

# **REFORMING THE BUSINESS ENVIRONMENT IN TANZANIA**

**BY**

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## **EXECUTIVE SUMMARY**

Socialism was the main mode of socio economic development in 70's, which was a centrally planned economy, led by the public sector resulted into macro economic instability as demonstrated by low economic growth rates, high inflation and foreign exchange crisis. The bottom line was the recognition that the public sector led economy embodied restrictive investment climate.

Today, Tanzania offers a wealth of market opportunities for foreign companies. With a population of over 34.5 million consumers, a rapidly growing economy, and high levels of domestic investment spending the Tanzania market will remain an important target destination for local and foreign products and services.

Since early 1986, The Government of Tanzania has, with determination, launched a comprehensive economic reform and stabilization programme. In pursuit of this, agricultural marketing has been liberalized, foreign exchanged controls have been lifted, price deregulated, enhanced private sector involvement in the economy through privatization programme and a new investment code offering competitive incentives has been put in place. These comprehensive economic reforms have resulted into improved competitiveness, lower tariffs, increasing levels of foreign investment and trade, improved key economic indicators and rapid integration into world markets. To this end, the Government of Tanzania is currently embarking on a strenuous exercise to upgrade its institutions and bring them at par with international standards. The expectation is to enhance the country's competitive position for investment flows destined for the region and meet the challenges of globalization.

The World Bank and other donors fully endorse Tanzania's economic and institutional reform efforts, as evidenced by an expanded level of donor support. Numerous bilateral donors are very active in the social sectors, public sector capacity building, infrastructure sector, civil service reform and governance issues. There are also a large number of non-governmental organizations working in Tanzania.

The Government of Tanzania in collaboration with the private sector and four development partners namely, SIDA, DFID, DANIDA and Royal Netherlands Embassy have established the BEST Programme. It is a 5-year programme commencing from 2003/04 whose major objective is to improve the business environment by reviewing the existing legal and regulatory framework.

Public institution interfacing with the private sector has been identified as an important aspect in the ongoing structural and institutional reforms that are meant to improve the environment for private sector. In this regard, the government has started reviewing regulations, focusing on removing obstacles to private sector development. Issues include (i) harmonization of local government taxation to remove excessive tax burden on private enterprises; (ii) streamlining work permit procedures; (iii) review and amendment of licensing legislation to reduce the cost of business establishment and continuation – the Business Licensing Reform has been approved by the Government following the consensus of stakeholders; (iv) review and revision of export – import procedures to reduce time costs and corruption related costs; (v) design and implementation of a program for enhancing access to commercial courts by SMEs; (iv) A Better Regulation Unit (BRU) established as a supportive unit for monitoring implementation of the Business Environment Strengthening in Tanzania (BEST).

However, there are some key challenges ahead of the Private sector as well as the Government, Donors. The Government and the private sector is working in partnership to improve the business environment in order to promote economic growth and contribution to income generation and poverty alleviation. The private sector in Tanzania has much to learn from the experiences of other countries as we strive to develop a private sector led economy in the country.

## **1.0. Background.**

Tanzania is indeed on the move. A lot of water has passed under the bridge from mid 1970s when Ujamaa/Socialism was the main mode of socio economic development; to date the Government has adopted market oriented policies and the private sector as the engine of economic growth. The centrally planned economy led by the public sector resulted into macro economic instability as demonstrated by low economic growth rates, high inflation and foreign exchange crisis. The bottom line was the recognition that the public sector led economy embodied restrictive investment climate.

### **1.1 Investment Destination**

Tanzania has become a destination for potential Investors from all over the world. This has happened due the following conducive environment of the country: -

### **1.2 Competitive Investment Climate**

In the African countries improvement index report, published by the Center for International Development at Harvard University, Tanzania clinched the top spot in a report titled “The Africa Competitiveness Report 2000/2001”, benchmarking macro economic and investment climate success factors; Tanzania ranked first followed by Morocco, Mozambique, Nigeria and Uganda. In the African Foreign Investors Survey 2003 Report by UNIDO, Tanzania ranked the first in IPA performance for the last 3 years and also the first in sales growth in 2002 by foreign investors perceptions

The comprehensive economic and political reform measures, undertaken since mid 1986, have progressively brought about an efficient economic management, financial discipline, and a framework for a dynamic, high growth economy. Tanzania has now won the confidence of foreign investors and the donor community.

### **1.3 Large Potential Market**

Tanzania offers a wealth of market opportunities for foreign companies. With a population of over 34.5 million consumers, a rapidly growing economy, and high levels of domestic investment spending, the Tanzania market will remain an important target destination for local and foreign products and services. On top of that, Tanzania is part of two distinct market areas: Southern Africa Development Community (SADC) and the East African Community (EAC), with some 304 million consumers.

### **1.4 Fiscal Regime**

Tanzania has a stable fiscal regime with sustainable level of inflation. Under its economic recovery program, Tanzania increased revenue streams and substantially reduced spending. During the quarter ending September 2003, the quarterly year-to-year inflation rate, declined to 4.6 percent as of December 2000. This continuous decline in the rate of inflation is mainly the result of prudent fiscal and monetary policies.

### 1.5 Investment Guarantees

Investments in Tanzania are guaranteed against nationalization and expropriation. Tanzania is a signatory of several multilateral and bilateral agreements on protection and promotion of foreign investment. Among other international agreements and membership, Tanzania is a member of Multilateral Investment Guarantee Agency (MIGA) and International Centre for Settlement of Investment Disputes (ICSID).

### 1.6 Access to Labour

Access to low cost labour is a key priority for companies competing in African economies. Tanzania offers trainable skilled labour at significantly lower labour costs. The Government has made a long-term commitment to develop a pool of well-trained and educated specialists. The government is continually increasing the budget for education for example since the financial year of 2000/1 to 2003/4 as shown in the table below: -

Year	2000/01	2001/02	2002/03	2003/04
Budget in US\$	27.64	34.36	38.38	45.72

### 1.7 Peace and Stability

Tanzania is free of ideological confrontations, ethnic problems and labour disputes. It is a center of economic and political stability in Sub Saharan Africa. Multi party democracy adopted in 1992 has not disturbed the peaceful political climate of the country. The political scene is characterized by parliamentary democracy and public consensus on key social and economic priorities.

### 1.8 Geographical Location

With three major ports located along the Indian Ocean and those along the fresh water inland ports around Lakes Victoria, Tanganyika and Nyasa, Tanzania provides access to the land locked countries of Uganda, Burundi, Rwanda, Zambia, Malawi, DRC and beyond. Tanzania has a central location in terms of its distance from major global markets. As such Tanzania location is close to any export markets.

### 1.9 Transparent Investment Laws

The pro investment attitude by Government is clearly demonstrated by the innovative investment legislation, the increasing number of foreign direct investments in the country and economic and structural reforms that have led to substantial progress in establishing a functioning market economy. Institutional support for priority investment projects is readily available from the Tanzania Investment Centre (TIC) and other Government institutions.

### 1.10 Infrastructure Facilities

There is a sustained programme for building good quality roads. Two railway networks connect 14 out of 20 cities and the neighbouring country of Zambia. There are also international and domestic airports linking Tanzania to the world. The three major ports of Dar es Salaam, Tanga and Mtwara function as hubs for traffic emanating from, and destined to land locked neighbouring countries of Uganda, Burundi, Rwanda, Zambia, Malawi, and Democratic Republic of Congo.

### 1.11 Investment Incentives

Tanzania offers a well-balanced and competitive package of fiscal incentives in comparison with other African countries. Aiming at providing competitive fiscal regime on foreign trade, Tanzania has signed double taxation treaties with Denmark, India, Italy, Norway, Sweden, Kenya, Uganda, Zambia and Finland. Countries with which negotiations are continuing include South Africa, Republic of Korea, Zimbabwe, United Arab Emirates, Russia, Seychelles, Mauritius, Egypt, Yugoslavia and Oman.

### 1.12 Abundant Natural Resources

Tanzania's untapped natural resources offer a wide range of investment opportunities; arable land, minerals and natural tourist attractions are all awaiting potential investors. Tanzania is internationally renowned for its abundance of wildlife attractions and unexploited mineral reserves. These sectors (Mining and Tourism) are the leading recipient of foreign investment flow and are tipped to become the "growth sectors" of the economy.

### 1.13 Comparison of Investment Climate in East Africa.

The Table below shades more light on the investment climate prevailing among the East African Countries of Tanzania, Kenya and Uganda.

#### World Bank 2004 Doing Business in East Africa Index as follows:

		<b>Tanzania</b>	<b>Kenya</b>	<b>Uganda</b>
Starting Business	No. of Procedures	13	12	17
	No. of Days	35	47	36
Hiring and Firing Workers	Difficult of Hiring Index	56	22	0
	Rigidity of Hours Index	80	20	20
	Difficult of Firing Index	60	30	0
Registration of Property	No. of Procedures	12	7	8
	No. of Days	61	39	48
Getting Credit	Cost to Create Collateral (%age of Income Per Capita)	21.3	3.3	11.9
	Legal Rights	5	8	5
Protecting Investors and Enforcing Contracts	Disclosure Index	1	2	2
	No. of Procedures	21	25	15
	Days Taken for Enforcement Contracts	242	36	209
	Closing Business (years)	3	4.5	2.1
	Cost as %age of Estate Concerned	23	18	38

## **2.0 Agents of Reforms in Tanzania**

### **2.1 Business Associations**

Business associations are a salient feature in a market oriented economy whose main objective is to advocate for their cases and lobby the Government to improve the business environment covering, among other things, the legal and regulatory framework and taxation.

Like in many other countries, business associations in Tanzania have been sectoral in nature for instance; Tanzania Chamber of Mines (TCM), Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA), Confederation of Tanzania Industries (CTI), Tanzania Bankers' Association (TBA) and Tanzania Confederation of Tourism (TCT).

Tanzania Private Sector Foundation (TPSF) is an umbrella organization of the business associations with the objective of promoting private sector development by way of dialoging with the Government directly or through the Tanzania National Business Council (TNBC). Some of the notable achievements is that TPSF and CTI are among Members of the Tax Task Force formed by the Ministry of Finance to review the Government Budget Estimates with a view to make the fiscal policy stable, predictable and investor friendly.

### **2.2 Tanzania National Business Council (TNBC)**

This is among the 5 Presidential Investors' Advisory Councils established in Africa in collaboration with the World Bank. Others are in Ghana, Senegal, Mali and Uganda. TNBC is a forum for consultative mechanism between the public and the private sector with the objective of promoting a conducive investment for the private sector growth. The Investors' Round Table process brings together local and international investors in an informal setting for open and frank discussions with the President of the United Republic of Tanzania and some of his Cabinet Ministers on improvement of the business environment, reducing the cost of doing business and international business practices.

The decisions of TNBC are reached by consensus but have contributed in Government thinking and policy formulation and at times in the legislative process. Visualize the Land Amendment Act 2004, Income Tax Act 2004 etc. The implementation of decisions of TNBC is being monitored through the President's Office, Planning and Privatization (POPP).

### **2.3 Tanzania Investment Centre (TIC)**

This is a Government investment promotion agency. They organize focused Investors cum Customers Group Meetings deliberating on impediments experienced by the investors. Recommendations are sent directly to the relevant Government Department or through TNBC for follow up and action.

## **2.4 Business Environment Strengthening for Tanzania (BEST) Programme**

The Government of Tanzania in collaboration with the private sector and four development partners namely, SIDA, DFID, DANIDA and Royal Netherlands Embassy have established the BEST Programme.

It is a 5-year programme commencing from 2003/04 whose major objective is to improve the business environment by reviewing the existing legal and regulatory framework. The programme covers 5 components, namely: -

- Better Regulations – examines all acts and their regulations, which govern the conduct of business in the country.
- Commercial Dispute Resolution – improve enforcement of contracts.
- Change of Civil Service Mindset – make civil servants investor friendly.
- Tanzania Investment Centre – make a one stop investment agency.
- Private Sector Advocacy – improve the capacity of business associations to advocate and lobby the Government.

## **2.4 Parastatal Sector Reform Commission (PSRC)**

This is a Government agency established in 1992 charged with the responsibility of divestiture of its properties. There were nearly 400 state owned enterprises which had accumulated losses and were heavily indebted to the Government and other creditors. They were heavily subsidized by the Government. All in all they were a big burden to the Government and the economy at large. To date over 300 parastatals have been privatized. The privatization programme is now focused mainly on the utility and infrastructure enterprises.

The privatization process has been conducted in a more transparent manner, the widest possible participation of the private sector in the ownership and management of the restructured economic activities.

## **3.0 Key Challenges Ahead and Intervention needed**

### **3.1 The existing investment climate and challenges**

The process of identification of investment impediments either through the Investors Round Table or other forum is a move in the right direction. Some action to mitigate the negative impact has been taken; nevertheless more has to be done to make the country attractive to local and foreign direct investments.

### **3.2 Business Licensing regime**

The Business Licensing Act 1972 was a major hindrance in starting up businesses by imposing a number of conditions. The 2004/05 budget reviewed the business environment by removing impediments in business undertakings, given that business licenses are intended to play a regulatory role and are not designed to raise revenue.

Abolished the fees payable for business licenses whose turnover is less than Tshs 20.0 million (US\$ 20,000) and set a minimum rate of Tshs 20,000/= (US\$ 20) for businesses with a turnover of more than Tshs 20.0 million (US\$ 20,000).



The Business Activities Registration Bill aiming at amending the Business Licensing Act has been sent to Parliament for first reading in June 2005 to reduce the cost of starting business.

### **3.3 Taxation related problems**

The main objective of any country's fiscal policy with regards to taxation is to promote a conducive environment for economic growth, employment and poverty alleviation and widen the tax base and thus to increase efficiency in tax collection and curb tax evasion.

- **Income Tax**

The new Income Tax Act was passed by Parliament in April 2004 and became operational in July 2004. This is a success story of the partnership between the Government and the private sector, which has led to a friendly tax regime. The challenge now is to finalize the regulations to make the income tax operate more smoothly.

- **Value Added Tax (VAT)**

The 2004/05 budget has increased the threshold at which VAT registration becomes compulsory from Tshs 20.0 million (US\$ 20,000) to Tshs 40.0 million (US\$ 40,000). The purpose was to remove small businesses from VAT threshold taking into account compliance and administrative costs involved in collection of this tax.

Nevertheless, there is more room for the Government and the private sector to dialogue on the VAT structure rates, which stands at 20%.

### **3.4 Access to Credit**

- There are no specialized banks to cater for specific sectors such as agriculture and real estate, thus restricting the growth of the economy.
- Commercial bank terms and lending conditions are considered restrictive.
- In order to improve access to credit from the banking system the Government has established the Export Credit Guarantee Fund managed by the Bank of Tanzania. SME Credit Guarantee Fund has recently been operationalized as the Bank of Tanzania and Treasury have finalized the Operational Guidelines.
- The Land Amendment Act was passed by Parliament in April 2004 after consultations with the various stakeholders including the private sector. The objective was to make land a desirable collateral by the banking institutions so as to extend credit to the various sectors of the economy. For this to be a success, improvement in the land registration office is imperative.

### **3.5 Enforcing Contracts**

There has been a backlog of commercial cases. The establishment of Commercial Court Division of the High Court will expedite the handling of commercial disputes.

The challenge is also to expedite the operationalization of the Commercial Dispute Resolution Component of the BEST Programme.

### **3.6 Negative Image**

The fundamental problem is the perceived negative image of Africa and Tanzania as a high-risk investment area. Moreover Tanzania has been underselling itself, hence not getting its fair share of direct foreign investments.

The private sector appreciates the Government efforts in establishing Branding Tanzania Task Force to spearhead the image settling and branding of the country.

### **3.7 Infrastructure**

- High tariff rates and unreliable power supply have contributed to high cost of production rendering our products uncompetitive locally and externally.
- Air and surface transport is underdeveloped. Rural roads are in poor state making growth of the rural sector low and poverty alleviation strategies difficult to implement.
- With limited resources the challenge is for the Government to invite the private sector to develop the infrastructure under public private partnership. Tanzania can borrow a leaf from the Malaysian experience where the private sectors engage on BOT, BOO etc.

### **3.8 Human Capital**

- The private sector is of the view that the budget for the education sector should be increased to the tune of 20% to 25% of the national budget.
- The implementation of Primary Education Development Plan (PEDP) whose objective is to enroll more pupils and improve on the quality of education and delivery system is a welcome move: These achievements could be rolled over to the Secondary Education Development Plan (SEDP) aiming at increasing the enrollment at secondary schools.
- This should be coupled with a review of curriculum development for a market oriented economy and emphasis on information communication technology. Lessons from the new industrializing countries such as Korea, Malaysia and Singapore illustrate the crucial role of human resource development in their development endeavours.

### **3.9 Labour Reforms**

The BEST Programme is covering labour reforms with the objective to make labour markets more efficient and improve on industrial relations: Thus encouraging more investment and employment.

### **3.10 Good Governance**

- The private sector recognizes the Government efforts in fighting corruption by establishing Prevention of Corruption Bureau and creating awareness on the negative effects of corruption.

### **3.11 Micro Small Medium Enterprises Project**

The Government and the World Bank have signed a loan agreement worth US\$ 95.0 million in order to promote: -

- Increase private sector growth.
- Increase employment in the private sector.
- Increase exports growth and market access.
- Improve financial services.
- Increase performance of MSMEs.

#### **4.0 Conclusion**

In recognizing the fact that private sector will be the engine of growth, National Strategy for Growth and Poverty Reduction (NSGRP) has identified Private Sector Development (PSD) as an important source of Growth. The strategy stipulates that domestic firms, including SMEs will be supported and encouraged to be innovative, pay attention to product development, quality and superior marketing strategies that make them competitive and capable of responding to global market conditions. PSD enabling factors, which are also in line with the strategies for the TMTP2020 (Tanzania Mini-Tiger Plan 2020) include:

- ◆ Addressing entrepreneurship development needs for rural private producers (on farm and non-farm). Agro-based industries, urban-based SMEs, formal and informal enterprises. Ensuring access to resources (finance, land, water); technological and managerial skills including marketing; market information and contacts;
- ◆ Facilitating linking-up of domestic producers with local and foreign R&D institutions;
- ◆ Fair competition to ensure level playing field; a smooth and stable administrative and regulatory framework, guaranteeing personal and property rights and security and enforcement of contracts;
- ◆ Basic infrastructure such as utilities, water, power, transport and ICTs at competitive prices in rural and urban areas.

The Government and the private sector are working in partnership to improve the business environment in order to promote economic growth and contribution to income generation and poverty alleviation. The private sector in Tanzania has much to learn from the experiences of other countries as we strive to develop a private sector led economy in the country.

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