EXPLORING TANZANIA’S INVESTMENT COMPETITIVENESS IN EAST AFRICA

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SOUTH AFRICAN INSTITUTE OF INTERNATIONAL AFFAIRS

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ABSTRACT

Since Tanzania’s transition from a purely socialist approach to economic governance, the country has made some strides in attracting foreign investment. Given its negligible domestic saving culture, the answer to capital formation, job creation and general social upliftment lies in large part in foreign investment. Unlike the Ujaamanization era – when the government wanted to play a dominant role as an investor, with disastrous economic consequences – the current situation demands that the state create an environment conducive to foreign investment. The Tanzanian government can achieve this through instituting regulations and providing a foundation for its own people to emerge as entrepreneurs with the capacity to partner with foreign investors. In addition, the government has to invest in human capital development. This paper recognises Tanzania’s political stability, its membership in the East African Community and SADC, and its physical location as constituting a positive platform on which it can build its competitive advantage for foreign investment. Further, Tanzania’s highly liberal regulatory regime on foreign investment, as encapsulated in various domestic statutes and bilateral investment treaties, is a positive attribute. Nevertheless, if the country is to realise its full potential as an investment destination it must deal with those structural challenges that impede the attraction and retention of foreign direct investment. It should update its bilateral investment treaty network; harmonise all investment regulatory instruments; empower the Tanzania Investment Centre as an institution; take primary responsibility for developing the skills of Tanzanians; facilitate the integration of its small and medium enterprises into regional and global value chains by encouraging foreign firms to set up in its export processing zones; incentivise locals to integrate into agricultural and agro-processing value chains by providing them with title deeds to their land (which can be used as collateral to raise finance); and link incentive schemes to the integration of locals into value chains and skills development.

ABOUT THE AUTHORS

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ABBREVIATIONS AND ACRONYMS

AGOA  African Growth Opportunity Act  
BIT    bilateral investment treaty  
BRN    Big Results Now  
DRC    Democratic Republic of Congo  
EAC    East African Community  
EPA    Economic Partnership Agreement  
EPZ    export processing zone  
FDI    foreign direct investment  
FIP    Finance and Investment Protocol  
FTA    free trade area  
GATS   General Agreement on Trade in Services  
GDP    gross domestic product  
OECD   Organisation for Economic Co-operation and Development  
SMEs   small and medium-sized enterprises  
SOE    state-owned enterprise  
TIA    Tanzania Investment Act  
TIC    Tanzania Investment Centre  
WTO    World Trade Organization
INTRODUCTION

Economic development in independent Tanzania has gone through three main phases. The first phase (1961–1967) was characterised by a capital economy. During this period Tanzania experimented with import substitution policies and public–private ‘partnerships’. The second phase (1967–1983) was under President Julius Nyerere’s African brand of socialism, which he termed *Ujaamaa*. During the *Ujaamanisation* era, Tanzania embarked on massive nationalisation, price controls, government subsidies and export restrictions. The Organisation for Economic Co-operation and Development (OECD) notes that during this period the number of state-owned enterprises (SOEs) grew from 40 to 425, contributing 25% of gross domestic product (GDP). In comparison, there are currently 176 SOEs in the country. Tanzania began to liberalise its economy in the early 1980s as the Washington Consensus and the attendant structural adjustment programmes began to gain momentum.

This third phase (1983–today) has seen the liberalisation of the Tanzanian economy, and is reflected in a web of trade and investment policies and plans. Most of the country’s economic policies are informed by various complementary regimes. This study has undertaken both a regulatory and an economic analysis of Tanzania’s investment regime. As a result it also analyses the different international agreements to which Tanzania is party that have a bearing on its investment policy. Also crucial to understanding Tanzania’s investment regime are the various bilateral investment treaties (BITs) that the country has signed.

What emerges from the study is that Tanzania has made important strides in liberalising its economy and opening up to foreign investment. The country’s membership of different international trade and investment agreements has had a positive effect in pushing for domestic reform. One of the main factors making Tanzania a preferred foreign direct investment (FDI) destination in sub-Saharan Africa is its political stability. However, there are multiple structural impediments to FDI attraction and retention. These include a lack of skills, cumbersome land ownership regulations, poor infrastructure, corruption, weak institutions and the inadequate implementation of certain existing laws. The paper therefore recommends that Tanzania take steps towards addressing the institutional and structural impediments to foreign investors. It should consolidate the advantage conferred by its political stability by easing the conduct of business, strengthening the judiciary, improving proprietary rights with regard to land, up-skilling its citizens and modernising its bilateral investment treaties.


2 Ibid.
LOCATING TANZANIA WITHIN AN INTERNATIONAL INVESTMENT REGULATORY FRAMEWORK

There is a strong connection between Tanzania’s investment and trade policy regimes. This is because, as a developing country, Tanzania leans towards using trade and investment policy as a tool of its industrial policy. In recent years studies have emphasised the need to link trade and investment to take full advantage of the emergence of value chains. The current analysis will therefore focus on the country’s investment policy within a trade regulatory lens.

Tanzania is a member of SADC, a free trade area (FTA), and the EAC, which is a more integrated FTA than the former. Most recently, Tanzania and its EAC partners have entered into an EPA with the EU. However, since the election of President John Magufuli in November 2015 Tanzania has been reluctant to ratify the EAC–EU EPA and has even threatened to withdraw. The Tanzanian Parliament has voted on the matter and has moved that the EPA should not be brought before it for ratification. This means that even if the government signs the agreement, it will not be ratified. Tanzania has a dualist system for international treaties, and as such they must first be ratified by Parliament before they can be enforced. The government argues that it wants to protect its infant industries and will not be able to develop should it open up to EU products. Former president Benjamin Mkapa was also critical of the EAC–EU EPA.

While the EPA has no investment chapter, it is crucial for the type of investment that Tanzania wishes to attract, as it allows for market access to the EU.

The country also benefits from unilateral tariff preference arrangements, notably the African Growth and Opportunities Act (AGOA), extended by the US until 2025. Besides offering duty- and quota-free market access to the US, AGOA also encourages respect for investment and property rights if a country wishes to retain its beneficiary status. Furthermore, Tanzania has BITs with most of the capital-exporting countries. It is also a member of the WTO and has signed the General Agreement on Trade in Services (GATS), which incorporates investment disciplines through the supply of services via commercial presence, also known as Mode III.

Most of these instruments deal with trade policy. However, in Tanzania, as in much of SADC, trade and industrial policy is intertwined with investment policy. These countries use (mostly foreign) investment to drive their industrial policy goals and support the

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3 Members are Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.


development of value chains. This is usually done through the imposition of performance requirements and export-led growth policies.

It is important to note that Tanzania has a patchwork of policies which, when critically analysed, reflect a country that yearns for the domestic policy space to drive an industrial policy agenda. However, its current policies generally reflect a liberal approach that might not guarantee that policy space. These policies are more skewed towards an emphasis on the rights of investors, while limiting the government's ability to impose certain obligations (performance and local content requirements, or the requirement to partner with local firms) on the former. So far the country's experimentation with performance requirements and import substitution suffers from benign neglect, as few domestic firms are able to operationalise this approach.

Several trade agreements have an effect on its investment policy.

**SADC Finance and Investment Protocol and Envisaged Services Protocol**

The SADC agreement contains the Finance and Investment Protocol (FIP). The FIP comes in the form of an OECD BIT prototype, meaning it has stringent FDI protection provisions. Tanzania's envisaged revised investment act, aimed at creating more policy space, will run counter to some of the FIP's provisions. One crucial difference between the FIP and the current Tanzanian Investment Act is that the FIP does not provide for a screening mechanism; within the FIP framework investors have the right of establishment. However, the Tanzanian Investment Act is premised on an opaque screening mechanism. Tanzanian investment policy allows for the minister of trade to designate what are termed 'strategic' industries. This divergence between the two instruments could be legally problematic, as the FIP does not allow for a lot of performance requirements, save for targeted and time-bound support for infant industries. In international law there is a general principle that avers that a state cannot use its domestic legislation to evade its international obligations. This implies that the FIP takes precedence over Tanzania's investment policy. Furthermore, Tanzania intends to introduce a lot of performance requirements, especially in the oil and gas sectors, while the FIP makes no provision for these. Similarly, the act's distinction between foreign and local investors is not reflected in the FIP. Hence the act violates the national treatment principle, a cornerstone of the FIP, and international investment law and policy.

SADC is currently also negotiating a Trade in Services Protocol. Tanzania did not adhere to many of the commitments in the GATS and failed to open up much of its services sector to foreign participation. The country could, therefore, within the SADC Trade in Services Protocol, open up its services sector to more foreign participation without excluding domestic firms. The fact that the protocol is under consideration also allows Tanzania to carve out its policy space when making commitments – the amendments to the FIP Annex dealing with regulating foreign investments are intended to create more policy space for homes.

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6 The Finance and Investment Protocol (FIP) was signed by all 14 member states except Seychelles, which was not a member in 2010. Tanzania ratified the FIP in June of 2014.
member states. It has already been approved by the ministers of trade and awaits adoption by heads of state.

Perhaps the most contentious investment policy regime for Tanzania is its BIT framework. Most of the BITs to which Tanzania is party are first generation and do not provide for government regulatory space.

One highlight of this major shift towards an investment policy framework infused with industrial policy was the review and amendment of the Tanzanian Investment Act 1997 (TIA). The act is the blueprint for the Tanzanian investment regime, as it provides for the ‘establishment of enterprises; attribution of investment benefits and guarantees; transfer of capital profits; guarantees against expropriation; dispute settlement; and employment of foreign staff’.7

Tanzania’s bilateral investment framework

Tanzania had quite an open investment framework, judging by domestic instruments such as the 1997 TIA and the National Investment Promotion Policy of 1996. Yet this openness to investment – characterised by strict foreign investment protection and generous incentives – was not matched by a policy space that allowed the government to pursue an industrial policy-led investment regime. The Finance Act 2016 has gone a long way towards eradicating most of these incentives, with the majority now confined to export processing zones (EPZs). The government has been shifting towards a more active role with a view to using its investment policy to extract industrial and developmental gains.

Tanzania’s liberal domestic investment policy framework, as set out in the 1997 TIA, reflected its commitments in the 20 BITs it had signed, 12 of which are still in force. While such a liberal investment protection regime is commendable, it can be a hindrance to a developing country such as Tanzania. A critical analysis of Tanzania’s BITs also shows that these treaties are first generation and therefore not in sync with the country’s development agenda.

Tanzania urgently needs to review its BIT framework to bring it into conformity with its need for policy space and the development and protection of infant industries. The country has in several policy documents stated the need to pursue the development of local industries in various sectors. The idea of developing small and medium-sized enterprises (SMEs) is understood in industrial policy terms as infant industry protection. It can be argued that the country’s trade and industrial policy is based on the infant industry protection theory.8 Most investment agreements do not make provision for governments to pursue this particular policy trajectory. Both developed and developing

8 The infant industry theory postulates that less developed countries should be given room to pursue targeted and time-bound protections on their nascent industries until they are competitive enough. Presently, this concept is usually expressed as a need for carving policy space in trade and investment agreements.
countries have come to this realisation, hence the move towards third-generation bilateral investment treaties.⁹

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⁹ Bilateral investment treaties have evolved over time from those that had stringent protections for foreign investors at the expense of host states’ rights to regulate in the public interest. Most of the current international investment agreements are moving towards greater balance. These are referred to as third-generation investment agreements.
A revisit of the country’s BIT framework is in line with international best practice. Within SADC, Botswana, Namibia and South Africa have already had to revisit their international investment agreements in their attempts to carve out space for different domestic policy objectives. At a regional level, the SADC FIP is currently under review with a view to ensuring that it reflects the region’s shift towards industrial policy-led growth. Namibia and South Africa have mainly been driven by the need to accommodate their economic transformation policies, while Botswana seems to be driven by the need to accommodate its beneficiation and indigenisation policy.

**Main principles of Tanzania’s bilateral investment treaties**

Tanzania’s BITs with its capital-exporting partners generally follow a typical OECD template. They encapsulate the following principles: national treatment, most favoured nation principle, prohibition against expropriation, regulatory takings, market value compensation, minimum standard of treatment, fair and equitable treatment, and full protection and security. The overall effect of these standards is the protection of investors’ rights – sometimes to the detriment of the host country’s right to regulate in the public interest.

In addition, all of Tanzania’s BITs provide for recourse to international arbitration. Tanzania has been taken to international tribunals three times under some of its BITs. In the Biwater case, the Tanzanian government was sued by two consortia partners for intervening when private firms that were supposed to provide water to residents in Dar es Salaam could no longer meet their obligations due to the non-payment of rates by citizens. While the case had many humanitarian aspects, it was resolved in a commercial manner. At the core of the Biwater case was the universal right to water. Similarly, in the Standard Chartered Bank cases, private foreign investors are taking action against the Tanzanian government for alleged breach of provisions within the BITs and violation of the TIA of 1997. These cases highlight the need for Tanzania to revise its investment treaty regime.

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12 See Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania, ICSID Case No. ARB 05/22.

13 Ibid.


15 Standard Chartered Bank v The United Republic of Tanzania, ICSID Case No. ARB/05/22, 2012; Standard Chartered Bank (Hong Kong) v The United Republic of Tanzania (TANESCO), 2016.
with a view to modernising it to the level of third-generation international investment agreements. This is something that the US State Department’s ‘Tanzania Investment Climate Report of 2015’ also recommends. In modernising its international investment agreements framework, Tanzania could use the SADC Model BIT as a guideline.16

DOMESTIC FOREIGN (AND LOCAL) DIRECT INVESTMENT REGULATION

In Tanzania, much like in many other developing countries, attracting FDI is a key government strategy to promote economic growth and development. Ever since the country transformed its centrally planned economy into a market-oriented system in the 1990s, the government has shown a commitment towards enhancing private sector development through the adoption of a wide range of investment-enabling regulations, practices and policies.

DOMESTIC INVESTMENT REGIME (PROMOTION AND PROTECTION)

The government of Tanzania actively engages in investment promotion through the Tanzania Investment Centre (TIC). This is a government agency established by the TIA 1997 with the objective of coordinating, encouraging, promoting and facilitating investment in the country, as well as advising the government on issues concerning investment policy. In Zanzibar, the Zanzibar Investment Promotion Agency carries out a similar function.

The TIC acts as a one-stop centre for investors, facilitating business and tax registration, land and business licensing, and immigration and labour issues, among others. It also offers fiscal incentives to foreign companies and joint ventures with Tanzanians for foreign projects with a minimum $300,000 capital investment, and for domestic projects with a minimum investment of $100,000.17 These incentives are granted through a TIC-issued certificate of investment, and include exemptions on projects’ capital goods, tax relief on deemed capital goods, capital allowances and depreciation allowances.18 In terms of non-fiscal incentives the TIC guarantees an automatic immigration quota of up to five persons during the start-up period; protection against non-commercial risks; protection against nationalisation and confiscation; and unconditional transferability of funds for


repatriation. The Finance Act also guarantees access to international arbitration in cases of an investment dispute and defines strategic investment and a minimal capital threshold of investment.

An additional set of incentives is available for strategic investors under the Tanzania Investment Regulations of 2002. There are no specific criteria for selecting these investors, but the TIC considers an array of factors, including the project's contribution to job creation, the introduction of new and innovative technology, the location of the project, the size of the investment and its impact on the national economy. In 2014 the minimum threshold to qualify as a strategic investor was set at $50 million for foreign investors and $20 million for Tanzanian investors.

Tanzania does not have specific FDI-screening criteria, but the TIC looks at a number of factors before approving a project, notably foreign exchange generation, import substitution, employment creation, linkages to the local economy, technology transfer, and expansion of production of goods and services. Currently, projects are not screened for competition potential, and companies are also not required to disclose proprietary information in order to be approved. In fact, virtually all projects submitted to the TIC with all required documentation presented are approved.

**FDI TRENDS AND INVESTMENT CLIMATE**

Through the TIC, the government of Tanzania promotes investment and trade opportunities in agriculture, mining, tourism, telecommunications, financial services, energy and transportation infrastructure. Between 2009 and 2013 Tanzania accumulated a total FDI stock of $14.9 billion, with an inflow of $2.1 billion – the highest registered to date – being observed in 2013 alone (see Figure 1). Between January 2010 and December 2015 the TIC registered over 4,000 projects in priority sectors such as manufacturing (1,283), transportation (768), commercial building (594) and agriculture (246).

Historically, the mining and quarrying sector has received the highest FDI inflows. However, in 2013 the lion's share of FDI inflows was registered in the financial and insurance sector (see Table 2). Yet mining and quarrying remains the lead sector in FDI stocks with $6,825.2 million registered in 2013, followed by manufacturing with $2,409.9 million, and finance and insurance with $1,629 million. Another important trend to note is the significant investment in energy and gas between 2010 and 2012, which increased the FDI stock in that sector to $1,182.3 million.

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19 Ibid.
20 Ibid.
21 Ibid.
22 US Department of State, *op. cit.*
23 TIC, *op. cit.*
FIGURE 1  TANZANIAN FDI, JANUARY 2009 – DECEMBER 2013, $ MILLION


TABLE 2  TANZANIAN FDI BY SECTOR, JANUARY 2009 – DECEMBER 2013, $ MILLION

<table>
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<tr>
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<tr>
<td>Mining and quarrying</td>
<td>385.1</td>
<td>909.9</td>
<td>406.5</td>
<td>889.3</td>
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<td>Manufacturing</td>
<td>214.5</td>
<td>157.1</td>
<td>217.3</td>
<td>563.7</td>
<td>386.6</td>
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<td>Financial and insurance</td>
<td>95.9</td>
<td>95.5</td>
<td>121.1</td>
<td>148.1</td>
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<td>Electricity and gas</td>
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<td>290.5</td>
<td>209.4</td>
<td>618.3</td>
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<tr>
<td>Transportation and storage</td>
<td>3.9</td>
<td>4.0</td>
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<tr>
<td>Other</td>
<td>251.7</td>
<td>356.2</td>
<td>264.9</td>
<td>(362.7)</td>
<td>414.9</td>
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</table>

In terms of FDI sources, in 2013 four African economies were among the top 10 countries investing in Tanzania, namely South Africa, Kenya, Nigeria and Mauritius (see Figure 2). Looking at FDI stocks at the end of 2013, South Africa had the biggest capital investment, amounting to $3,658.8 million, followed by the UK with $2,461.7 million and Barbados with $1,834.3 million.\footnote{Ibid.}

In recent years Tanzania has also become the leading destination for FDI inflows in the EAC, followed closely by Uganda and Kenya (see Figure 3). Political stability and its strategic geographic location – Tanzania provides port access to six landlocked countries in the region, namely Uganda, the Democratic Republic of the Congo (DRC), Rwanda, Burundi, Zambia and Malawi – are among the key reasons for this performance. The government of Tanzania’s continued commitment towards promoting private sector-led growth also plays an important role.\footnote{Tanzania Investment Commission, \textit{Tanzania Investment Guide 2014–15}. Dar es Salaam: TIC, 2013.} In addition to being a member of the EAC Common Market, Tanzania has also ratified the SADC FTA. This increases its relative attractiveness compared to the other EAC countries because investors can access a larger regional market. All of these contribute to establishing Tanzania as an important gateway for investment and a leading FDI destination on the African continent.

\textbf{FIGURE 2} \textit{TANZANIAN FDI: TOP 10 SOURCE COUNTRIES OF FDI STOCKS, 2013, $ MILLION}

\begin{center}
\begin{tabular}{cccccccccc}
Norway & US & Switzerland & Netherlands & Mauritius & Kenya & Canada & Barbados & UK & South Africa \\
215,5 & 345,2 & 615,8 & 656,0 & 664,9 & 819,4 & 1,805,3 & 1,834,3 & 2,461,7 & 3,658,8 \\
\end{tabular}
\end{center}

CHALLENGES FOR INVESTMENT

The government generally has a positive attitude to FDI, and has had considerable success in attracting it. However, a few challenges still hamper foreign investment in the country. In the 2016 Ease of Doing Business report, Tanzania is ranked 139 out of 189 countries, and the country performs below the EAC-regional business climate average in six of the 10 ranked indicators (see Table 3).

Some of the recurring challenges identified by investors are the lack of adequate public infrastructure, electricity and water; elevated taxation and fees; corruption; skills shortages in the local labour force; lack of contract enforcement, and law and order. However, it appears that the most severe impediment to investment in Tanzania is the difficulty accessing land and securing tenure.

The president is the custodian of all land and the government oversees the issuing of land leases, which can be granted for up to 99 years and are renewable. However, under the Village Act 1999 (Act 5 of 1999), villages issue permits for land within their boundaries.

27 Interview with Nkoji Tibenda, Head of Research, TIC, Dar es Salaam, 17 May 2016.
28 US Department of State, op. cit.
### TABLE 3  EASE OF DOING BUSINESS RANKING BY INDICATOR

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<tr>
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<th>Tanzania 2016&lt;sup&gt;a&lt;/sup&gt;</th>
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<td>Starting a business</td>
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<td>Registering property</td>
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<td>Getting credit</td>
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<td>Protecting minority investors</td>
<td>122</td>
<td>121</td>
<td>108</td>
</tr>
<tr>
<td>Paying taxes</td>
<td>150</td>
<td>147</td>
<td>103</td>
</tr>
<tr>
<td>Trading across borders</td>
<td>180</td>
<td>181</td>
<td>150</td>
</tr>
<tr>
<td>Enforcing contracts</td>
<td>64</td>
<td>64</td>
<td>103</td>
</tr>
<tr>
<td>Resolving insolvency</td>
<td>99</td>
<td>98</td>
<td>113</td>
</tr>
<tr>
<td>Ease of Doing Business rank</td>
<td>139</td>
<td>140</td>
<td>117</td>
</tr>
</tbody>
</table>


Securing land title deeds with village councils is generally a slow and fraught process, since many Tanzanians are sceptical about foreign investment and its benefits for local communities. The case of a Swedish company that sought to open a bio-fuel plant in 2008/09 illustrates this problem. Although the company obtained the title deed, it was involved in continued disputes with the local community over its right to occupy the land, leading to its eventually closing down operations. These types of conflicts (some of which have led to violence in Arusha) have pushed the Tanzanian government to improve the investment climate while ensuring that the intended results of foreign investment benefit Tanzanians.

Derivative rights for foreign ownership of land have now overridden the challenges described here; ie, the TIC has the right of occupancy and a derivative right is issued through it to a foreign investor. When this is done, there are hardly any cases of land conflict throughout the life of the investment. Over the years the Tanzanian government has adopted different strategies to ensure that the allocation of land to foreign investors does not lead to conflict with locals.

In 2010 the Prime Minister’s Office launched the implementation of the Government Roadmap on Improving the Investment Climate, which sought to streamline the regulatory framework and procedures, as well as to identify measures to improve the country’s...
Although the ultimate goals of this strategy have not been achieved yet, some progress has been made, notably in reducing the number of roadblocks on highways; streamlining business registration and making it available online; and increasing agricultural lending through a dedicated loan window at the Tanzania Investment Bank pending the establishment of a full agricultural bank.

In 2014 the National Business Council successfully lobbied the government to include investment climate reform in the Big Results Now (BRN) initiative, a programme aimed at reforming key sectors through public and private partnerships. Under this umbrella, six priority areas were identified as the focus of the business environment improvement strategy, namely: realigning regulations and institutions, improving access to land and security of tenure, improving taxation, curbing corruption, improving labour laws and skills sets, and ensuring contract enforcements. Unfortunately, the BRN programme was discontinued under the Magufuli administration.

Ironically, some Tanzanians believe that the new administration’s focus on corruption has had the unintended consequence of ‘undermining’ the business environment. They argue that the effort to eliminate bribery and corruption has made deal making difficult in an environment where people fast-track business and bypass red tape through rent-seeking behaviour. However, with concerted efforts in the fight against corruption, the investment climate should improve in the long run, provided that strong and independent institutions are created to anchor the new anti-corruption culture.

**POLICY RECOMMENDATIONS**

As indicated, Tanzania’s challenges are mostly institutional and structural. Domestic entities do not have the capacity to stimulate economic growth, and the country is heavily reliant on FDI. If Tanzania wants to attract more FDI, the government needs to play a facilitative rather than an interventionist role. Under the current administration there have been overtures leaning more towards an interventionist approach. Instead there is a need to strengthen institutions that are sustainable and that can be relied upon by investors, both foreign and domestic. Consequently, this study makes policy recommendations relating to skills development, agriculture, tourism and value chain linkages, highlighting ways in which Tanzania can harness FDI towards sustainable, inclusive development without these being too onerous for foreign investors.

**ADDRESSING THE SKILLS BOTTLENECK**

While the Tanzanian government should identify those sectors of the economy in which to encourage greater participation by locals, it should also recalibrate the policy framework.

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to the availability of skills in targeted sectors. According to World Bank data, currently more than 68% of Tanzanians live in rural areas. The government faces the challenge of bringing this constituency into the mainstream economy. This will be a mammoth task considering the pervasiveness of low-quality education and the narrow skills base. Thus the education and training system must first be overhauled if there is to be any meaningful sustainable development.

A study done in South Africa by the EU, for instance, has shown how policies designed for skills or technology transfer that are not accompanied by quality skills and educational standards can prove costly for foreign investors to implement. A skills transfer requirement would stimulate development, but the recipients should have a certain minimum level of competency (which may be achieved through training and/or experience) and the capacity to benefit from such an exercise. It is easier for foreign investors to transfer skills to people who already have a skills base. Currently, the Tanzanian labour market struggles to provide even skilled administrative capital. At the same time labour and migration legislation makes it difficult for foreign investors to bring in skilled labour, even from within the EAC.

A succession policy is embedded within the country’s Employment Promotion Service Act. This policy provides that when firms hire foreigners, they assign a Tanzanian understudy to the particular foreign national. At face value, this is a noble policy objective. However, due to the low skills base indicated above, efforts to fulfil this requirement could require foreign investors to allocate significant resources towards training personnel. This could diminish the value of their investments in real terms, and be construed as indirect expropriation. Furthermore, international comparative research has consistently shown that multinational companies (MNCs) provide better working conditions, with better pay, more training and greater spillovers into the local economy. Restrictive measures will inhibit this beneficial cycle and the associated spillovers.

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35 Most of the BITs to which Tanzania is party proscribe all parties from taking measures that have the effect of diminishing the value of investments through onerous obligations. Since workforce skills levels in Tanzania are low, legal requirements for companies to train workers could be construed as unreasonable in the sense that companies would have to expend substantial resources to adhere to them, and therefore be tantamount to indirect expropriation (by having to expend extra funds it could be argued that the value of investment had diminished).
SME development

Vibrant SMEs are critical to forging an inclusive and sustained growth path. Moreover, FDI can, and often does, lead to sourcing relationships between foreign investors and domestic SMEs. Due to SME capacity constraints, foreign investors generally tend to be averse to such partnerships as they can lead to a diminution of their value. Yet such relationships offer SMEs the opportunity to grow, develop and ultimately export via foreign investors’ value chains. Tanzania has a long way to go to develop its formal SME sector, given the skills constraints, and foreign investors could play a critical role in this process. While mechanisms are in place for assisting large enterprises (mostly foreign) to invest in Tanzania through incentives, none exists for SMEs and the reality is that there are more SMEs than large corporations in Tanzania. This results in the incentives regime benefiting large foreign firms at the expense of smaller local firms.

Financial literacy is also a stepping stone for Tanzanians into formal micro enterprises and SMEs. While the private sector, foreign and local, can play a role in building such literacy, this is not its responsibility – although it may well be in its interest to do so. Furthermore, access to finance is one of the greatest challenges for SMEs in Tanzania: more than 45.2% of Tanzanians are unbanked, with the financial sector serving only the formal sector.

Addressing these challenges does not require prescriptive instruments directed at foreign companies. Instead the government could work with foreign banks and companies in other sectors to develop mentorship schemes, inter alia, in order to encourage indigenous SMEs to enter formal supply chains. It could also develop a financial inclusion programme in which it encourages citizens to use formal banking structures. Financial institutions demand high collateral, but most Tanzanians are poor and own no real estate. The Tanzanian government should review the country’s land tenure system and offer title deeds to its small landholders, which they could utilise to secure loans from financial institutions.

Global (regional) value chains

The Tanzanian government, when revising its investment policy, should carefully consider placing its policy within a global value chain matrix, linking trade with investment. For example, it could encourage imports of unprocessed or semi-processed agricultural products, rather than protect domestic production in unfavourable circumstances, with a view to adding value for export to regional or even global markets. The EAC has the potential to provide a bigger market, and if the current negotiations within the Tripartite FTA succeed, Tanzanian producers will have access to an even larger market.

Similarly, Tanzania should position itself as a competitive port for goods coming from the DRC, Burundi, Uganda, Malawi, parts of Mozambique and Zambia, destined for India and China. The country recently entered into a $42 million agreement with the Chinese government to revitalise the TAZARA railway line. However, to succeed it will have to provide both the hard and soft infrastructure to facilitate trade and investment. The government has to make it easier to do business in terms of having fewer processes and rules in place that inhibit the setting up of businesses. Tanzania’s low score in the World Bank’s Doing Business Report is evidence of this constraint. This approach requires systematically reducing transaction costs for local and foreign investors alike. Furthermore, in terms of logistics, greater competitiveness will require bankable projects, investment, infrastructure, technology, know-how, and access to customers and markets. FDI plays a crucial role in providing all of these inputs, hence the need to create a more conducive environment.

Currently, according to the World Bank’s Doing Business Report, it takes 26 days and nine procedures to set up a business in Tanzania, compared to two days and two procedures in neighbouring Rwanda. Integrating into and upgrading within value chains require a strong trade facilitation approach, high skills levels, good corporate capabilities, and a responsive government. Tanzania mostly lacks these attributes but, by working with foreign companies rather than against them, it can gradually establish and embed these values. Key to initiating such a process is to establish and properly resource an independent investment promotion authority with sufficient clout to remove major domestic blockages and a strong market research capacity to target ‘lead firms’ in particular value chains – whether regional or global. The TIC does not have the capacity to engage in these matters. Ideally, it should be given greater powers and have a direct coordination role with the office of the president in order to speed up processes should there be bureaucratic bottlenecks. In terms of sectors on which to focus, Tanzania should consider paying more attention to the agricultural sector. Most Tanzanians live in rural areas and it would be best to leverage the resources that they already have.

Agriculture

Agriculture contributes about 26.8% of Tanzania’s GDP and employs about 70% of the labour force. Foreign companies could and should make a substantial contribution towards growing this sector. Yet the challenges to developing it are overwhelmingly domestic, and foreign companies cannot be obliged to address these. For example, most Tanzanians live in the agriculturally viable rural hinterland, growing crops and

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tending cattle. Any effort by the government to economically empowering them has to achieve this within that environment, allowing for some migration to the cities. The government should begin by issuing title deeds to farmers. It should then enact policies that encourage these smallholder farmers to integrate into agro-processing value chains, which in turn could link into an EPZ scheme (for example, to promote the processing of beef, leather and general agricultural products) for non-EAC foreign markets. Foreign companies could contribute substantially to this. This should be complemented with the aggressive strengthening of horizontal policies for domestic skills formation.

**Tourism and transport sectors**

The World Travel and Tourism Council estimates that the tourism sector contributes about 47.6% of Tanzania’s GDP and employs 19% of the country’s population. Foreign providers have a major role to play in the sector through their networks in the main developed-country markets, from which the wealthiest tourists come. These tourists spend the largest amounts per capita, and consequently this link to the highest end of the tourism value chain needs to be preserved and nurtured, since undue restrictions may stem the flow of tourists. At the same time the Tanzanian government should pursue opportunities to integrate local communities into the value chain at the lower end, with a view to upgrading their participation over time. Here the low-hanging fruit will be in the tourism sector.

Such skills development takes time, and cannot be imposed. Furthermore, a facilitative approach that gives positive incentives to foreign tourist providers to integrate communities into their value chains could boost skills development relatively rapidly. For example, rather than legislate those foreign providers, the government could require them to train local staff or communities, and tax incentives could be provided to encourage such training.

The government could also expand the participation of Tanzanians by reserving certain sections of the tourism sector for them. Such sectorial reservations could be successful if preceded by steps to identify the market segments in which Tanzanians have a comparative advantage, considering their relative lack of skills. This is the case with tour operators, while various sectors of the wildlife industry are also reserved for Tanzanians. The government should consider, for example, encouraging Tanzanians to enter into cooperatives and provide supplementary services in the hospitality sector, cultural tourism

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40 The agricultural sector in Tanzania consists of mainly communal production (on government land) characterised by subsistence production. The government is hesitant to issue title deeds in these communal areas. Title deeds can be used for collateral, but a default in repayment would cede government land to a financial institution.

41 While Tanzania’s EPZ regime is focused on exports to destinations outside the EAC, it has to date not produced any significant success stories.

or environmental (game parks) tourism. It could reserve services such as tour guiding, small catering facilities such as lodges, and transportation for locals. Such reservations would need to be consistent with Tanzania’s GATS and potential SADC commitments, and would have to traverse the BITs terrain given the undoubted presence in Tanzania (including Zanzibar) of European tourism services suppliers. Otherwise such actions could be construed as being inconsistent with the provisions in the FIP and BITs that rule against indirect expropriation and/or national treatment. Furthermore, the inclusion of Tanzanians in the tourism sector is reportedly hampered mainly by insecurity of land tenure and a general lack of coordination between and among various government agencies in land use planning. Lastly, the successful involvement of locals in the tourism sector will depend on their access to finance.

**Network Services**

Network or backbone services include telecommunications, transport, energy and financial services, and are highly capital intensive. These sectors cut across the economy and are strongly integrated with manufacturing, mining and agriculture. They are also critical to the successful operation of most of Tanzania’s EPZs, particularly the port of Dar es Salaam. Integration into, and upgrading within, global or regional value chains requires ready and competitive access to these services.

Since Tanzanian firms do not have the necessary financial resources to provide these services on an economy-wide scale, FDI is essential to the successful provision of such capital and services. A facilitative approach by the Magufuli administration to these services would serve the government’s infant industry development purposes. Without taking into account the specifics needed to empower locals, better and more cost-effective provision of these services would serve the SME sector well. This would impact positively on growing local firms through promoting entrepreneurial activities and access into global and regional value chains. In addition, facilitative approaches could empower locals to participate in these activities. For example, telecommunications companies could be offered tax incentives to source certain goods and services from locally owned SMEs; similarly, transport construction companies could be incentivised to incorporate domestically owned companies into their supply chains.

**Conclusion**

Tanzania is a key member of SADC and the EAC. The country is endowed with natural resources in the form of mineral resources, agricultural land, game and tourist-friendly beaches. In addition, the country has the port of Dar es Salaam, which increases its locational advantage with regard to foreign investment. Present-day Tanzania is a fairly economically liberal country, albeit with weak institutions and other attendant structural challenges. For it to realise its full economic potential, including plugging the country’s SMEs into regional and global value chains, the country has to harmonise its investment regulatory policies, both at a substantive and at a institutional level, through the improvement of intergovernmental coordination. The concept of a one-stop shop for investors should be further strengthened. There is also a need to revise the country’s
BITs to reflect its need for policy space. Tanzania’s BIT with Canada could be instructive in this regard, as it provides for much more policy space. Most importantly, considering that Tanzania is an agrarian society, the country needs to break away from its communist socialist past by reforming its land tenure laws. Amending these laws could unleash a lot of investment potential among farmers and boost agro-processing. Tanzania has the potential to become a hub in many sectors, especially as a producer of processed agricultural products and an exporter of these to countries such as India and China.
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