority sectors for Tanzania to pursue in promoting investment; and the privatisation of the state-owned banks since 1995 has been the principal means for attracting FDI into these essential economic sectors. There has, however, been little real progress in attracting and developing microfinance banking via FDI.

11. Foreign exchange regulations

The administration of foreign exchange control is undertaken by the Bank of Tanzania through the 1995 Bank of Tanzania Act, which empowers the Bank to control all aspects of foreign exchange in Tanzania and Zanzibar, including authorising payments abroad. Since 1993 the Bank's official local currency rates have been harmonised with those offered by commercial banks, and a single exchange rate now applies to all foreign exchange transactions.

The single exchange rate applies to both government and private sector imports; and there are no foreign exchange controls on trade although the release of foreign exchange in excess of \$5,000 requires a declaration form. Since July 1995 Tanzania has accepted the IMF obligations to refrain from imposing restrictions on foreign exchange payments or transfers of capital overseas; from engaging in discriminating currency transactions; or multiple currency practices without IMF approval.

12. Sectoral investment regimes

(a) Gemstone and minerals mining

This sector was originally dominated by the State Mining Corporation (established in 1973), which inherited all the existing mines throughout Tanzania. SMC still owns and operates a small number of ore mining concessions, and the National Research and Development Corporation (NRDC) also became involved in operating iron ore concessions in the South and remain active within the sector. From 1990 the Government began to encourage FDI in mining gemstones, gold and other minerals, and this resulted in the Mineral Policy of Tanzania being introduced in 1997, followed shortly by the 1998 Mining Act. This provides (with the 1997 Tanzania Investment Act) the present statutory framework for FDI into the mining sector.

The policy and operating framework is investor-friendly. In many ways it is 'best of its kind' in terms of providing a positive supporting environment. The taxation and investment allowances are attractive. The Ministry is relatively efficient and supportive and all necessary certificates are normally obtained within two weeks. The FDI framework is thus strongly positive. The industry, as well as the Ministry, is hopeful that Tanzania will become a significant international mining location in the future, creating employment and exports, thereby acting as a driving sector for change. The main areas for improvement are the removal of restrictions on land ownership and infrastructure in the main mining areas.

(b) Petroleum and gas

The Petroleum (Exploration and Production) Act of September 1980, currently implemented within

the framework of the 1997 Tanzania Investment Act, recognising the high costs and uncertain results of exploration and development, seeks to provide an attractive operating environment for international oil and gas companies.

As regards incentives, in addition to the standard fiscal incentives, these include zero import duties on any purchased equipment; and full allowance for un-recovered exploration costs incurred under earlier production sharing agreements (PSAs). An attractive feature is that international companies in this sector can opt to maintain their operating accounts for their Tanzanian activities in dollars, and to pay their Tanzanian taxes and charges in dollars at the prevailing exchange rate. This constitutes a dollar basis for investment, capital expenditure and purchases of the global oil and gas industry. This policy appears to be effective in encouraging FDI into the emerging Tanzanian hydrocarbon sector.

(c) *Tourism and hotels*

Attracting FDI in tourism and the hotel sector is a strategic priority for Tanzania, especially in relation to the major game parks, wildlife reserves and coastal areas. The emergence of Arusha as a significant new international airport in Northern Tanzania is an indication of the significant economic potential of tourism for the economy. Tourism FDI is generally governed by the 1997 Tanzania Investment Act, and its development is the responsibility of the Ministry of Natural Resources, which has the policy remit for the game parks, nature and coastal areas.

Investment in tourism enterprises in Tanzania are governed by the Hotels Act 1963 and the Tourist Agency Licensing Act 1969, both drawn up in the context of much less internationally competitive tourism markets. Licensing restrictions currently exist within this legislation and its implementing ordinances, namely car hire and travel agency licences can only be issued to Tanzanian nationals; and travel agencies must employ at least two Tanzanian nationals holding certificates in tourism.

13. International agreements

Tanzania is a signatory to several international agreements governing the protection of foreign investment in Tanzania (table II.3). It has also signed bilateral investment treaties (BITs) with 7 countries and bilateral treaties for the avoidance of double taxation with 9 countries (table II.4). The present international, regional and bilateral treaty network is an indication of Tanzania's intent to actively promote and protect FDI. This can be further strengthened by signing BITs and DTTs with the major home countries such as the United States, France and Japan as well as new dynamic home countries from Asia, such as Malaysia, Singapore or Thailand. The absence of a BIT with South Africa, a major regional home country, is also striking.

Table II.3. International agreements

Agreement	Date established	Tanzanian accession
Convention on the Recognition and Enforcement of Foreign Arbitral Awards	1959	1964

Convention on the Settlement of Investment Disputes Between States and Nationals of other States	1966	1992
Paris Convention for the Protection of Industrial Property, latest amendments	1994	1963
Convention Establishing the Multilateral Investment Guarantee Agency	1988	1992
Marrakesh Agreement Establishing the World Trade Organisation, Agreement on Trade-Related Investment Measures.	1995	1995

Source: UNCTAD, 2001a.

Tanzania is an active member of the main international treaties governing the protection of international investment, including the World Bank's FDI insurance organisation (the Multilateral Investment Guarantee Agency (MIGA)); and the International Centre for the Settlement of Investment Disputes (ICSID), which is also affiliated to the World Bank. The TIC and ZIPA make clear to potential foreign investors and Tanzanian joint-venture partners that the Government recognises the importance of providing a secure FDI framework through the provisions of the 1997 Tanzania Investment Act and the parallel legislation governing investment in the mining and petroleum sectors. In relation to FDI, these sectors and their legislation are deemed to be governed by the relevant FDI enabling and protection provisions (Sections 15-26) of the 1997 Act.

D. Role of the Investment Centre

Among its efforts to attract FDI, Tanzania has established the TIC with the mission, formulated in 1997, to be "the primary agency of Government to coordinate, encourage, promote and facilitate investment in Tanzania and to advise Government on investment policy and related matters". As part of an ongoing process of upgrading the TIC and strengthening its role, greater resources were allocated to the TIC; the formation of an Investment Steering Committee was approved to ensure that other institutions fully cooperate with the TIC in investment promotion and facilitation; and recommendations have been made to restructure and reposition the TIC as an autonomous body in order to allow the flexibility to recruit highly qualified professionals.

Table II.4. Tanzania's bilateral investment treaties (BITs) and double-taxation treaties (DTTs), as of January 2001

A. BITs	Date of signature
Denmark	1999
Egypt	1997
Germany	1965
Korea, Republic of	1998
Netherlands	1970
Switzerland	1965
United Kingdom	1994
B. DTTs	
Canada	1995
Denmark	1976
Finland	1976
India	1979
Italy	1973
Norway	1976

South Africa	1959
Sweden	1976
Zambia	1968

Source: United Nations, 2001, p. 124.

As the guardian of the Investment Act 1997 the Centre has acquired amongst the business community in Tanzania an enviable reputation for good sense, courtesy, and a willingness to help, inform and advise prospective investors. That is said by some investors to contrast with more negative, and sometimes rather slovenly attitudes that can be encountered in a direct approach to the ministries involved in a particular project. The Centre should build on this core competence and steer away from activities that involve screening, approval or even registration of investments if that requirement is to be provided under the Companies Act. Towards that end, the Centre should play the role of guide to the applicable Acts and Regulations that an investor may need to understand. At present many investors seem to rely on anecdote, which can result in an exaggerated idea of the difficulties they are facing. However the Centre should take care not to assume the function of legal adviser to prospective investors. To do so would be seen as encroaching on a legitimate private sector activity, and could open the Centre to liabilities at the suit of disappointed clients.

Under Section 16 of the Investment Act 1997 the Centre is given an active role in securing for prospective investors licences and approvals that may be required for a particular investment. In the Centre and amongst some investors considerable importance is attached to what is described as the “fourteen day rule”. Clearly this activity as facilitator should be continued. However it would be prudent to examine carefully how the fourteen-day rule has actually worked in practice. It is not generally considered good administrative practice to provide by law for the way in which one Government department should deal with another.

From the perspective of implementing the investment promotion and facilitation functions, the TIC *Corporate Plan*, covering the period July 2001 to June 2006, specifies the following:

- creating and maintaining a positive climate for private sector investment;
- stimulating investments by the private sector;
- attracting foreign investment and
- providing assistance to all investors.

Investor facilitation and servicing includes: improving procedures for processing inquiries, improving response time for inquiries and proactively responding to inquiries; developing investor tracking systems and a computerized information database; facilitating and servicing existing investors and assisting in project implementation. The development of the Centre’s after-care role is important. The existing stock of FDI provides considerable demonstration effect for subsequent and sequential investment. Another objective is to try to integrate foreign investors into the economy as development and alliance partners by encouraging linkages with domestic enterprises. These include backward linkages with suppliers: as the company examples in this report show, some investors import virtually all their requirements at time of set-up, and efforts need to be made to encourage local sourcing subsequently. But there are other

partnership possibilities too, such as in the area of education and training, collaboration with universities and research institutions on development projects, and the provision of management and marketing advice to local enterprises. Some of these activities will be sector-specific, but the TIC has a role as the body that should have the closest and most direct relationship with foreign-owned enterprises in Tanzania.

E. Assessment and recommendations

The URT has made considerable progress towards establishing an open and increasingly consistent and transparent legal framework for FDI. The establishment of TIC has been an important step in the direction of a single-door investment promotion agency with a direct Presidential remit to co-ordinate and deliver support from ministries and other agencies to foreign investors. A matching institutional capability has been achieved in Zanzibar through ZIPA.

Present investment framework is thus characterized by the relative ease of entry and establishment with few industries not open to FDI and no ownership restrictions or performance requirements. The standards of treatment and protection of foreign investors have been raised to best practices of other countries in the region. General investment and operational conditions have also improved because of the improvements in investment-related laws and regulations and the increasingly professional support of TIC and the ministerial representatives within the Centre. The improving economic situation and such changes in the investment environment as the emergence of private banks offering an increasing range of services have also helped in this respect. Rights of foreign investors are well secured through national legislation and Tanzania's participation in all important international investment agreements.

The adoption of the Mining Act 1998 has been a milestone in the improvement of investment frameworks in individual industries or sectors. The act, considered by investors as "the best of its kind", was a single most important policy measure which, together with attractive sector-specific investment incentives, has attracted to Tanzania major mining TNCs and contributed to significantly increased FDI inflows into Tanzania. Some progress has also been achieved in streamlining the incentives system and moving towards automatic awards of investors' rights. The Investment Act of 1997 was instrumental in improving the investment framework, and climate, of Tanzania in the second half of the 1990s. However the continuing process of change has outpaced reform of the statute book and, as a result, the Act is outliving its usefulness as an instrument to promote investment in the 21st century.

If Tanzania wants to consolidate its initial success in attracting FDI and move to new frontiers, it should continue to improve the investment framework. Recommended improvements include the following:

- Laws and regulations from the time of the centrally planned economy should be replaced with laws and regulations compatible with the requirements of the market economy and Tanzania's competitiveness. This includes in particular employment and labour laws, the commercial and contract law (including new companies act) and tourism and fishing industry regulations.
- The commercial justice system should be further improved. A recently established commercial court is a step in the right direction. While large foreign investors will tend to resort to international arbitration, small investors, including local business community, would benefit from a new arbitration act. A legal and administrative mechanism to identify, pursue and punish infringements of intellectual

property rights is also required.

- The existing law embodied in the 1997 Investment Act has become increasingly dysfunctional. The Act should be replaced by a new, modern act reflecting current conditions inside and outside Tanzania. Examples of areas where the Act has lost its relevance or should be updated include functions of TIC, references to legal acts, which no longer exist or have been replaced by new acts (e.g., the sales tax act replaced by the VAT act) or the Certificate of Incentives.
- The Competition Act of 1994, which focuses on traditional competition issues typical for developed countries, should be reviewed and amended, if necessary, to reflect, among others, the implications of the increased presence of foreign companies in Tanzania. A Competition Authority should be established.
- A plethora of local licences, permits, duties and levies throughout mainland Tanzania and Zanzibar, significantly more numerous than in most countries and imposing additional transaction costs on investors should be reviewed and their number reduced. In this respect, Government's commitment in the 2001/2002 budget to rationalize both local and central taxation is very timely.
- Investment incentives offered to both foreign and local investors should be reviewed and replaced by a simple and transparent system. The possible impact of the exclusion of FDI projects below thresholds determined by the 1997 Investment Act on the inflow of FDI into manufacturing, agriculture and tourism should be examined. Should Tanzania decide to keep the thresholds, they should be lowered to levels competitive with other African countries. Provisions in the Investment Act concerning additional non-specified incentives for strategic or major investments may lead to arbitrariness and discrimination among investors and should be reviewed. There is, however, no need to review incentives in the mining sector, which have proven to be instrumental in attracting FDI into this sector.
- The establishment of a first special economic zone should be used as an opportunity to create "a pocket of development" in addition to pockets already emerging around the gold mines. The first zone should fast track Tanzania's push for industrial growth. It is therefore very important that the zone succeed. The existing and advanced concept of the EPZ near Dar-es-Salaam can be useful for this but it could be improved in two respects. One is to broaden it to a Multi-facility Economic Zone (MFEZ). And secondly, the Government could be more involved than currently intended to make sure that the undertaking is successful.
- The network of BITs and DTTs should be expanded, especially to include actual and potential home countries including dynamic developing countries from Asia and the African region. UNCTAD programme facilitating BIT negotiations among partner countries could be a cost-effective way to do so.
- Efforts to turn both TIC and ZIPA into state-of-the art investment promotion agencies should continue. Their activities should initially concentrate carrying the message that "Tanzania is open for business" and on focussed targeting into areas of immediate FDI potential. These should gradually expand to include all functions of a fully-fledged, one-stop investment agency. Needless to say,

promotion strategies of TIC and ZIPA, though coordinated, should take into account differences in competitive advantages between the mainland and Zanzibar.

- A comprehensive investment guide should be prepared identifying investment opportunities in the URT and familiarizing foreign investors with FDI conditions, including entry and establishment procedures, the incentives available, the charges to be met, and practical information on the policy, legal and operating environment for investors. Recent TIC initiative in this respect is very timely and should be brought to successful conclusion, producing a guide of professional quality.¹

¹ This could be done within a project on “Investment guides and capacity-building for least developed countries”, a collaborative venture between UNCTAD and the International Chamber of Commerce, which has already resulted in 5 guides prepared for LDCs.

CHAPTER III. ENHANCING THE ROLE OF FDI IN DEVELOPMENT

Tanzania can be an attractive FDI location in Eastern and Southern Africa. This has been confirmed in mining – thanks to ample resources and an inviting investment regime – and it may apply to other sectors with as yet unexploited potential. But pushing FDI to new frontiers will require determined actions on a wide front: privatisation, infrastructure, human resources and, not least, a dynamic private enterprise sector and institutions supportive to the needs of an open, market economy.

A. Tanzania's FDI potential

1. Tanzania's comparative international position

Tanzania's investment potential is related both to its own attractiveness and to its comparative position, particularly with regard to its East African neighbours. While Tanzania has somewhat different features from Kenya and Uganda -- a larger population and labour force but lower per capita GDP and lesser degree of industrialization -- the three countries are more or less equally attractive (table III.1).

Table III.1. East African comparisons: selected indicators, 1999

	Tanzania	Kenya	Uganda
Population (millions)	33.0	28.7	21.6
Labour force (millions)	16.8	11.4	10.6
GDP (dollars)	7,747	10,649	6,400
GDP per head (dollars)	235	371	298
Real GDP growth forecasts (per cent):			
2000	5.2	0.4	5.5
2001	5.4	2.6	6.4
2002	5.9	4.0	6.6
Structure of economy (per cent):			
Agriculture/GDP	45.6	26.0	44.4
Industry/GDP	14.9	16.1	17.8
Services/GDP	39.5	57.8	37.8
Trade:			
Exports of goods and services/GDP (per cent))	18.3	25.0	11.3
Imports of goods and services/GDP (per cent)	25.0	29.6	22.9

Sources: Economist Intelligence Unit and World Bank.

Surveys of business opinion ranks Tanzania top among African countries in terms of optimism concerning the reforms and improvements (table III.2), thus signalling a strong vote of confidence in the liberalization and market reform process in the country. However, surveys on competitiveness and FDI attractiveness rank Tanzania and its neighbours below average in Africa (see tables III.2 and III.3), and at the bottom among SADC countries (BusinessMap SA, 2000). A disaggregation of competitiveness factors (table III.4) shows that the East African countries score poorly on finance, on most infrastructure and openness variables, and on certain government factors (principally payroll taxes, tax evasion and irregular payments). Tanzania scores particularly poorly on its import tariff levels, payroll taxes, internet usage, and secondary school enrolments and university education. However, the East African countries all rank high in

respect of corporate tax rates. The few areas where Tanzania scores highly are: an exchange rate policy that is supportive of exports, low levels of government expenditure and various institutional factors such as an enforced court system, low levels of organized crime and civil service stability. It also scores well relative to its neighbours on port facilities and railway network. Thus, for Tanzania to move up the competitiveness ranking, significant improvements are required in education, aspects of the physical infrastructure, and various trade and financial issues such as tariffs, taxes and irregular payments.

Table III.2. East African comparisons: national competitiveness, 2000
(Overall rankings)

	Tanzania	Kenya	Uganda
Africa Competitiveness Index (2000)	14	17	22
Improvement Index (1996-1999) ^a	1	15	5
Optimism Index (1999-2001) ^b	2	14	11

Source: World Economic Forum, 2000.

Note: Ranking of 24 African countries, where 1 is best.

^a Measures perceived changes over the previous three years; ^b Rates the level of optimism over reforms and improvements.

Table III.3. African countries ranked according to FDI attractiveness and business environment improvement

	Tanzania	Kenya	Uganda
Attractiveness for FDI (2000-2003) ^a	15	10	19
Business environment improvement(2000-2003) ^b	8	11	13

Source: UNCTAD, 2000.

^a Ranking of 20 countries, where 1 is best; ^b Ranking of 23 countries, where 1 is best.

2. FDI potential at the country level

Country experience suggests that FDI potential is related closely to a number of key factors including: market size and growth; labour costs and skills; infrastructure; the costs of doing business; and natural resources. Tanzania's market potential is long-term: its population is the largest in East Africa but its purchasing power is low. However, growth forecasts are positive and, if sustained, Tanzania could begin to attract market-seeking FDI. Moreover, when viewed within the context of the EAC and of the SADC, market size can become a major attraction for potential investors. As yet regional integration has not progressed to the stage where it provides these market attractions.

With respect to labour force and skill availability, Tanzania is not particularly attractive. During 1960-1994, the contribution of education to growth was below the African and other regional averages; the same is true for the contribution of physical capital to growth. Surveys show worker productivity to be low in Tanzania. Similarly, labour costs are considered to be very high by investors, in part due to significant fringe benefits and levies charged.

Table III.4. East African comparisons: competitiveness factors
(Various units and ranking)

Competitiveness factors	Tanzania	Kenya (Rank in parentheses ^a)	Uganda
Openness:			
Openness to trade	(24)	(21)	(11)
Average tariff rate (per cent, 1998)	23.7 (21)	11.0 (3)	30.0 (23)
Exchange rate policy	(14)	(19)	(17)
Government:			
Government expenditure (per cent of GDP)	8.8 (2)	16.1 (17)	9.6 (6)
Corporate tax (per cent rate)	30.0 (4)	32.5 (6)	30.0 (5)
Income tax (per cent rate)	18.8 (7)	22.5 (15)	15.0 (5)
Employee payroll tax (per cent rate)	10.0 (20)	5.0 (15)	5.0 (16)
Tax evasion	(18)	(22)	(14)
Irregular payments	(21)	(18)	(19)
Time for permits (per cent of senior management time)	14.4 (15)	10.5 (9)	14.8 (18)
Finance:			
Gross domestic investment (per cent of GDP, 1998)	16.0 (17)	14.5 (20)	15.1 (19)
Gross domestic savings (per cent of GDP, 1998)	6.0 (18)	6.7 (16)	5.7 (19)
Confidence in system	(20)	(15)	(21)
Infrastructure:			
Paved roads (per cent of total)	4.2 (22)	13.9 (17)	n.a. (24)
Railways (rail lines per 000 popn)	0.11 (9)	0.09 (11)	0.06 (16)
Telephones (mainlines per capita)	0.003 (17)	0.008 (12)	0.002 (21)
Telephone price	(12)	(8)	(24)
Internet users (Est. mid-1999)	7,500 (19)	45,000 (5)	36,000 (7)
Electric power supply	(13)	(22)	(16)
Air transport (cost/quality)	(14/15)	(8/9)	(10/13)
Port facilities (cost/quality)	(10/12)	(18/21)	(24/23)
Customs time (days to clear)	18.6 (17)	19.9 (18)	24.9 (21)
Labour:			
Primary enrolment (per cent)	47.4 (18)	65.0 (13)	n.a. (24)
University education	(14)	(5)	(6)
Institutions:			
Enforced court system	(8)	(22)	(21)
Certainty of rules and laws	(18)	(20)	(22)
Organised crime	(8)	(21)	(19)
Civil service stability	(4)	(22)	(15)

Source: World Economic Forum, 2000.

^a Ranking of 24 African countries in parentheses, where 1 is best. Where only rankings are shown, the rank is based on perceptions of interviewed firms.

A number of competitiveness and business climate surveys point to Tanzania's infrastructure as a serious deterrent to FDI. Poor infrastructure has a significant influence on the costs of doing business – both directly through the availability, quality and cost of services, and indirectly through, for example, port delays and impassable roads during the rainy season. Tanzania has the advantage of not being landlocked but the disadvantage from an infrastructural perspective of the largest land area. A further difficulty is that the population of Tanzania is concentrated on the periphery of the country. In respect of utility costs, electricity charges are two times higher in Tanzania than in Kenya and Uganda. Telephone calls to the

United States cost \$13.30 per three minutes, compared to \$11.17 from Kenya and \$6.80 from Uganda. Telephone density is estimated at 0.32 per 100

Box III.1. Investor perceptions of Tanzania versus Kenya

Many foreign companies in Tanzania also have affiliates in Kenya and are thus able to compare the two neighbours. Some of their perceptions are as follows:

Business. Kenya's private sector is definitely more developed and more dynamic, its informal sector smaller. Competition is also stronger in Kenya, whereas in Tanzania the Government still plays a more significant role. Asset/land ownership is a clear-cut issue in Kenya. In Tanzania, corruption is more widespread but is mostly "petty"; in Kenya, the amounts are relatively more significant and their consequences more serious. Smuggling is less of a problem in Kenya because the routes are fewer.

Human resources. The quality of labour is better in Kenya, reflecting its higher level of education and broader exposure to outside influences. Many job-seeking Kenyans migrate to Tanzania, bringing with them skills and work experiences that Tanzanians have yet to develop, especially at the management level. The quality of education is generally poorer in Tanzania, and there is widespread concern that the use of Kiswahili as the medium of instruction may become a serious handicap for young Tanzanians' access to outside communication and learning, including the Internet. On the other hand, Tanzanians are considered more committed and less confrontational in nature. Lacking the tribalism of Kenya, Tanzanians are more cohesive and teamwork is better in the workplace.

Costs. Salaries in Tanzania are estimated to be 25-30 per cent higher due to higher costs of housing, utilities, taxation, and overall transaction costs. VAT in Kenya is 17 per cent and 15 per cent in Uganda, whereas it is 20 per cent in Tanzania; tax administration is regarded as better in Kenya and Uganda.

Infrastructure. Infrastructure in Kenya is generally better.

Despite the difficulties, international businesses suggest that "sentiment is swinging south", with optimism rising more for Tanzania than for Kenya.

Source: UNCTAD.

inhabitants compared with 0.92 in Kenya. Further, internet usage is hampered by the limited bandwidth of the telecommunications network. Water supply is erratic and unsafe for drinking. Electricity supply is also frequently interrupted. Infrastructure has been made the major component of the large-scale privatisation programme that the country is pursuing.

Additional problems in the country in respect of FDI potential concern high transaction costs resulting from fiscal requirements, planning processes, business registration, import/export procedures, legal systems as well as bureaucracy and petty corruption. Problems have been highlighted in the *Tanzania Investor Roadmap* (The Services Group, 1999) and are currently the focus of proposed policy reform in Tanzania.

3. Potential at the sector and industry levels

There is no definitive prioritization of sectors for development in Tanzania. However, the minerals and natural resources, agriculture and agribusiness and tourism sectors are recognized as being of major significance.

(a) Mining and natural resources

Tanzania has substantial deposits of precious metals, industrial minerals and fuels. Around 40 per cent of Tanzania's FDI is currently in mining; and there are significant further opportunities. Gold is the current focus of mining activity, with the exploration of non-ferrous metals being greater than anywhere else in Africa. The number of licences for prospecting and reconnaissance has risen dramatically from about 29 between 1985 and 1991 to over 450 in the late 1990s (The Services Group, 1999).

FDI potential in mining is substantial, given the large reserves of a variety of minerals, the attractive incentives, and the cooperative approach of significant players like Kahama Gold. Issues such as illegal mining and environmental pollution are primarily considered "nuisance factors" by international investors, but may have an adverse effect on the "business climate" for FDI. Moreover, their implications for the Tanzanian economy are very significant: illegal mining is associated with widespread smuggling of gold and other precious metals and stones, and has been estimated to total around \$100 million. The other note of caution relates to declining commodity prices: for example, the world gold price has shrunk from its record \$850 per ounce in early 1980 to around \$260-270 at present. In such circumstances, the lack of basic infrastructure may become a barrier if mining interest shifts from gold to other minerals.

The importance of mining is not simply related to its FDI potential *per se* but also to its economic contribution to the economy. The Government has taken measures to promote technology transfer and diffusion as well as linkage formation to ensure that mining does not become an enclave. Thus far, capabilities have been developed in terms of small-scale engineering maintenance and repair expertise, which can be used in local agriculture and agro-industry. Similarly, investment in roads and power benefit agriculture. There is an employment localization programme linked to an education subvention from the Government and aimed at evaluating progress against targets. It is still too early to assess the impacts of this programme, but contributions of the mining sector are discussed in box I.1.

There are FDI opportunities in energy and water, specifically in the development of natural gas, coal, and possibly oil, as well as hydroelectricity, water and sewerage services. The Ministry of Energy and Minerals has licensed the exploitation of coal and iron ore deposits to the state-owned NDC (see box III.2), which is heavily involved in exploiting the coal reserves in the south of the country. The natural gas resources in Tanzania's coastal waters are under development (see box III.3) while oil prospecting has been proceeding for many years. Nine foreign companies have expressed interest in investing in new power plants.

Fiscal terms for the mining sector are more beneficial than the general incentives, and can further be stabilized through a Fiscal Stability Agreement between individual companies and Government. In addition to the 0 per cent import duty provided by the Finance Act 2001, mining companies are exempted from VAT on imported equipment. Licensing fees are the same for all types of minerals, irrespective of value. In order to stimulate exploitation, the Ministry is studying the option of reducing the fees for high volume, low

value minerals. This is considered an important area of future development, in part because industrial minerals, in particular, integrate better into the economy.

Box III.2. National Development Corporation : FDI through strategic alliances

Given the size and complexity of its projects and given the importance of strategic alliances with foreign investors, the parastatal National Development Corporation (NDC) plays an important role in FDI promotion and economic development. It thus constitutes the third mechanism for FDI attraction in Tanzania alongside TIC promotion of foreign investment and the privatization programme.

NDC was established to promote industry and to manage existing state-owned companies. In 1992, government decided to privatize companies under NDC control and to reinforce NDC's role as a catalyst for promoting development-oriented projects. Its mission is to identify areas of development to be undertaken in collaboration with the private sector (with its maximum permitted equity stake of 25 per cent being divested subsequently); and to undertake a series of special development initiatives. Some of NDC's major projects are:

Power projects. NDC's first and largest projects in its new role are within the power sector in southern Tanzania. Based on the findings of studies on local coal deposits and on a feasibility study, the project was promoted worldwide. A BOO agreement has now been reached with an international consortium to develop this project by 2005. The alliance includes Siemens (Germany), Anglo-Coal (South Africa), Synergy (United Kingdom), Duke Energy (United States) and LTA Construction (South Africa). The \$660 million project's subsidiary components are: coal mine \$110 million; power stations \$400 million; transmission \$110 million; and a village development \$40 million. NDC will take a maximum stake of 15 per cent. Project implementation is as follows; financial closing at December 2001; construction completion by December 2004; and power production by December 2005. The cost of power to the consumer will not exceed US 7 cents per kilowatt hour. Consumers currently pay US 13-23 cents per kilowatt hour elsewhere in Tanzania.

Liganga Iron Ore/Titanium/Ilmenite Project. Considered the backbone of industrialization in Tanzania, this project would exploit the 1.2 billion tons of iron ore deposits near Mchuchuma. It is linked to the Mtwara Development Corridor programme, which is jointly developed by Malawi, Zambia, Mozambique and Tanzania. Alliance with foreign investors is pursued.

Export processing zones (EPZs). EPZs are aimed at job generation by overcoming some of the infrastructure problems, particularly in regard to power costs and high levels of duties in the country. The proposed EPZ is to be a classic model of an export-oriented, tax-free zone, with activities focussed on agribusiness, textiles and electronics. Access to the European Union and to the United States markets has been assured under EBA and AGOA, respectively. NDC will have the role in planning and marketing of the EPZ, with the first one to be located in Dar-es-Salaam and subsequent ones in border areas

Industrial parks. Three sites have been identified for Industrial Parks, which is aimed at stimulating SME development and linkages. The objective is to improve the situation of industries which will not benefit from Export Processing Zone activity. No new legislation is required.

NDC, with 32 staff, is currently funded by the Tanzanian Government but is facing major resource constraints. To carry out its strategic role, it needs funds from other sources. If it is to succeed, it requires a strong and capable team of personnel, experienced in initiating and managing international strategic alliances.

Box III.3 CDC Group PLC: the evolving role of a long-established United Kingdom investor

While FDI stock in Tanzania is relatively small, a number of foreign investors have a long presence in the country. The nature of their investment has evolved, but they continue to play a role in the country's development.

A case in point is the CDC Group PLC, which commenced operations in 1948 as the Colonial Development Corporation and which primary function is to provide loans to public and private entities as well as to large projects. Operated through DFID, it is being slated for privatisation. Its new role is to act as an equity and value-added partner to commercially viable business ventures in emerging markets. CDC will thus operate principally as a foreign venture capital investor with links to United Kingdom development assistance. The United Kingdom Government would provide investment credits to facilitate CDC equity participation in Tanzania's privatization programme.

The CDC in Tanzania is one of the larger and more active of the 12 CDC offices in the African continent. It has a total of 42 investments in Tanzania, with stock valued at \$90-100 million and accounting for a large part of total United Kingdom investment in Tanzania. It is one of the largest non-mining investors in the country, with large holdings in agriculture. Four of these holdings, namely Kilombero Valley Teak Company; Tanganyika Wattle Company; East Usumbara Tea Company; and Tanzania Tea Packers, are due for divestiture. They are. One previous majority-owned subsidiary – Mbeya Cement – acquired under privatization programme, was recently sold to Lafarge Blue Circle as part of a package which included CDC's cement interests in Zimbabwe and Malawi. Current CDC equity investments include stakes in minerals, food and agribusiness, transport and tourism, as well as finance and real estate.

Tanzania has large offshore natural gas and oilfield reserves that are being developed; CDC is involved in a project to build a pipeline to Dar-es-Salaam. The total project cost is \$400 million, of which CDC has a \$20 million stake. CDC also invests through private investment venture capital funds, one of which is the Tanzania Venture Capital Fund. The Fund, of which CDC is one of seven partner-investors, was established in 1993 with a capital of \$7.7 million. By its closure in 1998 its capital has been fully invested in 20 indigenous businesses, of which 14 were start-ups in tourism, trucking, horticulture etc. Its successor, the Fedha Fund, was launched in 1998 with a \$13 million capital; about half of which has now been invested. Lack of experience of the local private sector is often cited as the principal hindrance to success.

Future interests of the Fund include telecommunications, ICT, financial services, FMCGs, power, minerals and oil and gas, and healthcare. South African supermarkets are in line to make substantial investment in the FMCGs. The Fund is also interested in the expansion of Kenyan companies into Tanzania, and can thereby have a significant role in regional integration.

Therefore, even though its activities and focus have changed significantly, CDC still plays an important role in promoting new areas of investment and in stimulating the development of Tanzania's fledgling private sector.

(b) *Agriculture and agribusiness*

This sector was adversely affected by the socialist strategies of the 1970s, which called for the diversion of resources from agriculture in favor of the industrial sector, the nationalization of estates, the use of state marketing monopolies, and the over-valuation of currency. These policies resulted in production costs of export commodities being far above the prices paid to the producers. Of the major commodities, cotton, which is mainly a smallholder crop, suffers from low productivity, with yields between a third and a half of the global average. Coffee, which is grown by half a million smallholders as well as some estates, was less affected by economic policies; but output has suffered subsequently because of low world market prices, poor weather conditions, and low usage of inputs. The tea industry, by contrast, recovered during the 1990s, as some estates were re-purchased and revitalized by previous foreign investors. Sisal estates, nationalized in the previous era and faced with stiff competition from synthetics, are now largely privatised and seem to be improving. Cashew production is increasing. In spite of a major processing facility established in the 1970s with World Bank support, most output is exported raw to India.

The Tanzanian economy remains basically agrarian and informal. About half of GDP is derived from agriculture, with subsistence production representing as much as a third of GDP. There are 88 million hectares of land suitable for agriculture, of which about 70 per cent could be used for livestock production. However, only 7 million hectares are actually under cultivation, with about 100,000 hectares under irrigation. Tanzania also has the largest population of animals in Africa after Ethiopia and Sudan.

Despite these challenges, FDI is trickling into the sector, often linked to privatization. The African Plantation Company, for example, has invested \$6-10 million in tea and coffee estates including the privatized Mufindi Tea Company. Other privatizations include tea and sisal estates, as well as enterprises in tobacco and oil seeds, dairies and rice mills. Within the sugar sector, Kilombero Sugar Company, the former state monopoly, was sold to Illovo Sugar (South Africa) and ED and F Man (United Kingdom), while Mtibwa Sugar was sold to Mauritian investors.

Kenya and Uganda have shown that significant opportunities exist in fresh fruits, vegetables and flowers. Tanzania itself has a growing markets for mushrooms in the Middle East, Kenya, the Netherlands and India; and for flowers from the Kilimanjaro area to Germany and the Netherlands. Diversification into these new agro-based commodities has been relatively slow in Tanzania, and could be further hampered by the lack of infrastructural support, especially the lack of chilled storage facilities and poor road network.

There is significant FDI potential in both agriculture and agribusiness; but fulfilling this potential will require major policy effort. In many cases, sector-specific action-oriented policies are required. Without this, FDI prospects are poor. In hides and leather and in other sectors like oilseeds, for example, there are quality problems that act as a barrier to the development of agribusiness. UNIDO's Integrated Industrial Development Programme, which commenced in April 1999, has focused on a number of critical problems including shortages/non-availability of raw materials, low capacity utilization, low productivity, poor quality and standards, e.g. of semi- and finished leather, and poor environmental management. The problems are wide-ranging and have hampered privatisation. The agribusiness sector thus includes many privatized companies that will be closed because of non-viability (see section III.B.2). There is the case, for example, of a privatised tannery having replaced leather exports by the export of raw hides.

There are many other policy challenges in agribusiness, including tariff distortions, land ownership, smuggling, marketing failures, and the lack of access to financial institutions. Reform has been slow in this sector: thus, food marketing is far from liberalized, and the state marketing boards still play an essential role. Furthermore, taxes at the local level reduce the profitability and the competitiveness of farmers, while cross-border trading bans prevent farmers from reaching their nearest markets. These issues are important in building the market economy and in attracting FDI.

(c) Tourism

Along with mining, tourism is the fastest growing sector in the economy. It generates an estimated annual earnings of \$733 million and contributes about 16 per cent to GDP and. In northern Tanzania, tourism is a significant source of non-farm employment in rural areas, with considerable multiplier benefits in terms of supply of food, tourist artifacts, transport and construction. In Zanzibar, tourism accounts for around 80 per cent of all services earnings. With its 12 National Parks, wildlife reserves, coastline and beaches, island resorts and archeological sites, Tanzania has very substantial tourist attractions and consequently, FDI potential.

There are, however, numerous constraints to the development of the industry. Most obviously, the inadequate infrastructure is a barrier, especially in terms of roads, telecommunications, water supply, and hotel accommodation, as well as service infrastructure (FIAS, 1999). Resolution of these constraints will generate major growth opportunities, including opportunities for FDI in hotels, financial facilities, and other tourist-related services. Improvements are occurring, such as the leasing of the Kilimanjaro International Airport, which allows for international flights to fly directly in and out of the northern tourist circuit. An added benefit from tourism development is that it could indirectly improve the investment climate, and is a form of image building. Business executives can form positive investment attitudes from visits to a country for tourism.

Tourism is the key sector in Zanzibar and the potential for expansion and for FDI is significant. Zanzibar could further exploit a combination of beach and cultural attractions to the profitable luxury end of the tourism market. Awareness of Zanzibar internationally is quite high, as reflected in the strapline of the TIC promotional video – "The land of Kilimanjaro and Zanzibar." Amongst other challenges, however, has been the political unrest in Zanzibar at the end of 2000. While its effect has been geographically contained and relatively short-term, measures should be taken to ensure that it does not resurface. Security, along with natural attractions, is an important requirement for successful tourism.

There is a need to review the national tourism strategy. The 10-year Tourism Master Plan, launched in 1996, has the broad aim of promoting low volume, high yield tourism. This concept was aimed at preserving the game parks. To the need of maximizing the economic benefits and opportunities derived from tourism, there has been propositions that the national parks be catalysts for tourism, with the coast being used for larger volume but well-planned tourism. Hotel development planning is critical in this regard to safeguard the beaches and surrounding environment on which tourism depends. On the other hand, there are indications that Zanzibar is facing some of the negative effects of tourism, namely increased cost of living, drugs and breakdown in family relationships. Within the tourism strategy, the role of Dar-es-Salaam as a tourist as well as a business center needs to be reviewed. There is also a marketing issue in tourism since Tanzania (although not Zanzibar) is still a little-known destination with a negative image from the past. Effective marketing of the tourism 'product' is required, and mainland Tanzania and Zanzibar should pursue an integrated approach to tourism attraction and development.

(d) Manufacturing

The manufacturing sector accounts for under 8 per cent of GDP in Tanzania, compared with nearly 10 per cent and 11 per cent in Uganda and Kenya, respectively. The sector is not only small, but has performed poorly since liberalization, with an annual growth of less than two per cent. The existing industrial structure is largely a legacy of the Basic Industry Strategy of the 1970s, which was built on nationalization and import substitution. A number of capital intensive enterprises, including those producing cement, pulp and paper, fertilisers, steel, vehicles and some basic consumer goods, have been privatized. Except for those with a strong local market, such as breweries and cigarettes, these factories generally operate at low levels of capacity utilization because of market constraints and non-competitiveness.

With import liberalization, Tanzania's textile sector was severely hit by cheap and second-hand clothing imports. Of the 30 state-owned mills, only 5 survived and are operating under private ownership. Since the sector is highly competitive globally, its revival will require complete rebuilding.

FDI potential is thus limited at present, although the growing domestic market is beginning to attract more consumer-oriented manufacturing enterprises. To exploit the potential of market-oriented manufacturing FDI, TIC might tag FDI projects of major TNCs as flagships for manufacturing investment in its targeting activities. Unlike the EPZ initiative which is aimed at export-oriented manufacturing, target FDI projects in this case would more likely to be market-seeking projects initially, evolving into export production over time. In the longer term, Tanzania needs a manufacturing base to promote balanced economic development and to compete with imported goods, including those from the subregion. This requires rebuilding existing industrial capacities and establishing new capacities through domestic and foreign investment in areas of competitive advantage, as proposed in the Sustainable Industrial Development Policy 2020.

(e) Other sectors

Liberalization and privatization has opened many other sectors to FDI, including small-sized investments and investors from developing countries. These include construction, where the acceleration of economic growth has created a demand for accommodation and office space as well as retail and other service. In telecommunications, the Tanzania Communications Commission has licenced telecommunication service operators, cellular phone, and radio paging services and data communications companies. There is potential in pharmaceuticals, hospitals and hospital services. There are also possibilities for expansion in education. At present, students have to go neighbouring countries to acquire higher-level education and to attain English language fluency.

4. Potential at the firm level

The privatization programme has been an effective vehicle for attracting FDI. Implemented through the Presidential Parastatal Sector Reform Commission (PSRC), the programme has concluded 333 privatizations (table III.5). Of these, 130 were with Tanzanian firms, many of these being SMEs; 25 to 27 were privatized as 100 per cent ventures to foreign enterprises, with the remainder being joint ventures with

TNCs. The latter category include the sale of 50 per cent of the shares in Tanzania Breweries to South African Breweries; the sale of a 51 per cent stake in Tanzania Cigarette Company to RJ Reynolds; the sale of 55 percent of the shares of the National Bank of Commerce to Amalgamated Banks of South Africa ; the sale of 75 per cent of shares of Kilombero Sugar to Illovo of South Africa and IDF MAN of United Kingdom; and the divestiture of Williamson Diamonds to De Beers. There is FDI potential from the forthcoming privatization of utilities and transportation enterprises.

Table III.5. Number of privatized enterprises, by year^a

1992	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	Total ^b
11	59	45	43	40	61	36	38	333

Source: Presidential Parastatal Sector Reform Commission, 2000.

^a Year to June 30th; ^b Includes 24 non-core asset sales.

Privatization has also encouraged market-seeking investment in a range of advisory and support services as well as in construction; and indirectly, has reassured future potential investors on Tanzania's commitment to liberalization and reform.

When Tanzania commenced its liberalization and market reform programme, the stock of privately owned firms in the country was dominated by Tanzanian Asians who during the socialist era, operated mainly in trading activities. With their entrepreneurial background and experience, they were well placed to take advantage of the opportunities associated with market opening. The Asian community is significant in respect of FDI potential, because of close ethnic ties with the Indian sub-continent and with other Asian communities elsewhere in East Africa as well as countries like Mauritius and the United Kingdom. Asian enterprises based in these locations may be encouraged to invest on the back of Tanzania's stability and the liberalization process.

5. Overall assessment

Tanzania's major strengths and weaknesses in attracting FDI are summarized in Table III.6. Tanzania is particularly well placed in respect of potential for resource-seeking FDI because of its minerals, oil and gas reserves. By comparison, the preconditions are not yet fully in place to permit Tanzania to capitalize upon its considerable agricultural resources and tourism attractions. The limited market size means that only relatively small-scale market-seeking (manufacturing) FDI can be anticipated in the near future; although there are encouraging signs in respect of services as companies follow their customers (often entering through privatization). The recent re-establishment of the EAC could produce major market-related benefits, but, as with SADC, this is a longer-term prospect. In the short-term, Tanzania could face problems in adjusting to competition from Kenya. The significant FDI potential is linked to the privatization of utilities and transportation enterprises. The efficiency with which the privatization programme has been implemented is likely to have a major positive effect on investors' perceptions of Tanzania.

The major challenges concern the costs of doing business in Tanzania, in part linked to infrastructural problems. Education levels are also relatively low, which leads to low productivity. To date linkages between FDI and the rest of the economy are very weak. While mining activities are not traditionally

associated with strong linkages, this sector may be used to pilot a programme to build partnerships and alliances between TNCs, the Government and other stakeholders in Tanzania. Trade policy issues produce distortions in some sectors (e.g. encouraging smuggling etc.), as does tax policy. The barriers to FDI derived from the high costs of doing business in Tanzania need to be tackled as a priority, especially in view of unfavourable comparisons with Kenya.

Table III.6. FDI potential in Tanzania: strengths and weaknesses

Strengths	Weaknesses
<p>Country level</p> <ul style="list-style-type: none"> ◆ Stable political environment ◆ Significant growth potential ◆ Market reform and liberalization process ◆ Foreign exchange liberalization, exchange rates and foreign exchange allocations ◆ Competitive corporate tax rates 	<ul style="list-style-type: none"> ◆ Low purchasing power and large informal sector ◆ Infrastructural weaknesses: transport, utilities (availability, cost and service quality) ◆ Education (primary, secondary, tertiary) ◆ Regulations: taxation, land and labour laws, business licensing and registration, import/export procedures; bureaucracy and petty corruption ◆ Suspicions of FDI and foreigners
<p>Sector and industry levels</p> <ul style="list-style-type: none"> ◆ Manufacturing: privatized manufacturing enterprises ◆ Mining: extensive and accessible deposits of a range of minerals, including gold; attractive incentives; strong FDI inflows ◆ Agriculture: abundant agricultural resources; privatization of former nationalized estates; early diversification efforts promising ◆ Tourism: rapid growth and potential for varied tourism products ◆ Other sectors: energy resources, especially natural gas and coal 	<ul style="list-style-type: none"> ◆ Manufacturing: small size, low capacity utilization, unfavourable industrial structure ◆ Mining: illegal mining; environmental pollution; poor infrastructure to develop potential in south of country; falling gold price; exports and currency appreciation ◆ Agriculture: weather; problems stemming from socialist strategies of the past: output, quality, little processing; tariff problems and smuggling; marketing systems; land ownership ◆ Tourism: infrastructure (roads and telecoms; service infrastructure; hotel accommodation; water supply); unrest in Zanzibar; marketing
<p>Firm level</p> <ul style="list-style-type: none"> ◆ Effective, wide-ranging privatization ◆ Commitment of long-established TNCs ◆ Entry of second-tier investors ◆ Interest of South African investors 	<ul style="list-style-type: none"> ◆ "Difficult" privatizations remaining, including utilities ◆ Suspicions of Asian and South African investors ◆ Large informal sector ◆ Low level of linkages between TNCs and the economy; backward linkages with suppliers are very weak

B. Policies and actions to realize potential

1. Building a market economy

Sustained progress in the liberalization and market reform programme is important for establishing Tanzania's credentials as an attractive FDI destination. Considerable progress has been made in a short period of time and investor response has been enthusiastic (see tables III.2 and III.3). There are urgent calls from the emerging private sector, including foreign investors, for the reform process to be sustained and reinforced.

The requirements for successful reform are wide-ranging including regulatory, to support an enabling environment and institutional, to drive the reform process. Two recent initiatives are the Business Environment Strengthening for Tanzania (BEST) Programme (box III.4) and the Tanzanian National Business Council (TNBC) (box III.5). It is necessary to ensure that the TNBC, successfully launched, meets regularly with active follow-up. Similarly, implementation of the BEST Programme should proceed without delay.

Box III.4. The BEST Programme

A Programme for Business Environment Strengthening for Tanzania (BEST Programme) contains a series of proposed actions for improving the business environment in 5 years:

- ◆ Achieving Better Regulation. This will entail the establishment of a Better Regulation Unit within the Planning Commission to drive fiscal reform at both central and local levels; land planning, allocation and site development; labour laws; business licensing and registration; import/export procedures; and sector-specific regulations in agriculture etc. The introduction of regulatory impact assessments and a Deregulation Act are also included in this component.
- ◆ Improving Commercial Dispute Resolution. This will include enhancing the accessibility of the Commercial Court; simplifying court procedures; and adopting anti-corruption measures.
- ◆ Strengthening the TIC. This will be undertaken as part of the implementation of the Corporate Plan 2000-2005.
- ◆ Changing the culture of Government through private sector orientation training across Government.
- ◆ Empowering Private Sector Advocacy. Support will be channelled through an Advocacy Fund to the Private Sector Foundation, which was established in 1997 as an umbrella organization of private sector interest groups including the Tanzania Chamber of Commerce, Industry and Agriculture, the Confederation of Tanzanian Industries and the Tanzania Bankers Association.

Joint donor effort in the BEST programme should enhance its effectiveness and its chances for implementation.

Another important constituent of the private sector reform and development programme, which is of significance for FDI attraction, relates to the informal sector in Tanzania. Estimates suggest that the informal sector represent 40-50 per cent of the economy. Liberalization allows local entrepreneurs to flourish; and indeed, the contraction of employment in government and the former parastatals, as well as declining real wages has forced many into self-employment and informal small-scale activities. Encouraging small business growth is an essential part of the government's pro-poor strategy and its objective of stimulating entrepreneurship.

Unemployment and dual economy issues, however, could become major barriers to private sector development and FDI-led development. Major distortions are created when new business development is largely informal. Therefore, efforts should be made to encourage "formality" and the formalization of the

informal sector. This will require tax reductions and measures to facilitate business establishment, as well as training facilities and micro-credit access.

Tanzania has for many years been a favored country for donor agencies, with ODA sometimes accounting for as much as a quarter or more of GNP. ODA has been critical in financing development expenditure and in funding debt obligations and balance of payments support. Although this assistance has been declining, Tanzania's progress in building a market economy may strengthen donor support. There is no doubt that ODA has played a considerable part in assisting liberalization and reform processes as well as in supporting infrastructure and other development programmes. In these ways ODA has helped create an environment that is conducive for FDI. It has also played a direct role through, for example equity participation in privatization.

Box III.5. The Tanzanian National Business Council (TNBC)

The TNBC held its inaugural meeting on 9 April 2001. Chaired by the President, it is aimed at providing the private sector, including foreign investors, with access to the President in order to discuss barriers to efficient business operations. Membership comprises half-and-half of government representatives and of private sector leaders and non-governmental organizations. Private sector organizations include the Confederation of Tanzania Industries, the Tanzanian Chamber of Commerce, Industry and Agriculture. The importance of regular meetings and follow-up on issues raised has been recognized.

The TNBC lobbies for private sector concerns to be kept visible and at the forefront of the government agenda, ensuring continuing support for market reform and private sector development at the highest levels of government. Follow-up action on the issues discussed at TNBC meetings is critical; and hence its link with, for example, the NISC (box III.7) is crucial.

Experience show that such councils, especially if chaired by presidents or prime ministers, could play a pivotal role in emerging market economies like Tanzania where support for private sector-led development is still half-hearted, and where the vestiges of a lengthy central planning remain.

2. Privatization programme

Tanzania's privatization programme is a key component of the Government's programme to build a market economy based on private ownership. About 61 per cent of the 333 privatizations implemented to date have involved foreign enterprises, mostly in joint ventures. For larger companies, such as the major utilities, the brewery and cigarette companies and the National Bank of Commerce, there is a Government policy to retain a 30 per cent stake in privatized enterprises. This stake is to be returned to the market after three years, thus offering further opportunities for TNCs.

With 60 enterprises remaining to be privatized, the major challenges now facing the PSRC are the privatization of utilities and transportation enterprises and of non-viable enterprises. A good number of the remaining investments in the latter category are likely to be liquidated.

The utilities are key to Tanzania's competitiveness for the future progress. Characterized by high cost supplies and poor services, this sector is a major problem area for the country. The state of the different utilities is as follows.

Power (FDI): The power sector, dominated by state-owned TANESCO (Tanzania Electric Supply Company), is characterized by high retail tariffs, poor service and coverage, and frequent supply interruptions. Privatization is still at its preliminary stage as the PSRC attempts to restructure the sector. This has involved unbundling transmission and generation in order to allow new entrants into the latter; transmission will remain as a monopoly. Bid submission and evaluation is scheduled for the first half of 2004, with handover by the end of that year.

Water (leasing arrangement): The privatization of the Dar-es-Salaam Water and Sewerage Authority (DAWASA) is to be used as a model for other water utilities. The strategy is to enter into a ten-year lease with an international private operator to handle management and operations, leaving the assets in public hands. The tender process is to be open to all international water operators with the proposed date for handover being January 2002.

Harbours (leasing contract): The contract for leasing the container terminal for a period of 10 years has been signed with two firms: one from the Philippines and the other a Tanzanian company. The remaining assets and services of the Tanzania Harbours Authority (THA) are still to be privatized.

Railways: The PSRC commissioned studies of the railway sector and state-owned Tanzania Railways Corporation in 1999 and 2000. A vertically integrated concession arrangement is being considered for this sector. Issues of layoffs have to be resolved in a sector considered over-manned with 10,000 employees. The timeline is June 2002 for completion of the divestiture project.

Airlines : The Air Tanzania Corporation (ATC) privatization has highlighted one of the challenges of the PSRC, namely the balance between speed and transparency. Initially, the privatization of ATC was planned for 2002, but the financial situation of the airline has been so precarious that the Government has had to inject funds. As a consequence, alternative possibilities for privatization are being explored.

Besides being an important tool for attracting FDI directly, indirectly these privatizations can have a significant demonstration effect for potential investors. There is evidence of numerous foreign consulting firms entering the Tanzanian market on the back of privatization, as well as other services companies, in hotels (e.g. Royal Palms) and banking (e.g. Citibank). The PSRC explicitly and actively encourages investors to set up partnerships with local firms to stimulate capacity building, and make provisions for the eventual replacement of expatriates with similarly-skilled Tanzanians.

Although the PSRC would have preferred to relinquish its responsibility with companies after privatization, it is perhaps inevitable that issues have arisen where investors have sought post-privatization support from the Commission. Examples have ranged from replacement of obsolete machinery to a claim for VAT exemption.

The most critical impacts of FDI in the privatization programme are lowered costs and prices, and improved quality, range and coverage of infrastructure services. Experience in other countries has shown that these benefits may not occur spontaneously, especially in monopolistic sectors. Key requirements to

ensure that the benefits of privatization are achieved are: firstly, an attractive business climate; secondly, effective competition policy; and, thirdly, a transparent and independent regulatory regime. The last two conditions are important because customers seek protection from anti-competitive practices and market power abuse, especially in industries like telecoms where there is only one monopoly operator. Tanzania's Fair Trade Practices Act (Act No. 4 of 1994) could provide such protection, but needs support is needed for its implementation. World Bank support may also be forthcoming to strengthen the Tanzanian competition authorities. Competition policy has an important role in ensuring, for example, fair prices of goods and services.

The Tanzanian Government is also to establish two multi-sectoral regulatory agencies: one for utilities, including electricity, water, gas distribution, and telecommunications; and the other for transportation, including aviation, airports, ports, maritime services, railway and road public transport. These agencies would monitor progress and implementation of the commitments declared by the privatized enterprises in their business plans. In addition, a clear and independent regulatory regime is important to encourage major capital expansion and to broaden the existing low levels of accessibility in services. The regulatory bodies should have a complementary role to the competition authorities in monitoring the price levels of privatized services, including benchmarking price levels in Tanzania with those in neighbouring countries. As in other countries, the regulatory authorities may consider linking price levels to profitability, future investment commitments and investment incentives.

Recommendations

The participation of FDI in the privatization programme has an important role in supporting continued liberalization, strengthening the business environment and promoting Tanzania to prospective investors. At the same time, privatized enterprises have responsibilities in terms of honoring the commitments made at time of privatization. There are also legitimate expectations of improved services and lower prices. Achieving these benefits requires an effective competition policy and an appropriate regulatory regime.

The privatization of the utilities needs to proceed as rapidly as possible in order to reduce costs and improve services to businesses and consumers.

Privatization has had a positive impact in terms of improved communication and dialogue between the private sector and Government. The Private Sector Foundation, an association of private investors, has been set up to foster and facilitate public-private sector dialogue. The PSRC has an advocacy role to play, particularly in maintaining good investor relations and providing a supportive environment.

3. Infrastructure development

The issue of infrastructure improvement is closely related to privatization, both of which are important to attract FDI. Given government expenditure constraints, privatization should provide an effective route to improved infrastructure. Steps are now in place to restructure companies and sectors and in the process to overcome weaknesses in some aspects of the infrastructure through the privatization programme. Timescales are still problematic among the utilities. The problems of attracting FDI into infrastructure projects have been recognized by the World Bank and other bilateral donors. While not unique to

infrastructure projects, the International Finance Corporation has taken an equity stake in some privatizations to encourage the participation of foreign investors.

Infrastructural inadequacies have been shown by a UNIDO study to pose two sets of problems. First, infrastructural weaknesses have led to substantially increased production costs through high power costs and intermittent supply; high telephone charges and consequent limited Internet access; and high transport costs stemming from poor road conditions and delays when roads are impassable. Second, poor infrastructure leads investors to set up shop in urban areas and thus excludes rural locations from potential FDI benefits. This is a major issue in a predominantly rural country like Tanzania.

Apart from infrastructural improvement through privatization, the major challenge for Tanzania concerns road development. There is no overall legislative framework for road development: while there are various legislation in the area, some going back to the 1920s, these have not been updated nor integrated into current law. There is an ongoing ten-year Integrated Roads Programme which is aimed at upgrading 70 per cent of the main roads and building 3,000 kilometres of new roads, but there are still weaknesses in the basic strategy for prioritizing routes and in coordinating the road-building programme with that of the mining companies, for example. Little consideration has been given as yet to the funding of the road-building programme, and the role of foreign investment and types of contracts (BOT, BOO, leases and/or concessions) that might be implemented. Large investments by donors over the past 30 years have left few improvements because of lack of maintenance; however, in mid-1998, the European Union announced an aid package of around \$1 billion for the upgrading and maintenance of Tanzanian, Kenyan and Ugandan roads.

Given the poor road system and the size of the country, air transport has a potentially important role in improving transportation and communications. Tanzania has three international airports – Dar es Salaam, Kilimanjaro and Zanzibar – as well as 21 main aerodromes, which services 14 foreign airlines as well as 20 local aviation companies. The improvements in Kilimanjaro International Airport following the concession agreement with Mott Macdonald (United Kingdom) might act as a model for other airports. But other forms of private including foreign participation need to be considered in order to upgrade the airport infrastructure, which is critical for other areas of development including tourism.

Recommendations

Infrastructure development, especially road-building, offers opportunities for foreign investment. The preconditions for this to take place include the establishment of the appropriate legislative framework; the formulation of a road development strategy and the direction of donor funding to priority development areas. Roads and railways, for instance, are currently administered by two different ministries. There is a strong case for merging the two to ensure an integrated transport strategy. Airports are also in urgent need of investment, and the experience gained with Kilimanjaro International Airport should be used as a partnership model to attract foreign investors.

The promotion of partnerships between foreign and other private sector investors (e.g. mining companies) in the planning of road and other infrastructure developments, particularly in rural areas, is recommended.

4. Human resources

Tanzania has a large human resource pool. Substantial investment in education and training and other reforms are required to convert this into an asset for FDI attraction and for overall economic development. Problems range from low literacy rates; inadequate level of investment in education; to weak vocational and technical skill training facilities; and a general lack of motivation of the workforce. Allied with extensive labour regulations and relatively high labour costs (largely due to a range of levies on wage bills), the end result is low productivity and high unit costs. Skill shortages are more apparent in the technical and managerial areas.

In mid-1990s, the Open University of Tanzania was set up and private universities licensed in order to upgrade and expand higher education. Response in terms of enrolments for degree programmes in public and private universities is highlighted in table III.7. However, there still appears to be no coordinated strategy, both in terms of policy planning and curricula revision.

Table III.7. Student enrolments for degree programmes in public and private universities

	1995/96	1997/98	1999/00
Undergraduate			
University of Dar-es-Salaam	3544	4131	4765
Open university ^a	3064	4809	5160
Other public universities	1696	1841	2737
Private universities ^b	-	105	926
Postgraduate			
University of Dar-es-Salaam	357	198	208
Other public universities	117	203	269
Private universities ^b	-	-	151

Source: Ministry of Science, Technology and Higher Education, 2000.

^a Includes Foundation Course entrants;

^b Excludes diploma and certificate courses. Postgraduate includes medicine.

Human resource issues are critical for FDI. Investor perceptions (see box III.1) indicate the importance of labor issues, with Tanzanian workforce being considered to be lesser educated but more trainable than the Kenyan counterparts.

Vision 2025 sets out a series of policies and strategies to create a well-educated, highly-trained and technically skilled population. These include increasing resources for education and training. The introduction of loans at higher education level and of cost sharing between Government and students, are on the agenda of the Ministry. These initiatives should be pursued vigorously.

The private sector itself has an important role to play in improving the efficiency and effectiveness of the workforce. Partnerships between the government and the private sector must be developed to improve and expand technical and business education. In addition to widening university access, more technical and management institutes are required to develop a cadre of well-trained engineers, scientists, and public and private sector managers. The private sector can make education more relevant to the job market, and can actively participate in curriculum development, especially in areas such as entrepreneurship. Other ways in

which the private sector can support educational and training provision is by employing and offering sponsorship to graduates, and providing apprenticeships and assistance with projects. These private sector initiatives need to be supported by appropriate policies, including fiscal incentives.

Furthermore, foreign investors specifically can make an important contribution through their training policies. Examples within the foreign banking sector are highlighted in box I.2. Foreign companies operating in the same or related sector may pool their resources to run common training courses in conjunction with local institutions. The Government can act as broker to coordinate training programmes, and to encourage education and training institutes to offer particular programmes.

Recommendations

Human resource problems will become an increasingly crucial issue as the pace of FDI inflows expands. There is need to establish a policy framework and identify priorities. This includes determining skill needs and developing funding systems for training, in partnership with the private sector.

Investors including foreign investors need to be integrated into the decision-making processes for human resource development, so that their needs can be reflected in policy making. This is an ideal area to nurture partnerships and alliances between the public and private sectors.

5. Regional integration, trade policy and FDI

Tanzania is a member of both the East African Community (EAC) and the Southern African Development Community (SADC). It is also party to the Lomé Convention and the Africa Growth and Opportunities Act (AGOA), which provides access to European Union and United States markets, respectively. Regional trade currently represents about 20 per cent of Tanzanian trade.

East African Community. The EAC was originally established in 1967 but was disbanded in 1977 due to divergent political and economic philosophies among member states. A revised Treaty was signed on 30th November 1999, with focus on the harmonization of policies and on the creation of a common market. It is envisaged that the Community will broaden its membership to include Rwanda and Burundi. In the areas of policy harmonization, the measures being considered include: free movement of people within the community; common travel documents; joint secretariat for the railways; synchronization of fiscal and monetary policies; the coordination of infrastructure; and the promotion of trade and investment at the regional level.

Given the importance of market size and growth as FDI determinants, an EAC with a population of 89 million could offer foreign investors major opportunities. Domestic markets within Tanzania, Kenya and Uganda separately lack critical mass.

However, realising the opportunities of a single East African market will not be easy for all member states. There are concerns in both Tanzania and Uganda that they would not be able to compete with Kenya's manufactured goods. Subsequently, agreement has been reached that the proposed zero tariff regime will be phased in within seven years, depending on the country's level of industrialization and competitiveness. Furthermore, Tanzania and Uganda will be permitted to apply a surcharge of 10 per cent

for certain products for a specific period of time. Tariffs are sensitive in another way, since they represent an important source of government revenues in Tanzania.

The focus on manufacturing is to some extent misleading. While Kenya has the most advanced manufacturing sector, Tanzania has a large natural resource base which remain to be exploited. Conversely much of the land area of Kenya is arid or semi-arid. However, these opportunities for Tanzania are long-term, whereas the threats from Kenyan manufacturing imports are more immediate.

The business community has been given a lead role within the institutions of the EAC. The East Africa Business Council (EABC), comprising of the main private sector organizations in the three countries, will act as a voice in support of business-friendly policies. It will also be a valuable forum to review issues of competitiveness, trade and investment. It must not be a vehicle, however, to support long-term protectionism on behalf of its member companies. Other measures taken has been mainly in the finance field, notably measures to avoid double taxation and prevent tax evasion; currency convertibility; and the setting up of a joint monetary affairs committee by the central banks. The potential impact of the EAC on FDI is difficult to forecast at this stage. It is clear, nevertheless, that there will be little impact on FDI unless (a) the larger market without barriers is created and (b) investors are confident that the EAC does not collapse as it did earlier and that internal trade barriers are not re-imposed.

Southern African Development Community. Signed in August 1992, the SADC Treaty currently covers Angola, Botswana, the Democratic Republic of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, the Seychelles, South Africa, Swaziland, the United Republic of Tanzania, Zambia and Zimbabwe. Its goals are basically the same as the defunct Southern African Development Co-ordination Conference (SADCC) which it replaced; namely, to promote regional trade and integration, to boost the region's general economic independence, and to mobilize support for national and regional projects. Regional integration within SADC is to be attained through sectoral protocols, of which 8 have been signed including minerals development, energy, education and training, trade and tourism. The SADC Trade Protocol, which came into effect in September 2000, aims to remove tariff and non-tariff trade barriers in the region within eight years. However, to date only South Africa has made concrete commitments.

The SADC is an important initiative which could prove attractive to foreign investors. Unlike the EAC, the SADC protocol recognizes different levels of development, with Tanzania being classified as a lesser developed country. This allows, *inter alia*, greater access to more developed markets in the community such as South Africa and Mauritius.

Geographically, Tanzania could be a gateway to the land-locked Central African countries in the SADC region, but problems with the TAZARA railway link have led to the increased use of South Africa as the route to and from the sea for these countries. Improvements in the rail link and in the port of Dar es Salaam are thus essential if Tanzania is to rebuild its gateway position. Roads in the south of the country linking Tanzania with its SADC neighbours are also poor and a deterrent to trans-border trade.

As with the EAC, therefore, it is unlikely that FDI response will be immediate. As noted elsewhere in this report, South African investors are entering Tanzania in increasing numbers; but their objective is to serve the internal market in Tanzania.

Trade policy. Trade policy is critical for FDI both in respect of facilitating necessary imports for production processes and in encouraging export-oriented FDI. Tanzania has a relatively open economy, with foreign exchange allocation, import licensing and the exchange rate having all been liberalized. The average tariff rate has fallen considerably, but as table III.4 shows, is still generally higher than those in Kenya. Tanzania ranks poorly in terms of openness to trade. Illegal imports remain a problem, with allegations that Zanzibar is a primary route for channelling such imports to mainland Tanzania; border controls need to be tightened but coordinating action is also required at the high political level. On the positive side, the cumbersome and time-consuming import/export processes are being tackled as part of the BEST programme.

The economic liberalization has not led to an export growth that is commensurate to increased imports, and as a result trade balance has widened. This is because the country is still heavily dependent on exports of agricultural commodities and on imports of finished goods. Promoting exports, particularly manufactured products, is important to exploit the potential of the EAC and to ensure its success, which in turn will increase FDI potential. There is great potential for diversifying and expanding Tanzania's export base. For the European and Asian markets, it could export fresh vegetables, cut flowers, canned fish, wood products, leather goods and minerals. For Eastern and Southern African markets, Tanzania could expand into fishery products, certain food and cash crops, livestock and energy, as well as cement and metal products. But the fulfilment of these potentials is dependant on the implementation of a number of concrete measures, including an appropriate land policy, the legal provisions for creating partnership between local and foreign firms, the establishment of industrial parks and export processing zones, conducive fiscal incentives and investment in infrastructure.

Numerous export or trade development strategies have been formulated, but implementation has been lacking. For example, an export promotion strategy developed with World Bank support in 1996 has not been implemented as designed. A subsequent Tanzanian Government initiative to develop an integrated framework for trade development has been negatively characterized as a shopping list for donor support. Improvements in the trade environment are critical for investment attraction. Similarly if foreign investors are to be encouraged to export, a supportive trade policy and efficient low-cost infrastructure services are essential.

Actions are clearly required to assist the transformation of industry from a domestic to an international focus. This is a multifaceted challenge for both domestic enterprises and foreign investors. One strategy being pursued is the establishment of export processing zones.

Export processing zones (EPZs) and industrial parks. Among the development initiatives that the NDC is exploring on behalf of the Government of Tanzania is the development of industrial parks and EPZs, on which there has been concerns. Competition among countries to attract FDI to EPZs has become very fierce and Tanzania's competitiveness may be in doubt given present cost levels. The notion that foreign companies will invest in EPZ infrastructure is rather doubtful, even while EPZ infrastructure and facilities represents one of the most important FDI determinants, along with low cost labour, tax holidays and political and economic stability. Moreover, EPZ operations are noted to be rather footloose, relocating as wages and other costs change.

Zanzibar has been experimenting with EPZs since 1992, albeit with little success. As chapter II showed, free zone incentives include generous tax holidays and import tax exemptions. However, instead

of attracting FDI, the latter, which may be 50 per cent lower than in mainland Tanzania, have encouraged large scale smuggling and tax evasion.

Privately-operated EPZs or industrial parks, modeled after the Asian experience, has been suggested. Asian investors would provide the skilled labour, park management, as well as trade links. This could be an effective way of getting around the resource and managerial constraints of NDC.

Recommendations

FDI prospects into Tanzania and the successful progress of the EAC are closely related. There are already signs of TNCs with operations in Kenya expanding into Tanzania. For both existing and new investors an open regional market is critical for attracting FDI inflows. The larger market size will also ensure greater commitment by investors and lead to a greater level of strategic as opposed to short term and opportunistic investment.

It is important that member countries recognize their respective objectives and problems in creating a unified market, and learn the lessons from the 1977 demise of the EAC. Although there are many potential pitfalls ahead, Tanzania should be wholly committed to the notion of a unified East African market and constructive in ensuring its successful implementation. Even if progress is slow in introducing a free market across East Africa, TNCs will be reassured by positive signals from policy makers and harmony in negotiations.

In order to net gains from the EAC, Tanzania requires a sustained effort to improve its cost competitiveness. It should therefore focus on areas of actual or potential competitive advantage, as detailed elsewhere in this report.

Tanzania needs to recognize the problems faced by foreign and indigenous manufacturers in competing with Kenya. While moves to the elimination of tariffs and non-tariff barriers need to be made cautiously to avoid a surge of imports, it is important to resist demands for continuing protection.

In respect of SADC, foreign investors are unlikely to see significant opportunities for intra-regional FDI in the short to medium term. Aside from active participation in and promotion of SADC initiatives, Tanzania must improve its transport (road, rail, port) infrastructure in the south of the country if it is to achieve its potential as a gateway into the region.

In order to exploit the larger EAC market and other opportunities opened through the various market access initiatives, greater attention needs to be paid to the development export capacity, including assisting indigenous industry to attain export-quality production level and attracting export-oriented FDI. To facilitate this, export and import procedures need to be improved and streamlined. Implementing the recommendations of the BEST programme is important in this respect.

6. Policy coherence, consistency and coordination

Although Vision 2025 proposes an important role for FDI in Tanzania's development, a major barrier to its implementation stems from the fact that there does not appear to be complete "buy-in" at the

level of different Ministries and Departments. This leads to different and sometimes conflicting interpretations about the role FDI in the economy and the policies to be pursued. Furthermore, due to Tanzania's socialist past, the civil service has been slow in fully committing itself to the private sector reform process, with little understanding and appreciation of the needs of the private sector. Large-scale retrenchment in government employment, moreover, has led to concerns over job preservation and resistance to changes.

In respect of FDI, the outcome of these problems is "turf wars" among the various parties involved in attracting foreign investment. The problems are associated with a continuing regulatory culture, conflicting policies and regulations, as well as inconsistency in implementation.

The major public sector institutions involved with FDI are listed in box III.6. Their involvement with FDI relates principally to investment facilitation and investor services activities, although some (for example, the PSRC and the Ministry of Energy and Minerals) are also involved with FDI attraction. The PSRC / TIC relationship appears relatively problem-free, the former is routinely informing TIC when privatization tenders are advertised. Once privatization is approved by PSRC, the TIC takes the lead in respect of incentives, work permits, etc. Both TIC and PSRC also undertake joint missions abroad.

Coordination between TIC and the Ministry of Energy and Mines relationship, especially in terms of investment attraction, could be strengthened. The Ministry actively promotes mineral development through the organization of local investment promotion conferences and participation in international investment promotion events around the world. More than specific country targeting, the focus is on the "juniors" who are considered more flexible than bigger mining TNCs. It is important that the TIC has a role in these marketing activities. More generally, there is scope across the board for coordinating policies on localization of employment and the promotion of linkages.

The main problem areas concern investment facilitation and investor services, on which TIC works chiefly with 4 key Ministries: namely, the Customs and Excise Department of (TRA); the Ministry of Lands; the Department of Immigration of the Ministry of Home Affairs; and the Ministry of Industries and Trade (MIT). As chapter II shows, the secondment of staff from a number of Ministries to the TIC has significantly improved the service to investors. In other areas, however, there is still much room for progress.

Relations between the TIC and the TRA had been particularly problematic, especially with regards to the definition of capital goods. Other issues concerned investment incentives, the carrying forward of losses, capital and other allowances, and the assessment and collection of duties on imports and exports. Most of these differences have since been resolved at a high-level meeting chaired by the Minister of Finance in January 2000 and the subsequent establishment of a 6-member working committee comprising of TRA deputy commissioners and TIC managers. This committee was charged with resolving investor-related problems. The problematic interpretation of capital goods is handled by another committee composed of Commissions, chaired by the Deputy Permanent Secretary of Treasury. The TIC is Secretary to this committee. Thus far, the arrangements seem to be working well.

There may also be difficulties over labour issues, especially the allocation of work permits for expatriates, which needs to be balanced against the undoubted need to promote local employment and

training. Both the PSRC and the Ministry of Energy and Minerals explicitly and actively promote local employment and training.

Box III.6. Major public sector institutions involved in FDI

Institution	Role in FDI
Tanzania Investment Centre (TIC)	Co-ordinates, encourages, promotes and facilitates FDI; and provides advice on investment-related issues.
Presidential Parastatal Sector Reform Commission (PSRC)	Promotes privatizations of state –owned enterprises to domestic and foreign investors; mandate ends in 2003.
Planning Commission	Oversees planning issues that affect Government policy and co-ordinates work with other Ministries; TIC and PSRC report to Planning Commission.
Ministry of Industries and Commerce	Wide-ranging mandate including SMEs, external trade, intellectual property rights, sectoral developments and competition policy
Ministry of Energy and Minerals	Oversees energy and mineral development, including FDI promotion in mining;
National Development Corporation (NDC)	Oversees heavy industries, including power projects EPZ and industrial park development
Tanzanian Revenue Authority (TRA)	Collects central governmental revenue and enforces tax laws
Ministry of Lands and Urban Settlement	Planning regulations, land allocation and site development; Land Act 1999 to be implemented.
Ministry of Labour	Labour laws, conditions of employment, work permits.
Ministry of Home Affairs	Immigration issues (Department of Immigration).
Business Registration and Licensing Agency (BRELA)	Business licensing and business registration.
Planning Commission/Office of the President	Recommended in BEST Programme to be charged with proposed Better Regulation Unit.
Court system	Commercial dispute resolution: includes Court of Appeal, High Court (including Commercial Court set up in 1999), District Court, Residual Magistrates Court, etc.

Many of these issues are identified in the BEST programme, with a timescale in place for their resolution. The establishment of both the TNBC and the NISC (see box III.7) should contribute substantially in resolving these problems. Similar institutional arrangements and mechanisms have been successfully used in other countries to facilitate FDI.

Recommendation

The efficient and effective functioning of the NISC as a crucial mechanism to ensure policy and institutional consistency and coordination should be assured.

Box III.7. National Investment Steering Committee (NISC)

Because there are several institutions dealing with FDI in Tanzania there is considerable scope for conflict in terms of policies, treatment and information. At the recommendation of a comprehensive UNIDO study, endorsed at a national workshop on investment regulations, the *National Investment Steering Committee* was set up by the President in September 2000 to ensure co-ordination and consistency among the different Government ministries and institutions. Chaired by the Prime Minister, membership includes the Ministers of Finance, Planning, Agriculture, Industry and Trade, and Lands and Settlement Development, as well as the Attorney General, the Governor of the Central Bank and the Executive Director of TIC. The Committee is responsible for identifying and resolving legal, regulatory and administrative barriers to investment; for addressing legal and administrative issues involving two or more ministry/government agencies; and for building the confidence of investors.

Linked to the BEST Programme (box III.4) and the TNBC (box III.5), the NISC was launched in mid-2001 as the major mechanism for resolving immediate problems and for removing blockages; and equally important, for ensuring that the systems are put in place to address and eliminate underlying difficulties. This will require the establishment of a transparent and effective legal and regulatory framework on investment.

As at end 2001, the NISC has held three meetings and has dealt two issues of cross-sectoral interest, namely the Dar-es-Salaam Waterfront Project and the construction of Central Corridor Road under BoT arrangement.

CHAPTER IV. ENHANCING THE TECHNOLOGICAL IMPACT OF FDI

Tanzania is one of the few African countries to have given consistent priority to science and technology in its national development strategy. Since the establishment of the Tanzania National Scientific Research Council (TNSRC) in 1969, policy guidelines for the promotion of science and technology have been formulated and implemented at the highest level of Government machinery.¹ Despite concerted efforts, however, to date the level of local technological capability has remained low. Technology policy needs reform to match reforms in investment and trade and to enhance the technological impact on FDI.

The recent FDI inflow to Tanzania, along with the surge in domestic investment induced by the shift to a market economy, have opened up opportunities for technology transfer, diffusion and learning through linkages and spillover effects. Some transfer of technology and skills are taking place (as shown in Chapter 1). The challenge is to enhance these positive impacts by strengthening the ability of domestic enterprises to acquire, master, adapt and assimilate technology. Building a dynamic domestic enterprise sector is an essential condition for increasing the contribution of FDI.

A. Tanzania's technology policy framework

The Government's vision of the role of science and technology in national development strategy was first elaborated in its National Science and Technology Policy (NSTP) of 1986.² It reflected the policy orientation pursued at the time, which overall objective was to reduce dependency on foreign technology suppliers by regulating technology flows and promoting domestic technological capability.

The 1996 revision to align the NSTP with the shift from a planned to a market-oriented economy actually introduced very little change. As a result, the current NSTP still reflects many of the pre-liberalization objectives, vision and priority areas. The structure and functions of science and technology support institutions have also remained unchanged. The only difference is that detailed and ambitious sub-sectoral activities - especially in the manufacturing sector, which were included in the 1985 policy document - are no longer retained as priority areas. Therefore, technology policy reform has lagged behind other policy reforms, especially those of investment-related policies. Officials in Tanzania recognize this inconsistency in the sequencing of policy reforms. According to a TIC senior official, for example, "the issue of technology policy and how it fits into the new investment environment has not yet been seriously addressed".³

The main objectives and features of the existing policy framework are:

¹ For example, at present, the highest policy-making body on science and technology-related issues is the Ministry of Science, Technology and Higher Education (MSTHE), which also has the mandate to formulate and implement policies on higher education. In addition to providing the overall policy guidance on science and technology, MSTHE is also responsible for the coordination of a number of public sector support institutions, including the Tanzania Commission for Science and Technology (COSTECH).

² In 1986, the Tanzania Commission for Science and Technology (COSTECH) was also established replacing TNSRC, and with a wider and clearer mandate to promote science and technology in the country. Under the direction of MSTHE, it advises the Government on priorities in scientific research; the allocation and utilization of research funds; policies on R&D and transfer of technology; and the training and recruitment of research personnel.

³ Interview with the Head of Investment Promotion/TIC, March, 12, 2001

- Building domestic research and innovation capacity through state funding of public sector R&D institutions. Up to 1 per cent of GDP was earmarked for expenditure on R&D, although in reality, annual total expenditure on R&D never exceeded half of the targeted figure. Moreover, R&D is conducted almost entirely in the public sector, either in specialized centres, state enterprises and ministries. Independent studies of the country's R&D capacity show that it is de-linked from the private/productive sector and contributes little or nothing to technological adaptation and upgrading at the firm level (see for example, Mlawa, H.M, 1999). In effect, therefore, the present policy was primarily designed to promote science-based, public-sector controlled R&D capability. Little attention has been paid to the technological needs and activities of enterprises.
- Centrally determined R&D priority areas. At present the Tanzania Commission for Science and Technology (COSTECH) identifies the priority research areas and deciding on allocation of state funding under the overall policy guidance of the Ministry of Science, Technology and Higher Education (MSTHE). A quick glance at the long list of research priority areas indicates that the choices of sectors and specific areas of research are not based on thorough analyses of the technology needs or problems of production enterprises, nor on a coordinated priority-identification exercise, for example with the priority sectors identified for investment promotion. The selection of priority technology areas of research is, therefore, supply determined rather than demand driven.
- Monitoring and regulation of technology flows with a view to encouraging the transfer of "appropriate" technologies. To implement this policy objective, the Government established the Centre for the Development and Transfer of Technology (CDTT), for which primary responsibility was "establishing rules and regulations for rationalizing the acquisition, evaluation, choice, coordination and development of technology; as well as conceiving policy measures that will facilitate an enabling environment for technology autonomy and sustainable development." In principle, therefore, the existing policy still upholds a "regulatory" approach with a view to monitoring the types of technology imported. MSTHE also believes that some of the existing technology regulatory mechanisms must be retained and strengthened as there is "a danger that import liberalization may encourage the flow of inappropriate technologies" into the country.⁴ However, the new investment code provides for unrestricted technology flows, thereby overriding the mandates and functions of CDTT. Investors that qualify for benefits can now import machinery and capital equipment free of import duty. In effect, therefore, at present, there is both confusion and a mismatch between investment and technology policies – giving potential investors conflicting signals about government intentions and policies. This ambivalence must be addressed urgently in order to ensure policy consistency and avoid presenting contradictory messages to potential investors.
- Local capacity in technology infrastructure. Over the past three decades, Tanzania has established a number of specialized technology-related institutions which provide support, mainly to state enterprises, in such diverse areas as technology selection, adaptation, innovation, and assimilation as well as productivity improvement, standard-setting, repair and maintenance and training (box IV.1). Some of the institutions were established through an Act of Parliament, but most are attached to ministries or state enterprises. Nearly all are State-owned; many established and subsidized with donor support. Studies examining the impact of these institutions show that they have little

⁴ Interview with high-level officials at the MSTHE, 19 March 2001.

contact with the private sector (see for example Lall, 1999 and Wangwe, 2000). With liberalization and the privatization of state enterprises, the position and viability of some of these institutions have become unclear. It would seem, moreover, that those heavily dependent on donor support – the majority – were more affected as funding was cut or switched to other uses. Recent government efforts to encourage these institutions to sell their products and services to the emerging private sector have been unsuccessful. This is partly because of lack of confidence in the quality of goods and services provided by local support institutions, especially now that better technologies and services can be easily imported, and partly because the institutions themselves have little experience in marketing their services in an open and competitive market environment. However, this should not be interpreted to mean that the existing technology support institutions are irrelevant or have no role in the new liberal market environment. To the contrary, the core competencies and capability accumulated are relevant for the needs of Tanzanian enterprises. The problem seems to lie in two areas; first, lack of awareness of private-sector needs and of changing market conditions; and secondly, lack of resources, poor management and motivation, and uncertainty associated with the reduction in the state sector. Therefore, the immediate challenge facing the Government is how to build on existing technology infrastructure capacity to create a market-oriented and private-sector focused technology support system.

Box IV.1. Technology support institutions

A sample of the types of technology support institutions in Tanzania is presented below. The list is not exhaustive but indicates the diverse areas in which support institutions are present.

- Tanzania Industrial Research and Development Organization (TIRDO)
- Tanzania Bureau of Standards (TBS)
- Centre for the Development and Transfer of Technology (CDTT)
- Tanzania Industrial Studies and Consulting Organization (TISCO)
- Institute for Production Innovation (IPI)
- National Construction Council (NCC)
- Building Research Unit (BRU)
- National Radiation Commission (NRC)
- Small Industries Development Organization (SIDO)

In short, the present technology policy and the structure of the technology support system still reflect the economic philosophy and objectives pursued prior to liberalization. The policies pursued in the past paid little attention to the technological needs and problems of the enterprise sector, particularly private-sector enterprises. They failed to encourage linkages between local R&D capacity and the productive sectors. Instead of promoting local technological learning, as initially envisaged, regulating technology transfer from abroad may have restrained technological development as demonstrated by the country's continuing dependence on imported technology and skills.

B. The direction of policy reforms required

In line with Tanzania's Development Vision 2025 and investment policy reforms, it is imperative that the Government further reform the National Science and Technology Policy with a view to making it compatible with the current strategy of private-sector-led development.

Further reforms in the NSTP should aim to refocus the direction of policy objectives into the following areas:

- Technology activities at the enterprise level. Technological learning and technology upgrading in a host country takes place only when domestic enterprises acquire the capacity to understand, use, improve and assimilate technologies that are transferred either as part of FDI and/or through direct imports. This, in effect, means designing technology policy that encourages and supports the efforts of local enterprises to upgrade their skill and technology capability. The specific policy measures may, for example, include direct fiscal incentives for enterprises acquiring more advanced technology and/or introducing a technical training programme; easing credit access for enterprises manufacturing and exporting higher-valued products or establishing backward linkages with foreign affiliates; providing information on technology; establishing specialized institutions to facilitate support in areas such quality control, standards, marketing, inter-firm partnership, and other aspects essential for improving productivity and technological capability. It would also mean reviewing the current Government policy on R&D with the view to ensuring that such a support is performance related and subject to effective linkages with the productive sector.
- Selection of priority technology areas for R&D must be based on enterprise needs and market demand structure. In other words, demand driven prioritization of technology development policies and allocation of public resources. The current technology policy in Tanzania lumps scientific research and technology development together and pays little attention to technology upgrading at the enterprise level. This approach needs rethinking. Policy makers should bear in mind that the immediate economic priority in Tanzania lies mainly in technology upgrading by productive enterprises, rather than basic scientific research isolated from the productive sectors, and that most the technological activities necessary for improving productivity and attaining competitiveness takes place at the enterprise level. The current pattern of FDI inflows, especially its sectoral distribution, can be a useful indicator of the priority areas for technology and skills development. In addition, regular consultations with the enterprise sector can provide a more relevant information on the technology needs of the productive sector in the country and can help identify the specific technology-related constraints and the areas in which state support through R&D should focus.
- In a market-based economy, compatibility and complementarity between technology and investment policies are essential requirements for enhancing the impact of investment on economic growth and competitiveness. This means that the existing regulatory measures implicit in Tanzania's NSTP must be revised. Institutional mandates, such as that of CDTT, also need to be reoriented from regulatory to supportive functions. Focus should be on technology upgrading in domestic enterprises, including linkage promotion programmes aimed at increasing and deepening interactions between foreign affiliates and domestic enterprises. Such programmes, common in many developing countries, promote technology diffusion by increasing information flows in the enterprise sector and also through matchmaking. The latter involves identifying domestic enterprises that have the actual or potential capacity to forge backward linkages with foreign affiliates on the one hand, and collaborating closely with potential or actual foreign investors on the other to encourage their interest in setting up partnership with domestic enterprises. As noted above, in Tanzania, the “Fiscal Stability Agreement” that the Tanzanian Government has signed with a number of foreign investors in the mining sector could serve as a model.

- Building market-oriented and coordinated technology support infrastructure. This task would require streamlining and restructuring the existing technology support infrastructure. In some cases, there may be a need for closing down ineffective technology institutions. In other cases, what is needed is simply a through overhaul of institutions and a clear definition of their objectives. In a few cases, for example, support institutions operate more like manufacturing units than providers of technology support services. A case in point is the Institute of Production Innovation (IPI) which was established in 1981, initially as a department and subsequently as an autonomous institution within the University of Dar-es-Salaam, to develop product prototypes and transfer technology to industry and also provide constancy service to domestic firms. Despite the attractiveness of the concept of University and industry links and the focus on innovation, the interaction between enterprises and the Institute has been limited with the exception of a few well-publicized cases. Moreover, the Institute began to produce simple machines (sugar milling, oil processing, grain milling, solar heating) for sale on the market which, in essence, means it has become a manufacturing unit rather than a technology development centre as initially envisaged. Not surprisingly, now local firms regard the Institute as a competitor rather than a technology support institution. Similar trends are also observed in other support institutions creating poor image of public sector support institutions among local firms.

C. Conclusions and recommendations

1. Technology development and policy framework

The 1996 NSTP should be brought into line with the policy changes in other economic areas, particularly investment policy. The broad direction of changes required is outlined in Section C above. The need to give a prominent role to private sector development and enterprise technological activities is the most important of the adjustments required in the technology policy framework. In addition, particularly in less developed markets, clearly defined and targeted policy measures tend to be more effective than generic policies. Therefore, where possible, the new technology policy framework should clearly identify policy instruments, the target audience, the desired outcome and the means of policy delivery.

Ultimately, the impact of technologies transferred by foreign affiliates is measured by the extent to which local technological learning takes place through the diffusion of technologies and skills to domestic enterprises. Although the market mechanism is often the most effective instrument for technology diffusion, in less developed economies like Tanzania - where the market is still at an earlier stage of development - there is a need for establishing a “subcontracting exchange” programme aimed at promoting linkages between foreign affiliates and domestic enterprises. Such a programme – to be managed jointly by TIC and COSTECH - would serve as a bridge between foreign affiliates in the country and domestic enterprises by providing information on prospective domestic suppliers and maintaining a register based on a technical evaluation of the capabilities of potential supplier firms.

In terms of technology transfer, the main focus of technology policy should shift from regulating technology flows to information provision to enterprises, particularly SMEs, on sources, costs and appropriateness of foreign technologies. In this respect, it is recommended that Tanzania should set up, with the assistance of and in close consultation with relevant international development agencies such as UNIDO, a “one-stop technology information unit”.

The primary objective of the unit would be to provide, upon request, information and specific advisory services on the sources, quality and appropriateness of technologies and equipment acquired by domestic enterprises. In the absence of private sector entities to provide such services, it is recommended that the Government, if possible in partnership with a private sector investor, should establish the unit. Access to information and advisory services provided by the unit should be on fee paying bases. However, at the initial stage, the Government should consider the option of providing free information and advisory services to small-scale productive enterprises.

The new technology policy should identify specific incentives for R&D by private enterprises. In terms of fiscal incentives, the possibility of granting tax deductibility to the amount of the enterprises' expenditure (100 per cent) and even more than the total expenditure in cases where new products are generated and commercialized should be seriously considered. To assist in this process, the possibility of establishing a "Technology Fund" to co-finance enterprise R&D (for example, on a 50-50 basis) should be considered. The Technology Fund should provide resources as a conditional loan, to be repaid by successful ventures.⁵

The technical skills base of Tanzania is small and it needs to improve if the country is to continue to attract additional FDI and build competitive enterprises. As a matter of priority, the Government must launch a "skill strategy" aimed at creating competitive skills and easing the shortage of skills in areas that are potentially attractive to FDI. The stimulation of enterprise-level learning and training is a key area of policy intervention that needs to be undertaken as part of the new "skill strategy". This requires both concrete incentives that encourage enterprises to undertake in-house training and the launching of concrete campaigns to inform domestic enterprises, especially small- and medium-sized enterprises, of the benefits of, and the need for, employee training to be able to upgrade technology and cope with the intense import competition.

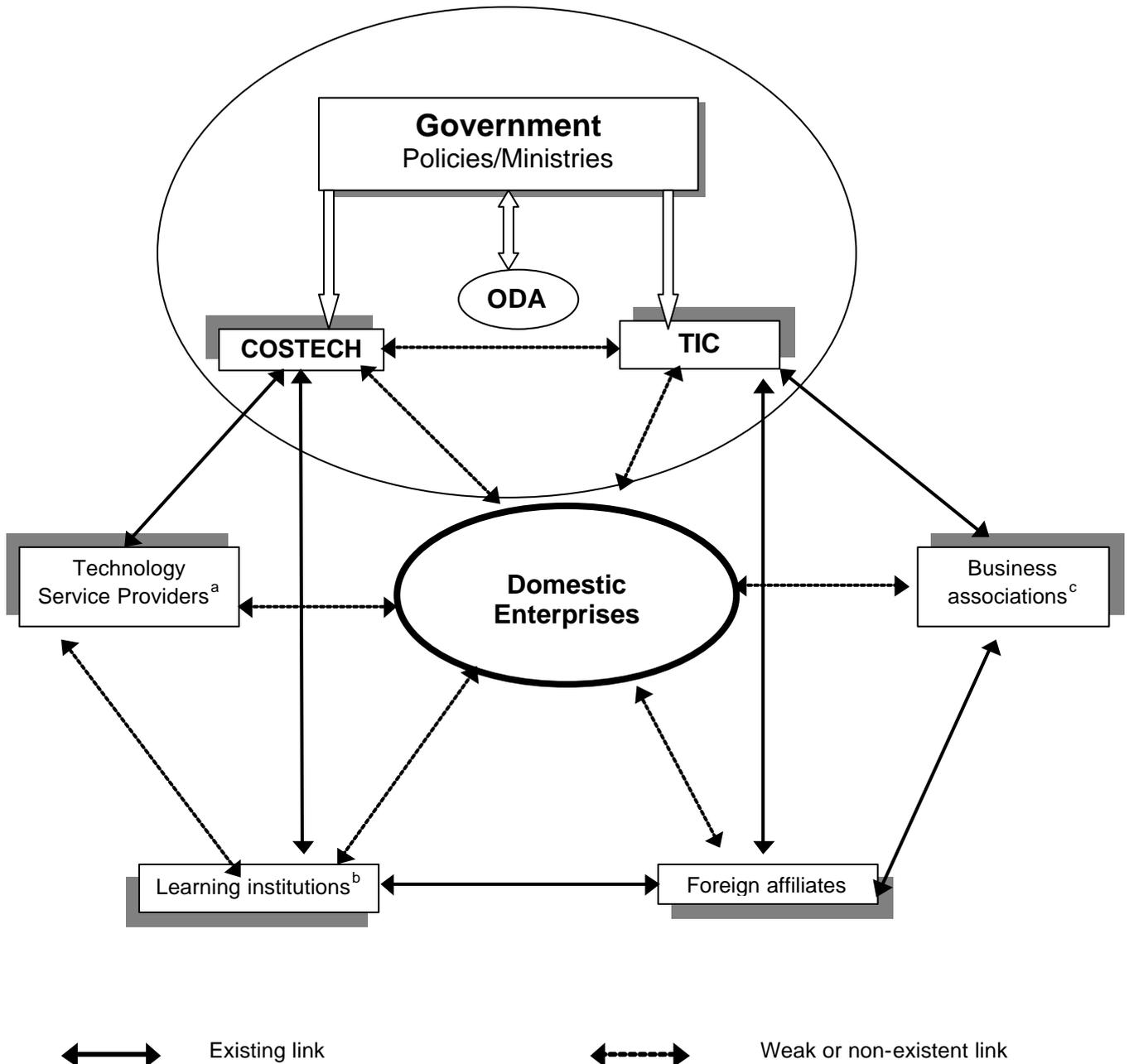
Enterprise focused technology policy requires an integrated and systemic approach to policy formulation and implementation. It also requires a network of support institutions, whether at the national or regional levels, that provide technical services and influence the technological behaviour of enterprises. An example of the type of "National Technology and Innovation System" that Tanzania may need to build is presented in figure IV.I. It shows some the key policies/actors/institutions that influence the process of technology upgrading and innovation by enterprises. The most important aspect of the system is the interactions among the various elements in the system and between them and the enterprise sector. Even if single elements of such a system are strong, the system as a whole may be weak either because the failure of policies to stimulate interaction or lack of coordination between the various parts in supporting enterprises. Only by applying such a systemic perspective and formulating policies that stimulate interaction in the system and encourage the active participation of the private sector can technologically weak economies like Tanzania be able to develop a dynamic enterprise sector and maximize the impact of FDI.

2. Technology infrastructure

Enterprises do not innovate or upgrade technology in isolation but in response to and interaction with technology suppliers, customers, other enterprises, but above all, specialized

⁵ While this raises the risk of losses if a large proportion of the projects fail, experience in other countries suggest that the risk is quite small. In addition to stimulating R&D activities by enterprises and the benefits that they would drive from it, enterprises would not deliberately take the risk if they are required to put up half of the capital required to initiate the project. Such a Fund could be initiated with the assistance of donors.

Figure IV.1. National System of Innovation of Tanzania



^a National Centre for Development and Transfer of Technology (NCDTT), Centre for Agricultural and Rural Technology, Tanzania Bureau of Standards (TBS), Tanzania Engineering Manufacture and Design Organisation, Tanzania Industrial Research and Development Organisation (TIRDO), Tanzania Industrial Studies and Consulting Organisation (TISCO), etc. ;

^b University of Dar es Salaam, Sokoine University of Agriculture, Institute of Technology, etc. ;

^c Tanzanian National Business Council (TNBC), Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA), Confederation of Tanzanian Industries (CTI), and Tanzanian Private Sector Foundation (TPSF).

technology institutions that provide services in diverse areas such as quality control, testing, standards, technical training, finance, information, benchmarking and so on. In Tanzania, this infrastructure - consisting of a number of public sector institutions - has been generally ineffective in generating linkages with the private sector and in promoting technological capability. There have been some attempts to reform and improve the main institutions in recent years but in the absence of active Government support the results so far have been less effective.

In addition to revising its science and technology policy, Tanzania needs to strengthen its technology infrastructure by improving – on selective basis - the performance of existing institutions and building new capacities where essential services are missing. In the absence of credible private sector entities capable of providing technology-related services, public sector institutions will need to continue to carry out such services. To that end, it is recommended that the Government undertakes a major restructuring and overhauling of the existing technology-related institutions with a view to identifying those that provide essential services and need strengthening and those which are ineffective and should cease to operate. At the same time, the scope for private sector involvement in the provision of technology extension services and the means for promoting it should be explored.

The Tanzania Commission for Science and Technology (COSTECH), for example, is one of the institutions that should be strengthened since it can be a vital agent of technological change and linkages between FDI and domestic enterprises. It was established in 1985 to manage science and technology policy and coordinate R&D activities in the country. Unfortunately, it has not been able to fulfill this role due to resource constraints, lack of adequate skilled personnel and the difficulties in mainstreaming science and technology policies across sectoral ministries. It is essential that its capability is enhanced and its ability to implement technology policy greatly strengthened. This can be achieved by:

- raising the skills and resources available to COSTECH. One of the consequences of resource problems, for example, is that the salary levels of COSTECH staff is low, especially compared to the pay structure in the private sector, and this is affecting staff motivation and the ability of the agency to attract and retain skilled technical and management personnel.⁶ If it is to serve as an effective agent of technological change, then its resource problems must be dealt with urgently.
- improving COSTECH's information processing and analysis capacity. As an organization responsible for advising the Government on scientific research and technology priorities, access to reliable and `best practice` technology-related information is critical for performing its functions efficiently. At present, the information and analysis capacity available to it is inadequate and needs to be strengthened. The establishment of an information unit proposed above could help remedy this problem;
- generating greater awareness about the need for technology upgrading and the critical role of technology policy for long-term growth and competitiveness within the private sector and among all levels of government. This will facilitate COSTECH's task in mainstreaming technology issue across all key agencies dealing with – industry, finance, agriculture, health, education, mining, infrastructure and enterprise development.

Another important support institution, which requires special attention, is the Tanzania Bureau of Standards (TBS). The capacity to produce higher quality products, especially at internationally recognized standards, improves competitiveness and assists in attracting FDI.

⁶ This is a common problem faced by all public sector technology institutions and needs serious consideration.

Despite the operations of TBS - which currently focuses on metrology, standards, testing and quality functions - quality consciousness among Tanzanian enterprises is at present very low. Indeed, by mid 2000, only two enterprises (a soft drinks firm and battery manufacturer) have been awarded ISO 9000 certification. Most firms, especially SMEs, are not aware that such certification exists. It is recommended that TBS should be reorganized with a view to strengthening its standards setting and awareness generating roles and upgrading its accreditation capacity to international standards while reducing its testing facilities and functions. At the same time, the Government should seriously consider encouraging the private sector to develop testing capacity. At present, about 70 per cent of TBS's budget comes from the provision of testing services, suggesting that the market exists for an early entry of the private sector in this field of technology service.

For services relating to technology selection, the development of appropriate technologies, efficient use of energy, advisory service in the application of clean technologies and the provision of repair services for instruments, the most important support institution in the country is the Tanzania Industrial Research and Development Organization (TIRDO). Although it has existed since 1979, the consensus view is that its overall impact on technology development has been limited. Indeed, in recent years, the organization has been paying less attention to core activity – which is to assist enterprises in upgrading and generating technology – and has been instead concentrating on equipment maintenance and repair services in order to generate income. About 58 per cent of the organization's revenue is now generated from selling maintenance services in the market. While this is commendable, it should be noted that there are a number of private sector enterprises that provide these services and the need for a public sector institution such as TIRDO to provide repair services is not clear. However, in the absence of private sector entities to assist enterprises, particularly SMEs, to upgrade technology and select efficient technologies, there is a need for a supporting institution like TIRDO. In restructuring TIRDO, therefore, the first task should be to ensure that it maintains and strengthens its core activities and generates demands for its services through pro-active marketing strategy. At the initial stages of the restructuring process, Government support in terms of time-bound financial assistance will be necessary. Additional measure to be taken will include improvement in management and technical capability, developing competence after-sale services and strengthening linkages with private enterprises. The idea here is not simply to pump in additional funds or grant without clear objectives or strategy, but to suggest well planned and time-bound restructuring exercise to ensure improvement in performance and relevance to the needs of enterprises.

In order to enhance the technological impact of FDI in Tanzania, it is necessary to build the capacity of SMEs, which consist the majority of private sector enterprises, to interact with foreign affiliates and acquire, operate, adapt and upgrade technology. In Tanzania, the Small Industries Development Organization (SIDO) is responsible for providing institutional support in diverse areas including marketing, skills formation, credit delivery and transfer of technology. SIDO has established up to 14 industrial estates as well as three training-cum-production centres. As with TIRDO, there is a need for restructuring this institution to make it more focused and more relevant to the needs of enterprises. This again needs a strategic plan that looks at its approach, staff motivation and skills and overall capability. The logic for SIDO to operate industrial estates – which could easily and perhaps more efficiently be owned and managed by private entrepreneurs – is not clear. The Government should encourage, through attractive incentives, private investors to take over and manage the industrial estates. SIDO's activities should focus on reaching SMEs with programmes of technology, training and marketing assistance and the promotion of subcontracting, especially with foreign affiliates.

Production-related innovation is carried out by the Institute of Production Innovation (IPI), as mentioned above. The recommendation for restructuring also applies to IPI which has, over the years, drifted away from its initial objectives – that is to develop product prototypes, transfer technology to industry and generally provide technical advises to enterprises. These are essential services badly needed by private sector enterprises. IPI recognizes the need to adjust to the new market system and has, in fact, tried to respond by manufacturing simple machines for sale on the market. However, this makes it a competitor to private enterprises rather than a technology transfer agency. It is recommended that IPI should focus on its original objectives and should develop an outreach campaign aimed at winning the trust and confidence of private sector enterprises and understanding better their needs and technology-related problems. Until the institute is able to establish credibility among private sector enterprises, Government financial assistance will be necessary, especially for upgrading equipment, developing marketing capability and attracting skilled personnel.

For the immediate future, the best option open for Tanzania in dealing with technology infrastructure is to restructure and rationalize existing institutions by strengthening those that provide essential services not available in the private sector and phasing out duplicative and less essential services. The institutions mentioned above are only a few of numerous technology-related support institutions scattered across ministries and attached to major public sector enterprises. But, the recommendations elaborated above should serve as a basis for other institutions as well.

CHAPTER V. CONCLUSIONS AND RECOMMENDATIONS

Tanzania has emerged from a lengthy period during which state ownership and control dominated most aspects of economy and society. After a hesitant start, the reform process quickened in the late 1990s, characterized, among others, by improvements in the investment framework, successful privatisation and an upturn in economic growth and other macroeconomic indicators. The new investment climate is attractive to foreign investors as evidenced by increased FDI inflows. But these inflows have not yet reached the levels satisfying Tanzania's needs and expectations and, most importantly, potential.

Tanzania's long term FDI goal should be to develop from its present "trickle-in" phase to achieve a position as an attractive FDI location in Eastern and Southern Africa. There is need to sustain current inflows and attract new FDI, which will be a particular challenge at a time of global slowdown. At the same time, with sustained flows of FDI, the economic contribution should be planned to expand and widen, from its limited capital investment and employment effects as at present, to include a substantial export contribution and a significant level of technology transfer into the indigenous sector through the creation of local linkages and other mechanisms.

Thus, the strategy for FDI and the expected benefits from FDI must distinguish issues of investment attraction and economic contribution. In the short term, levels of FDI inflows can be increased by further improvement in the investment framework and by imparting a select number of strategic thrusts. In the medium and long term, a range of economic contributions will be enhanced as broader policy initiatives are put in place and the market economy develops.

Objective 1: Strengthening the investment framework

Over the past decade Tanzania has, with some rapidity, been moving from the constraints of a centrally planned economy to a more open, market-based, regime for investors both local and foreign. The continuing process of change has outpaced reform of the statute book. There is need to enact new legislation:

- Laws and regulations from the time of the centrally planned economy should be replaced with laws and regulations compatible with the requirements of the market economy and Tanzania's competitiveness. This includes in particular employment and labour laws, the commercial and contract law (including new companies act) and tourism and fishing industry regulations, as well as a new arbitration act.
- The Competition Act of 1994 should be reviewed and amended, if necessary, to reflect, among others, the implications of the increased presence of foreign companies in Tanzania. A Competition Authority should be established.
- The existing law embodied in the 1997 Investment Act has become increasingly dysfunctional. The Act should be replaced by a new, modern act reflecting current conditions inside and outside Tanzania.

- The network of BITs and DTTs should be expanded, especially to include actual and potential home countries including dynamic developing countries from Asia and the African region.

Objective 2: Reducing cost of doing business

To stimulate both foreign and domestic investment, policy emphasis must continue on reducing the high costs of doing business. The analysis and recommendations of the BEST Programme provide a clear pathway for achieving these aims pointing clearly to the need of creating an enabling environment for investment. While the implementation of all the components of the programme is essential, priority from an FDI perspective should be given to the following:

- Regulatory improvements in the areas of central and local taxation, land planning, allocation and site development, labour laws, business licensing and registration, import/export procedures, as well as sector-specific regulations. The establishment of a Better Regulation Unit within the Civil Service Department is important to ensure implementation.
- Improving commercial dispute resolution. This will include enhancing the accessibility of the Commercial Court; simplifying court procedures; and designing an anti-corruption strategy for the Courts.
- In addition, the recently launched National Business Council has an important role to play in the efforts to remove barriers to efficient business operations. It should meet regularly with identified problems being followed up vigorously. The early launching of the National Investment Steering Committee is also recommended as a crucial mechanism to ensure policy and institutional coherence and consistency.

Objective 3: Ensuring continued success of privatization

The Tanzanian privatization programme has been successful to date. It has been a major source of FDI; it is helping to build the market economy and investor confidence; and it has encouraged sequential FDI in, for example, services. Critical issues are:

- The privatization of the utilities needs to proceed as rapidly as possible in order to reduce costs and improve services to businesses and consumers. The timescales currently in place need to be adhered to.
- The National Development Corporation (NDC) has an important role in developing power and associated infrastructure, but it needs resources and capabilities. The secondment of private sector executives to NDC should be investigated. Links with the TIC should be enhanced.
- Privatization policies need to be matched by policies to deal with redundancies/retrenchments associated with rationalization or the closure of non-viable enterprises. Such policies could include encouragement of small business start-ups to create jobs and a fund to temporarily support and retrain displaced workers.

- The countries in the Far East, over the last two decades, have undertaken successful privatisation of public utilities (roads, electricity, water, sewerage, ports etc). The Asia Africa Investment Technology Promotion Centre (AAITPC) could help build a bridge between Asia investors and Tanzania.

Objective 4: Implementing effective infrastructure development

Infrastructure offers opportunities for foreign investment and other forms of foreign involvement, including roads, airports and ports:

- In airports, the experience gained with Kilimanjaro International Airport should be used to develop a partnership model that is attractive to foreign investors and beneficial for the country.
- Dar Es Salam Port's full potential as a major shipping and cargo centre should be explored. Among the possibilities are for DAR Port to become a centre of excellence for port services, by either joint venture or hiring the appropriate expertise and full government commitment. In addition, the DFZA authority, or the DAR Port Authority (DPA) itself, could create a "Trade Corridor of Excellence" between Tanzania and neighboring land locked nations that utilise DAR Port as one of their import or export channels. This could be initiated through "inland ports" within these countries, either fully owned by the DFZA or DPA or in joint venture with domestic agencies. If this is done efficiently and helps to accelerate movement of goods and reduces costs, DAR Port could emerge as a major hub for trade in the Region.
- Instead of pursuing the path of creating separate industrial parks and export processing zones (EPZs) in mainland Tanzania, consideration should be given to a "Multi Facility Economic Zone" to cater for domestic production, partial export and fully export oriented industries. The MFEZ concept (see box V.1) is to provide the best possible business environment within a limited geographic area, including infrastructure, a regulatory regime as envisaged in the BEST Programme and efficient administration. The cost can be shared with the private sector, particularly if the project is offered a special package of incentives, including a 10-year tax holiday.
- In the medium and long term, if the initial MFEZ proves successful, a number of MFEZs should be encouraged at different strategic, geographic locations to create multiple "Engines of Growth". MFEZ status / facilities can also be extended to other areas of large-scale economic activity that could include the creation of townships, e.g. large mining areas.

Objective 5: Stimulating human resource development and linkages

Human resource development, and policies to encourage the transfer and diffusion of technology, and linkages and partnerships with foreign investors are essential. Lack of vocational and technical skills places Tanzania in an uncompetitive position compared to neighbours. The private sector can be encouraged to play a pro-active through training. Actions required include:

- Expanding the provision of higher education and technical training, and revising the curricula to meet the needs of the market economy.

Box V.1. The Multi-Facility Economic Zone Concept

Creation of a conducive investment environment -- physical, legal, administrative -- all over the country will take years of effort. These efforts should not be put off. But, in the short-term, it may also be desirable to selectively create "Engines of Growth" areas within Tanzania i.e. limited areas of dynamic economic activity, that can be "fast tracked" for take off, and which will create positive multiplier effects and a positive image for Tanzania as an economy that can sustain modern economic activity.

The concept in summary is as follows: Identify a substantial area – e.g. 1000 hectares. In this area create a MFEZ Authority and suspend all outdated national laws, rules and regulations. Create best practice rules/laws for investors in this area at all levels – from project approval to production. Create world-class infrastructure – electricity, water, roads, etc in this area. Cater for housing for executives, workers, hotel, a small Township and recreation areas (if these not available nearby). Promote this MFEZ as a hassle free, efficient investment location. Train local government officials on best practices from other IPAs around the world.

The MFEZ should cater for both export oriented and domestic oriented industries and thus save valuable land lying idle if the country is unable to attract 80 per cent export oriented industries. Every investor located within the MFEZ should be given a special "Certificate of Privileges" that will assure a series of guaranteed privileges and incentives.

Multiple MFEZs can be created in different parts of the country and can also be privately operated. The initial MFEZ should ideally be a Government effort or a joint effort with the private sector. If private sector is involved, the project should be offered a special package of incentives, including a 10-year tax holiday.

- Integrating human resource development into programmes for the support of priority sectors (including those with FDI potential, particularly mining, tourism and even banking). This means determining the skill needs of priority sectors, and developing funding systems for training, in partnership with the private sector.
- Developing sectoral programmes in, for example, energy and minerals, agribusiness and tourism not only to improve their attractiveness to foreign investors but also to encourage linkages with local enterprises including technological linkages. These sectors are of fundamental importance for FDI attraction, but the conditions are not in place to fully exploit their potential. Tourism is the easiest to develop in the short term, and should be the initial emphasis.
- Encouraging existing companies to undertake greater "in house" training for their own staff and possibly offer training opportunities for those outside of their direct staff requirements. The experience of other countries suggests that tax deductions of training expenses can be an effective incentive.

Objective 6: Building a dynamic enterprise sector

In the medium- to long-term, the most effective way that Tanzania can maximize its gains from FDI, especially in technological development, is by improving the capacity of its domestic enterprises to learn,

adapt and assimilate technology. Indeed, the existence of dynamic domestic enterprise by itself can be an important investment promotion tool as international investors are increasingly seeking investment locations with high-level skills base and partnership-ready enterprises.

The skills and technological capabilities and investment capacity of domestic enterprises are key determinants of their ability to qualify as suppliers to foreign affiliates operating in increasingly competitive market environment. More and more foreign affiliates demand that their suppliers comply with quality standards such as ISO 9000. Tanzania needs to adjust its technology policy framework and make its relatively extensive technology infrastructure responsive to the technology and quality-related problems currently facing most domestic enterprises, particularly SMEs. Actions include:

- Modernizing the present National Science and Technology Policy to bring it in line with policy changes in other economic areas, particularly investment policy.
- Undertaking a major restructuring and overhaul of the existing technology infrastructure with the view to identifying those technology-related institutions that provide essential services and need strengthening and those that are ineffective and should cease to operate. At the same time, private sector involvement in technology-related support services should be actively encouraged.

Objective 7: Enlarging markets through regional integration

Tanzania should continue efforts to build a stronger East African Community (EAC) and Southern African Development Community (SADC). A larger market size ensures stronger commitment by investors and leads to a greater level of strategic investment. The following issues are important:

- In order to net gains from the EAC, Tanzania requires a sustained effort to improve its cost competitiveness, and to focus on areas of actual or potential competitive advantage. Greater attention needs to be paid to encouraging export orientation in indigenous industry and attracting export-oriented FDI to exploit the larger EAC market. To facilitate this, export and import procedures must be improved and streamlined. Implementing the recommendations of the BEST programme are important in this respect.
- In the short term, Tanzania needs to recognize the problems faced by foreign and indigenous producers in manufacturing in competing with Kenya. Moves to eliminate tariffs and non-tariff barriers need to be made cautiously to avoid a surge of imports, but it is important to resist demands for continuing protection.
- In respect of SADC, foreign investors are unlikely to see significant opportunities for intra-regional FDI in the short to medium term but if Tanzania improves its transport (road, rail, port) infrastructure in the south of the country, it could achieve its potential as a gateway into the region in the longer term.
- Tanzania should take the initiative in encouraging regional FDI promotion events, particularly for East Africa.
- Tanzania should take full advantage of the "window of opportunity" that WTO offers for tariff protection, to encourage import substitution industries, but with the full understanding that these are strictly short-term "booster" measures to help incipient manufacturers.

Objective 8: Imparting a new strategic thrust to investment promotion

At a time of global slowdown, Tanzania cannot reasonably expect waves of FDI into its economy, which is yet to show its resilience and ability to attract and sustain FDI. Investment promotion will require strategic thrusts in select areas driven as a "Sustained Programme of Action" and aimed at yielding positive results on the ground, in 2 to 5 years.

Earlier discussions have highlighted three strategic thrust prospects: Multi Facility Economic Zone (MFEZ), Dar Port and privatization. Education is a possibility. Three additional areas are:

- **Agriculture.** The irony of a country with abundant land and yet land not easily available for large-scale agricultural investments appears a major bottleneck. Tanzania's abundant land should be translated into investment opportunities, starting with 5 large areas of land that can offer potential for large-scale commercial farms / plantations. It can be envisaged that such investments will help develop smallholder farms and facilitate quality control, production support, marketing and distribution.
- **Manufacturing.** Given the country's present development stage, the domestic market is limited but could attract investors who are "pioneers" who identify opportunities and because of their smaller size or experience in other emerging markets can gain "first-mover" advantages by moving quickly to enter and consolidate their position in the Tanzanian market (see box IV.3 for examples). Such "second-tier" investors should be targets for the Tanzania Investment Centre. However, there are also major TNCs, especially in the consumer goods sector, which historically have been pioneers in emerging markets. Targeted investment promotion at the firm level may be a precursor for wider investments in manufacturing as other big foreign players in, for example, food and pharmaceuticals, may follow.
- **Existing investors.** Already established foreign and domestic enterprises should be extended every encouragement and support to reinvest in the domestic economy. Box III.3 presented the case of an investor in Tanzania from colonial times, and now transformed into a venture capital company with 42 investments throughout the country. Its importance for FDI potential lies in the long-term commitment to partnership investments in Tanzania, and in encouraging foreign and indigenous companies in Kenya to expand into Tanzania. Although small in number, there may be other similar types of companies which offer opportunities and with which the TIC should develop alliance relationships.

This report has not assessed Tanzania's investment prospects in the above areas. For that, the Government should establish separate National Task Forces appointed with experienced members drawn from the private and public sectors, to work out the feasibility and detailed implementation steps necessary for promoting each area as a strategic thrust. TIC and ZIPA are well positioned to lead the effort and the National Investment Steering Committee is the right body to sanction and receive it.

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