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The United Republic of Tanzania

CHAPTER 3

UNITED NATIONS

CHAPTER III. ENHANCING THE ROLE OF FDI IN DEVELOPMENT

Tanzania can be an attractive FDI location in East 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: privatization, infrastructure, human resources and, not least, a dynamic private enterprise sector and institutions supportive of 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 a 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 (percentage):			
2000	5.2	0.4	5.5
2001	5.4	2.6	6.4
2002	5.9	4.0	6.6
Structure of economy (percentage):			
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 (percentage)	18.3	25.0	11.3
Imports of goods and services/GDP (percentage)	25.0	29.6	22.9

Sources: Economist Intelligence Unit and World Bank.

Surveys of business opinion rank 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 the Southern African Development Community (SADC) countries (BusinessMap, 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 use, 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 regarding 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, 2000a.
[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	Uganda
Openness:			
Openness to trade	(24)	(21)	(11)
Average tariff rate (percentage, 1998)	23.7 (21)	11.0 (3)	30.0 (23)
Exchange rate policy	(14)	(19)	(17)
Government:			
Government expenditure (percentage of GDP)	8.8 (2)	16.1 (17)	9.6 (6)
Corporate tax (percentage rate)	30.0 (4)	32.5 (6)	30.0 (5)
Income tax (percentage rate)	18.8 (7)	22.5 (15)	15.0 (5)
Employee payroll tax (percentage rate)	10.0 (20)	5.0 (15)	5.0 (16)
Tax evasion	(18)	(22)	(14)
Irregular payments	(21)	(18)	(19)
Time for permits (percentage of senior management time)	14.4 (15)	10.5 (9)	14.8 (18)
Finance:			
Gross domestic investment (percentage of GDP, 1998)	16.0 (17)	14.5 (20)	15.1 (19)
Gross domestic savings (percentage of GDP, 1998)	6.0 (18)	6.7 (16)	5.7 (19)
	(20)	(15)	(21)
Infrastructure:			
Paved roads (percentage of total)	4.2 (22)	13.9 (17)	n.a. (24)
Railways (rail lines per 000 population)	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 (percentage)	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)
Organized 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 twice as high in Tanzania than in Kenya and Uganda. Telephone calls to the United States cost $13.30 per three minutes, compared with $11.17 from Kenya and $6.80 from Uganda. Telephone density is estimated at 0.32

Box III.1. Investors' 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 there are fewer routes.

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.

per 100 inhabitants, compared with 0.92 in Kenya. Furthermore, Internet use is hampered by the limited bandwidth of the telecommunications network. The water supply is erratic and water is unsafe for drinking. Electricity supply is frequently interrupted. Infrastructure has been made the major component of the large-scale privatization programme that the country is pursuing.

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

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 rose dramatically from about 29 between 1985 and 1991 to over 450 in the late 1990s (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 such as 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 benefits 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 be further stabilized through a Fiscal Stability Agreement between individual companies and the

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, the 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. On the basis of findings of studies on local coal deposits and a feasibility study, the project was promoted worldwide. A build-own-operate (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 being jointly developed by Malawi, Zambia, Mozambique and Tanzania. Alliance with foreign investors is being 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 focused on agribusiness, textiles and electronics. Access to the European Union and to the United States markets has been ensured 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 are aimed at stimulating SME development and linkages. The objective is to improve the situation of industries which will not benefit from EPZ 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, 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 has long been present 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 began operations in 1948 as the Colonial Development Corporation and whose primary function is to provide loans to public and private entities as well as to large projects. Operated through the Department for International Development (DFID), it is being slated for privatization. Its new role is to act as an equity and value-added partner to commercially viable business ventures in emerging markets. It 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. One previous majority-owned subsidiary – Mbeya Cement – acquired under the 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 had 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.

The Future interests of the Fund include telecommunications, ICT, financial services, fast-moving consumer goods (FMCGs), power, minerals and oil and gas, and healthcare. South African supermarkets are in line to make substantial investment in 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 favour of the industrial sector, the nationalization of estates, the use of State marketing monopolies and the overvaluation 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, has low productivity, with yields of 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 suffered subsequently because of low world market prices, poor weather conditions and low use of inputs. The tea industry, by contrast, recovered during the 1990s, as some estates were repurchased and revitalized by previous foreign investors. Sisal estates, nationalized in the previous era and faced with stiff competition from synthetics, are now largely privatized 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 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 market 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 the poor road network.

There is significant FDI potential in both agriculture and agribusiness; but fulfilling this potential will require a 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 such as oilseeds, for example, there are quality problems that act as a barrier to the development of agribusiness. UNIDO’s Integrated Industrial Development Programme, which began 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 privatization. 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 privatized 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 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. 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 artefacts, 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 archaeological sites, Tanzania has very substantial tourist attractions and, consequently, FDI potential.

There are, however, numerous constraints on 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. For the purpose of maximizing the economic benefits and opportunities derived from tourism, there has been proposals 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 centre 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 also has performed poorly since liberalization, with an annual growth of less than 2 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, fertilizers, 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 five 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 be 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 have 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 services. In telecommunications, the Tanzania Communications Commission has licensed 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 for higher-level education and to acquire fluency in English.

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 of Tanzanian firms, many of them 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 includes 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 the Tanzania Cigarette Company to RJ Reynolds; the sale of 55 per cent 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 the 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: United Republic of Tanzania (2000b).
[a] Year to 30 June 30. [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 about Tanzania's commitment to liberalization and reform.

When Tanzania began 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 subcontinent and with other Asian communities elsewhere in East Africa as well as in countries such as 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, which are 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 have been 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 caused by 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
Country level • Stable political environment • Significant growth potential • Market reform and liberalization process • Foreign exchange liberalization, exchange rates and foreign exchange allocations • Competitive corporate tax rates	• 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 about FDI and foreigners
Sector and industry levels • 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	• 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 insfrastructure; hotel accommodation; water supply); unrest in Zanzibar; marketing
Firm level • Effective, wide-ranging privatization • Commitment of long-established TNCs • Entry of second-tier investors • Interest of South African investors	• “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 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 are wide-ranging for successful reform, including regulatory reform to support an enabling environment, and institutional reform 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

The *Programme for Business Environment Strengthening for Tanzania* (BEST Programme) contains a series of proposed actions for improving the business environment over a period of five 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 efforts 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 attracting FDI, relates to the informal sector in Tanzania. Estimates suggest that the informal sector represents 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 favoured 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 it has helped create an environment that is conducive to FDI. It has also played a direct role through, for example, equity participation in privatization.

Box III.5. The Tanzanian National Business Council

The Tanzania National Business Council (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 crucial to Tanzania's competitiveness for 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 described below.

Power (FDI). The power sector, dominated by the State-owned Tanzania Electric Supply Company (TANESCO), is characterized by high retail tariffs, poor service and coverage, and frequent supply interruptions. Privatization is still in the 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 are scheduled for the first half of 2004, and handover at the end of the same year. In April 2002, the Government of Tanzania appointed the South African engineering firm Netgroup Solutions to run and operate TANESCO until it has been privatized.

Water (lease contract). The Dar es Salaam Water Supply and Sewerage Authority (DAWASA) provides water from the distribution mains at standpipes located around the city. There is no charge for this water, which is used by individuals as well as water vendors who transport water their customers' premises for a fee. DAWASA also oversees the city's sewerage. The divestiture process was started in November 1998, with resulting bids in February 2000 considered too low to be accepted. A re-bid process was initiated soon afterwards. The following year Parliament passed the DAWASA 2002 legislation, which provided for a multisector regulator to oversee the national water supply.

Harbours (leasing contract). The Tanzania Harbours Authority (THA) is wholly owned by the Government, although it leases out certain assets such as the container terminal. Dar Port's container terminal has been privatized to a consortium consisting of the International Container Terminal Services Inc., ICTSI International Holdings Corporation of the Philippines and Vertex Financial Services Ltd of Dar es Salaam on a 10-year lease contract. There are plans to privatize all the remaining cargo terminals in Dar-es-Salaam as well as those in Tanga, Mtwara, Lindi, Mafia and Kilwa.

Railways (vertically integrated concession). The Tanzanian Railways Corporation (TRC) is one of the country's largest infrastructure enterprises providing transportation of goods and passengers with the country, and of transit traffic to the land-locked countries of Western Congo, Burundi, Rwanda and Uganda. In May 2001, the Government adopted a privatization strategy whereby it will retain ownership of infrastructure assets which will be concessioned out to a private rail operator on a 25-year basis, who will be responsible for maintaining the infrastructure and providing freight and passenger services on the track. Lay-off issues have to be resolved in a sector considered over-manned (it has 10,000 employees). Final bidding is scheduled for April and takeover in October 2002.

Airlines The Air Tanzania Corporation (ATC) currently operates as the national airline servicing domestic and regional routes, with recently acquired international route rights to Europe. Its privatization has been one of the challenges for 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 it. 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 reduced 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 such as telecommunications where there is only one monopoly operator. Tanzania's Fair Trade Practices Act (Act No. 4 of 1994) could provide such protection, but 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 multisectoral regulatory agencies: one for utilities, including electricity, water, gas distribution and telecommunications; and the other for transportation, including aviation, airports, ports, maritime services, and railway and road public transport. These agencies will 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 role complementary to that of 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 to play 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 honouring the commitments made at the 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 the 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 for attracting 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. Time scales 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 this is 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 such as 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 laws in the area, some going back to the 1920s, these have not been updated or integrated into current law. There is an ongoing 10-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 service 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 participation, including foreign, 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 directing 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 attracting FDI and for overall economic development. Problems range from low literacy rates and an inadequate level of investment in education, to weak vocational and technical skill training facilities, and a general lack of motivation of the workforce. Together with extensive labour regulations and relatively high labour costs (largely due to a range of levies on wage bills), the result is low productivity and high unit costs. Skill shortages are more apparent in the technical and managerial areas.

In the mid-1990s, the Open University of Tanzania was set up and private universities were licensed in order to upgrade and expand higher education. The response in terms of enrolments for degree programmes in public and private universities is shown in table III.7. However, there still appears to be no coordinated strategy 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	3 544	4 131	4 765
Open university[a]	3 064	4 809	5 160
Other public universities	1 696	1 841	2 737
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: United Republic of Tanzania (2000c).
[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 labour issues, with the Tanzanian workforce considered to be lesser educated but more trainable than its Kenyan counterpart.

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 the Government and students is 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 in order 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. The private sector can also support educational and training provision 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 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 a related sector may pool their resources to run common training courses in conjunction with local institutions. The Government can act as a 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 a 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 in which 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 African Growth and Opportunity Act (AGOA), which provide 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 because of divergent political and economic philosophies among member States. A revised treaty was signed on 30 November 1999, with a 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; a 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, realizing 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 will not be able to compete with Kenya's manufactured goods. 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 remains 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 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 have been mainly in the area of finance, notably measures to avoid double taxation and prevent tax evasion, and for 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 will collapse as it did earlier and that internal trade barriers will not be reimposed.

Southern African Development Community. Signed in August 1992, the SADC Treaty currently covers Angola, Botswana, the Democratic Republic of the 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 those of the defunct Southern African Development Coordination 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, eight of which have been signed, including protocols on 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 landlocked Central African countries in the SADC region, but problems with the Tanzania-Zambia Railways Authority (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 transborder trade.

As with the EAC, therefore, it is unlikely that an 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 all having been liberalized. The average tariff rate has fallen considerably, but as table III.4 shows, is still generally higher than that 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.

Economic liberalization has not led to a export growth that is commensurate with increased imports, and as a result the 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 of manufactured products, is important for exploiting the potential of the EAC and ensuring 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 East 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 dependent 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 infrastucture.

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 attracting investment. 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 in order 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 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, about which concerns have been expressed. 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 though EPZ infrastructure and facilities represent one of the most important FDI determinants, along with low-cost labour, tax holidays and political and economic stability. Moreover, EPZ operations are rather footloose, relocating as wages and other costs change.

Zanzibar has been experimenting with EPZs since 1992, but 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, modelled on the Asian experience, have been suggested. Asian investors would provide the skilled labour and park management, as well as trade links. This could be an effective way of getting round the resource and managerial constraints of NDC.

Recommendations

The prospects for FDI in 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 EAC 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 only slow progress is made 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 derive 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 and port) infrastructure in the south of the country if it is to achieve its potential as a gateway to the region.

In order to exploit the larger EAC market and other opportunities opened up through the various market access initiatives, greater attention needs to be paid to the development export capacity, including assisting indigenous industry to attain the 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 a 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, owing 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 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 attracting FDI. The PSRC-TIC relationship appears relatively problem-free, with the former 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 larger 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 four key Ministries, namely the Customs and Excise Department of the Tanzania Revenue Authority, the Ministry of Lands, the Department of Immigration of the Ministry of Home Affairs and the Ministry of Industries and Commerce. 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.

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

Institution	**Role in FDI**
Tanzania Investment Centre (TIC)	Coordinates, 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 coordinates work with other Ministries; TIC and PSRC report to Planning Commission.
Ministry of Industry 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.

Relations between the TIC and the TRA had been particularly problematic, especially with regard 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 were resolved at a high-level meeting chaired by the Minister of Finance in January 2000 and the subsequent establishment of a six-member working committee comprising 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 need 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.

Many of these issues are identified in the BEST Programme, with a time-scale in place for their resolution. The establishment of both the TNBC (box III.5) and the NISC (box III.7) should contribute substantially to 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 ensured.

Box III.7. National Investment Steering Committee

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 (NISC) was set up by the President in September 2000 to ensure coordination and consistency among the different government ministries and institutions. It is chaired by the Prime Minister, and 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 the end 2001, the NISC had held three meetings and had dealt two issues of cross-sectoral interest, namely the Dar-es-Salaam Waterfront Project and the construction of Central Corridor Road under a BoT arrangement.