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Investment Policy Review
The United Republic of Tanzania



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CHAPTER I. FOREIGN DIRECT INVESTMENT: TRENDS AND IMPACT

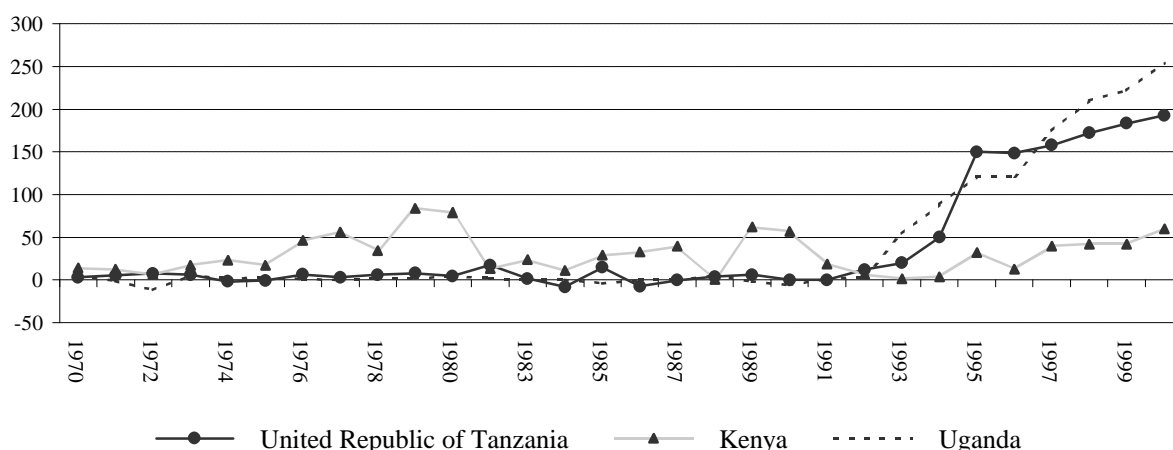
Foreign direct investment (FDI) is showing an upward trend in Tanzania, as the reforms initiated in 1985 appear to have begun to firmly take hold. Positive impacts from the initial investment inflows are also beginning to be felt. On a sure footing at last, Tanzania should now keep pace with the FDI front runners in 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 the country decided to initiate the process of transition from a centrally planned economy to a market-based economy. The process focused 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 with less than \$2 million during 1986-1991. On an annual basis, from 1992 onwards, 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 \$193 million in 2000 (figure I.1). This is a remarkable acceleration, for a country that was receiving zero inflows just 10 years ago.

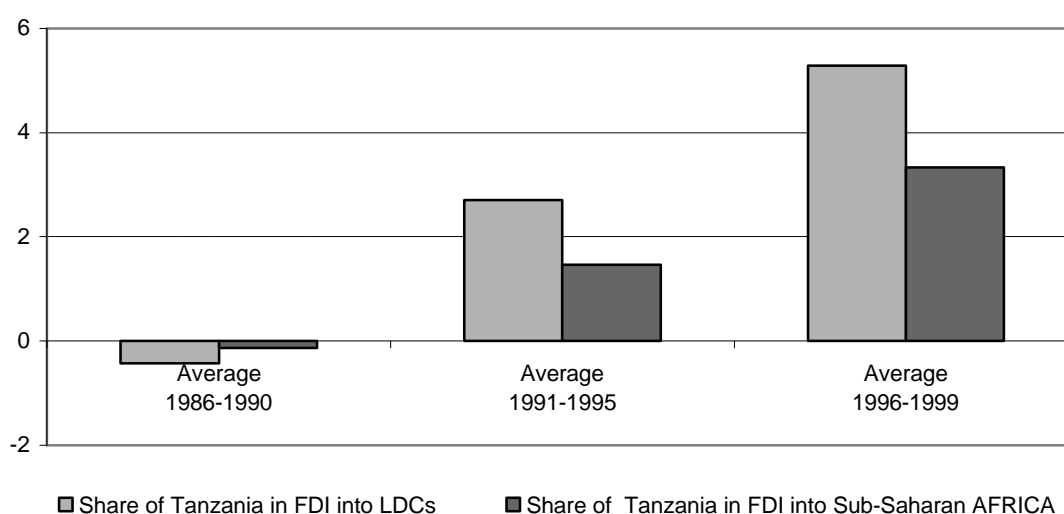
Figure I.1. FDI inflows into Tanzania, Kenya and Uganda, 1970-2000
(Millions of dollars)



Source: UNCTAD, FDI/TNC database.

The acceleration of inflows between 1992 and 1996 improved considerably Tanzania's FDI performance relative to that of other countries, including neighbouring countries with which Tanzania may compete for certain kinds of FDI. Its 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 the share 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 inflows into LDCs or sub-Saharan Africa, and Tanzania lost some of the position it achieved in the mid-1990s. On an annual basis, these shares were the highest in 1995 and had decreased slightly by 1999.

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



Source: UNCTAD, FDI/TNC database.

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 to Kenya. Nearly 10 per cent went to Tanzania, while Uganda hardly received any at all. The picture changed during the 1990s with the improving performance of Tanzania and Uganda and the deteriorating performance of Kenya (figure I.1). Uganda – slightly ahead of Tanzania – was found by the *World Investment Report 1998* to be one of the seven best performing countries for FDI in Africa during the mid-1990s.¹ It placed Tanzania close to the African FDI front runners. By 2000, both Tanzania and Uganda had outperformed Kenya in terms of FDI stock.

In relative terms, accounting for differences in the 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 with the average for LDCs in terms of inflows per \$1,000 of GDP and were much below the LDC average in terms of inflows per capita and as a

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

percentage 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 with that of selected countries during the 1990s
(Dollars and percentages)

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		As percentage of GFCF			Per capita			Per \$1000 GDP		
	1991-1995	1996-1999	1990	1995	1999	1991-1995	1996-1999	1991-1995	1996-1999	1991-1995	1996-1999	1999	1990	1995	1999	1990	1995	1999
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
EAC	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 have taken predominantly the form of greenfield investment in spite of some participation by 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 (UNCTAD, 2001a, p.123). 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, and the data

on FDI projects approved by the Tanzanian Investment Centre (TIC) during 1990-2000 and on FDI deals during 1997-2000, give some indication on where the investment goes and by whom it is undertaken.

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 (WTO, 1998, p.94). 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*² 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 as follows: mining (65 per cent), services (19 per cent) and manufacturing (16 per cent). These data underestimate the share of the services sector, because they do 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, ^a gold mining
Tanzanian Telecommunications Company	Netherlands/ France	120	Privatization, jv, ^b telecommunications
Voda Com	United States/South Africa	120	New, telecommunications
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, telecommunications, jv ^b
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).

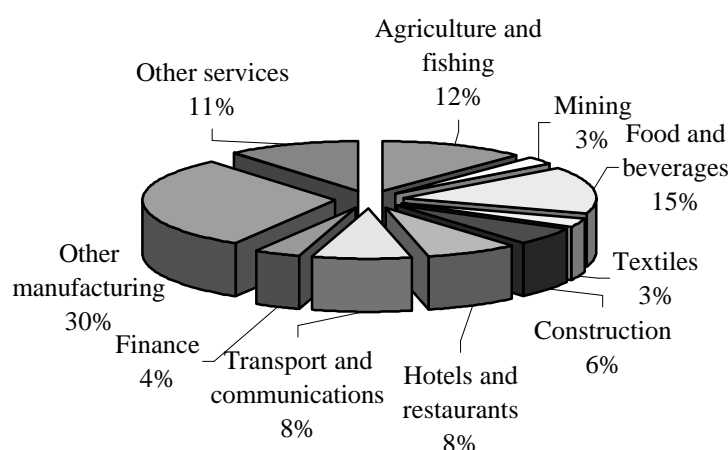
^a M&A = mergers and acquisitions.

^b jv = joint venture.

² The total value of investment by foreign affiliates is not directly comparable with FDI flows, which encompass only the part of the total value financed by equity capital or loans from the parent company or reinvested earnings. The two correspond with one another especially in a country such as Tanzania, where financing of FDI projects from the domestic financial market is unlikely, owing 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.

Data on *the number of approved foreign affiliates* indicate 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 potential for, FDI in manufacturing in Tanzania. The largest manufacturing industry 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, is 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 are 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)

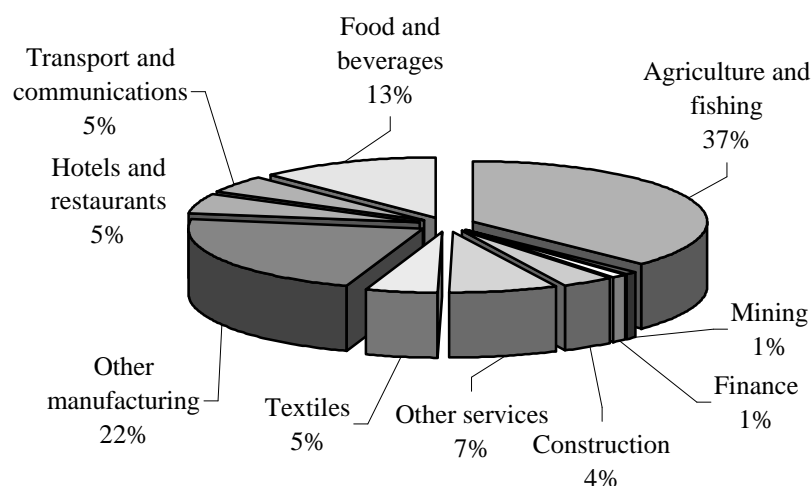


Source: Tanzania Investment Centre.

FDI in Tanzania originates from a wide range of countries from four continents. On the basis of *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 favour countries with FDI projects in capital-intensive mining and services such as banking, telecommunications 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

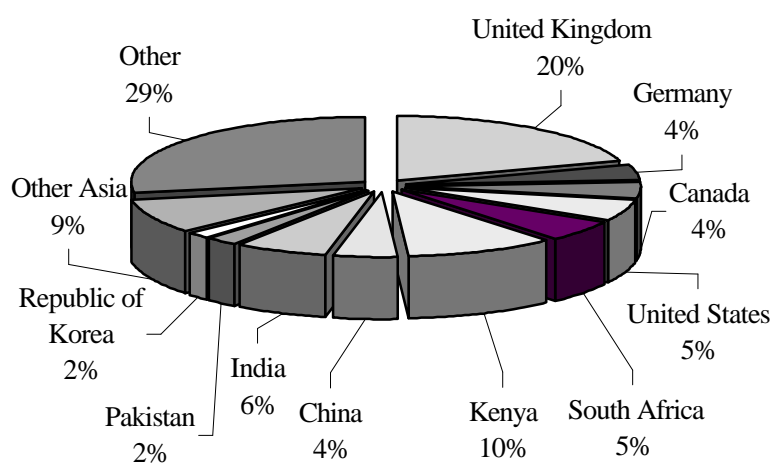
Africa (\$145 million) and Australia (\$119 million). Some FDI projects from South Africa are undertaken by foreign affiliates with headquarters in developed countries (e.g. Holiday Inn).

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 give 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 rapid increase, this share is still half of that for all developing countries and for Africa, showing potential for a 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, percentage)

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

Sources: 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 the latter year, the growth of FDI inflows kept pace with the growth of domestic investment and the share fluctuated at 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 its rapid growth in the mining sector (especially gold mining) and in banking, FDI is high in these sectors, while in manufacturing and especially agriculture it is still insignificant.

5. Explanatory factors

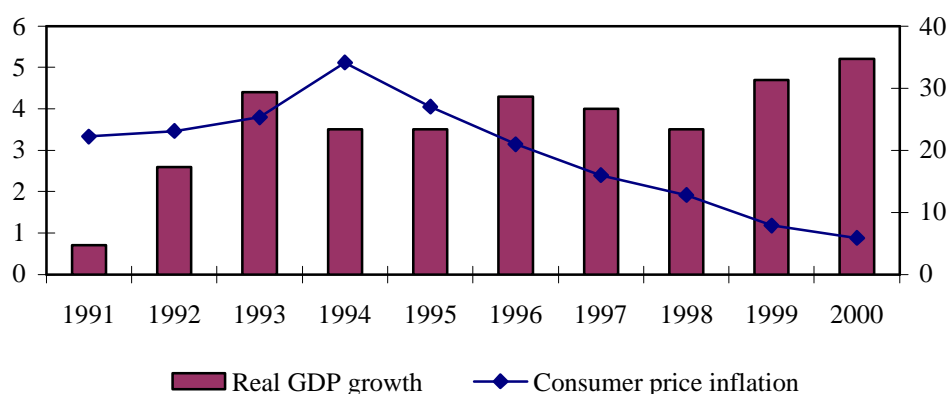
Tanzania's FDI performance mirrors its economic performance. The transformation from a centrally planned to an open, market-based economy has been impeded by a variety of internal and external factors and the Government acknowledges that "the various reform programmes implemented since the 1980s could not achieve the targets set" (UNCTAD, 2001b, p.4). 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 has joined the ranks of better-performing FDI countries in Africa.

Tanzania's reforms were initiated in the late 1980s, but initially the reform process focused 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 (TRA) 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” (Lindahl and Tsikata, 2000) and the pace and intensity of reforms accelerate. Components of an enabling policy framework for FDI were also introduced gradually and a critical mass emerged only in the second half of the 1990s. 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 priorities. But more importantly, only in 1998 did the Tanzanian Mining Act relax regulatory control over the mining sector – an area with strong FDI potential – and thus remove a number of barriers that previously limited foreign control of mineral exploitation enterprises (UNCTAD, 2001b, p.13). 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 on foreign trade. A 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 the World Trade Organization (WTO), “was followed by a partial liberalization of the capital/financial account, which allowed foreigners to participate in direct investment activities in the country” (WTO, 1998).

The macroeconomic environment, another pillar of a 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 (UNCTAD, 2000b, p. 300). Inflation was nearing 40 per cent and the budget deficit was 5 per cent. Towards the end of the 1990s Tanzania made significant progress in achieving macroeconomic stabilization 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 (EIU, 2001, p. 11). The budget deficit turned into a surplus in 1999 and foreign exchange reserves increased from about 1.5 months of merchandise imports to 4.5 months (Lindahl and Tsikata, 2000, p.9).

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



Source: World Bank.

All these factors, 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, 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, since annual profit remittances exceeded inflows in the years before 1994). With the increasing inflows of FDI and the 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 in the Tanzanian economy, playing the role of an engine of growth and also diversification, reducing Tanzania's traditional dependence 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" (World Economic Forum, 2000). If these plans are implemented, the increased gold production would add 8 per cent to the annual GDP. The 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).

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 had 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 kilometres (\$5 million investment) and a 47-kilometre-long water pipeline (\$3.4 million). This has brought benefits to the 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-metre shaft, 6.4 metres 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 and 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. Currently, 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 of gold is a highly mechanized and technologically sophisticated activity. Kahama requires geologists, mining, electrical and mechanical engineers, underground miners, and 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.

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(Box I.1, continued)

Aware that education is the 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 the 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 currently 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 in 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, so as 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 South 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. These 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 programme described above. Kahama has also opened one of the most up-to-date, and best-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 at minimizing its impact on the air, water, flora and fauna around the mine during 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 are 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.

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(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 takeover 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*, 24 May 2001).

Sources: UNCTAD and Barrick Gold Corporation.

Tanzania also has 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, for exploration activities in all these areas. In 1998 alone, there were more exploration activities in Tanzania than in any other country in Africa, including traditional mining countries such as South Africa and Ghana. Spending on exploration has increased to \$58 million per year (Temu and Due, 2000, p. 709).

(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 had been established, 6 of them foreign, accounting for close to 30 per cent of the total assets of the commercial banks (Temu and Due, 2000, pp. 686-687). State-owned banks were successfully privatized, with the largest bank - the National Bank of Commerce - restructured and sold to the Amalgamated Banks of South Africa (ABSA) in 2000. This sale and the return of Barclays Bank to Tanzania after 30 years of absence increased the role of foreign banks in the financial sector.

The first steps in the liberalization 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 the private sector and the business community, local and foreign. Both local and foreign banks have contributed to this success in their areas of expertise and specialization. If problems occur, they are not confined to local banks. 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 (EIU, 2001, p. 24).

As the reform and the rationalization of the banking system continue, however, foreign banks are likely to increase their contributions to the economy. One could even argue that without foreign banks, full transformation into 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, the 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 (IMF,

2000, p. 165). 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 expatriate banking personnel, on-the-job training and sending local staff for training abroad in specialized training institutions (box I.2). These contributions do 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 (Temu and Due, 2000, p. 691).

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 can therefore 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), the 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. The number of employees totals 100, 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 1,176 people after its 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 subsequently increased to 11. 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 eight 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.

(c) Privatized enterprise sector

Of the 83 companies privatized as of 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” (Temu and Due, 2000, p. 697). As Government has retained between 30 and 40 per cent of these companies, another benefit is increased direct revenue.

Evidence from individual firms also points to foreign firms’ positive impact 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 is reported to have led to substantial improvements in service provision and revenue collection.³ In the telecommunications sector, alongside the privatization of the Tanzania Telecommunications Company, Ltd. (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). The Tanzania Harbour Authority (THA), which is operated under a performance contract, 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. , 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 to 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, the increased participation of FDI is quite likely, and this should lead to an increased FDI impact on privatized companies in terms of not only injection of capital and new investment but also, and more importantly, technology, skills and improved management.

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

³ “Privatization” of water services in Arusha consists in 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 privatizing the water supply system has been largely effected in unplanned settlements in Arusha. Source: *United Nations Centre for Human Settlements website, Chapter 6: "Privatizing municipal services in East Africa: the experiences."* Untitled document.

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 for use 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). This is to be expected as most of the foreign investment entering the country has been 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:

- 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. These 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 (ATMs) 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 Chartered 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 had 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 six branches are fully computerized, satellite-linked and equipped with ATMs. Other international banks have since followed suit.

Standard Chartered 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 topics 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, it has spent over TZS 400 million on 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 few of the technological and technical skills needed by the company come from local sources. But mining machinery and equipment are complex products which require a 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 an 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 maintaining 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, the WTO ban on certain trade-related investment measures (TRIMs) makes it difficult to apply local-content requirement,

although since it is a least developed country, this does not apply to Tanzania at the moment.⁴ 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 concluded with individual mining companies – in the context of the Fiscal Stability Agreement – may provide an answer. For instance, the agreement signed with Barrick Gold of Canada, the owner of the 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 understandings with other major foreign investors, covering broad areas such as 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 a 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 sugar cane 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 sugar cane 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.

⁴ 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 a 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 with technologies imported from developed countries – in terms of local technological learning and technological adaptation through linkages and spillover effects remains 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 greater. 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 the transfer of technology and of 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 sachets 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 the sugar industry or equipment for cement or food manufacturing.
- The introduction of specialized industrial technologies such as packing machines also provides the opportunity to learn new machine designs and for adaptation or even imitation through reverse engineering.

The impact of the recent surge in FDI in 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 a noticeable decline in education, especially technical training, due largely to the gradual reduction 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 behind 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 the increasingly skill-driven and competitive national, regional and international market conditions.

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, which is 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, a 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 in 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 Government recognizes the constraints on economic growth and further investment which are 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 Sixth 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 the 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 the 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 the major foreign investors now rely on expatriate personnel for technical and managerial functions. In some cases, such as that of 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 and 30; should this reduction happen as planned, it will suggest that local technological learning and capacity building have taken place. Among foreign companies in the areas of banking and food processing, 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.⁵ 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 whereby locally recruited staff are 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 are critical. Another example is the Kahama Mining corporation, which has budgeted \$6 million for training in Tanzania and abroad.

Some of the foreign firms have their staff trained in the home country and often by the parent company so that the trainees, while acquiring new skills, also gain a better understanding

⁵ Although, as explained in chapters II and III, the cost of labour in Tanzania is higher than in other countries with the same level of economic development.

of the working methods and culture of the company. For example, when the International Bank of Malaysia was establishing its operations in Tanzania, it headhunted and recruited Tanzanians studying in Malaysia, who were then given three to four 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 into 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 into Tanzania is the transfer of technology by FDI from other developing countries. Targeted investment promotion efforts may be necessary in order 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 exports 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 taken. 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. However, it has recently started to make increasingly important contributions in that area. There have been various major FDI projects in gold mining for exports 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 farming. FDI in major hotel projects also has the potential for boosting the tourism industry in the direction of high-quality services, thereby widening the country's foreign exchange earning capacity.

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 form of management contracts for airports, rationalizing of ports and foreign acquisition of domestic banks. The latter has a direct impact on the transfer of technology and technical know-how and the provision of efficient and cheaper services for trade and investment financing.

Crucial to the 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 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.

The EBA has brought about 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 except arms and ammunition, while for a limited number of very sensitive products, namely bananas, 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 period 2002-2006, whereas for rice and sugar the process of tariff liberalization will 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 in order to maintain the benefits of that protocol.⁶

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

⁶ 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" basis;
- "simultaneous examination method": based on distribution in proportion to the quantities requested when the applications are lodged;
- "traditional/new arrivals method" whereby traditional trade patterns are taken into account.

sugar products, cocoa products, pasta, and alcoholic beverages. A further improvement of the EBA would be to improve the rules-of-origin.⁷

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 where competitors continue to face very high MFN tariffs when exporting to the EU.

The United States has also removed most of its duties relevant to sub-Saharan African 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, 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, continuing to attract very 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 into 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 less developed AGOA beneficiaries with more favourable rules-of-origin requirements over an initial four-year period. Tanzania should undertake the necessary steps to benefit from this special initiative within AGOA.

Furthermore, the “AGOA-enhanced” GSP benefits will be in place for a period of eight years, and this longer than usual period 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.

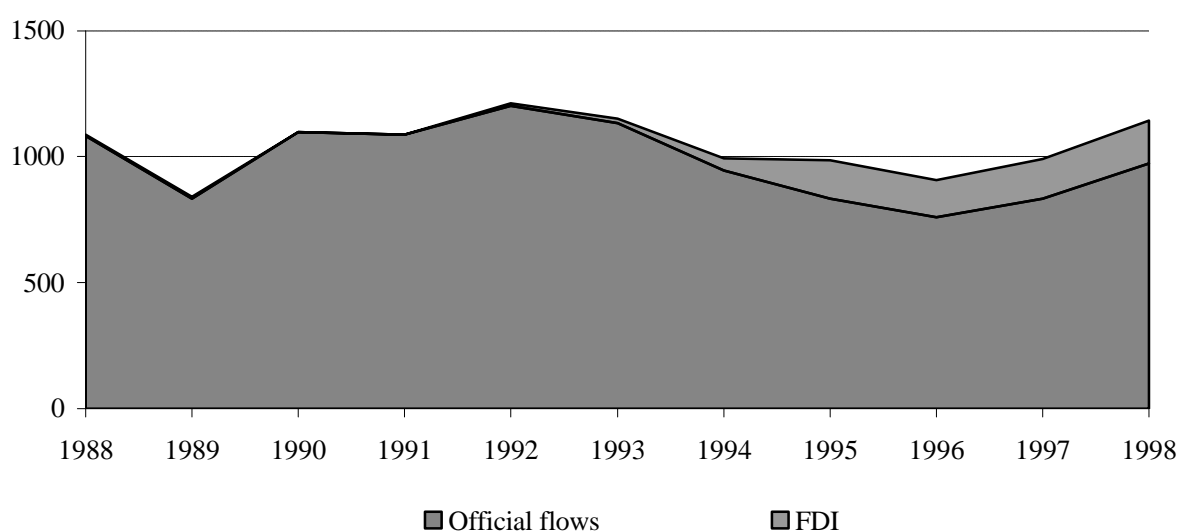
The Tanzanian Government should encourage potential foreign investors to join in actively exploring possibilities for exploiting these duty-free and preferential market opportunities available in the European Union and United States markets. To that end, it may be necessary to launch an investment campaign which is focused on a few priority sectors tailored to each target market, investment promotion missions to potential markets in the European Union or the 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.

⁷ 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 the 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 allowed to selected regional groupings. For further reading see UNCTAD.../DITC/TNCD/4 (2 May 2001)

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 with \$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 flow to Tanzania by type, 1988-1998
(Millions of dollars)



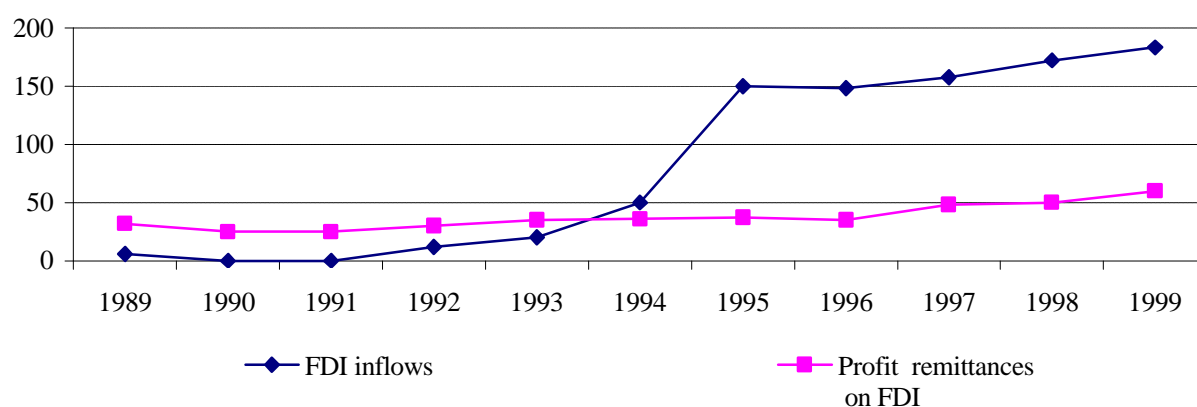
Sources: UNCTAD and World Bank.

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 are not available. But one can recognize the contribution of foreign affiliates in increasing gold exports as well as the inflow of hard currency from tourism.

When discussing the implications of FDI for overall productivity, growth, employment, and so forth, one should bear in mind that the share of industries with FDI in the economy is still small. The mining sector's share in GDP, although growing rapidly, is still very small – over 2 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 the 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 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 versus 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, a figure which has hardly changed during the 1990s. FDI in this sector is very small. Perhaps as a result of the forthcoming 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's 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 did market-oriented reforms reach critical mass. The economic situation also improved after sluggish growth and high inflation in 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 with \$90 billion during the preceding six years. This is commendable, given that Tanzania remains one of the poorest countries in the world and that it emerged from its socialist past not so long ago.

The acceleration of inflows between 1992 and 1996 considerably improved Tanzania's FDI performance relative to that of other least developed countries which have also worked hard to receive more FDI, but which with few exceptions have not been very successful in this regard. Tanzania has also improved its position vis-à-vis neighbouring countries. Overall, during 1995-2000, Tanzania received inflows comparable to those of Uganda (\$1.1 billion) and Mozambique (\$0.8 billion), which were ranked by the *World Investment Report 1998* among seven front runners 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, the 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 the 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 the achievement of 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 – such as linkages to the local economy or the encouragement of local science and technology capacities – are hardly taking place at all.

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 benefits from FDI.