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TANZANIA PRIVATE SECTOR ASSESSMENT

FINAL REPORT

Bureau for Private Enterprise
U.S. Agency for International Development

Prepared for:	*USAID/Tanzania*
Prepared by:	*Coopers & Lybrand* *J.E. Austin Associates, Inc.* *The Services Group*
Sponsored by:	*Private Enterprise Development Support Project II* *Project Number 940-2028.03* *Prime Contractor: Coopers & Lybrand*

March 1992

Coopers & Lybrand

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CHAPTER I
EXECUTIVE SUMMARY

A. AN OVERVIEW

In January and February 1992, a private sector assessment team of four specialists from J.E. Austin Associates, The Services Group and Coopers & Lybrand, Washington, assisted the USAID Mission in Dar es Salaam in its effort to develop a private sector program. The Team focussed on three areas of concern: Financial Sector Reform, Parastatal Reform, and Reform of the Business Environment. Its methodology included synthesis of available data resources, and interviews. The Team was assisted by Coopers & Lybrand, Dar es Salaam.

Tanzania has for some years been moving from single to multi-party governance, from a centrally directed to a market economy, from parastatal to private enterprises. These changes have long been announced but slow in arriving. Effective implementation remains problematical, as it is not certain that national leadership (including regional and district party cadres, and the civil service) has completely digested and accepted the personal consequences of these changes.

Tanzania's structural adjustment program is on track as is Economic Recovery Programme II. Bilateral donors have understood they can better assist the process of economic growth through stimulation of private sector enterprise than with cash infusions of the Treasury.

B. WHAT TANZANIA NEEDS

Much like the ex-communist countries of East Europe, Tanzania is attempting something without a model: the purposeful redirection from a planned, centrally-directed to a free market economy. It is not clear whether it is oxymoronic to believe that governments can put in place the conditions that entrepreneurs created or seized in times past.

Over the quarter century of its African socialism, Tanzania has lost economic ground. It has become a poorer nation on the basis of constant dollar per capita GNP. Foreign aid has actually increased as a share of total GNP. Crop yields have dropped and production enterprises so declined as to be evidently worthless, even to their managers.

Like the former communist countries of Europe, Tanzania requires Price Reform, Financial Reform, Privatization, Trade Reform, and Institution-building.

<u>Prices</u> in market economies are the allocators of resources and the incentives or disincentives to produce. Tanzania's extensive informal economy has been setting prices (including those for foreign exchange) independent of government for at least a decade.

Financial Reform includes Fiscal Policy, Monetary Control and Banking Supervision. The first two are the foci of World Bank programs. The third is addressed by the Team.

Privatization includes, in addition to eliminating the access of loss-making enterprises to the Treasury, redirecting the attitudes of management and workers. In that they had no direct, personal risk associated with the operation of their enterprises, assets were often depleted in favor of greater immediate pay-outs in the form of wages and perks. Capital investment was inefficient.

Trade Reform for Tanzania requires a mental about face from African socialism and self-sufficiency to acknowledgement of the necessity of links with the world. The net result of Tanzania's ideologies was a cutting off of the Tanzanian market from international buyers and sellers, both in terms of protective tariff barriers, and reliance in substitution industries. Much of the required policy reform focusses on details of trade reform, from the law of contracts and enforcement of contracts, to import and export regulations. The intangible of attitude change is also addressed.

Institution building in the Tanzanian context refers to the public institutions, such as the civil service (courts, customs, record keeping, etc), to the physical infrastructure of communications and services, and to private business associations. As the CCM Party flourished, it tended to supplant or usurp the roles of various institutions. All institutions are deteriorated and will require technical assistance to recover their proper roles.

A World Bank observer notes that "Tanzania's plight in the 1980s had as much to do with a decline in the provision of public services as with the mess policies had made of resource allocation in the production of private goods. Reform of public sector management and expansion of physical and social infrastructure will be essential to success. This can only occur, however, if growth takes off in goods production, which depends in turn upon an enabling environment for the private sector - a tough recipe to fill. Because of poor infrastructure and weaker market institutions, supply responses will sometimes be slower in Africa [than in Asia], but evidence demonstrates that producers do respond when given the proper incentives and the tools to work with. Indeed, Tanzania's urban informal sector is estimated to have tripled in size since the mid-1980s. When markets were (partially) liberalized, rural welfare improved immensely, simply because goods became available again."[1]

C. RECOMMENDATIONS

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1 "The Challenges of Development," Lawrence H. Summers, in, Finance & Development, March 1992, pp6-ff

Tanzania's restructuring needs are so extensive and deep that a single donor cannot physically assume more than a small portion of the burden. The Team recommends that USAID/Tanzania:

- o strengthen central bank operations and supervision in preparation for competitive private, commercial banking. Assist in the creation of sound, private commercial financial institutions. These are lacking and their absence creates nearly insurmountable obstacles for any attempts to establish free market enterprises, domestic or foreign in ownership.

- o take steps to create a workable check clearing system to put bank(s) on an operating basis and to assist enterprises in their cash management. The level of effort recommended includes a technical project to create an efficient data communications to serve a check clearing system as well as improved BoT supervision.

- o support World Bank programs for restructuring of State Owned Enterprises, but do not take an active role. USAID should participate in aspects of, but not assume a leading role in, the restructuring of State Owned Enterprises. The World Bank has already taken the logical first steps for the valuation of the SOE portfolio (see the Haggerty report); enterprise and holding company level management has already started its search for partners (see Chapter III of this report); but it is not clear whether the political conditions necessary for a sound resolution of the issue will be permitted to exist. Outsiders run the risk of being accused of stripping the only valuable assets from the State's portfolio and leaving indigenous Tanzanians with the least viable.

- o take the leading role in the restructuring of the office and records of The Registrar of Companies in order to create the basis for accurate information on businesses in Tanzania - both for GOT purposes and for business-to-business relationships, including sales and service, and mergers and acquisitions.

- o consider joining with other donors to create a venture capital fund and/or unit trust as a first step toward an indigenous capital market and the creation of a stock market. A model plan has been described in a separate document by USAID/ONI.

D. OBSERVATIONS

1. Ideology is one of the most important forces in Tanzania constraining private sector development in Tanzania.

The Arusha Declaration of 1967, which gave expression to the ideology of socialism and self-reliance, shaped the role of the private sector in Tanzania, First, it extended the role of the state to the "commanding heights" of the economy, including

financial services, estate agriculture, commerce, and industry, with the goal of driving the private sector under. The reverse took place. The legacies include an enormous parastatal sector,[2] a deteriorated infrastructure, an insolvent state banking system, weak private sector organizations, an underpaid, undermotivated civil service, and skepticism among potential private investors.

For seven years, the results of Nyerere's experiment in African socialism were positive. The economy was kept strong by rising prices for the country's traditional export crops. There was strong intellectual leadership with a clear vision of the future. Even those most opposed to government policies during this period agree that many government officials were highly qualified. Basic services effectively reached the rural poor. Foreign donors, particularly the Scandinavians, were highly supportive of the Tanzanian development model.

This positive economic and social performance during 1967-74 helps us to understand why it took another eight years of economic disaster before any policy change occurred to reverse the decline. Moreover, the rampant inflation and declining foreign exchange reserves could be attributed by the leadership and by the public to external shocks (oil prices, worsening terms of trade, and a costly war with Uganda) rather than to failed policies and public mismanagement.

As is pointed out in Chapter IV, in his February 18, 1992, keynote address to the CCM National Executive Mr. Nyerere framed the issue in the negative. That is, a sufficient number of independent politicians will be required to vote <u>in favor of capitalism</u> in the National Assembly to provide the necessary two thirds vote to revise the Constitution to eliminate its direct reference to the primacy of CCM economic policies. Culturally and socially, this will be extremely difficult.

<u>2. The government has shown itself to be capable of pragmatic response, at the level of macro policy, to economic problems</u>.

The granting of own-funds import licenses in 1983 was a momentous decision that in effect recognized the failure of the fixed rate exchange policy that greatly overvalued the currency, discouraged exports, and could only be sustained through import licensing, foreign exchange allocation, and price controls.

Import licenses issued through the own-funds scheme had reached a value of $475 million (over one-third of all import licenses issued), peaking out in 1988 at $639 million and declining

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[2] Economist Intelligence Unit, <u>Tanzania: Country Profile, Annual Survey of Political and Economic Background, 1991-92</u> (Business International, Dec. 1991).

to $448 million in 1990 as other import schemes gained in importance.[3]

Policies under the Economic Recovery Programme (ERP) in 1986 further reduced the discretionary allocation of foreign exchange. The currency was allowed to devalue by 80 percent so that the parallel market premium, which had been 9:1 in 1985, settled at 1.5:1 in 1990.[4] A less overvalued currency opened the way for a partial liberalization of imports through the open general license (OGL) granted automatically for certain categories of imports. With World Bank and bilateral donor support, the value of OGL licenses issued has increased from $50 million in 1988 to $310 million in 1990, about a fifth of the value of all import licenses. The OGL was supplemented by other specific import support programs, by the government's allowing retention of a percentage of export earnings, and by an increasing volume of loans, grants, and credit from bilateral and multilateral agencies.

3. As foreign exchange policies were becoming more liberalized, regulations on the implementation of these policies have become more stringent.

When the retention scheme was begun it was held to ten percent of export earnings but the exporter was allowed to retain these in an overseas account in which he or she had check signing powers. The government later moved them into a trustee account in the exporter's name. The retention limit has since gone up to 35-50% (depending on the goods exported) but funds are held in a trust account in the National Bank of Commerce's (NBC) name and it is the NBC that must open the letter of credit. Because of questions and delays by the NBC, exporters such as tour operators cannot obtain timely inputs such as safari vehicles to generate export earnings during the tourist season.[5] Own-funds imports will soon be made more difficult by a new requirement that merchandise be inspected prior to shipment.[6]

4. While policy changes have proceeded rapidly in the areas of foreign exchange, banking, and parastatal reform, there has been far greater resistance to institutional change.

On the positive side, there has been some deconfinement of marketing channels and a drastic reduction, for instance, of National Milling Corporation's monopoly position. Private grain mills have been built and are coming onstream. Wheat estates and

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[3] Data on windows of foreign exchange availability provided by the World Bank Representative in Dar es Salaam, January 24, 1992.

[4] World Bank, Tanzania Economic Report: Towards Sustainable Development in the 1990's (Washington, D.C., June 11, 1991), Vol. I, p. 7.

[5] Interview with businessman, Dar es Salaam.

[6] Announcements appearing in the Daily News (Jan. 30, 1992) and the Business Times (Jan. 31, 1992).

cooperatives are now selling into private channels. On the negative side, five years after the need for divestiture of loss-making parastatals was recognized, only a handful of minor companies have actually been privatized or divested.[7] A year and a half after the Presidential Commission on the Banking Sector submitted its report, there is little evidence of change in commercial banking practices or in the level of service of present institutions.

Resistance to institutional change is to be expected by groups that are adversely affected by these changes:

1. Parastatal managers: liberalization means cheaper imports and greater competition for companies that previously enjoyed monopolies in a highly protected market. The parastatals continue to receive bank credit to offset operating deficits, but the commercial and development banking sector is under increasing pressure from the Bank of Tanzania to transfer non-performing assets to a Loans and Advances Realization Trust (LART), charged with the recovery of overdue debts.[8]

2. Parastatal employees: reform and restructuring of parastatals in the banking, industrial, and commercial sectors will mean retrenchment and loss of jobs. Some schemes have been proposed for training for alternative employment, but these schemes cannot be expected to absorb all redundant workers and managers.

3. Civil servants: deregulation and the reduction of discretionary resource allocation by the bureaucracy means that civil service employees will have fewer opportunities to extract side payments for "lubrication" of the government decision-making process. On the positive side, the more competent will benefit from being part of a more professional, merit-based civil service.

5. There is a potentially powerful coalition of groups that have benefitted from the ERP and that might be mobilized into to support further institutional reform. These include:

1. Exporters of non-traditional products. With a devalued TSh, their products are more competitive in world markets and the prices that they receive are higher when converted into local currency.

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[7] Daniel Ngowi, update of parastatal assessment; interviews with decision makers in parastatal reform; Team research described in Chapter 3

[8] The most complete explanation of the LART mechanism is contained in the "Report and Recommendations of the Presidential Commission of Enquiry into the Monetary and Banking System in Tanzania" (Dar es Salaam, July 19, 1990), Implementation Section, pp. 26-36; see also, Chapter 2 of this report

2. Smallholder farmers. Prices for many domestic food items are decontrolled and channels (at least in theory) deconfined, meaning higher prices at the farm gate.

3. Manufacturers. Greater access to non-discretionary foreign exchange makes it possible to import the capital goods and inventories needed to increase production and utilization of plant capacity.

4. The informal sector. Small producers and traders, previously driven underground by a series of restrictions, are now able to operate more openly.

Finally, more Tanzanians have benefitted from government economic policies under the ERP and from more vigorous private sector activity. As discussed in Chapter IV, the private sector has made the larger contribution to GDP for the last five years. On the other hand, breakdown in rural services is evident in the food shortages in the Dodoma Region and cholera outbreaks in Arusha in January and February. Despite the gains, however, there are significant constraints to continued private sector growth and development. These constraints are particularly evident in three areas: banking and the financial sector; the parastatal sector; and the policy environment.

CHAPTER II
THE FINANCIAL SECTOR

Several significant changes in recent years have provided the foundation for substantial financial sector reform. They have also served to remove the frustration experienced by bankers who were until recently forced to operate as fiscal agents of the Government of Tanzania (GOT). Most important has been the change in Government's attitude regarding how it can create an enabling environment for economic growth and opportunities for its citizens.

The most noticeable indicator of this change is the positive feeling among Treasury, central bank and business leaders that the Government is finally going to allow the financial system to operate on commercial principles and empower those responsible for maintaining its health and efficiency to operate without political or other unnecessary interference. A significant majority of the necessary policies are in place, implementation has begun and this new attitude should provide the momentum for it to continue.

A. INTRODUCTION

There are thirteen legally constituted financial institutions in Tanzania including the central bank, three commercial banks (the largest of which dominates banking activity, controlling over 90% of all deposits), three development finance institutions, and six non-bank financial institutions, nearly all of which are government-owned (ownership and other statistical data on these are presented in Appendices 2-1 and 2-7). There are also nearly 400 savings and credit societies as well as over 200 cooperatives involved in financial intermediation in rural areas.[9]

In addition to the formal financial institutions, there is substantial informal financial sector lending that has developed as a result of the loss of confidence of the general public in the financial institutions' ability to respond promptly and efficiently to urgent needs for capital. Following some brief background information, the main focus of this financial sector review will be the numerous, and often interrelated, barriers to the introduction of private banking. These can be thought of as barriers to an efficient means for the mobilization of savings and allocation of credit. In addition to the regulatory barriers facing prospective and existing participants, this discussion will include the other types of barriers (educational, technological, financial, political and perceptual) which have hindered the development of a sound financial sector in Tanzania.

Following the identification and description of each broad group of barriers are recommended solutions to these barriers, as well as suggestions of ways in which USAID can play a role in the

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[9] Financial Sector Restructuring in Tanzania (The Report and Recommendations of the Presidential Commission of Enquiry into the Monetary and Banking System in Tanzania), July 1990, p.5.

development of an efficient private banking environment in Tanzania. This is followed by a brief discussion of how these findings and recommendations may affect private enterprise development and the economy in general.

B. BACKGROUND INFORMATION ON NEED FOR FINANCIAL SECTOR REFORMS

Beginning with the ideological changes brought about through the Arusha Declaration in 1967, the Tanzanian financial sector has been subjected to a tremendous amount of government and CCM Party interference and control. Since most of the managers of these financial institutions were under the Government's direct control, they were given little if any authority to operate their institutions as independent profit-making entities. Many began to appear more like fiscal agents of the government instead of productive financial intermediaries designed to fuel economic growth.

Excessive Government interference in the financial system took several forms and has had a significantly negative impact on the financial institutions' ability to mobilize resources, provide adequate service to customers, achieve profitability and extend credit to viable borrowers. This interference and other negative impacts resulted in what can be considered the largest barrier to the introduction of an efficient private banking system in Tanzania: loss of public confidence in the financial system (discussed in following section).

The World Bank Financial Sector Adjustment Credit Report categorized the policies which led to the deterioration of the banking system in Tanzania.[10] Briefly, they are as follows:

<u>Government Ownership and Interference</u>: The lack of management autonomy and the GOT's practice of directing credit to specific sectors (parastatals and agricultural cooperative unions) at subsidized interest rates effectively restrained financial institutions from extending credit based on sound commercial principles (borrower's ability to repay; financial condition; use of proceeds; and favorable credit history) and at rates reflecting the risk inherent in each loan.

<u>Deposit Mobilization and Credit Allocation</u>: The large amount of credit directed by these GOT-controlled financial institutions to uncreditworthy industrial, commercial and agricultural parastatals led to an extremely large amount of loans on their books which were not receiving any payments of principal or interest. Many parastatal borrowers would use overdrafts to fund long-term investments or, in some cases, for personal use. Lack of efficient deposit mobilization capabilities, as well as shrinking cash flow streams resulting from non-payment by parastatal borrowers, led to excessive

[10] World Bank Financial Sector Adjustment Credit (FSAC) Report, October 1991, p.19.

borrowing by the financial institutions from the central bank, Bank of Tanzania (BoT). Uncontrolled access to BoT left the financial institutions with little incentive to improve deposit mobilization capabilities and services.

Regulatory and Supervisory Framework: Since financial institutions were forced to occupy the role of implementing fiscal rather than monetary policy, the GOT (prior to recent developments described below) placed little emphasis on developing prudent banking regulations or practices. Unlike a central bank operating in a sound private banking environment, BoT was given little supervisory authority to establish prudent guidelines or monitor financial system health. For example, most bank supervision was done off-site with poorly designed forms, since there were only one or two examiners to review all commercial bank activity. BoT also did not have the full authority to order commercial banks to stop accruing interest on the many loans to parastatals which were months or years in arrears, thereby compounding the other distortions often found in Tanzanian bank balance sheets.

Specialization and Lack of Competition: Instead of allowing the large number of financial institutions in Tanzania to form a healthy competitive atmosphere, the GOT directed the commercial banks to focus on specific sectors (NBC -retail banking; CRDB - rural banking; PBZ - Zanzibar) while creating other financial institutions which serve specific sectors such as housing and development finance. Combined with the GOT's restrictions on the entry of new participants, over-specialization has left each GOT-owned financial institution with a virtual monopoly in the sector it serves, thereby eliminating the competition necessary to maintain a healthy financial system.

Institutional Weakness and Lack of Enabling Environment: Years of GOT mismanagement has dramatically reduced the productivity of bank employees and the quality of services offered to customers. Financial institutions were given little incentive to train management and staff, modernize, improve salaries, improve credit review and accounting methods, monitor borrower health or actively compete for depositor funds. As a result, many depositors decided to remove their funds from the formal banking system until the efficiency and quality of the services it offers improves considerably. Poor telecommunications, lack of sufficient legal structure (to recover loans, register collateral, etc.) and other factors have further reduced the ability of financial institutions to operate efficiently.

C. RECENT FINANCIAL SECTOR POLICY REFORMS

During the early 1980s, the GOT began to realize that its financial sector policies were resulting in a weakening of the financial system, growing budgetary deficits, increased inflation

and the flow of funds from the formal financial sector to rapidly developing informal financial markets. It made some policy changes at the time and, in 1986 (supported by the IMF with an 18-month stand-by arrangement and by the World Bank with a Multi-sector Rehabilitation Credit), introduced a new Economic Recovery Program (ERP).

The ERP's objectives were to "achieve a positive growth rate in per capita income, lower the rate of inflation and restore a sustainable balance of payments position."[11] During this time, a series of other important changes were made (exchange rate adjustments, expansion of "own funds" import scheme, introduction of an Open General License (OGL) system for inputs) which were important complements to the following major policy changes directly related to the financial institutions.

Presidential Commission of Enquiry into the Monetary and Banking System in Tanzania: The Commission was given the mandate to explore the underlying causes of the severely weakened financial system in Tanzania and to identify the measures which must be taken to: 1) restore the financial health of the system and its participants and 2) support the economic reforms associated with the ERP. It began its work in August 1988 and released its report (a copy of which is available at the USAID/Tanzania Mission) on July 19th, 1990.

It is a relatively thorough report and, considering it was prepared at the request of the GOT, is quite open in discussing the misdirected GOT policies and parastatal practices which led to the financial sector's severe problems. The report included evaluations of the financial institutions and has come to serve as the foundation for subsequent reforms related to the financial sector, as well as proposed reforms related to the parastatal enterprises. Although some have questioned why it took two years to produce the report, it appears to have been the necessary amount of time for key individuals in the Ministry of Finance (MOF) and BoT to develop a consensus among other senior GOT officials.

Banking and Financial Institutions Act: Enacted in April 1991 to replace the Banking Ordinance of 1960, the Act allows for the introduction of private banks (both domestic and foreign) and a greatly strengthened supervisory and regulatory role for the BoT. A copy of BFIA is attached as Appendix 2-2.

In accordance with the prudent banking practices called for in BFIA, major regulations relating to: 1) the classification of loans, establishing provisions for losses, and accrual of interest; and 2) guidelines on the licensing of banks and financial institutions were released in October and November of 1991, respectively. Copies of these regulations are attached as Appendix 2-3. Discussions with BoT Supervision officials revealed that two

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[11] Economic Policy Framework Paper for 1991/92-93/94, Prepared by Tanzanian authorities in collaboration with the IMF and the World Bank, p.1.

additional major regulations, concerning capital adequacy and loan concentration and exposure limits will be released by March 1992. Off-site regulatory reporting forms created by these officials, in accordance with BFIA, are attached as Appendix 2-4.

Approval of World Bank Financial Sector Adjustment Program: The World Bank and IMF assistance to the GOT has been the driving force behind much of the positive developments in financial sector policy and implementation. The World Bank's Financial Sector Adjustment Credit was approved in November 1991 and became effective shortly thereafter. The GOT committed itself to major policy changes intended to develop an efficient, competitive and autonomous financial sector. The IMF's ESAF has funded additional important economic changes.

GOT Agrees to Policy Framework Paper: In June 1991, the GOT reached an agreement with the World Bank and IMF on a Policy Framework Paper for 1991 through 1993, whereby the GOT committed to follow a monetary policy consistent with macro-stability. A major policy change resulting was the decision to liberalize interest rates.

Loans and Advances Realisation Trust Act: Enacted in April 1991, LART was created to operate as a recovery mechanism (through collection or liquidation) for overdue debts of financial institutions. Appendix 2-5 contains the LART Act as well as a circular released by BoT which describes LART's operating procedures. The USAID-funded evaluation of NBC's (and eventually other financial institutions) loan portfolio will assist BoT, MOF and LART in determining which non-performing loans must be transferred to LART. This will give MOF an idea of the amount of funds necessary to recapitalize NBC (and the others) once they are ready for restructuring (once contingent liabilities and suspense accounts have been reviewed). The Administrator of LART, Dr. Felician Mujuni, has recently been appointed and the MOF is in the process of appointing a Tribunal and Board of Trustees for LART. The specific types of loans to be assigned to LART has yet to be determined.

Other Recently Announced Policy Changes: Liberalization of interest rates took effect on the 1st of September 1991. Prior to this date the GOT set the rates on deposits (generally below the inflation rate) and lending (at a varying scale, giving preferential rates to "priority" sectors). The maturity, use of proceeds, borrower's credit history or risk inherent in each loan was not considered when the GOT determined lending rates.

In accordance with the interest rate liberalization, bank and financial institution managers have now been given the freedom to set their deposit rates at whatever levels they feel are necessary to attract funds for their lending and other credit operations. The only restriction is that the twelve month deposit rate must be positive in real terms. In accordance with this requirement, the minimum deposit rate is currently set at 21% (this minimum will be reviewed quarterly). These managers were also given the freedom to

determine lending rates based on traditional measures of risk, subject to a maximum rate of 31%. This maximum will be reviewed quarterly and is intended to be completely removed in within several years.

Another component of this increased autonomy granted to financial institution managers has been the authority to turn away uncreditworthy borrowers. This is a monumental change from the many years of government directed lending to parastatals, cooperative unions and marketing boards which (in addition to economic developments beyond their control) often mismanaged the funds they borrowed to such an extent that few of their loans from banks were repaid. Senior Treasury officials and bankers have confirmed that this new autonomy has already been tested, with the recent refusal of NBC to lend to several uncreditworthy agricultural cooperative unions. These cooperative unions, according to a senior MOF official, will have to direct any appeal of the bank's decision to the Ministries of Agriculture and Finance, which will not consider any funding until these cooperative unions return to creditworthy status. If this new attitude is maintained, it is indeed a major break from previous policies.

D. BARRIERS TO THE INTRODUCTION OF PRIVATE BANKING

1. Government Policy and Regulations

Barrier #1: Lack of fully-implemented prudent regulations and practices. The major legislation and regulations described in Section C above are extremely encouraging to prospective domestic and foreign bankers because they show a commitment on the part of GOT to make major policy changes. However, due to their memories of nationalization and government interference in the past, these prospective bankers may remain on the sidelines until GOT shows a commitment to advance these policies to the implementation stage and to consistently apply them.

Solution to this barrier: Continued multilateral (for political and financial reform) and bilateral support (financial reform) of GOT efforts to improve the supervisory capacity of the BoT, foster legal reforms and revise the BoT Act and NBC Act. Specifically, enhancement of the capacity of the BoT to efficiently implement the necessary regulations, and properly supervise the banks which will operate under those regulations, is the most sensible way to prove that the most effective means of resource mobilization and credit allocation is under an independent and efficient central bank.

The passage of the Foreign Exchange Act (which is a major attempt to move away from several exchange rates to a market determined rate) in January 1992 provides an opportunity to assist the BoT in the implementation of regulations and guidelines (license requirements, operating procedures, etc.) which are in the process of being developed. BoT's Director of Exchange Control

indicated they expect the Act to receive Presidential Assent sometime in March and they have already received notification from more than twenty individuals or groups interested in opening foreign exchange bureaus ("Bureau de Change") allowed under the Act. BoT officials have indicated they need assistance in training new Bureau de Change operators as well as monitoring their activities. The Foreign Exchange Act of 1992 is attached as Appendix 2-6.

USAID role in solution: USAID is already providing assistance to BoT by funding a Price Waterhouse evaluation of NBC's loan portfolio, with a view toward determining which loans should be transferred to LART and the amount which GOT will need to recapitalize NBC, CRDB, PBZ and TIB. Additional USAID support could be used to extend this review, or begin separate reviews, to cover: 1) the loan portfolios of other financial institutions (THB, POSB, NIC, ZIC); 2) other key balance sheet accounts such as contingent liabilities, suspense accounts (ODA is currently funding a Coopers & Lybrand reconciliation of NBC's interbranch suspense account activity), foreign exchange pipeline and related accounts.

USAID could play a vital role in moving some of the major policy changes in BFIA relating to bank supervision (vital to private banking development) closer to full implementation. For example, Mr. S.K. Juma, BoT's Director of Supervision, attended the highly-regarded Federal Reserve/World Bank Washington-based seminar for bank supervisors. He highly values the knowledge and insights gained during the course and he has expressed interest in obtaining funding/sponsorship for some of his staff (recently increased from five to twenty) to be able to attend. A strengthened BoT Suspension Department (soon to be raised to the Directorate level) will be the most effective tool to measure the implementation and application of prudent banking policies and regulations.

Additionally, although the IMF has been funding a technical advisor (for policy matters) to Mr. Juma, this department would benefit from two additional measures of great importance to expanding its institutional capacity. The first would be to bring a Federal Reserve bank supervisor to Tanzania on secondment for at least one year. The Fed would continue to pay his or her salary while USAID could agree to cover living expenses. The second measure which USAID could fund would be the initiation of in-country seminars/workshops led by former or current U.S. bank supervisors. These would be several weeks in duration and would take bank examiners through the intricate steps of thorough bank supervision.

USAID will be able to facilitate the implementation of foreign exchange regulations by providing technical assistance for the training and guidance of the new foreign exchange bureau owner-operators. BoT is planning in-country seminars for which it may need USAID-funded guidance, which could include sponsoring visits to neighboring countries with successful foreign exchange operations.

USAID assistance to LART would accelerate its development so that it is fully functional when the time comes for it to receive non-performing loans transferred from NBC, CRDB, PBZ, TIB and other financial institutions. Since its Administrator was only recently appointed and is so far its only employee, LART would benefit by the provision of one or two USAID-funded technical advisors to hire and train competent staff (this could be coordinated with proposed USAID assistance to BoT's supervision activities) to properly perform LART's role of recovering value from non-performing loans. These advisors may include individuals from the Resolution Trust Corporation (U.S.) or similar recovery agencies from other developed or developing countries.

Barrier #2: Public perception of financial institution services. The Tanzanian banking public does not perceive banks as responsive to their own financial needs. The people have waited in line for hours to access their savings or to inquire about accounting mistakes made by their bank. They have waited for months for a check to clear because of an outdated method to clear checks is used. There is a general perception that bank secrecy is non-existent; depositors assume that the government is always watching them and their affairs. As business managers, they have watched their businesses suffer as they miss another necessary purchase (tour bus, truck, tractor) because NBC often is very slow in processing LC requests or because they require an excessive amount of cash cover. When one asks a worker or shopkeeper why they do a large portion of their business outside the formal financial sector, they simply say they are tired of the poor service and inefficiencies associated with this sector. These people wonder "why the financial institutions cannot be as efficient as the informal financial markets." Some of these same doubts about the financial services market has, and may continue to, frighten prospective bankers from entering Tanzania.

Solution to this barrier: The assistance USAID is already providing in the area of loan portfolio review are the first steps to improving the financial health of the financial institutions but public confidence in these institutions will only increase when service improves. For example, a construction company that needs thirty thousand shillings for petrol to complete a seventy million dollar contract on schedule will be far more concerned about the speed of disbursement than about the rate of interest. Continued multilateral consultation with GOT senior officials will help to ensure that they remain committed to reform. Computer assistance, basic business training and management training (discussed later) will assist the financial institutions in improving their service to customers.

The entry of new private banks will provide the technology transfer, bank management skills and the necessary competitive pressure to induce GOT to assist in the continued development of

methods to improve the range and quality of service offered by Tanzanian financial institutions.

USAID role in solution: In addition to the solutions offered for barrier #1, USAID could bring in successful U.S. bankers (i.e., from small, regional or money center banks) to offer customer service training courses and workshops.

Technical assistance can also be provided to develop a relatively untapped business opportunity for financial institutions in Tanzania: lending to microenterprises. If set up properly (i.e., along commercial guidelines similar to those designed by ACCION International, with USAID/PRE/I loan guarantee assistance), it would be an excellent way for USAID to use a relatively small amount of funds to link Tanzanian financial institutions with Tanzanian entrepreneurs and then be able to transfer progressive amounts of the loan risk to the local financial institutions.

Local institutions, including TIB and DJIT, have indicated that their recent efforts to tap this market show many signs of being a profitable, efficient and prudent (ACCION reports a payback rate of 98%) banking service for which there is tremendous demand. NBC and CRDB are also exploring the idea of microenterprise lending and have contacted some donor agencies, as well as the local Entrepreneurs Development Fund, to discuss funding. ODA is studying prospects of developing a Grameen Bank-type of financial institution.

USAID/PRE/I has an excellent relationship with ACCION International (based in Cambridge, MA) and could arrange for a feasibility study regarding the possible application of this method of microenterprise lending in Tanzania. The World Bank financial sector team currently visiting Tanzania has expressed interest in funding assistance for such a study.

Barrier #3: Capital requirements difficult for local groups to meet. The Banking Act, BFIA, established a paid-in capital requirement of one billion shillings (US$4.3 million) for new commercial banking entrants and TSh 500 million (US$2.2 million) for new non-bank financial institutions (allowing existing local banks two years before they must meet these requirements). The capital requirement could make it difficult for any local group to be able to set up a private bank.

While the thought of lowering the requirement comes to mind, in that it would indeed make it easier for an indigenous group to establish a private bank in Tanzania, it carries the risk of undermining the GOT's recent efforts to improve the health, performance and efficiency of the banking sector. Also, given the requirement that core capital must be greater than 6% of total assets, a smaller capitalization requirement would not permit the volume of operations necessary.

Discussions with local business groups in mainland Tanzania and Zanzibar began with the comment that foreign banks will most likely focus initially on export and trade finance types of activities. Therefore, these local business groups are considering joint venture banks, or possibly a 100% local bank, to be formed to serve particular sectors of the economy which do not currently have much access to credit (SMEs) or which have been "crowded-out" of the borrowing market (larger private sector companies) by the parastatal sector's dominance of formal financial sector credit.

Solution to this barrier: Assist local groups in their efforts to locate joint venture partners who will agree to a transfer of needed technology and the offering of management and staff training.

The Diamond Jubilee Investment Trust (Tanzania) Ltd. has indicated they are interested in applying for a license to operate a financial institution in Tanzania. They will decide within the next six months whether they will apply to become a commercial bank or a non-bank financial institution. They could possibly be persuaded to accept a local partner.

There is tremendous demand for small business lending in Tanzania. For this reason, the Tanzania Investment Bank (TIB) has recently shifted some of its focus (the GOT recently said TIB could explore its desire to expand its activities beyond its traditional DFI role) to small and medium-sized business lending since the loans are more manageable and there is more flexibility to work-out any payment problems. TIB is mentioned in this discussion of solutions because it has an extremely qualified staff and could easily expand its range of services to include merchant banking. Since there is currently no capital market in Tanzania, TIB could then play a vital role in developing pools of local investment capital, assisting local business groups develop financing proposals for investment in new local banks and equally important, TIB could take the lead role in the distribution of shares in NBC, CRDB, PBZ, POSB, THB and other local financial institutions (including TIB itself) when the GOT decides to privatize all or part of these institutions.

USAID role in solution: USAID could assist TIB in its attempt to expand its range of services to include merchant banking and lease financing, as well as its desire to shift its lending focus to small and medium-sized enterprises. The current discussions regarding eventual privatization of some local financial institutions could also provide USAID with an opportunity to offer low risk support through USAID/PRE/I's Worldwide Privatization Guarantee Facility. The USAID/Tanzania Mission can coordinate this activity with USAID/PRE/I.

USAID should also study the operations of savings and credit societies in Tanzania. They have relatively good reputations and have been successful by remaining small and providing efficient service to their members. Technical assistance in the form of basic business training and management training could strengthen

their links with existing members as well as forming links with local entrepreneurs intending to begin microenterprise operations.

Barrier #4: Inadequate access to foreign exchange. Although there is no specific restriction on the repatriation of earnings by foreign financial institutions, they, like everyone else, must wait in line for allocation of a limited amount of foreign exchange.

Solution to this barrier: The GOT could allow financial institutions better access to foreign exchange through specific mechanisms to be determined.

Barrier #5: Concern that existing local banks will receive preferential treatment over new private banks. New private banks may remain on sidelines until they are convinced that there will be a level playing field. They will need assurance that, as foreigners, or as partners with foreigners, they will not be treated differently from existing banks.

Solution to this barrier: This will require effort on the part of GOT to foster transparency in the banking and other business legislation which may impact the operations of a bank. It must follow that such legislation and regulations are enforced without bias toward any particular group. In addition to the improvements to BoT supervision assistance mentioned earlier, legal advisors may be able to assist the BoT and MOF in developing a legal framework for such issues as bankruptcy, loan recovery and collateral registry. Further assistance could be provided in the implementation of policies related to these and other legal issues.

USAID role in solution: USAID could provide legal assistance to MOF, BoT or other ministries involved in drafting and implementing bank-related legislation. Technical assistance, in the form of funding of U.S.-based and in-country seminars and workshops by U.S. bank supervisors and experienced bankers, would provide useful guidance to the bank regulators whose task it is to enforce all regulations fairly and equitably. The GOT could be informed that attempts on its part to favor local banks over new private institutions will negatively impact the financial sector reforms as well as USAID assistance.

2. Lack of Physical and Financial Infrastructure

Barrier #6: A lack of suitable and available facilities for branch locations: This is seen by representatives of one foreign bank as their greatest barrier to entry. It is also the most formidable competitive advantage of the NBC, which already has a corner on the prime locations in Dar Es Salaam and other major cities.

Solution to this barrier: If the eventual competitive banking environment centers around the need to have access to a broad deposit base, this barrier will surface.

Barrier #7: Absence of communications network and shortage of necessary computer technology. The existing financial institutions in Tanzania currently use manual methods to maintain their records and produce reports and financial statements. This method of bookkeeping prevents these institutions from operating efficiently and is one of the main reasons for the slow and error-ridden service which alienates many of their customers. The absence of computer technology to monitor the use of loan proceeds and the financial condition of borrowers limits a financial institution's ability to control loan arrears.

An additional drawback of their use of manual accounting procedures is the length of time it takes for checks to clear. It is not unusual for many customers to wait for several months before a deposit by check is credited to their accounts. Even worse, businesses often wait months for a payment by check to work its way through the archaic method of clearing, only to discover that the check they received as payment was refused by the paying bank.

There is no computer linkage between bank branches or with the BoT (which has no organized check processing facility) and, to complicate matters further, communication between branches is reduced to reliance on a telephone system which is obsolete, lacking in capacity and functions intermittently.

Solution to this barrier: The best way to improve the communication of data between bank branches, as well as to the BoT, would be to improve the quality of the phone system. As this is nothing close to a short-term or inexpensive solution, it is recommended to explore the feasibility (with other donors) of establishing some form of microwave or VHF cellular system of communication. This solution is discussed in more detail in Chapter IV.

Regarding the inefficient manual accounting, loan monitoring and report generation methods, immediate improvements in the ability to offer fast and efficient service to customers can be made through a coordinated donor effort to provide computer hardware, software and related training. Monumental costs can be avoided by focusing on key branches and departments. For example, departments responsible for lending, accounting, internal auditing, treasury and clearing (checks, LCs, etc.) would show dramatic improvements in the speed and efficiency of their operations. Branches in the major cities and Zanzibar could be linked for communication and clearing purposes.

The BoT should be assisted in establishing regional check clearing centers, similar to the system used by the Federal Reserve Banks, whereby a check drawn on an NBC branch in Mwanza and deposited in a branch in Tanga would not have to make the trip all the way to, and through, the check processing labyrinth of NBC's headquarters in Dar Es Salaam. The computerization of the check clearing process, and key departments and branches of financial institutions, would be instrumental in improving the level of

service to the point where it would convince many people to return their savings and business dealings to the formal financial system.

USAID role in solution: USAID could take a lead role in coordinating this effort with multilateral and bilateral donors. It is necessary to coordinate efforts in order to avoid duplication of equipment or different bank departments receiving software or hardware which is not compatible. A steering committee of senior officials from the MOF (Mr. Kipokola, Deputy P.S.) and BoT (Mr. Mgonja, Director of Economic Research & Policy) has been formed to coordinate efforts to computerize financial institutions.

A critical component of an efficient financial system (and one that is very important to prospective private investors and bankers) is the accuracy and reliability of financial statements. USAID could play a role in the eventual privatization of the Tanzania Audit Corporation (TAC), the state-owned entity responsible for auditing all parastatals. Although BFIA authorized financial institutions to choose private auditors instead of TAC, the local accounting firms (including affiliates of Coopers & Lybrand and KPMG) may not currently be ready for this task. SIDA played a role in linking KPMG up as an advisor to TAC, whereby KPMG offers training and other assistance to TAC staff. USAID could assist in bringing private sector discipline to TAC's operations by exploring KPMG's possible interest in acquiring some ownership interest in TAC.

USAID should review the findings of an ODA-funded study, currently underway, of accounting and auditing procedures in Tanzania. The World Bank is quite interested in the outcome of this study as it will provide valuable insight into the evaluation of financial institutions and their value to prospective investors.

Barrier #8: Absence of capital and money markets and related financial instruments. The lack of an organized financial market (comprised of two distinct types of markets: a money market and a capital market) in Tanzania limits the flexibility, profitability and services of existing financial institutions (in short, it limits their ability to operate according to truly commercial principles) and could discourage the entry of new private banks. The absence of a stock exchange is a vital missing link in current efforts to privatize financial institutions and parastatal organizations.

The absence of any type of forward foreign exchange market limits the ability of a borrower to hedge the risk of devaluation during the life of a loan which must be repaid in hard currency. This has a ripple effect since a large devaluation can cause a company earning impressive profits in local currency to default on a bank loan. The bank now has a loan on its books which is non-performing not as a result of the borrower's profitability or financial health, but instead due to his lack of options to hedge his currency risk.

Solution to this barrier: The Minister of Finance, Mr. Steven Kibona, recently announced that "an Act establishing a Capital and Stock Exchange Market would be presented to Parliament to coincide with the envisaged change in the Interim Constitution of the United Republic in April."[12] A Coopers & Lybrand (Toronto) study to explore the feasibility of establishing a stock exchange in Tanzania is being funded by CIDA Incorporated.

The creation of a stock exchange may take some time but there are some relatively short-term steps which could be taken in coordination with the MOF and BoT to assist in the development of a money market. Since Tanzania already has the main instruments normally employed in a money market (short, medium and long-term government securities), the first step should be the creation of a secondary market in Tanzanian government securities, possibly modeled after the Open Market operations conducted by the Federal Reserve. This would provide flexibility to financial institutions wishing to manage their liquidity position more efficiently (since they currently have little alternative but to hold government securities to maturity) as well as offering BoT a tool with which it can manage monetary policy. An IMF-sponsored monetary policy advisor is expected to begin working in the BoT by early March 1992.

Another way to assist banks in managing their liquidity and create another monetary policy management tool for the BoT would be to assist in the creation of an interbank market. While there may currently be too few financial institutions (especially those with excess funds) to follow a model used in developed countries, it is possible to establish an informal network whereby a financial institution with excess deposits (i.e., which cannot be put to immediate use as loans) could contact another local bank directly. The institution with surplus cash would then use the BoT as a central electronic settlement facility so that the physical cash would not have to be delivered from one bank to another. This has worked in other developing countries and its feasibility should be studied here.

While it may be premature to create a forward foreign exchange market in Tanzania, it may be possible to develop some variation of this idea. The World Bank may be interested in this development in connection with its Financial Sector Adjustment Credit. An alternative to this would be for GOT (with donor assistance) to offer businesses some form of foreign currency devaluation insurance.

USAID role in solution: USAID could bring in a U.S. financial market expert(s) with experience in developing money and capital markets in developing countries. While the interbank system discussed above may not be extremely active at first, it will be instrumental in convincing prospective new private banks that the Tanzanian financial market is gaining depth. The liquidity which

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[12] "Holding companies to be 'engines of growth' - Kibona", Business Times, 5 February 1992, page 5.

these new entrants bring to this market will serve to accelerate continued financial market development.

USAID could also play an important role in the success of these new markets by providing technical assistance in the form of the computer and other training discussed below.

Barrier #9: Lack of private banking experience and tradition among Tanzanians. This is a barrier to staffing a foreign private bank because of the high cost of expatriate staff. It is an even greater barrier to establishing an indigenous bank along the lines of the African Bank in South Africa, an idea that appeals to the Tanzanian business chamber. Following years of socialism and government interference in bank operations and management, bank managements have to a large extent become reluctant to make long-term strategic decisions and are often unable to make decisions based on sound commercial principles. Bankers in Tanzania need to develop a competitive banking environment by learning to act in response to market forces rather than government directives.

Solution to this barrier: Management and staff of local banks will gain prudent banking expertise and experience by working with established international banks and participating in their training programs. Local financial institutions need several forms of training, including management training (strategic planning, decision-making, staff motivation methods, personnel management, marketing, new product/service development, regulatory matters, etc.) and the training of staff in accounting, statistics, record keeping, computer operation, internal auditing, lending, customer service, loan monitoring, credit analysis, and other areas critical to efficient financial institution operations.

USAID role in solution: USAID is already providing some assistance to BoT's staff in the evaluation of loan portfolio evaluation. In addition to the USAID assistance to BoT's supervision capacity recommended elsewhere in this report, USAID, in coordination with other donors, can play a major role in initiating training programs which, in addition to improving the efficiency and customer service of financial institutions, will dramatically improve the investment climate in Tanzania. This will facilitate the attraction of private investors necessary for successful financial institution and parastatal privatizations. The assistance can be in the form of in-country seminars and workshops by U.S. accounting firms, bank rating agencies, bank examiners, college faculty and computer training companies.

Barrier #10: Concerns About Lack of Creditworthy Borrowers. Most prospective bankers have enough confidence in their knowledge of banking to see the funds currently circulating in the informal financial markets (for reasons described earlier) as potential deposits in their banks. They realize that if GOT continues to implement the financial sector reforms described earlier, including interest rate liberalization, bank supervision and other measures to restore confidence in financial institutions, the general public and businesses will bring their funds back into the formal

financial system. However, they also have been able to obtain enough information (reports produced by multilateral and bilateral agencies as well as local and other independent sources) about the poor financial condition of Tanzania's parastatals and cooperative unions to make them concerned about whether Tanzania's market may be too limited in large volume business to justify the investment in fixed assets that would be needed for a serious commercial banking operation.[13]

Solution to this barrier: One option would be the creation of a guarantee mechanism to stimulate investment in venture capital companies and related funds. This option is one of the most promising possibilities since it would attract the types of investors willing to make a long-term commitment to Tanzania and the progress of its financial sector reforms. Traditional venture capital is temporary start-up financing in the form of equity capital or loans, with return linked to profits and with some measure of financial control and has been identified as an alternative to development finance institutions.[14] Since venture capital investors desire liquidity in addition to profits, the network of business contacts in Dar Es Salaam and Zanzibar should be an adequate substitute for the lack of a secondary stock exchange.

Encourage repatriation of capital by Tanzanians through an amnesty scheme. An example of this would be the MOF bearer bonds currently being offered by BoT. They are available in one, two and three year maturities and no questions are asked concerning the former location of the cash brought in to purchase the bonds. They offer a tax-free return and the MOF is hoping it will bring in a lot of the cash currently circulating in the informal financial sector.

Many of the other efforts discussed and proposed solutions recommended in this report will hopefully increase public confidence in the formal financial sector to the extent that the informal financial sector will lose much of its appeal. Combined with improved financial institution health and private sector business development, these changes will serve to convince prospective outside and local investors that there is measurable progress in developing a creditworthy private sector client base. The planned parastatal reforms and privatizations will hopefully result in the expansion of the pool of creditworthy industrial and commercial borrowers in Tanzania.

USAID role in solution: USAID can begin by assisting in the formation of venture capital funds and the necessary location of investors. This can be coordinated with the IFC's Capital Markets Department, which has established these funds in several countries

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[13] Interview with representative of international bank, Dar es Salaam, January 22, 1992.

[14] Financial Systems and Development, The World Bank, 1990, page 89.

and may be able to develop additional options such as lease financing.

USAID can become directly involved in the development of creditworthy borrowers by expanding the training proposed for financial institutions to include the training of prospective local borrowers in accounting, bookkeeping, business plan development, cash management and other key areas.

E. LIKELY IMPACT ON TANZANIAN ECONOMY AND PRIVATE SECTOR DEVELOPMENT

The technical assistance recommended as solutions to the barriers to the introduction of private banking addresses the several weaknesses which have severely limited private enterprise development in general. All of these recommendations, including: the improvement of public perceptions of banks; the efficient implementation of financial sector reforms; the restoration of business skills; the improvement of the service offered by financial institutions; and others discussed above are designed to create an environment that will enable an efficient financial system to develop. This must happen before local and foreign private sector individuals and entities will be able to fully benefit from the resource mobilization and resource allocation necessary for a private sector economy to survive.

The entry of foreign financial institutions can be expected to accelerate the wide range of reforms and improvements necessary to create a competitive banking environment and, eventually, an efficiently operating private sector economy which can turn to this banking system to fuel its growth. The opening of a reputable foreign private bank in Tanzania can be expected to stimulate savings. To date, five foreign banks have expressed interest in applying for a commercial banking license. Representatives of Standard Chartered Bank were reportedly told that they would be besieged by depositors the day they opened a branch in Dar es Salaam. A private bank would also presumably be more aggressive in making productive loans. The result would be greatly increased financial intermediation, leading to the growth and development of enterprises in the productive sectors of the economy.

If the introduction of private banking and financial sector reforms are allowed to succeed, the winners will be the creditworthy private and public sector entities which will be served by the private sector financial institutions. The losers will be the existing state-owned local financial institutions if they (and the GOT) do not rise to the challenge of competition and take advantage of the enabling environment created by the reforms discussed above.

If the reforms are not given the opportunity to succeed, the informal financial sector will continue to account for at least forty percent of the liquidity in Tanzania.

CHAPTER III
PRIVATIZATION AND THE PARASTATAL SECTOR

A. BACKGROUND ON THE PARASTATAL SECTOR

1. Description/Performance

The parastatal State Owned Enterprise (SOE)[15] sector in Tanzania is one of the largest worldwide. SOEs engage in a wide range of commercial and non-commercial activities, affecting every part of the economy. In 1988, the parastatal sector consisted of 413 enterprises, composed of 339 commercial SOEs, 56 non-commercial SOEs, and 18 holding companies. In aggregate, the Tanzanian SOE sector is a major economic activity, accounting for 24 percent of non-agricultural wage employment, and 13 percent of total value-added.[16] Sectorally, public enterprises have sole control of utilities, a strong presence in the agriculture, mining and manufacturing, but are relatively weak in construction, commerce and transportation.

The overall inefficiency and financial failure of the parastatal sector has been well-documented in numerous studies inside and outside Government; key data are presented in Appendix 3-3.[17] It is useful to briefly summarize major findings:

- the vast majority of SOEs have been consistent money-losers, and the trend is accelerating. In 1988, more than 180 parastatal enterprises (audited by the TAC) reported losses totalling almost TSh 33 billion. In particular, over half of industrial and agricultural SOEs, and three-quarters of all marketing parastatals reported losses. The 1990 TAC annual report indicated that the net surplus (total profits minus total losses) of the SOE sector as a whole deteriorated from a deficit of TSh 11.5 billion in 1987 to a deficit of TSh 14.9 billion in 1989.[18]

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[15] Parastatals have been defined as commercial enterprises (providing goods and services for sale for profit to the public or private sector) in which the GOT owns 51 percent or more of equity, and non-commercial enterprises such as regulatory agencies, marketing boards, cooperative unions, holding and trading companies, and various educational and research institutions. This report concentrates on commercial parastatal enterprises; financial PEs are not included.

[16] World Bank (1988), p.6.

[17] See, for example, Daniel Ngowi, Parastatals in Tanzania: An Assessment, January 1989; H.P.B. Moshi, "Tanzania's Public Enterprises and the Economic Recovery Programme: Is Re- and Privatization the Answer?"; and World Bank, Parastatals in Tanzania: Towards a Reform Program, Report 7100-TA, July 27, 1988. Much of the data presented in this section are drawn from those reports, and annual reports of the TAC.

[18] The TAC profitability figure underestimates total losses since government subsidies are treated as normal operating revenues.

- the low and negative profitability of the SOEs has been financed directly and indirectly by GOT. Direct payments (through subsidies, transfers, grants and subventions), accounted for 8 percent of total expenditures in 1989. Implicit subsidies (through interest-free loans never re-paid, and credit for bilateral import support programs) worth at least 3 percent of total government revenues in 1990, have been liberally provided. In addition, exemptions from customs duties, sales and corporate taxes have also been provided on an ad hoc basis.

- the contribution made by SOEs to the government budget has been minimal, and is worsening. Dividends paid by the SOEs to the GOT budget have never exceeded 7 percent of total direct subsidies provided to the parastatal sector during any year.

- most holding companies and industrial parastatal enterprises are insolvent. According to the World Bank, total outstanding debt of industrial parastatal holding companies at the end of 1988 was TSh 74 billion, greater than the value of net fixed assets of TSh 54 billion (on a revalued basis). Moreover, over 70 percent of the outstanding debt was in arrears for two years or more. In addition, 95 percent of NBC's total arrears for example, are accounted for by the SOE sector.

- borrowing by industrial and commercial SOEs has "crowded out" the private sector. In 1991, over 79 percent of NBC lending to the agriculture sector went to agricultural SOEs; 58 percent of total credit to the industry sector was claimed by industrial SOEs. Allocation of foreign exchange has similarly been skewed in favor of SOEs.[19]

- despite considerable advantages, parastatal enterprises are more inefficient than private firms. Compared to private enterprises engaged in similar activities, industrial parastatal enterprises are significantly more import dependent, capital intensive and operate at low capacity utilization rates. As a result, SOEs tend to be more inefficient, generate negative value-added, and have contracted significantly over the past five years.[20]

More alarming is recent evidence which indicates that the financial condition of the parastatal sector may actually be far worse than generally realized. In a survey of 72 industrial SOEs undertaken in 1991, it was estimated that the annual net loss of the 350 commercial parastatals may be in excess of TSh 100 billion,

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[19] World Bank (June 11, 1991), p. 95.

[20] World Bank (July 27, 1988), p. 18.

(equivalent to a staggering TSh 2 billion per week) if the effects of inflation and devaluation are included.[21]

B. ANALYSIS OF PARASTATAL POLICY REFORMS AND PRIVATIZATION EFFORTS

Prodded on by the increasingly unsustainable fiscal burden of loss-making SOEs (and increased pressure and assistance from the World Bank and other donors), the Government of Tanzania has been making gradual progress towards reforming the parastatal sector. GOT efforts have proceeded on two levels: defining the formal policy and institutional framework on the one hand, while at same time selectively restructuring, liquidating and privatizing certain enterprises. The analysis below examines the extent to which actions in both areas have been undertaken in accordance with each other.[22]

1. The Evolving Formal Policy and Institutional Framework

Since 1983, the government has introduced a number of general measures liberalizing the parastatal sector overall, and the industrial, agricultural and financial parastatals in particular (Table 3-1). In addition to these measures, broad policy changes implemented under the ERP (e.g., maintenance of a competitive real exchange rate, introduction of the "Own Funds Scheme" and the OGL) have significantly reduced the effective rate of protection for parastatal enterprises, and facilitated competition from private companies and imports. These actions greatly reduced barriers to entry of new firms, and the preferential advantages enjoyed by parastatal enterprises.

However, despite the formal liberalization, the reality has been that concrete reforms have been very slow to materialize, partial in application, or selectively implemented. Many previous steps taken have been reversed or diluted by poor implementation and conflicting objectives. The extent to which GOT has "dragged its feet" in the area of parastatal reform can be seen by contrasting the recommended actions of various analyses, and those actually implemented (Table 3-2).

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21 Olly Haggerty (November 1991), p. 2. Haggerty notes that accumulated losses of the 72 PEs surveyed (TSh 181 billion at end-1990), accounts for over 94 percent of their accumulated debt (TSh 192 billion), rendering repayment highly unlikely. He also notes that the reported increase in total profits of profitable PEs is actually reversed if adjusted by the GDP deflator.

22 Privatization as defined in this report are those actions that directly enhance private sector ownership and provision of goods and services. Common privatization methods include: public offering of shares, private sale of shares, new private investment in a parastatal enterprise, sale or transfer of parastatal or government assets, re-organization into autonomous parts, management/employee buy-outs and lease and management contracts.

Several observations can be made about the data presented in Table 3-2. First, the recommendations made by the various studies are remarkably similar, recommending the development of a coherent policy statement articulating reform objectives, identification and classification of SOEs, establishment of a centralized body to implement the program, and development of a monitoring system. Second, there has been some implementation of recommended actions -- particularly those of the Hamad Commission. However, the GOT has not taken action on most recommendations for the better part of one decade:

- a coherent policy framework for privatization/restructuring has not been defined. This is the result not only of conflicts at the highest levels of policy development, but also of an increasing prioritization placed by GOT on financial sector reform.

TABLE 3-1
MAJOR ACTIONS UNDERTAKEN TO LIBERALIZE THE PARASTATAL SECTOR

Measures Affecting the Parastatal Sector Overall

1. Adoption of policy abolishing explicit subsidies to SOEs.
2. Reduction in number of goods subject to price control from over 400 to three basic commodities.
3. Presidential directive issued giving parastatals two years to clean up their accounts and run operations efficiently, or face liquidation.
4. Enaction of National Investment Promotion and Protection Act (1990) to promote private investment in the parastatal sector.
5. Passage of Public Corporations Act (1992), to streamline process of converting SOEs into public corporations, and vest executive authority in the Office of the President.
6. Issuance of Parastatal Sector Reform policy statement (Dec. 1991).
7. Amendment of Parastatal Pensions Scheme Act (1978) in order to raise lump-sum pension payable from TSh 7,200 to TSh 18,000 per annum.

Measures Affecting Agricultural SOEs

1. Deconfinement (demonopolization) of importation and wholesale distribution of food crops.
2. Decontrol of real prices of agricultural commodities; liberalization of agricultural marketing framework.
3. Privatization of selected sisal, tea and coffee estates.
4. Reduction of credit to agricultural marketing parastatals; elimination of credit to the National Milling Corporation.
5. Liberalization of cashew nut marketing and deconfinement of cotton marketing; private cotton ginning.
6. Passage of the Cooperatives Act of 1991.

Measures Affecting Financial SOEs

1. Adoption of positive real interest rates to facilitate improved savings mobilization and resource allocation.
2. Passage of Banking and Financial Institutions Act (1991) allowing for domestic and foreign private participation in banking activities.
3. Enaction of the Loans and Advances Realization Trust Act (1991) to streamline framework for recovery of non-performing debt.
4. Preliminary contact with foreign banks made by BoT.
5. Announcement of introduction of foreign exchange bureaus in the near-term; shifting of import support financing into OGL.
6. Abrogation of policy of "directed credit," thereby allowing banks to operate autonomously.

Measures Affecting Industrial SOEs

1. Effort for privatization of selected leather, edible oil and textile processing parastatals initiated.
2. Transfer of inviable SOEs' assets to LART and liquidation.

TABLE 3.2
PARASTATAL REFORM: GAP BETWEEN RECOMMENDED AND IMPLEMENTED ACTIONS

Group/Mechanism Implementation	Principal Recommendations	Actual
1. Hamad Commission (1983)	- revival of agricultural cooperatives	- implemented
	- replacement of all purpose crop authorities by marketing boards	- implemented
	- liquidation of inviable SOEs, merger of others	- selective implementation
	- removal of members of Parliament from SOE Boards	- implemented in 1985
	- limitation of Boards to 10 members	
	- appointment of technicians, creditors and users to SOE Board of Directors	- selective implementation
2. Presidential Implementation Team (1984)	- autonomy for SOE managers in hiring, pay structure	- some action
	- assessment of each SOE to determine utility	- some action
	- develop coherent set of reform objectives	- statement issued in 1992
	- form new agency for SOE policy reform implementation	- no action
3. Nsekela Commission (1987)	- better procedures for identification of SOE CEOs	- under review
	- creation of new policy making/supervisory body and elimination of SCOPO	- some action
		- civil service salaries increased; some retrenchment of officers
4. World Bank Report (1988)	- clarify goals/expectations through policy statement	- statement issued in 1992
	- classify SOEs into SOE to be maintained, divested, commercial, non-commercial, viable, un-viable	- classification in progress

	- undertake study to increase private competition	- Investment act, but poor implementation of actions
	- eliminate preferential treatment for SOEs through formation of special task force	- guaranteed credit policy abandoned; tougher collections policy
	- remove barriers to SOE activity	- some liberalization
	- set up supervisory body to implement actions, reporting to the Office of the President	- no action taken
	- develop implementation monitoring system	- no action taken
5. O. Haggerty Report (1991)	- Phase 1: develop privatization policy framework; appoint director; categorize enterprises according to viable, nearly viable; potentially viable and non-viable	- some action taken
	- Phase 2: select candidates for privatization; identify individual objectives/constraints & select privatization method	- some firms identified - ad hoc implementation
	- Phase 3: prepare SOE for privatization by deregulating or regulating; valuation; enabling legislation; capital structure	- ad hoc implementation
	- Phase 4: implement the privatization by restructuring the SOE financially and managerially; decide size, form of sale; identify suitable partners and negotiate deal	- no organized action
	- establish a central privatization unit reporting to President and adequate monitoring system	- no action taken

- a permanent body reporting to the highest authority, with sufficient authority to formulate policy guidelines, identify and undertake specific actions has not been established.

- specific guidelines for privatization/restructuring transactions have not been formulated. As a result, selected enterprises have been privatized on a lengthy, case-by-case basis.

The formal policy of GOT towards reform of the parastatal sector has not been in favor of structural change. Initial efforts focused on strengthening GOT supervision and control; later efforts emphasized measures to enhance the operating efficiency of SOEs. <u>However, the underlying and fundamental issue of ownership of enterprises has not yet been examined in a public and straightforward manner. Despite increasing evidence pointing to the futility of SOE restructuring efforts, the GOT has still not adopted a policy of outright privatization of parastatal enterprises</u>. Haggerty's report (supported by the World Bank and ODA) was the first to urge privatization of most SOEs, and outlined a coherent program for planning and implementing a privatization program.

The recent issuance of two long-awaited documents provide the first real indication of the development of an overall policy and institutional framework for parastatal reform and privatization. These are: (a) issuance of the Ministry of Finance Policy Statement on parastatal reform, dated December 31, 1991 (and distributed January 29, 1992); and (b) passage of the Public Corporations Act (1992).[23]

Parastatal Reform Policy Statement. This is the first attempt by GOT to define general objectives of the parastatal reform program. The document:

- articulates priority program objectives: improve the operational efficiency of SOEs; enhance the GOT budget by removing loss-making SOEs; facilitate private sector participation, and allow GOT to concentrate on "its role as provider of basic public services;" and "increase and encourage a wider participation of the people in the running and management of the economy."[24]

- retains certain enterprises (social service institutions and most public utilities) within the public sector (transitionally or otherwise), but to deepen policy reform in these cases, including "elimination of monopoly rights, barriers to entry for competitors, preferential access to credit, foreign exchange and government procurement, and exemptions of tax, duty and other payments."[25]

- outlines a program to determine, on a case-by-case basis, commercial enterprises which "will be available for foreign and local participation, including privatization by means of joint ventures, full or partial sale of shares, leasing and management contracts." However, the GOT will determine "the minimum proportion of the equity shares to be retained on behalf of the people of the country, and the proportion to be divested to local or foreign investors."[26]

- permits shares to be retained within the Treasury or through specialized mechanisms such as investment trusts, and "in due course, as the capital market develops, part or all of the shares ... will be sold, either to the general public, or to the workers and management of enterprises. By these means indigenous Tanzanians will

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[23] It should be noted that the Public Corporations Act has not yet been signed into law by the President. He is expected to do so shortly.

[24] Ministry of Finance, "Parastatal Sector Reform (A Policy Statement)", December 31, 1991, p. 4.

[25] Ministry of Finance (December 31, 1991), p. 5.

[26] Ministry of Finance (December 31, 1991), pp. 7-8.

retain a significant share in privatized enterprises..."[27]

- provides for detailed guidelines to be developed for the sale of SOE assets and shares to "ensure transparency and fair price."

- recognizes that the indebtedness of SOEs are an obstacle to their privatization, and determining "appropriate mechanisms for dealing with debt."

- develops mechanisms to offset the effects of worker lay-offs, including "retraining and severance payments and mechanisms to ensure self-employment."

- establishes the Presidential Parastatal Sector Reform Commission to develop operating policies and implementing procedures, undertake detailed analyses of individual parastatals, and recommend actions to be taken directly to the Cabinet.

Public Corporations Act (1992). The passage of this Act provides for a relatively streamlined mechanism for the conversion of various types of parastatal enterprises into limited liability companies in preparation for their eventual partial sale or divestiture. Under its provisions, the President can summarily transfer any assets or liabilities of existing SOEs into newly established corporations. He has full authority to effect this transfer with or without any liabilities of the old company, and under any arrangement deemed necessary. Such transfers automatically mean the old SOE ceases to exist. The only limitation on action is on employees of the SOEs. In these cases, any employee transferred to the new corporation will enjoy terms and conditions of employment that "are not less favorable than those which were applicable to him immediately before the transfer," including retirement benefits.

The policy statement and the Public Corporations Act provide the first real indication of GOT intent for a <u>program</u> of SOE reform and privatization. Since issuance of the two documents, a number of additional steps have been taken:

- the composition of the Parastatal Reform Commission has been finalized, consisting of Mr Mbowe (Chairman, presently at East African Development Bank); Mr Mdundo (Commissioner of Public Investments); Mr Hatibu Senkoro (Managing Director, TDFL); Dr Alex Khalid (President, Agroconsult); Ms Zakya Ahmed (Economics Secretariat, CCM); and Mr Amboci Lipumba (Economics Advisor, Presidency). The commission would be supported by a Technical Secretariat which will be composed of technical

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[27] Ministry of Finance, (December 31, 1991), p. 8.

specialists from SOEs and GOT, as well as experts financed by various donors.

- the classification of SOEs (into commercial and non-commercial enterprises) has been completed, resulting in 260 commercial SOEs, according to the Commissioner of Public Investments;

- holding companies have also been given until March 30, 1992 to identify the capital and other resources necessary to rehabilitate their SOEs, and enhance their operating efficiency and profitability, or face closure.

- holding corporations would be "disbanded if they fail to earn their keep." However, "there will be no more management fees, nor would holding corporations earn any dividends." Instead, the Board of Directors and the Chief Executives of SOEs will be held accountable for the "success or failure of their firms."[28]

It is quite evident that the GOT has made substantial progress in laying the foundation for a program for parastatal reform. Still, there are important policy and institutional deficiencies and ambiguities that are likely to slow implementation. These factors are presented and reviewed later in this chapter.

2. Analysis of Specific Privatization Transactions

The Government of Tanzania has been "privatizing" selected parastatal enterprises since 1984 as part of its efforts to rationalize the parastatal sector overall. Initial efforts were focused on liquidating, "mothballing" and merging selected unviable public enterprises, following the recommendations of the Hamad Commission and the Presidential Implementation Team (Table 3-3). More recently, the GOT has embarked upon a piecemeal privatization approach, starting with selected enterprises in the manufacturing, agriculture and tourism sectors. While the actual mechanics of the privatization process has varied greatly, the process has basically entailed a deliberate, enterprise-by-enterprise approach, as detailed below.

Industry Sector. The approach adopted by the Ministry of Industries and Trade has been to undertake detailed studies of manufacturing sub-sectors,

TABLE 3-3
LIQUIDATED PARASTATAL ENTERPRISES

Company	Reason for Liquidation

[28] Minister of Finance quoted in "Holding companies to be 'engines of growth' -- Kibona" in Business Times, February 5, 1992.

General Food Company 1984	Reorganization/Consolidation
Tanzania Livestock Mktg Co. 1984	Reorganization/Consolidation
Biashara Transport Company 1984	Reorganization/Consolidation
Tanzania Livestock Authority 1984	Reorganization/Consolidation
National Cold Chain Co. 1984	Action by creditors
Domestic Appliances & Bicycles 1985	Reorganization/Consolidation
General Agric. Prods. & Exports 1986	Reorganization/Consolidation
Tanzania Agri. Research Org.	Absorbed by Ministry of Agriculture 1988

including leather (October 1989); edible oils (January 1990); textiles (August 1990); wood and paper (October 1991); and metal and engineering (April 1991), chemicals (currently underway). A study on the building materials sub-sector (funded by the Dutch) is also likely in the near-term. The principal findings and privatization recommendations of the various studies are summarized in Appendix D for reference. The principal findings of the various studies was that the majority of industrial SOEs were unprofitable, highly indebted, and technically insolvent. However, in the case of several enterprises, the assets on the ground, and the technology utilized, had substantial value and market potential. Key privatization/restructuring recommendations include:

Leather. Immediate divestiture of three tanneries to the private sector (with GOT assumption of debt and transfer of assets to a new company); liquidation of the remaining two enterprises. In several cases, where factories are over-designed and have too much capacity for the local market, the consultants recommended down-sizing and other actions to restructure the enterprise prior to sale to private interests.

Textiles. Retention of three enterprises within the public sector due to their semi-monopoly status; liquidation of three firms (sale of assets and absorption of debt); full divestiture of eight to private interests; division of one company into autonomous units and sale to private investors; and joint venture with private partners for three enterprises.

Edible Oils. Creation of four new "regional" companies, composed of the merger of existing enterprises; ensuring operational autonomy for the new enterprises (through private sector majority shareholding); and the hiving-off of non-edible oil activities, and concentration in core areas.

Wood and Paper. Liquidation of one firm; sub-division and sale of another to private interests; and the remainder for full sale to the private sector. The major asset in most cases is adjoining tracts of timber lands for long-term use of the factories.

TABLE 3-4
PRIVATIZED INDUSTRIAL PARASTATAL ENTERPRISES

Company	Business	Nature of Transaction
Blanket Manufacturers Ltd	Textiles	Partial sale (40%) to private interests
Perma Sharp Tanzania Ltd.	Metals	Direct sale by TDFL, after taken over by creditors
Tanga Cement Company	Cement Processing	Management contract with Swiss firm financed by DANIDA
Tanzania Cement Company	Cement Processing	Partial sale (26%) just concluded
Tanzania Sheet Glass	Manufacturing	Full sale
Tanzania Starch Mnf. Co.	Starch Processing	Full sale

Metals and Machinery. Liquidation of four enterprises; partial private sector equity participation in five enterprises; full sale for remaining eight enterprises, after substantial financial and other restructuring.

Despite active efforts to privatize selected industrial parastatals, relatively few transactions have been successfully concluded to date (Table 3-4). However, there are a number of deals underway as shown in Table 3-5. The approach of the Ministry of Industries initially was to allow each sub-sector holding corporation to take the lead in identifying and negotiating with investors. The leather sub-sector was chosen as an initial area of focus, with a public bid held by a inter-ministerial committee. Although bids were received for the Morogoro Shoe Company and the Moshi Tannery, negotiations stalled. The major stumbling block has reportedly been the insistence of the GOT that private investors assume the hard currency debt of the leather tanneries. More recently, there have been substantial disagreements about the value of the SOE assets.

The approach taken by TEXCO has been quite different, and more successful. TEXCO chose to seek equity investment in the Kilimanjaro Textiles Mill (DSM) and the Morogoro Polyester Textile mill. Instead of a public bid, TEXCO independently identified potential joint venture partners (including Daewoo Corp, Unilever, and a Belgian firm). TEXCO was willing to assume the liabilities (including the debt) by selling other assets in its portfolio. Despite active efforts, neither of deals has been closed. In the case of Kiltex, to meet conditions for financing from the IFC and CDC, TEXCO had to conduct three feasibility studies, and revise its proposal several times. The potential investor still demurred due to concerns about political stability.

In the case of Polytex, negotiations with Daewoo stalled because of Daewoo's insistence on paying substantially below the book value of the facility, and its demand to receive adequate quantities of cotton at 30 percent below world prices. The GOT has been reluctant to divest the asset even though Daewoo would operate it at full capacity (only at 15 percent currently), and would be 100 percent export-oriented. As discussed later in this section, negotiations have been unnecessarily lengthy (more than 2 years) because of lack of experience of negotiating with foreign investors, hesitancy to accept a market value for the asset (rather than book value), and a very cumbersome GOT negotiating framework. Political considerations, and lack of defined mechanisms to deal with debt, also hampered negotiations with investors.

TABLE 3-5
INDUSTRIAL SOE PRIVATIZATION EFFORTS UNDERWAY

Public Enterprise	Type of Transaction	Private Investor	Results/Status
Mbeye Cement Co.	majority sale	Daewoo	discussions continuing
Morogoro Ceramic Wares	majority sale	German firm	joint venture discussions underway; investor offering DM600,000 in equity plus debt financing o' DM2.6 million
Morogoro Tanneries	majority sale	IPS	discussions underway
Moshi Tanneries	full sale	n/a	discussions underway, difference in asset valuation
Nyanza Glass Works	full sale	n/a	discussions underway
Polytex	majority sale	Daewoo	no action because of Daewoo demand for (a) subsidized cotton and (b) offer of US$30 million when enterprise worth US$70 million
		Belgian firm	no agreement because of concern over outstanding hard currency debt
Kiltex	full sale	Unilever	no sale due to concerns over political stability and disagreements among existing equity holders (CDC, IFC) about product mix and export orientation.
Tanzania Breweries	majority sale	n/a	discussions underway
Tanzania Shoe Co	full sale	Bata	no sale because GOT opposition to write off hard currency debt.

Agriculture. Unlike the industry sector where transactions have been extremely slow to conclude, deals in the agricultural sector and the agro-processing area have been proceeding steadily. Since 1985, as shown in Table 3-6, there have been a number of

private acquisitions of tea, coffee and sisal estates. Representative transactions are detailed below.

In 1984-85, CDC entered into negotiations to acquire the East Usembeze tea estate from the Tanzania Tea Authority, and Kilimanjaro Coffee estates from the Kilimanjaro Cooperative Union. The first deal took CDC five years to conclude, because of disagreements with the high valuation determined by a Kenyan independent valuator, and very slow decision-making on the part of TTA. The final transaction involved the creation of a new company and the purchase of assets by CDC for 6 million pounds; all liabilities were absorbed by the TTA. The other deal, which began earlier, was slowed by resistance from the local dwellers near the coffee estates. After a long period of fruitless negotiations with the cooperative union, CDC launched an investigation which determined that (a) the local people did not want to be represented by the cooperative union; (b) they were not convinced that they were receiving a fair value for their property; (c) were not informed of the nature of the transaction, and were not included in the negotiations; and (d) had not actually received title to the land after it was nationalized many years ago.

TABLE 3-6

PRIVATIZATION IN THE AGRICULTURE SECTOR AND DEALS UNDERWAY

Past Privatization Deals	Transaction/Status
East Usembeze Tea Estate	Sale of assets to Commonwealth Development Corp.
Kagera Sugar Ltd.	Joint venture in new company with Booker Tate, a U.K. company
Kilimanjaro Coffee Estates Development Corp.	Direct sale to Commonwealth
Kimamba Sisal Estates Co.	Several estates sold to Abdul Farhaji
Mifundi Tea Company	Re-privatization by Lonrho
Ngombezi Sisal Estates Co.	Several estates under management contract with Booker Tate (U.K) funded by German Kfw
Ralli Estates	Direct sale to U.K. group
Tanga Planting Company	Management contract with Danish company

Privatization Deals Underway	
Manawa Ginnery	Majority sale (51%) to Cargill
Morogoro Cooking Oil Refinery	Direct sale negotiations with Cargill almost finalized
National Food Corporation	Direct sale negotiations underway
Tanzania Tea Authority	Full sale to Brooke Bond
Tanzania Seed Company	Full sale to Cargill

After the project was re-designed without the union (dealing directly with the primary society), and agreeing to fix the valuation of the property in British pounds, the deal was concluded.

While information is difficult to come by, it is clear that the experience of other investors has been similar to that of the CDC. Lonhro went through extensive negotiations with the Government to re-acquire the Mifundi Tea Company, which was nationalized in 1968. In this particular case, part of the small compensation payment for the nationalization was applied to purchase 75 percent of the equity of the company, but the difficulty and ambiguity of the negotiating process was the same. In another notable case, take-over the Ralli estates was partially financed by a debt/equity conversion (of Tanesco debt held by French financial institutions).

Political concerns about concentration of economic power in the hands of Asian Tanzanians has allegedly delayed the acquisition of the MOPROCO facility by Cargill. It had been reported that the sale of factory to the Rajani group, which controls the majority of private edible oil processing facilities as well as imports of oil, was resisted by GOT. Again, information like this is hard to verify, given the lack of transparency. Still, it is significant that a number of potential sales to foreign private investors appear to be progressing.

TABLE 3-7
OTHER PRIVATIZATION DEALS UNDERWAY

Company	Status of Transaction
Air Tanzania Corporation	Emergency financing measures adopted, including search for equity investment. Probable down-sizing, sale of assets or liquidation.
Board of External Trade	Privatization discussions underway.
Buckreef Gold Mines Co.	Joint venture discussion with Australian firm.
Tanzania Mangnesite Co.	Joint venture discussions underway.
Pugu Kaolin Mines	Joint venture discussion underway.
Tanzania Audit Corp.	Possible investor interest.
Tanzania Coastal Shipping	Possible investor interest.

Tourism Sector. A severe lack of funding to undertake critical rehabilitation of its hotels led Tanzania Tourist Corporation (TTC) to seek external funding in 1985. As part of the funding requirements demanded by creditors, TTC began to negotiate a performance/management contract with Novotel (ACCCOR/France). Negotiations have continued in the form of an inter-ministerial committee, and have resulted in a twelve year performance contract for the management of seven hotels (three hotel companies). The contract is expected to start in March. The contract with Novotel is a flat fee, plus an incentive payment based upon a pre-agreed level of profits being generated. The agreement can be terminated at any time; part of the arrangement includes training.

In addition, a majority share (77 percent) in the New Africa Hotel was acquired by Tadema, a Swiss-registered, local company. This transaction is relatively unique because: (a) the investor agreed to assume the outstanding debt, as well as investing some US$10 million in equity; and (b) the Tanzania Investment Bank agreed to reduce its outstanding loan of TSh 1.4 billion to TSh 600 million.

TTC is currently engaged in discussions with Sheraton and Intercontinental for management of the Kilimanjaro Hotel, as required for the substantial financing that is seeking for complete rehabilitation of the hotel. Potential joint venture partners are being identified for the remaining TTC hotels and the State Travel Service. Lonhro is also pursuing a joint venture in a tourist facility in Zanzibar, but further details are unavailable.

Other Sectors. Although not a clear Government priority, various joint venture agreements have been reached with foreign companies in the mining and transportation sectors (Table 3-7). The Buckreef Gold Mining company has reached agreement with an Australian company; potential joint venture discussions are being finalized for the Pugu Kaolin Mining company and the Uvinza Salt Company. Reportedly, joint venture proposals have been made for the two national shipping companies, and there is active interest in the telecommunications sector. Finally, joint venture negotiations with a number of foreign companies are underway in the wood and paper sector, where the primary attraction is utilization of adjacent timber growing areas.

3. Lessons Learned

It is difficult to generalize about these transactions given the basic lack of information, and the fact that there has been a significant element of "learning by doing" on the part of Government. Still, there are important common themes and elements that provide a guide to the major factors affecting privatization efforts in Tanzania:

privatization deals have taken much longer than originally anticipated. Relatively simple transactions (a small, relatively less indebted company, and an identified private

sector investor), have averaged about 2-3 years to conclude; more sensitive or complicated arrangements have taken in excess of five years. In the case of the tourism sector, in particular, talks with potential joint venture partners began in 1985, and have yet to be concluded. In order of importance, the primary contributing factors include: GOT inexperience with privatization in general, and lack of experience in negotiation with investors; lack of technical knowledge about privatization techniques; lack of clear guidelines for the negotiations; perceptions that the investors were typically "demanding too much," and an overly bureaucratic GOT negotiating structure, resulting in as many as fourteen GOT officials negotiating with one investor in a given session.

successful privatization has depended on actions taken by creditors and internal management capability and willingness. In general, when creditors have tried to recover their loans (eg, TDFL with Perma Sharp Corp), GOT was forced into relatively quick action. In the absence of this pressure, transactions have been delayed. Similarly, deals depend on internal management willingness: in the case of NAFCO management, which supported privatization, several transactions occurred. Where the capabilities of the holding company management was weak (as in the leather sector), deals have not been concluded successfully.

there has been a gradual movement towards divestiture. Initial offers by the GOT in the leather sector did not go forward because of GOT insistence on majority control and management control. More recent deals -- such as the efforts to divest the Polytex mill, and the recent divestiture of the New Africa hotel -- have been characterized by GOT willingness to take a minority equity position, or divest holdings altogether.

negotiations have been difficult because of lack of technical know-how and negotiating guidelines. The GOT negotiating process was extremely cumbersome in most cases, involving first the holding company, relevant ministry, Ministry of Finance, Bank of Tanzania, and then the Cabinet itself. Political interference and "second guessing" have plagued the decision-making process, forcing negotiators to frequently "go back to the drawing board." GOT has also never clearly defined its basic objectives to guide the negotiating process. In many transactions, this has resulted in positions having to be over-turned at a later date. The lack of an overall framework forced negotiators to operate on a "deal-by-deal" basis, which in turn resulted in very different outcomes.

political considerations have also played a role in delaying a number of promising transactions. In particular, allegations have been made that the reason why certain deals have taken a long time to conclude is the reluctance to place government assets in the hands of Asians. In the case of

MOPROCO, worries about ethnic economic concentration has delayed deal making, with GOT preferring to try to reach an arrangement with Cargill. In general, foreign joint venture partners have been sought, either because they "have more experience," or because "the local private sector doesn't have the money required."

lack of experience with foreign investors has greatly hampered deal-making. Aside from the technical deficiencies of GOT negotiators, a simple lack of experience of dealing with foreign investors is a major factor in the relative lack of movement. TEXCO revised its original project proposal for the sale of Kiltex mill several times, as it gained more knowledge of investor concerns (such as political stability), assurances required (such as inputs of cotton of a certain quality and price). For example, lack of knowledge of textile operations and arrangements in other countries meant that TEXCO could not verify claims of Daewoo about benefits it was receiving in other countries (Sudan and Ethiopia). Inexperience with the way the foreign investors evaluate risk resulted in TEXCO undertaking three feasibility studies. In the tourism sector, the TTC was hampered by its lack of practical knowledge about the international accommodations industry, and its inexperience in negotiating with multinational companies.

lack of a business orientation has made GOT negotiators very hesitant about concluding deals. It is difficult for government bureaucrats to think like businessmen. In many cases, GOT has been unwilling to accept the offer of an investor, because of the amount of investment already made in an enterprises. Clear evidence of this fact is that in almost all cases, the GOT valuation of an enterprise was much higher than the offer of a private investor. TEXCO makes the point that the US$70 million, state-of-the-art Polytex factory (in book value terms), was worth only US$30 million to Daewoo -- even though they agreed that the factory was worth more from a technical perspective. From a business perspective, the government loses money when the factory is operating only at 15 percent capacity. Daewoo guaranteed operation at full capacity, and a 100 percent export market orientation, but at a lower price, based upon their assessment of market potential.

the lack of concrete mechanisms to deal with parastatal debt has greatly slowed the privatization process. In the case of several potential deals in the leather sector particularly, GOT has been reluctant to write-off the outstanding hard currency debt of enterprises. The lack of some mechanism to facilitate this (such as LART), resulted in many potential deals falling through. In one case, GOT spent eight months negotiating with one creditor to convert debt into an equity holding.

individual transactions are delayed by the extremely bureaucratic GOT decision-making process. A major reason

repeatedly cited by private investors and managers of holding corporations, was an overly cumbersome process of decision-making. Each decision would go through the holding company to the overseeing ministry, onwards to a technical working group of mid-level civil servants, and then to an inter-ministerial committee of more senior civil servants, then forwarded to the Inter-ministerial Technical Committee (composed of Permanent Secretaries), back to the relevant ministry, and finally taken by the Minister to the Cabinet for a decision on each and every deal! If sensitive issues are involved, some deals have reportedly been forwarded to the Central Committee of the CCM.

privatization efforts have been focused on poor performers. In general. GOT has tried to divest its interest in enterprises that have been consistent money-losers, and therefore the worst candidates for privatization. Instead, more success is possible with more attractive candidates such as Tanzania Breweries.

C. IMPLEMENTATION OF A PRIVATIZATION PROGRAM: KEY CONSTRAINTS AND POSSIBLE SOLUTIONS

1. Constraints to Privatization

Despite the considerable achievements of the Government of Tanzania in generally creating a conducive policy and institutional framework for privatization, and in actually consummating several transactions, there are important barriers that still deter the process from moving forward. These barriers can be organized in number of areas: a still undeveloped institutional framework, the need for further "deepening" of key policies, technical deficiencies, and important socio-political factors.

Institutional Factors. A major barrier is a still inadequate and poorly defined institutional framework for privatization. First are concerns about the adequacy, composition and effectiveness of the new parastatal reform commission. Second is the anticipated role for holding corporations in the new framework. Major concerns are the following:

Constraint 1: Effectiveness of the new commission remains unknown. The outline of the framework for privatization, and the composition of the Commission in particular, has been received with mixed reviews. Many critics of previous GOT efforts (such as the TATE) believe that the Commission's members are quite competent, and are known for their independent views. On the other hand, the view of one observer from the TCCIA was that the "composition of the commission was stacked against the indigenous businessman," and that the Commission was likely to be ineffective. In contrast, the primary criticism of a manager within one of the leading parastatal holding companies was that the Commission was flawed because it does not include real businessmen or managers, and their was a risk for decisions to be made by

economists and bankers. Another major point that was raised is that most of the new commission members are well-meaning technocrats, but will be unable to take decisions on, what are fundamentally political issues. Finally, there are real fears that the Commission may just become a permanent bureaucracy. While mid-level civil servants at the Ministry of Finance claim that the commission will be "time bound" and have a maximum tenure of three years, the Minister of Finance has publicly stated that "there is no time limit to the Parastatal Commission's work."[29]

Constraint 2: Autonomy and independence of the commission is not assured. While the composition of the new commission has been defined, its ability to make decisions independently is still unknown. Individuals within the Ministry of Finance feel that the only way to guarantee independence is to have the Commission report directly to the President or the Prime Minister, who "cannot be accused of corruption." If instead recommendations of the commission had to be vetted first by the Interministerial Technical Committee, then the Commission was likely to be ineffective, and decisions "could take months or years." The major point is that the policy- and decision-making process is still to be defined.

Constraint 3: Lack of sufficient technical support for the commission. A major reason for the creation of the commission was to unify and centralize privatization efforts and decision-making. Given the large number of SOEs in Tanzania, there is a possibility of over-centralization, leading to further delay. According to the GOT, the commission is to be assisted by a technical secretariat of practitioners and local and international experts, who will actually do the deals. However, there is potential that the Parastatal Commission's effectiveness will depend on the effectiveness of its technical secretariat. A parallel can be drawn to the experience of the IPC, according to a representative of a major multinational company. The ineffectiveness of the IPC is due in large measure to poor personnel and inadequate technical support.

Constraint 4: The inter-relationship among new and old parastatal regulatory/reform institutions is unclear. Another complication is that the precise relationship among various institutions (eg, Parastatal Reform Commission, technical secretariat, LART, SCOPO, holding companies, ministries, etc.), and their precise role in planning and implementing the privatization program is ambiguous.

Policy Inadequacies. Rapid parastatal reform and privatization is possible only if the broad policy liberalization undertaken is "deepened" to further reduce barriers to the entry of private

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[29] Minister for Finance Steven Kibona quoted in the Business Times, February 5, 1992, p. 5.

competition, and to create a "level playing field." Specific constraints include:

Constraint 5: Continuing special privileges for parastatal enterprises and barriers to entry of private firms. Although considerable results have been achieved, policy reform needs to be deepened to ensure that public and private firms are operating on a "level playing field." Considerable efforts have to be made in (a) ensuring that remaining monopolies are dismantled; (b) barriers to investment by private firms are minimal; and (c) that critical support legislation, regulations and institutional framework is in place.

Constraint 6: Ambiguity about GOT intent regarding the parastatal sector. Despite the issuance of the policy statement on parastatal reform, and preliminary moves in terms of implementation, significant policy ambiguities exist:

- what is the fate of the holding companies? Are they abolished, or will GOT retain some of them? Will this be done according to some framework of priorities, or will this be determined on a case-by-case basis?

- GOT policy about retaining SOEs "temporarily" needs to be clarified.

- what is the precise time-table to stop continuing implicit and explicit subsidies for the parastatal sector? What steps will GOT take to precisely identify all SOE subsidies and other advantages?

Technical Deficiencies. As demonstrated by the experience of privatization efforts to date, major constraint is in the form of deficiencies in technical skills of valuation and pricing, readying SOEs for privatization, evaluation and negotiation of bids, and so forth.

Constraint 7: Lack of operating guidelines. A major barrier to privatization in Tanzania is the lack of coherent guidelines to prioritize and operationalize the privatization program. Operational of guidelines clearly identifying priority enterprises and sectors for privatization, and defining what steps would be taken to prepare each SOE for privatization, estimating the full costs of the action, and identifying financing resources and techniques, do not exist. The government has announced that three categories of parastatals will remain in the public sector: (1) natural monopolies such as TPRC, TRC, and THA; (2) public utilities such as TANESCO and NUWA; and (3) enterprises "strategic to the nation." However, the criteria for deciding whether a parastatal is to be classified strategic are not clear, and delay on this score is undermining confidence.

Constraint 8: Lack of audit capacity and adequate accounting controls. A major constraint to privatization is the lack of adequate accounting practices and controls, as applied to the parastatal sector. Evidence of this is the current practice of not explicitly showing (and treating) GOT subsidies and other support, and instead, including such flows as operating revenues. Although the percentage of SOEs that received "clean" reports from TAC increased from 41 percent (1985) to 68 percent (1989), major issues are not covered by existing accounting guidelines. Remaining ambiguities about what the precise definition and accounting treatment of a "non-performing loan" and the nature of a government guarantee," and the like, need to be clarified.

Constraint 9: Lack of sufficient mechanisms to handle the debt of parastatal enterprises. Past mismanagement and a 200 percent cumulative depreciation in the value of the Shilling has combined to create a highly indebted SOE sector. The lack of adequate mechanisms to remove the debt from the balance sheets of SOEs inhibits investor interest. This is further complicated by the fact that the majority of debt is hard currency debt. While local debt has been handled in a variety of ways (written off by the GOT, in other cases, local financial institutions accepted equity for debt outstanding), foreign exchange debt has proven more troublesome. In the absence of an established mechanism to handle the debt, decisions are made on a case-by-case basis. The role of LART is unclear as to whether it will transfer non-performing loans or entities, and what type of debt it will assume. Some GOT officials feel that LART will offset only the debt burden due to the depreciation of the Shilling, but that "genuine" debt resulting from the management of the company will remain. Aggressive collection by local banks of their loans is likely to result in the liquidation or the "backdoor privatization" of SOEs in the agriculture sector, where the largest creditor is GOT. This will hardly affect industrial SOEs, which together, owe less in local currency terms than the NMC facility.

Constraint 10: Valuation. Another factor that has slowed privatization transactions relates to difficulties in valuating an enterprise in an environment where land has no value. According to GOT officials involved in negotiations with potential investors, valuations of SOEs undertaken are typically much higher than bids received, in the vast majority of cases. This is typified by the experience of CDC in trying to take over the East Usembeze Tea estate. In that case, the CDC bid for the property was some 30 percent below the value determined by an independent Kenyan firm. The same disparity was found in the case of the valuation of the Moshi Tannery, where the investor's bid was roughly half of the valuation. The reason for such disparities is not just methodological, but attitudinal. The GOT focuses on trying to recover its past investment; the private investor focuses on past financial performance and the earnings potential of the asset.

This is compounded by the fact that land value is not explicitly part of the deal. In many cases, valuation is high because government imputes value for use of the land and treats it as payment for "goodwill." The lack of adequate valuation techniques, the general lack of various approaches utilized in other countries, and the land valuation issue, pose a constraint to privatization.

Constraint 11: Lack of technical experience in negotiating privatization deals. A constraint that was described earlier, but deserves its own treatment, is the general lack of experience of GOT officials in dealing with foreign investors. Many GOT officials are simply not aware of how an investor evaluates opportunities, assesses risk, and requires assurances. The GOT is also "not used to behaving like an investment bank, and have little or no practical skills in negotiating deals with investors."

Constraint 12: Lack of capital markets. The lack of a capital market is extremely serious deterrent to privatization, especially strategies based upon widespread shareholdings. An organized stock exchange would not only have the advantage of greatly simplifying the valuation of public enterprises, but would do so in a highly transparent manner.

Socio-Political Issues. The final set of constraints revolve around the political will of the Government to move forward to implement a program of privatization.

Constraint 13: Economic concentration by Asians. There is a fear among many indigenous Tanzanians that if parastatal enterprises were put up for sale, the economy would be further dominated by the Asian community which is already heavily involved in trade, plantation crops, and in some productive enterprises. The Asians are perceived as investing little, looking for a fast turnover, extracting large profits, maintaining tight secrecy concerning their operations and "lubricating" the system whenever necessary. Such a stereotype is certainly unfair, but it persists. As a consequence, the indigenous business community has mixed feelings about privatization and is unwilling to take an aggressive position in favor of it. The problem for the GOT is that the private investor group that has the means and the interest in acquiring SOEs, is illegitimate in the eyes of the population at large.

Constraint 14: "The family silver." There is a great fear among GOT of being accused of stripping national assets. There is tremendous resistance among large segments of society to part with the parastatals for anything less than their full asset value. One recent letter to the editor of the Daily News quoted Harold Macmillan's comment about privatizing state-run entities as "akin to selling the family silver." This is complicated by an apparent misunderstanding of what the parastatals are really worth: certainly not the book

value and much less the replacement value of the assets, but rather the future cash flow streams discounted at a rate that reflects the risks of doing business in this environment.

Constraint 15: Opposition of the SOE managers and employees. Another obstacle to privatization comes from the people who have the most to lose from it: SOE managers, some civil servants and employees. More precisely, the parastatal sector is the power base of some people; parastatal managers wield a lot of power, and could mobilize employees against government, according to a member of the Parastatal Reform Commission. In this vein, it should be noted that there are allegations (completely unsubstantiatable) that members of the Nkesela Commission was actually extorting from the parastatal enterprises, and found that over 90 percent of the SOEs should be retained within the public sector.

Constraint 16: Political risk of laying-off workers. The existence of large numbers of redundant employees in the parastatal sector, and the need to down-size certain operations before sale is likely to result in substantial lay-offs of workers and managers. Some have estimated that as much as 15 percent of the total labor force would be laid-off. This is further complicated by the fact that there is no social security net, and retirement and severance benefits are guaranteed by law. However, it is unlikely that there will be any organized labor resistance, as there is a relatively weak and unorganized labor sector. Labor suffers from poor management and limited technical abilities to analyze issues and lobby effectively. In addition, labor's views regarding privatization are mixed. According to two papers presented at a recent labor union meeting, privatization was viewed alternately as a scapegoat for poor management (and should therefore be opposed), and as a mechanism that would result in the prospect for more and better employment in the future.

Constraint 17: Attitudinal problem. Another constraint is purely attitudinal. After three decades of socialism and government domination, it is going take a lot for the general population to stop viewing the government as the wealth generator and "big brother" in the country. It will also take some time for people to view private business and commercial activities favorably. SOE managers and workers may find it very difficult to adjust to the new environment, lack of security, and the like. Old habits may also die hard, after operating in a system characterized by corruption and lack of accountability throughout the whole structure, it may be difficult to operate in an environment of the rule of law.

Constraint 18: The need for further liberalization of the political system. The fundamental barrier to change is the political system. To state the self-evident: the government, the civil service and the parastatal enterprises have all been aspects of the CCM. Restructuring cannot go too far if political and career governmental leadership adheres to the

socialist principles which are the essence of CCM philosophy. The story of liberalization in Tanzania is the story of tension between the CCM and the government. In 1990-91 when the economy was liberalizing, and the SOEs were expected to be accountable, the CCM actually appointed political commissars within each enterprise. The autonomy of the new Commission, in this view, will only come when a bill is approved in parliament for multi-party democracy, removing the supremacy of the CCM. That measure was endorsed by the CCM NEC (February 18, 1992 in Dar es Salaam) for adoption by the National Assembly in April 1992. According to some observers, the pace of true privatization and parastatal reform depends on the ability of the GOT to differentiate itself from the CCM, which created the present situation.

2. Possible Solutions and the USAID Role

Before discussing possible solutions, it is important to note that privatization is not an end in itself, but part of a broader program of reforms designed to promote a better allocation of resources, encourage competition, foster a supportive environment for entrepreneurial development, and develop the capital market. To a large extent, privatization is not necessarily synonymous with private sector reform and deregulation. A government objective of raising the maximum from the sale of public enterprises, for example, may require tariff protection or direct subsidies. Wherever possible, the recommendations detailed below suggest actions generally supportive of the overall objective of private sector development and economic liberalization; actions suggested for USAID are based on the plans of other donors as well (see Appendix I for details).

Institutional Enhancement Recommendations. It is absolutely critical that the GOT Parastatal Reform Commission be clearly defined and strengthened by implementing the following actions:

Recommendation 1: Provide technical assistance to develop a comprehensive privatization program. Immediate technical assistance is recommended to aid the GOT in implementing the actions outlined in Haggerty's proposal, namely:

1. Categorize enterprises. Review the progress made in categorization of the parastatal enterprises, and group them according to viability, select and prioritize enterprises for alternative courses of action (possible criteria suggested include: the need to stem losses; ability of enterprise to be self-sufficient within a set period; maximization of divestiture proceeds; need for investment for rehabilitation; level of interest from potential joint venture partners; ease of privatization in relation to the condition of the enterprise). Apply these criteria to classify the enterprises (to retain in public sector, joint venture, partial or full

divestiture, liquidation, restructuring, leasing or management contracting).

2. Develop specific guidelines for privatization action. For each of the major categories of enterprise, assistance can then be provided to develop operational guidelines defining basic parameters and minimum standards for each type of potential transaction.

3. Depending on the importance of the enterprise, undertake firm-level actions to prepare the enterprise for privatization. Actions that may be necessary include enterprise preparation (asset rehabilitation, collection of accounts and debts, divesting loss-making activities, debt resolution, efficiency and quality improvements, provision of adequate documentation and titles); regulation or deregulation (if an enterprise is a de facto or natural monopoly); undertake valuation; preparing enabling legislation (if necessary); revising the capital structure.

4. Implement the privatization deal. Depending on the SOE, and the privatization method chosen, implementation would involve developing necessary project proposals, identifying potential partners, negotiating/implementing the deal, and developing and monitoring system.

Recommendation 2: Provide long-term technical assistance to the commission. It is recommended that at least two long-term expatriate advisors be placed in the commission. These individuals should have extensive experience with planning and implementing privatization programs. One person would be principally responsible for devising with GOT the overall policies and framework for the privatization program as a whole, defining and establishing the relationship between the various institutions, and in developing appropriate monitoring and control procedures. The second expert would have a more "hands on" deal-making focus, and would oversee enterprise-specific actions such as restructuring and valuation.

Recommendation 3: Establish a technical assistance fund for short-term technical specialists. This fund would finance short-term technical specialists (local and foreign) that would participate in specific deals, negotiate with investors on behalf of the GOT, identify potential joint venture partners, and the like.

Recommendation 4: Undertake a short-term study to establish the structure and functioning of the commission and the technical secretariat. A study recommending the structure, operating procedures and responsibility, line of communications, funding, relationship with other institutions, etc., should be undertaken. Study should make specific recommendations for the elimination of specific institutions such as holding companies, SCOPO, etc.

Recommended Role for USAID. Discussions with the World Bank, ODA and the Commonwealth Fund for Technical Assistance seem to indicate that the Bank and these other donors are well along the path of implementing many of the recommendations listed above. In particular, it is likely that the ODA will provide the long-term technical specialists listed, and develop operational guidelines, and the like. In this light, it is recommended that USAID provide funding into the short-term technical assistance fund, to fund U.S. consulting and investment banking expertise, in areas of specific competence.

Recommendations to Accelerate Policy Reform. In conjunction with the actions recommended to enhance and deregulate the business climate, the following actions are recommended to remove remaining SOE privileges and facilitate entry of private firms.

> **Recommendation 5: Undertake a study to identify actions to implement the deconfinement measures already announced.** In the agriculture sector, this would include: deconfining the role of export crop marketing boards, allowing private distribution of farm inputs and demonopolizing the Tanzania Fertilizer Company, suspending current budgetary support to non-performing large-scale farms, further the move towards indicative prices for food and export crops, and permitting private seed companies in competition with the Tanzania Seed Company. In the industrial sector, a number of actions need to be taken, including: phase out direct GOT subsidies to SOEs (except that necessary for privatization), removal of monopoly rights for some industrial SOEs, relieve SCOPO of its responsibility of personnel matters, make recommendations for elimination of the holding companies, assist in the development of a time-table to for discontinuation of all direct and indirect subsidies.
>
> **Recommendation 6: Develop supporting legislation and regulations.** In order for the private sector to be able to compete with parastatal enterprises, undertake effort to develop enabling regulations in several areas: bankruptcy, land acquisition and building construction, labor hiring and other conditions, and other areas.

Recommended Role for USAID. In general, it is recommended that USAID concentrate its efforts more in the area of creating an enabling environment for the development of new private sector activities. To that end, it is recommended that USAID support recommendation 6.

Recommendations to Offset Technical Deficiencies.

> **Recommendation 7: Provide assistance in enhancing accounting standards and practices.** A short-term effort, reviewing the adequacy of SOE accounting standards and control procedures should be undertaken to upgrade them. The analysis should be followed-up with several in-country training exercises for TAC, parastatal enterprise managers, and bank managers.

Recommendation 8: Establish a privatization fund. To facilitate private sector take-over of enterprises, a venture capital fund should be established in Tanzania. The management of fund would be in the hands of a professional firm, overseen by a Board of Directors. The fund would provide equity and long-term loans on a commercial basis to purchase equity in a parastatal enterprise or rehabilitate a privatized enterprise. Other possible applications could be to purchase shares on behalf of a "public trust" for re-sale to the public, or to purchase commercial debt for a debt/equity conversion.

Recommendation 9: Facilitate private bank lending for privatization by using the PRE/I Privatization Guarantee Program facility. Once private banks begin operations in Tanzania, USAID can work with PRE/I to provide a 50 percent guarantee on debt provided by eligible financial institutions to fund the purchase of shares in SOEs, or to facilitate privatization through other means. The facility could be tailored to just funding employee purchases of shares in a privatized company.

Recommendation 10: Convene seminar to discuss privatization valuation approaches and provide technical assistance in valuation techniques. It is recommended that a seminar with international experts be convened to discuss the practical application of earnings-based and asset-based valuation methodologies. Specific attention should be paid to identifying practical methods that can be applied to the valuation of assets in the absence of organized capital market. Technical assistance from professional valuation specialists can be provided through the technical assistance fund (see recommendation 3).

Recommendation 11: Develop options for removing or reducing parastatal debt. In order to facilitate the sale of enterprises, it is recommended that a study be undertaken to develop concrete methods for management of debt. Debt restructuring could include: debt to equity conversions; rescheduling and re-financing of debt; direct buy-back of debt at a discount; allowing a trust fund to service debt (as part of an interim arrangement) for a SOE; direct assumption of the debt by GOT. Particular emphasis should be paid to the viability of setting up a private trust funded by counterpart funds for ESF program to SOEs. The trust can then assume the debt of specific SOEs for a grace period before transferring the debt back to the company.

Recommendation 12: Revise debt/equity conversion program to focus on privatization transactions. Debt equity swaps can be an important tool to attracting foreign investment for privatizing public enterprises. They are an investment incentive as well as a debt management tool. Commercial debt could be bought at a discount and swapped directly for equity in the company. This has the advantage of a non-inflationary

impact, and will not burden the government's budget. The current debt swap program in Tanzania would have to be broadened to specify eligible debt, conversion procedures and eligible investments.

Recommended Role for USAID. Clarification of specific technical issues, is the area of focus within privatization activities for USAID. Specifically, it is recommended that USAID sponsor recommendations 8, 9, and 11. Both the World Bank and DEG are planning to set up venture capital funds to finance privatization activities. DEG's approach is different in that they focus on setting up a management consultancy, and have a total capitalization of about US$5 million. As their plans develop, it is recommended that USAID consider contributing to the activity. Other areas -- debt/equity conversion, capital markets development, deal negotiation skills -- are currently planned by different donors. The World Bank is focussing on the debt/equity program; CIDA is already sponsoring a study on capital markets development; and ODA is likely to provide practical assistance with investment negotiations, as mentioned earlier.

Recommendations to Offset Socio-Political Constraints

Recommendation 13: Devise practical methods to avoid concentration of ownership. There are a number of possible methods to try to broaden ownership of SOEs in Tanzania. One approach is to set up a trust to purchase shares in target SOEs. The trust could then lend money to the public to purchase the shares, with the shares as collateral. Another possible approach is to encourage the formation of employee stock ownership plans (ESOPs). Creditor banks could then convert their debt into equity and lend money to the ESOP to purchase the shares. The primary drawback of these approaches is that they (in effect) swap one liability for another, and do not generate a new cash investment which is what is sought. Also spreading share ownership among a large number of small investors can be very risky, unless sufficient effort is spent providing necessary information, analysis and regulation. The purchasers of stock in a SOE may assume that the government is providing an implicit guarantee of their share value, and indeed the government may feel obliged to intervene if the value falls. Broad ownership may not also assure the strong guidance to turn a firm around.

Recommendation 14: Devise a comprehensive public education campaign to offset perceptions of "giving away national assets." It is recommended that a publicity campaign be devised to prepare the public for the privatization program. This program would involve clearly letting the public understand the true costs and benefits, from the national perspective, of various parastatal enterprises, and the advantages and disadvantages of various privatization actions. The experience of other countries, and the results of past deals can be examined. Individual deals can be facilitated by conducting an open valuation of the enterprise, and

publicizing the results. Experience has shown that privatization will be debated regardless of whether information is hoarded or released. The challenge is to make the debate an informed one: the public should know more about how much implicit and explicit subsidizing goes on with state ownership, and the costs of foregone activities, and the like.

Recommendation 15: Establish a fund to facilitate the retrenchment of laid-off SOE employees and managers. The fund can finance a number of activities including training courses in entrepreneurship development that will enable SOE employees to survive in the informal sector, and basic contribution to the GOT budget to finance provision of severance packages, retirement benefits, and the like These approaches have been successfully utilized in reducing worker opposition to privatization in Ghana, Tunisia and Philippines. Severance packages are very important where there is no social safety net, and retraining and re-deployment schemes have a very poor track record.

Recommended Role for USAID. It is strongly recommended that USAID undertake the activities described above. This is a clear need of Government, who simply does not have the resources to re-train and re-deploy redundant SOE workers and managers. Existing courses focus on management and administrative training; there is no practical source of training and expertise in entrepreneurship skills development. These activities also have the greatest potential for contributing to the development of a viable indigenous private sector, which is an important goal.

D. LIKELY IMPACT OF PRIVATIZATION ON THE ECONOMY

The likely impact of a privatization program in Tanzania can be viewed in terms of short-term, static effects, and longer-term, dynamic effects. On the positive side, privatization efforts (including liquidation and divestiture) will greatly reduce the grants, subsidies and other public transfers that have kept money-losing parastatal enterprises alive. New inflows of funds would flow to the GOT budget as the privatization program proceeds, consisting of new private equity and debt, proceeds from divestitures and reductions in subsidies, and increased interest and principal payments from the newly privatized enterprises. Based upon the analysis of about 90 SOEs, Haggerty (1991) estimated that the Government might receive about TSh 22 billion over a five year period in terms of net inflows. Given the large number of loss-making firms, the impact of privatization on the Tanzanian economy is likely to be quite positive, even when long-term, dynamic effects are considered.

The big winners include labor, the private sector in general, and a new breed of manager. There is little doubt that a change in ownership and management will result in great improvements in productivity and efficiency. Even with the currently flawed investment climate, privately owned and operated Tanzanian firms

are much more efficient users of labor, capital, foreign exchange and other resources relative to public firms. Similarly, while there will be substantial unemployment in the short-term (perhaps up to 15 percent of the labor force), it is more likely that employment will increase significantly in the longer run -- as resources are used more efficiently, and private sector activities increases. Finally, the new breed of indigenous entrepreneur who is now trapped in the parastatal sector, or engaged in informal activities, is the big beneficiary as new opportunities and resources are made available. Sectorally, big winners are likely to be in the tourism, minerals and light manufacturing activities, which are based on the comparative advantages of the country.

The principal losers include civil servants and parastatal managers -- especially those than have depended on the opportunity to influence decisions through illegal means -- and other bureaucrats, who have built up illegal sources of income and depend on a captive parastatal sector to extend their influence and patronage. Certainly, a loser, if privatization activities accelerate is the CCM, which is likely to be blamed for past policies. As said elsewhere, "the divestiture process necessarily entails public admission that investment resources were wasted."

Finally, sectorally, large-scale, capital-intensive production is likely to be scaled-back as cheaper imports and private sector competition increases.

CHAPTER IV
BUSINESS ENVIRONMENT

A. INTRODUCTION: History

Tanzania's private sector at independence consisted of numerous peasant agrarian smallholders, a few traders along the coast and in the key inland towns, and some large commodity estates controlled largely by European and Asian descended owners. It was not especially developed in terms of industries of transformation. sector. After independence, The Arusha Declaration of 1967 gave expression to an ideology of African socialism and self-reliance, in terms of production, transformation and distribution. Rather than to drive out the new nation's inherited European and Asian-descended private sector, this ideology to confine its opportunity and markets until such a time when the national enterprises would overwhelm and erase it.

If not against their persons, there was, however, violence against the property of Tanzania's non-Blacks. In the wake of (partially compensated) nationalizations or outright seizure of property, the state became the owner, operator and manager of most, if not all, Tanzanian financial services, estate agriculture, commerce, and industry. The uni-party Chama Cha Mapinduzi (CCM) government sought to extend the role of the state it controlled to the "commanding heights" of the economy. The stated goal was to drive the pre-Independence private sector under. The reverse took place.

For seven years, the results of Nyerere's experiment in African socialism were positive. Foreign donors, particularly the Scandinavians, were highly supportive of the Tanzanian development model. Basic services effectively reached the rural poor. The economy was kept strong by rising prices for traditional export commodity crops. A strong intellectual leadership articulated a clear vision of the future. Even those most opposed to government policies during this period agree that many government officials were highly qualified.

An indigenous Tanzanian entrepreneur recalled for the Team that the few educated Black Tanzanians there were at Independence were required for the civil service. With the nationalizations of 1967, additional educated Blacks were absorbed into the Government of Tanzania (GOT) and State Owned Enterprises (SOEs). Equally effective in drawing the Black Tanzanian leadership away from private enterprise was a required five year minimum term of government service after graduation. Asian-Tanzanians were neither required nor encouraged to do government service, but were left to occupy themselves as they saw fit. As may be assumed, this structural differentiation further divided the Black/government from the Asian/business populations of Tanzania.

Participation in and experience with the private sector (other than subsistence agriculture and informal trading) among Black Tanzanians was further restricted by a CCM policy of discouraging Black men from developing a cash base independent of the party-state lest they become political threats. In addition to the political, there was a status issue connected with a decision to enter into business. For a generation, anyone in private business has been presumed to be uneducated (since the educated were assumed to have entered into government service) and has been scorned. An educated son was ashamed to join his father in the family business with the result that what Black-owned businesses there were at independence largely died out for lack of natural hand-over. The lack of hands-on experience in business also meant there was no public or private vision of the potential to develop private business operators from trade into manufacturing and export to achieve the same goals sought by African socialism.

Finally, the private sector suffered by comparison since, for a time, the parastatal system worked. Tanzania's positive economic and social performance during the 1967-74 period helps explain why it took eight years of economic disaster before any policy change occurred to reverse the decline. Moreover, the leadership and public was encouraged by past success, and lack of contact with the rest of the world, to attribute rampant inflation and declining foreign exchange reserves to external shocks (oil prices, worsening terms of trade, and a costly war with Uganda) rather than to failed GOT policies and public mismanagement of the country's wealth.

B. BACKGROUND ON NEED FOR BUSINESS ENVIRONMENT REFORMS

A Tanzanian lawyer (who is also a government official) told the Team that "in 1967 the business atmosphere in Tanzania went into prison. In 1984 it came out of prison with the liberalization of trade. But it is one thing to take the physical body out of prison and another to take the spiritual. As we say, once bitten by a snake you jump in fear at each movement in the grass." He believed the public's confidence level has moved up from 5% to 75%.

Public confidence be what it may, the fact is that Tanzania's youth have inherited little more than a heavily mortgaged and encumbered title to a market of dubious present value. The legacy of a quarter century of economic experimentation includes these obstacles to development:

- a deteriorated and informalized economy;
- weak and ineffective private sector business associations and organizations;
- an enormously burdensome parastatal sector;
- an underpaid, undermotivated civil service, and skepticism among potential private investors.

- a deteriorated infrastructure, the restoration of which will challenge even the joint effort of all donors;

- an insolvent state banking system, and lack of project/investment financing beyond trade financing;

To reverse these conditions will require the reforms of the financial sector as discussed in Chapter II, reforms of the Parastatal sector as discussed in Chapter III, and wide scale revision of the policy and legal framework within which business seeks to operate.

Constraint #1 - Legal and Policy Framework

As may be presumed from the country's initial direction, Tanzania has never had a particular body of law on private sector business. The present code, inherited from East African common law, was taken over at Independence without fundamental revision. The present regulatory environment is the accretion of a series of Acts: the 1967 nationalization of banks, 1970 nationalization of properties (which had a great psychological impact on foreigners and locals), and the 1984 measures on liberalization of trade.

Successful establishment of a competitive, market oriented, business environment in Tanzania is not a foregone conclusion. It is interesting that the present SOE management interviewed by the Team either stated that they were, or appeared to be, awaiting orders to show initiative. This is partly due to successful indoctrination of these people, who owe their position to Party favor, and partly due to their fiscal weakness.

In his keynote address to the CCM National Executive on February 18, 1992, Mr. Nyerere declared that "CCM was formed, and its leaders elected on the basis of its ideological commitment to ujamaa and self-reliance. It has not changed its policies on that aspect. Nor has there been any discussion or complaints by Party members in the country demanding change." Parties advocating capitalism, however, could be voted into Parliament. "If the people favour a party advocating such a fundamental change, and it gains a two-third majority in Parliament, then the constitution could be changed."[30]

Some indigenous Tanzanian and foreign operators are acting in anticipation of a liberalized business environment. Opportunities revealed by economic necessity (such as selling off SOEs draining the Treasury, as discussed in Chapter III, supra), have excited the interest both of established Tanzanian business units (such as the Groups discussed below and in Appendix J) and opportunistic newcomers who had lingered on the sidelines or in the informal economy over the past decade.

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[30] DAILY NEWS February 19, 1992 p 3 column 1: "Nyerere: Arusha blue-print stays [for CCM]".

The Tanzanian economy is now in the frontier zone of development. Team members were approached informally by would-be entrepreneurs eager to create linkages and win foreign investment for enthusiastic but poorly analyzed projects in tourism, gemstone mining, and non-traditional agribusiness. Additionally, several established private sector groups have stated that they are now plunging especially into tourism projects in Zanzibar and the Arusha-Moshi region and have arranged partial foreign financing of their projects. Others, such as Lonrho, Brooke Bond and Karimjee, have already made significant investments in agro-estates, especially tea. Cut flowers is an area of increasing interest and investment.

It is also important to state that regulatory and legislative changes, especially to the procedure to establish both Tanzanian and foreign enterprises, are underway. The Investment Promotion Centre has commissioned and received recommendations on "Facilitating The Investment Process In Tanzania"[31] According to Sir George Kahama, the recommendations contained in this report will be implemented by the National Assembly at its April 1992 sitting. Major revisions of the constitution (mid-April 1992), legislation and regulation on such issues as business establishment, taxation, land rights and employer-employee relations will also be required to create sufficient conditions for wide development of private sector business. Additional policy reform will focus on the constitutional and regulatory role of Ministers to issue approvals for business establishment, access to financing, and allocation of property.[32]

While specific policy reform, and revision of the basic legal texts appear necessary, these are closely linked to issues of past national ideology and future political direction. Therefore, USAID should identify opportunities for policy change intervention which neither violate present Constitutional limitations to change nor adopt specific champions in the arena of business associations.

The Mission may wish to consider a technical study of Tanzania's legal code as it relates to private enterprise by a team including specific expertise on international, European Community and domestic business law. Specific texts suggested for review for revision, harmonization, or elimination, include:

Business Licensing Act: No. 25 of 1972
Business Names (Registration) Ordinance Cap 213
Companies Ordinance: Cap. 212, October 1, 1932, Rev.
Companies (Registration of Dividends and Surpluses and Miscellaneous Provisions) Act: No. 22 of 1972

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31 Report Prepared for The Technical Assistance Group, Commonwealth Fund for Technical Co-Operation, by M. Arthanari and J.R. King, 24 May 1991; available from The Investment Promotion Centre, Dar es Salaam.

32 A Land Commission was meeting in January and February 1992 to deal with these issues and intends to issue draft revisions to present legislation by late summer 1992.

Customs Tariff Act: No. 12 of 1976
Dodoma Special Investment Area Act: No. 7 of 1989
Dodoma Special Investment Area (Control Mechanism and Operational Procedures) Regulations 1989
Exchange Control Ordinance: Cap. 294
Exports Control Ordinance: Cap. 297
Factories Ordinance: Cap. 297
Fisheries Act: No. 6 of 1970
Forests Ordinance: Cap. 389
Hire Purchase Act
Hotels Act: No. 22 of 1963: Cap. 521
Immigration Act: No. 8 of 1972
Imports Control Ordinance: Cap 292
Income Tax Act: No 33 of 1973
Law of Contract Part X (Partnerships) Cap.433
National Board of Architects Quantity Surveyors and Building Contractors Act No.35, 1972
National Industries (Licensing and Registration) Act: No. 10 of 1967; amended 1977, 1978, 1982 (Act No. 13)
National Investment (Promotion and Protection) Act: No. 10 of 1990
Sales Tax Act: No. 13 of 1976
Tenancy Act
Tourist Agents (Licensing) Act: No. 2 of 1969
Town and Country Planning Ordinance: Cap. 378

The practical impact of these regulations on the business environment is described in Appendix H, "The Business Regulatory Environment".

In summary, fundamental requirements for the development of a strong private sector in Tanzania include:

- additional infrastructural improvements to roads, airports, telecommunications, electricity, water and sanitary disposal;

- fundamental changes in attitude, both official and public, for private enterprise to take root and flourish;

- access to and knowledge of external markets and basic information on the creation of market linkages to empower the indigenous Tanzanian entrepreneur.

C. RECENT BUSINESS ENVIRONMENT POLICY REFORMS

The government has already shown itself capable of pragmatic response to its economic problems, at the level of macro policy. The granting of own-funds import licenses in 1983 was a momentous decision. By this step the GOT publicly admitted that it knew what all businessmen and most consumers knew: significant domestic wealth had remains outside the formal monetary system. It in effect recognized the failure of its fixed rate exchange policy that had greatly overvalued the currency, discouraged exports, and could

only be sustained through import licensing, foreign exchange allocation, and price controls. Consumer goods at long last began to appear on the shelves in the mid-1980's. The availability of these goods in rural areas provided farmers with some incentive to market their produce rather than consuming it.

Import licenses issued through the own-funds scheme had reached a value of $475 million (over one-third of all import licenses issued), peaking out in 1988 at $639 million and declining to $448 million in 1990 as other import schemes gained in importance.[33]

Policies under the Economic Recovery Program (ERP) in 1986 further reduced the discretionary allocation of foreign exchange. The currency was allowed to devalue by 80 percent so that the parallel market premium, which had been 9:1 in 1985, settled at 1.5:1 in 1990.[34] A less overvalued currency opened the way for a partial liberalization of imports through the open general license (OGL) granted automatically for certain categories of imports. With World Bank and bilateral donor support, the value of OGL licenses issued has increased from $50 million in 1988 to $310 million in 1990, about a fifth of the value of all import licenses. The OGL was supplemented by other specific import support programs, by the government's allowing retention of a percentage of export earnings, and by an increasing volume of loans, grants, and credit from bilateral and multilateral agencies.

As foreign exchange policies were becoming more liberalized, regulations on the implementation of these policies have become more stringent. For example, when the retention scheme was begun it was held to ten percent of export earnings but the exporter was allowed to retain these in an overseas account in which he or she had check signing powers. The government later moved them into a trustee account in the exporter's name. The retention limit has since gone up to 35-50% (depending on the goods exported) but funds are held in a trust account in the NBC's name and it is the NBC that must open the letter of credit. Because of questions and delays by the NBC, exporters such as tour operators cannot obtain timely inputs such as safari vehicles to generate export earnings during the tourist season.[35] Own-funds imports will soon be made more difficult by a new requirement that merchandise be inspected prior to shipment.[36]

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[33] Data on windows of foreign exchange availability provided by the World Bank Representative in Dar es Salaam, January 24, 1992.

[34] World Bank, Tanzania Economic Report: Towards Sustainable Development in the 1990's (Washington, D.C., June 11, 1991), Vol. I, p. 7.

[35] Interview with businessman, Dar es Salaam.

[36] Announcements appearing in the Daily News (Jan. 30, 1992) and the Business Times (Jan. 31, 1992).

The private sector is sensitive to government's tweaking of policy reform. Entrepreneurs indicated that they believe rapid action and results are required to take advantage of what may prove only a temporary opening. While policy changes have proceeded rapidly in the areas of foreign exchange, banking, and parastatal reform, there has been far greater resistance to institutional change. On the one hand, there has been some deconfinement of marketing channels and a drastic reduction of The National Milling Corporation's monopoly position. Private grain mills have been built especially in key consumer markets such as Dar es Salaam and the Arusha-Moshi area, and are coming onstream. Wheat estates and cooperatives are now selling into private channels. However, five years after the need for divestiture of loss-making parastatals was recognized, only a handful of minor companies have actually been privatized or divested.[37] A year and a half after the Presidential Commission on the Banking Sector submitted its report, there is little evidence of change in commercial banking practices or in the level of service of present institutions.

The very politization of business over the past quarter century has led to a confusion of effort. Political change shows all signs of absorbing the energies of national political and economic leaders. Policy changes may take a subordinate position in the interests of "national unity" as it remains defined in the Constitution. The present broad panoply of putative private business associations appear to be nascent or crypto political parties whose success in the polls may be a precondition for fundamental revision of the legal and policy environment.

Resistance to institutional change is to be expected by groups that are adversely affected by these changes:

1. Parastatal managers: liberalization means cheaper imports and greater competition for companies that previously enjoyed monopolies in a highly protected market. The parastatals continue to receive bank credit to offset operating deficits, but the commercial and development banking sector is under increasing pressure from the Bank of Tanzania to transfer non-performing assets to a Loans and Advances Realization Trust (LART), charged with the recovery of overdue debts.[38]

2. Parastatal employees: reform and restructuring of parastatals in the banking, industrial, and commercial sectors will mean retrenchment and loss of jobs. Some schemes have been proposed for training for alternative employment, but these schemes cannot be expected to absorb all redundant workers and managers.

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[37] Daniel Ngowi, update of parastatal assessment; interviews with decision makers in parastatal reform; Team research described in Chapter 3

[38] The most complete explanation of the LART mechanism is contained in the "Report and Recommendations of the Presidential Commission of Enquiry into the Monetary and Banking System in Tanzania" (Dar es Salaam, July 19, 1990), Implementation Section, pp. 26-36; see also, Chapter 2 of this report

3. Civil servants: deregulation and the reduction of discretionary resource allocation by the bureaucracy means that civil service employees will have fewer opportunities to extract side payments for "lubrication" of the government decision-making process. On the positive side, the more competent will benefit from being part of a more professional, merit-based civil service.

D. BARRIERS TO INVESTMENT AND ENTREPRENEURSHIP

The adoption of the principle of multi-party rule by the CCM extraordinary National Conference on February 18, 1992, in Dar es Salaam, and especially the blessing of the concept by Father of the Nation, Mwalimu Nyerere, has put in place some necessary conditions for the development of a competitive business environment in Tanzania. The publication of a new pair of independent newspapers, EXPRESS and MWANANCHI[39] is indicative of the degree of freedom now sensed by Tanzanians.

Constraint #2: Attitude toward private enterprise

The attitude of Tanzanians is an issue: their attitude has to be changed for private enterprise to take root. One Black Tanzanian averred that the majority of literate Tanzanians consider state employment on salary to be their only option, since private work is beneath contempt. Moreover, CCM ideology can be considered to have suppressed its own believers, he stated, by urging people 'not to keep chickens, don't be a capitalist.' In fact, there are very few manufacturers or industrialists in Tanzania. The majority of business is trade and commerce. One effect of the increased informality of the Tanzanian economy has been the wholesale complicity of consumers and tradesmen in illegal commerce. It is now to the point that to admit to being a businessman is as much as to admit to being a crook. One example of the inertial power of ideology was discussed in Chapter III in relation to "the family silver."

Thus, several streams have converged in Tanzanian economic history to create the present morass. In the first place was the frequently cited ascendancy of the CCM and the adoption of the 1967 Arusha Declaration and subsequent nationalizations and establishment of SOEs. Their model example was the Indian, in which industrialization and expansion was sought without regard for true efficiencies. While CCM ideology spoke of "African Socialism", the model may have been closer to 17th century European state-licensed monopoly trading companies than to post-1848 European socialism.

While participation shares in the East Indies Company, the VOC, the West Indies Company, and various others, were actively

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[39] Issue 001 of the English language EXPRESS appeared February 20, 1992; the new publications are backed by a member of the Ismaeli community, operating as Media Holdings Ltd, POB 20588, Dar es Salaam, tel. 36167. The weekly BUSINESS TIMES is said to be considering expanding to a daily newspaper, but is limited by the comparative absence of businesses to subscribe and to provide news.

bought and sold on early European stock exchanges (Amsterdam being the best 17th century model), in the case of post-1967 Tanzania, the "shares" in the regional trading companies, the regional transport companies and the various holding companies were traded politically among members of the CCM. As there was no profit incentive based on the risk-taking of personal investment, these CCM preferred shares became senior debentures whose issuers paid out with no regard for the health of the enterprises themselves. Revenue was confused with profits. Corporate and personal accounts were co-mingled. Revenue intended to flow to the Treasury diminished with each set of hands through which it passed. Indeed, it appears that these rights of access to the public revenue stream were intended as compensation for party loyalty in the (increasing) absence of cash compensation from the Treasury. A weak Treasury increased incentive to seek personal compensation as close to the revenue source as possible. In this way, one can speak of national complicity in the economic demise of Tanzania. Only the willingness of some nordic countries to keep refilling the cash reservoir kept the system moving.

The second convergent stream flows from cultural attitudes. Western individualism is not necessarily an African social or cultural assumption. As the Team and other consultants readily observe, it is expected in many African societies that the extended family benefits from the success of one member. Concomitant is a predisposition to consume the fruits of a harvest when there is a surplus rather than to save or reinvest. The parastatals operated from this assumption. The result for an enterprise can be either draining of potential investment funds into immediate consumption, or the increase of overheads resulting from "employment" of family members in the enterprise. What could be an efficient seven-worker enterprise becomes loss-making at twenty. Capital formation is problematic within this cultural context.[40] Private businesses tend to cap their growth at a level of revenue and employment judged to be below the perceptive horizon of both family members and Inland Revenue in an effort to husband resources. Expansion, if any, is horizontal through the formation of additional businesses with their own overhead structures. The constraints of this cultural predisposition on enterprise building are self-evident. The Mission should consider carefully the consequences of directly addressing this issue, or whether it may be better to offer role models and examples of other approaches to business as discussed below.

The Indigenous African - Asian issue plays a determinant role in Tanzania's business world. The Asian community in Tanzania has displayed cultural behaviors contrary to those of Indigenous Africans: group support of individual initiative, forward planning and savings. The conflict between the two cultural assumptions may

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[40] The Entrepreneurs Development Fund DAILY NEWS February 16, 1992, inaugurated by President Mwinyi in August 1990, appears to follow this tradition in an institutional way. Indeed, EDF Trustee Reginald Mengi follows the "extended family" concept in his own businesses. He does not have employees or workers, but rather "members of the IPP Family" who are expected to give efficient labor in return for inclusion in "his family."

be intractable. Therefore the Team suggests USAID adopt, for all funds, programs and projects, a straightforward eligibility standard of historical residence and demonstrated investment commitment to Tanzania rather than a racial one when dealing with Tanzanian business.[41]

A major contribution of USAID to the improvement of the Tanzanian business environment could be a long-term program of information and model transfer through lectures, symposia, conferences and luncheon club meetings. Venues will probably include the various business associations, but should also include a specific "American Business Forum" to be created by the Mission, and which ought to be convened in cities outside Dar es Salaam as well as Tanzania's major economic center.

The goal is to expose Tanzanians to American business people and concepts to which they now have no access due to the country's isolation, e.g., that OECD economies have room for, and are built upon the mobility of, corporate giants, medium sized companies and individual entrepreneurs. One would seek to foster a sense of permission, legitimacy and security for established businesses to grow deeper and taller as well as wider. As this concept may be alien to cultural assumptions, it may usefully be put into the more familiar cultural context of "building the nation with individual bricks rather than monoliths." Recognizing that free enterprise includes the freedom to fail, a key subcontext, that will take on increasing significance as the opening process continues, is that business failure is evidence of an attempt to accomplish something which is technically difficult as well as of mistakes made, and that individual effort is laudable.

E. NATURE OF TANZANIA'S PRIVATE SECTOR

The Tanzanian economy has developed in a familiar two tier structure (establishment and informal) which cuts across the public and private sectors. That is to say, established operators and enterprises act both formal and informally (rent-seeking behaviors, seeking of opportunities for short-term or one-time personal aggrandizement) and informal and illegal operators act in establishmentarian ways in an effort to establish and legitimize their enterprises. On the one hand SOE management has to certain extent operated their firms as personal cash cows, and Tanzanian Asians have exacted rents to recover assets seized by the State or simply to gain revenge. In both cases, revenues derived in these ways necessarily had to be held informally, with the result that liquidity was removed from productive, formal re-investment for business growth, and from the Treasury.

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[41] The Registrar of Companies pointed out that while The Business Registration Act Section 320A for foreign owned businesses and Section 14A for locally owned, give the Registrar absolute discretion to refuse registration, he cannot determine from the body of Tanzanian law whether he is to operate on the basis of citizenship or residence. The same is true with the Exchange Control Ordinance Section 8 Cap 294, which talks about resident and non-resident rather than citizen and non-citizen.

TABLE 4-1: The Share Of Private Sector In Monetary GDP

Year	Total DGP TSh mln	Private Sector GDP TSh mln	Share of Private Sector in total GDP
1968	4,797	3,488	74.3%
1970	5,860	4,080	69.3%
1974	10,205	6,591	64.5%
1978	19,067	12,554	65.8%
1980	23,351	14,797	63.3%
1985	25,075	16,259	54.8%
1986	26,044	16,795	64.5%
1987	27,004	17,553	65.0%

SOURCES: Semboja and Rugumisa (1985) and Bureau of Statistics, in, "The Challenges and Potentials of The New Investment Promotion Policy," M.S.D. Bagachwa, December 2, 1991

Tanzania's private sector now consists of numerous, small formal and established firms and informal firms. Despite the public policy of encouraging and favoring SOEs in an effort to overwhelm and eliminate private (largely Asian) businesses, precisely the opposite has been achieved.[42] In nearly all sectors, private, formal businesses are far more numerous than public in terms of absolute number of firms and revenues, if not in numbers of employees. While the scope of the informal sector is considerable (estimates of its weight in the economy range from 40% to 60%), the terms of reference for this assignment excludes its consideration.

TABLE 4-2: GROSS DOMESTIC PRODUCT, PUBLIC AND PRIVATE ENTERPRISES

(million Tanzanian Shillings)

	1986		1987		1988	
	Public	Private	Public	Private	Public	Private
AGRICULTURE	459	83694	887	117095	1301	177459
MINING	168	306	110	535	216	507
MANUFACTURES	5696	2855	4960	9832	3021	12166
CONSTRUCTION	18	3113	36	6475	45	11763
COMMERCE	1518	17958	7027	18936	12936	28655
TRANSPORT	2164	5633	5526	6058	110199	4060
FINANCE	801	7326	6325	4736	14025	107
SERVICES	7	810	59	817	272	682

SOURCE: Bureau of Statistics

According to sub-contractor Coopers & Lybrand DSM, the private sector accounts for 99.9% of all Commerce enterprises. These are small units employing an average of 11 people per enterprise. The private sector also accounts for 99% of all Construction

[42] Iddi Simba, interviews February 18, 1992, and February 8, 1992.

enterprises; these employ an average of 61 people. 97% of all Transport enterprises are privately owned, and employ an average of 6 people per firm. In Agriculture, 66% of all enterprises are private, and employ an average of 55 people per enterprise. In Mining, 62% of all firms are private, employing an average of 66 people per firm. 59% of Manufacturing firms are private, and employ an average of 220 people per firm.

The private sector is also significant economically. According to one study, the private sector has contributed between 54-75% of Tanzania's monetary GDP since independence.

While the contribution to GDP of Manufacturing, (public and private enterprises aggregated) has actually decreased from TSh 2,811 mln in 1976 to TSh 2,587 mln in 1990 (constant prices), the private sector's contribution within the sector has grown rapidly. The ratio of public to private contribution reversed in favor of the private sector in 1986.

TABLE 4-3: TANZANIAN ENTERPRISES: Public and Private (1990)

SECTOR	Number of Enterprises		Number Employees	
	Private	Public	Private	Public
Agric	316	164	17344	14219
Mining	20	12	1312	4442
Manufact	283	193	62247	79074
Construc	1126	3	68366	7360
Commerce	370000	49	4133000	
Transport	897	29	4975	63810
Other	0	48	0	

SOURCE: Coopers & Lybrand DSM, Bureau of Statistics

RACE RELATIONS AND PRIVATE ENTERPRISE

One issue in the transformation of Tanzania's economy, and especially the transformation of parastatal enterprises to free market companies, is the future role and power of the non-Black Tanzanians. As has been amply described, these parastatal enterprises were created for purpose of empowering the indigenous population to take control of their own economy in opposition to European colonial and Asian entrepreneurs.

Tanzania's economy today consists of some 325 State Owned Enterprises (SOEs) and numerous, small, established formal, and informal firms. In nearly all sectors, the private businesses are far more numerous than the public in absolute number of firms and revenues, if not in numbers of employees. Estimates of the informal sector's weight in the economy range from 40% to 60%. This is to say that, despite the application of public policy to encourage and favor SOEs in an effort to overwhelm and eliminate private (largely Asian) businesses, precisely the opposite has been achieved.[43]

[43] Iddi Simba, interviews February 18, 1992, and February 8, 1992.

In the present state of affairs, the Black private sector i too small and under capitalized to purchase much of what may b privatized. Moreover, the Black private sector does not have th depth of experience venture capital firms would look for. Finally the Black management cadre is largely engaged in and familiar wit the ethos of SOE rather than private enterprise. This state o affairs has given rise to concern among some Black-Tanzanians (an donors) that, done too quickly, privatization will result in transfer of ownership from the Black State to private Arabs Indians and other non-Black foreigners.

As has been discussed in previous Chapters, the very notion o private enterprise has been so compromised by CCM ideology o opposition to "capitalism", and experiential knowledge that privat entrepreneurs operate on the margins of society, that it i doubtful whether respected Black Tanzanians even see it as personal option to put their capital, reputations and persona lives at risk in this market.

The vitality of Tanzania's non-Black private sector is, t some observers, proof positive of its corruption. Tanzanians wit whom the Team spoke tended to equate business success wit corruption. Successful Asian- and Black-Tanzanian businessmen were widely assumed to have achieved their success by bribery, personal connections and corruption of officials. Few of these observers extended this logic to consider the putative bribe taker's identity and ethics.

Asian-Tanzanians have also admitted to Team members that they have been exacting rents from Black Tanzanians wherever and whenever possible to recover assets seized by the State or simply to gain revenge for wrongs done them. Other Asian-Tanzanians have simply written off lost assets and expressed amazement that the present government would even consider asking them to purchase back run-down properties at unrealistic prices. Still other Asian-Tanzanians, despite the government's track record, have purchased agricultural estates and invested in small processing plant (such as flour mills, printing plants, textiles, etc).

Asian-Tanzanians were neither required nor encouraged to do government service, but were left to occupy themselves in the private sector. One observer remarked that, in all the years of African Socialism, most of the former chambers of commerce and business associations function only as the personal consulting firms of their Executive Secretaries - who had been appointed by the government to these positions upon their retirement from active and direct government service. The only business association which continued to represent the interests of its membership to the government was the so-called "Indian Chamber" in Dar es Salaam, the Dar es Salaam Merchants Chamber. As may be assumed, this structural differentiation further divided the Black/government from the Asian/business populations of Tanzania.

Finally, the Black/Asian Tanzanian issue in the business world plays out along lines of cultural assumptions and behaviors. The

Team observed first that Tanzania's Asian population is relatively small. Rather than the 5 million, the Team finds a maximum of 500,000 "Asian Tanzanians" a more realistic number. In discussions with Asian businessmen it became clear that, as is usually the case in Europe, North America and India, the majority of these people are engaged in small business: retail shops, small factories, small transportation businesses, etc. The Diamond Jubilee Investment Trust (T) Ltd has only recently made several loans of TSh 5 mln; its largest ever loan was TSh 9 mln. This private financial institution describe a low default rate among its borrowers, but also a very management intensive approach to helping its debtors remain credit-worthy. The Team doubts whether the Asian community of Tanzania is sufficiently well capitalized to be in a position to buy Tanzania's "family silver" and seize control of the economy.

Secondly, there are significant cultural differences between the Black and Asian populations of Tanzania. It is evident from their very survival that the Asian citizens of Tanzania have displayed frontier cultural behaviors: group support of individual initiative, forward planning, and saving of surplus. The conflict between their assumptions and that of African socialism (self-sufficiency leading to management self-aggrandizement; cutting of business linkages with outsiders; assumption of the right of personal exploitation of public property; maximization of present value through immediate consumption) may be intractable and certainly give rise to clear animosity.

Thirdly, a policy of positive discrimination to favor non-Asians will effectively eliminate access to the very entrepreneurial skills which, having demonstrably kept their possessors alive during a hostile period, will be needed by the newly privatized Tanzanian enterprises in order to survive in the real world of the transnational economy.

Therefore the Team suggests that, when dealing with programs and projects impacting Tanzanian business policy, issues and entities, and in order to:

- o put an end to any U.S. Government role in racial issues,
- o recognize successful business track records,
- o and mobilize all of Tanzania's available talent pool for the difficult task of reconstruction,

the Mission adopt a straightforward eligibility standard of historical residence and demonstrated investment commitment to Tanzania rather than race.[44]

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[44] The Registrar of Companies pointed out that while The Business Registration Act Section 320A for foreign owned businesses and Section 14A for locally owned, give the Registrar absolute discretion to refuse registration, he cannot determine from the body of Tanzanian law whether he is to operate on the basis of citizenship or residence. The same is true with the Exchange Control Ordinance Section 8 Cap 294, which talks about resident and non-resident rather than citizen and non-citizen.

F. BASIC STATISTICS AND RECORDS

Constraint #3 - Absence of Accurate Data

As interesting as the data provided by the Bureau of Statistics may be, it must be stated that no complete and accurate picture of Tanzanian business activity is available. It is not possible to disaggregate individual enterprises from sectoral data. This lack of accurate or even available data is the result of GOT past policy which was hostile or indifferent to, and thus completely ignored, the private sector in the expectation that it was not expected to exist for long. Secondarily, it is the result of the lack of a credit market. With only the State lending (albeit via a number of institutions as discussed previously), and then for policy purposes, there was no need for the financial industry to develop accurate, independent sources of financial data on potential customers. The vigorous informal credit market lends on a personal basis and collects in the same way. The country's sole independent, private financial institution, Diamond Jubilee Investment Trust (Tanzania), Ltd (DJIT) had confined itself to a religious community whose members it knew personally. In is an interesting reflection of the sense of opportunity and openness abroad in Tanzania that the DJIT has already opened its membership beyond its base community, both for deposits and loans[45], in anticipation of establishing itself as a private bank.

The only potentially accurate source of company information are the files of The Registrar of Companies, the Registrar of Business Names and The Registrar of Industries. A visit to The Registrar, interviews with personnel in Dar es Salaam and Arusha, and personal inspection of the premises revealed the condition of these records is so abysmal as to be useless. Individual files on companies as may be uncovered are far from accurate or current in their statutory reporting requirements on revenue, taxes paid, etc. Third, not all enterprises are registered. Further discussion of The Registrar may be found below.

Without going into a sectoral analysis, there are indicative data on the efficiencies of private enterprise in Tanzania. As is typical in most economies, the Chemicals sector (oil, chemicals, paints, fertilizers, pharmaceuticals, etc) provides the greatest turnover and value added per employee in absolute terms. More interesting is that the Metals Sector (primary and metal-working) ranks so high. This is an important entry point for start-up businesses, both formal and informal. More efficient still is the Paper and Paper Products Sector, one which Tanzania could easily develop. Finally, as may be predicted from world market conditions,

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[45] DJIT has written to most motor vehicle dealers to solicit financing opportunities and has financed a number of 80% chattel mortgages on light vans for the daladala market. It will expand this lending and move into leasing as soon as the Hire Purchase Act is revised to permit it. Interview with N.E. Kassam, Assistant General Manager, DJIT 18-2-92.

and the fact that the sector does export, the Textiles and Leather sector also recommends itself for further exploitation.

TABLE 4-4: Tanzania Private Sector Enterprises, 1990
(value in current T Shillings)

Turnover/ Employee	ValAdded/ Employee	SECTOR	Value Added/ Turnover
1,120,101	854,247	Chemicals	76.3%
841,215	658,375	Metal Industries	78.3%
684,708	549,182	Paper & Products	80.2%
591,146	426,446	Pottery,Glass,etc	72.1%
332,208	259,919	Textile,Leather	78.2%
247,783	184,264	Wood, & Products	74.4%
263,393	177,975	Food, Bev, Tobac	67.6%
170,812	119,260	Other Mfctring	69.8%
121,800	79,887	Mining,Quarrying	65.6%
506,668	385,371	TOTAL MFCTRING	
492,561	374,174	TOTAL INDUSTRY	

SOURCE: Coopers & Lybrand DSM, Bureau of Statistics

While the agro-business sector is not specifically included in Tanzania's industrial statistics, past data and present reporting indicates steep growth in production of export commodities such as mangoes and other tropical fruits, flowers, etc. Tanzania does not now have a significant fruit and vegetable processing sector, and so most of these goods are exported fresh or unprocessed. This sector should and is receiving considerable private sector attention.

Developing private sector opportunities requires several preconditions. The first is the successful conversion of informal liquidity into formal and its investment and/or lending into private enterprise. Measures already taken by GOT, and recommendations for USAID intervention have already been discussed. Equally interesting is that the availability of formal lending will demand-pull improvements in public rating of enterprise credit-worthiness. Not only does this create opportunity for the establishment of various service firms (credit rating, collection agencies, investment pools) but it will also demand the improvement in public sector record keeping and information provision.

Other measures include:

revision of the law on tenancy
revision of land ownership laws
revision of the leasing and hire purchase regulations
legislation specifically permitting private enterprise
harmonization of laws on business registration

G. FORMATION OF A BUSINESS: PERMITS AND PERMISSIONS

There never has been a particular body of law on private sector business in Tanzania. All is based on a series of Acts: 1967 Nationalization of Banks, 1970 Nationalization of properties, and policy revisions of 1984. The system is extraordinarily old-fashioned. The law defines an industry as any processing entity employing more than 10 people. There is no minimum capitalization requirement, no legal requirement that one half of investment capital be placed in a blocked Tanzanian bank account.

What are the steps to create an enterprise? Business establishment procedure is described in even greater detail in Appendix H.

1. Clearance Of Business Name: this fee-less process in fact should take 48 hours and is intended to prevent pirating of a name already in use or registered in Tanzania or abroad. While Tanzania is not yet a member of trademark convention it may be in 1992; for the present and there is a High Court case on trademarks which has the effect of law.

UNDP has a project for industrial and trademark patents. Papers were sent for action to Treasury in September 1991, but there has been as yet no reply, which is necessary as Treasury has to accept the funds from UNDP for the project. The Registrar claims to receive 30-40 trademark applications per month and process completely 5-10 per month. Most requests are of foreign origin and communications are very difficult.

The Registrar tries to control "private thinking" by his staff on name issues under the "notwithstanding" clause of Section 14A of the Law on Business Names. In any case, there is recourse for an applicant in case of refusal under Section 7 which allows for High Court reversal of decisions by The Registrar to refuse for cause.

One problem with the present system is that a Tanzanian business man who lives upcountry must operate blind. He selects a business name without knowing or having the ability to check in advance whether the name is available. Telecommunications are so bad as to require personal intervention at every step of the process. It may be weeks or months before he comes back to The Registrar to check on his paperwork. The District and Regional Trade Officers cannot do anything but fill in the paperwork.

Only one person actually performs the check for business names. While the Registrar says the clerk processes 10 requests per day, she claims seven. The abysmal condition of the records, manual listing in chronological order of registered business names, and lack of motivation under these conditions means that verifying a request actually may take three weeks before the physical file passes through to the correspondence clerk.

2. Articles, Memoranda and Amendments of Association - the lawyers draw these up and the Registrar feels they are blatant liars to their clients on the amount of time and money the process takes in order to increase billing. The Registrar wants fast turn-around, but the quality of work by Tanzanian lawyers is spotty to bad in

drafting these documents. The Registrar feels himself forced to return the documents for rewrite. This is a great nuisance factor.

3. Required forms:
   Form 1 (from Section 16)
   Form 14 particulars on Directors
   Form 15 Registered office

4. Fees are laid out in Finance Act Section 8 (passed by Parliament)
   Tax on Capital: TSh 10 per TSh 1000 registered capital
   Registration Fee: nominal
   Filing Fee: TSh 500 per document
   Stamp Duty: TSh 150 for the original and TSh 65 per copy

   Kenya requires foreign companies to have local shareholders. Tanzania does not under the constitutional provision of free association.

In addition to the preliminary steps already noted, after the paperwork is processed by the Registrar, it moves to a District Trade Officer for approval, then the sectoral Ministry for approval, and then to a Committee empowered to issue ad hoc judgement on the political suitability of the applicant and the enterprise. If that hurdle is taken, the District Health Officer must issue an approval of the premises. This has proven impractical. There are too many applicants for too few health officers, and no uniformity of enforcement. After the Health Officer, the Land Officer also must give approval for use of the location.

The Registrar believes the present Business License procedures are corruptive. Prior to 1978 an applicant went to Inland Revenue and filled out a form which predicted annual turnover and then got a pre-payment tax. That took 30-60 minutes and even illiterates could do it with the aid of the many "public writers" who hung out at the office. After 1978, the GOT came to the view that the then-increasing shortage of goods was due to "middlemen", and that too many people were licensed in trade and commerce. To exert greater central control the GOT removed the process from the Ministry of Finance, and amended The Business License Act to make it the responsibility of the Ministry of Industry and Trade. The Registrar regards this as unnecessary and harmful to business development, because that Minister now has and exerts absolute right of refusal to business establishment "to protect the economy."

The Registrar recommends scrapping the Business Name Ordinance. Too many people simply register a business name and presume they have a legally registered firm. The capital threshold is too low. It would be better to put the entire process (all steps) under a single new Ordinance, to be developed with the assistance of The Registrar, representatives of the private legal community, and relevant Ministries.

Establishment of Foreign Companies:

At creation it was incorrectly presumed that the IPC would supersede all other bodies. It does not. Before the National Investment (Promotion and Protection) Act, 1970, the only body of law on which the IPC could rest is the Foreign Investment Act of 1962. As noted in interviews with the Team in March 1992 (and publicized in EXPRESS, March 13, 1992), a harmonization of laws impacting on foreign investors is planned for April 1992. "The laws [seven in all] have been overdue for review for about two years because they were specifically mentioned in the 1990 Act that led to the establishment of the IPC. Investors have thus been finding it difficult to get the waivers mentioned [in the Act] because its provisions are not in harmony with the tax laws in operation."[46] Land for foreign-based companies operating in Tanzania is to be given (allocated) by the respective sectoral Ministry, but this also has no basis in law. IPC was supposed to operate via a Committee, but there is no structural relation to the extant Law on Industrial Licensing.

Mr. Kahama may monitor compliance with provisions on capital requirements, and reserved sectors, but cannot actually register a firm. Foreign firms necessarily must follow the sole procedure available as already described, as well as special regulations of Immigration. In addition, Foreign Exchange Ordinance has not been modified and must be.

The Registrar has sent a written proposal that a meeting be held among representatives of Immigration, Taxation, IPC, and The Registrar to work out a solution to the present vicious circle in which foreign companies necessarily find themselves, with all the opportunities and temptations to lubricate the system. The Registrar also feels that the GOT has to streamline and rationalize the process to eliminate the very real present opportunity for local con-men to seize locally invested foreign assets by arranging to have their erstwhile partners declared persona non grata.

The Registrar's Office:

Despite the Registrar's ideas to improve the regulatory environment, it must also be said that the basic records on companies in Tanzania are in such chaos that a necessary condition to the establishment of the basic conditions to do business in Tanzania is to straighten them out. Accurate records will be necessary for GOT revenue collection, financial institution credit-worthiness decision, business-to-business sales, and investment (both in terms of equity purchases and determination of competition and market potential) before one could even consider compiling accurate information on enterprises.[47]

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[46] "Investment Climate: Laws to be amended" by Felix Kaiza; EXPRESS March 13, 1992, p.1

[47] Mrs. Matilda Bella, Regional Trade Officer, Arusha, explained on 17-2-92 that she was unable to obtain any list of companies in her Region from Dar es Salaam. She then carried out a census of doorways to compile the data she requires to fulfill her duties.

The Office's level of effort is considerably greater now than thirty years ago at independence. The primary constraint is the Office's record keeping system. The file cabinets and shelving space available cannot hold the volume of paper generated by the system, even through a significant number of companies neglect to file even the present nominal reports required. Corporate files are stacked on tables and on the floor. Through sheer confusion it happens that a file which has passed through stages one and two of the approval process does not get hand carried to stage three but either remains where it is or is mistakenly replaced at the beginning of the process. This confusion also creates opportunity for clerks purposely to misplace files to induce bribes. In addition, warehousing of records in a Pugu Road facility has resulted in the loss (reason not clear) of old records to scrap paper merchants, so that it may be impossible to reconstruct an accurate history of business formation in Tanzania.

It may also be noted that this Office is also responsible for Trademarks and Tradenames, and for Patents. The latter function is now the responsibility of an Acting Assistant Registrar untrained for this work. The Registrar, a lawyer, is actively working to create legislation on intellectual property to bring Tanzania into compliance with international standards. **USAID may usefully consider providing technical assistance in the drafting of this legislation.**

The Registrar's Office is also the location where projects deemed undesirable can be held up. One informant noted the case of a tourism enterprise held up in this way. Another noted that a request to change a company name has been held up for thirty days. Another noted the either ignorant or willful denial of use of a company name due to alleged close resemblance to an extant name: Bahari Hotel, Fahari Hotel, Bendari Hotel all were considered. Denial of a request is not accompanied by an explanation. Nor are requests for use of a business name published prior to approval or denial to afford timely opportunity for a current holder of that name to file a request to deny.

USAID could consider technical assistance to restructure and bring The Registrar's Office into utility by application of computer technology to its data base. This will first reduce the sheer confusion of paper, free space for more useful pursuits, and permit accurate and timely research for various legitimate business purposes. In addition, the professional and clerical staff may usefully be offered professional seminars and training to aid them in the more efficient performance of their work. At the same time, the text of the Business Names Registration Ordinance should be reviewed and rendered more efficient both in its specifics and in the procedures required to access its protection. Finally, the above changes will reduce the opportunities for rent-seeking behavior and blackmail inherent in the present system. The end result will be the elimination of an important barrier to business establishment and operation, the creation of a useful database of

business activity, and improvement in Tanzania's attractiveness as a place to consider conducting business.

In other areas of legal reform:

The land tenure policy is being reviewed and is likely to change to allow private ownership of land.

The Patent Law 1986 and Trade Marks and Brand Names Act 1987 are expected to come into effect in the near future.

The Law Reform Commission is reviewing labor laws regarding areas such as strikes, lock-outs, wages, and hiring and firing which constrain efficient commercial operation.

H. FINANCIAL SERVICES

Constraint #4 - Check Clearing and Cash Management

Closely related to the absence of basic business information (for business and for government) from the office of The Registrar is the structural deficiencies of the financial sector. These issues have been specifically addressed in the chapter on financial markets. While the lack of efficient check clearing makes it very difficult for the banks to operate as efficient businesses, the business community has traditionally paid the cost of the banks' inefficiencies. Their specific impact on the formation, sustainability and expansion of business is addressed here.

The former head accountant of Friendship Textile Mill Ltd recalled that in the 1980s he would accept a check in payment of goods from traditionally reliable customers, despite the knowledge that check clearance was a very lengthy process. Acceptance of checks was obviously necessary from the standpoint of record keeping of orders and customer buying patterns as well as the practical aspect of handling the large sums involved. Acceptance of checks, however, also put the seller in an untenable position. The pattern was this. The next month, on the customer's assurance that he had banked the cash proceeds of the sale of the previous order, the accountant would approve payment by check for the next lot, and so on, month after month. When the first check in a series finally cleared and was presented at the originator's bank branch some four to six months later, typically it would be dishonored and returned for insufficient funds. The mill was levied a penalty for the bad check and would be charged interest on the resulting overdraft to its own account. Moreover, the mill was also required to pay the sales tax due on the transaction. Ultimately, the mill had to carry receivables which matured into bad debts. The textile mill, which was already inefficient on operations, had to adopt a cash and carry policy, thus reducing its volume and increasing overheads.[48]

In an interview with a Team member an NBC assistant branch manager in Arusha confirmed this state of affairs when he

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[48] Senior Accountant, Diamond Jubilee Investment Trust (T) Ltd 18-2-92

categorically eliminated the possibility that he himself would ever clear a check by telephone. In the first place, the telephone system completely inadequate within the country. Telephone directories are not accurate. The effort to make a successful connection, even when a correct number is known, places an intolerable time burden on him and his staff. In the second place, it was the assistant branch manager's belief that clients of a distant branch make a practice of providing false telephone numbers to allow the clients' confederates to masquerade as the manager of the issuing bank.[49]

In April 1991 the Tanzania National Assembly passed an amendment to Cap. 16 of the Penal Code, which makes the issuing or delivering of a check that will bounce for lack of fund's in the drawer's account a criminal offense. According to the Schedule under the Written Laws (Miscellaneous Amendments) (No. 2) Act, 1991, the drawer shall be liable, on conviction, to imprisonment for a term not exceeding ten years only if he fails to pay the banker or the beneficiary the equivalent amount of money after 30 days notice of dishonor of the check.[50] In its commentary on this revision of the law, "The Accountant" notes that "the monopolistic public banks (are) one source, greedy traders the second source and dishonest bankers/individuals the third... The unpleasant state of affairs has continued despite the protective Cheques Act 1969 which guard banks from losses out of forged or stolen cheques.[51]

The legal framework may be in place, but there are two other foci to assist Tanzania implement a more efficient payments system. Naturally, enforcement and prosecution in the courts must be impartial and rapid. Eliminating the opportunity to kite checks present in the completely inadequate communications, and thus clearing, system will be still more efficient.

Both to assist in the installation of adequate backroom bank operations of the present and future banks in Tanzania, to assist the BoT in a more adequate supervisory role, and to aid enterprises in more efficient cash management, **it is recommended that USAID conduct a feasibility study into the creation of a data network independent of the TP&TC landlines dedicated to inter-branch communications.**

The TP&TC now has 6 Ghz microwave links among a number of key cities centered on Dodoma. As can be seen from the map (attached) there is no true network among secondary cities. Moreover, the Dar

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[49] Maleia Rashid, Assistant Branch Manager, NBC Uhuru Branch 17-2-92; see also "No More Fear: Clear Cheques Faster," The Accountant, Vol 4,No1, 1991, p2

[50] "The Accountant", Dar es Salaam, Vol 4, No. 1. 1991, p.6

[51] "The Accountant", Vol 4 No.1 1991, p.2 "No more Fear: Clear Cheques Faster."

es Salaam - Dodoma main link has reached capacity.[52] While there are plans to increase microwave channel capacity, realization is at least three years in the future. Moreover, this technical assistance does not address the key issue of internal linkages among and between all key cities of Tanzania at the moment that other policy reforms will be enacted. Delaying communications infrastructural capacity will create inherent obstacles to successful business expansion.

After discussion with Mr. E.I. Kweka, Head of Frequency Management, TP&TC[53] it is evident that the Tanzanian frequency spectrum in the 230-300 Mhz range is not congested, and would lend itself to a UHF packet radio data network capable of at least 9600 baud capacity. This network could link computers in financial institutions and pass encrypted data. It is envisioned that this capacity would be sufficient for overnight clearance of checks and L/Cs among key cities, and may also serve to consolidate the accounts of major branches in key cities, and serve the Bank of Tanzania's supervision tasks.

USAID may usefully approach the Director General of the TP&TC with a proposal to install this UHF data network in key cities by using present microwave towers as repeater sites. TP&TC would allocate and license the frequencies for fixed service, give permission to install equipment on their microwave towers, and carry out equipment maintenance. This data network would ideally be managed by the Bank of Tanzania[54] as a common carrier nominated by the TP&TC, and be open to any financial institution which may be licensed in Tanzania. The Bank of Tanzania now uses HF and VHF frequencies for internal voice communications and therefore has a responsible official familiar with communications issues. Financial institutions would purchase or lease the transceivers and related apparatus for each location and pay appropriate user fees to support the system. Technical and training requirements, and capital expenditure are limited to relatively inexpensive, off-the-shelf UHF transceivers, packet TNCs and PCs, all of which are manufactured in the United States.[55] USAID's role would be limited to policy change interventions and the creation of a funding instrument to enable the transactions.

I. BUSINESS ASSOCIATIONS

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[52] Discussions with Spanish interests to fund and construct a second channel between Dar es Salaam and Dodoma, with extensions to Pemba and Zanzibar, have been underway for some time.

[53] 20-2-92 on recommendation of Thomas Hettel, CPO, USEMB DSM

[54] World Bank consultants Simon Bell and Chris Barltrop have indicated the World Bank's interest in engaging BoT in this capacity.

[55] Commercial transceivers meeting DOS and DOD standards are typically available from Collins and other vendors. Amateur radio equivalents are typically of Japanese manufacture: Icom, Yaesu and Kenwood. TNCs are manufactured in the US

Constraint #5 - Lack of viable business associations

It must be assumed that all present business associations are nascent. For twenty five years there have been no active business associations in Tanzania, as all efforts were directed to the support of the public sector, while private sector activity was tolerated until the inevitable triumph of the parastatal economy. Private sector business associations were ignored and left to wither rather than being legally disbanded or dissolved. Typically, a retired civil servant would occupy the leadership of a chamber of commerce and use the position as a "contact consultant" able to open doors for access to bureaucrats, carry out registration for clients.

As it became apparent that the private business sector had not withered away, the GOT found it necessary to have a forum through which to address the business community. The Dar es Salaam Chamber of Commerce took on that role of designated window to the private sector. As a result, the head of that body felt himself to be legitimized as "spokesman for the private sector." Then a few years ago the umbrella Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA) was called into being for the purpose of grouping all the remaining city chambers of commerce. The city chambers, however, did not want to lose their direct role and fought the change. After some political manoeuvering, the present solution finds the TCCIA as well as the old city specific chambers of commerce, and a of the Confederation of Tanzanian Industries (CTI) which groups public and private industrial enterprises, and the Dar es Salaam Merchants Chamber (known as "the Indian Chamber"). None of these bodies presently provides the range of business services which we understand to be their main purpose. The TCCIA has received UNDP technical assistance, the CTI has purportedly assessed its 150 members a total of TSh 30 mln and plans to hire an Executive Director and staff, while the old city chambers of commerce also remain in place. The only chamber of commerce which is generally knowledged to have provided true member services over the past twenty five years is the Dar es Salaam Merchants Chamber.

Comments on Chamber(s) of Commerce:

Informant A: The Chamber of Commerce, of which he is a member, does not help him either check for credit-worthiness or to collect from debtors.

Informant B: A foreign group of businessmen asked to stop at the Arusha Chamber of Commerce to get data on local companies and business opportunities and (as informant expected) got absolutely nothing. The Chamber has had no function for eight years - except to have officers. He had not heard of the TCCIA operation coming to town. There are no business associations in Arusha, except for the Rotary Club the membership of which is said to consist of Asians and a few leading Black Tanzanians.

Informant C: The Chamber of Commerce is not effective and may also be an obstacle to development.

Tanzanian Business Associations

Architectural Association of Tanzania
Hon. Secretary
Dar es Salaam
17 Feb 92 1830 get together with UK architect

Arusha Chamber of Commerce and Agriculture
POB 141
Arusha
tel 3721
As of 17 February 1992 rated by Regional Trade Officer to be inactive.

Association of Tanzania Employers
Executive Director
Mr. A.T. Maenda
AMI Building, Samora Ave POB 2971
Dar as Salaam
tel 22981, 23152

Computer Association of Tanzania (COMPAT)
W.A. Magambo, secretary
c/o Tanesco HQ
Dar es Salaam
annual meeting to be late April 1992

Confederation of Tanzanian Industry
Iddi Simba
c/o Interfinas
TDFL Bldg
Dar as Salaam
tel 30844

Dar es Salaam Chamber of Commerce
E.C. Mzenda, chairman
POB 41
Dar Es Salaam
tel 23759
tlx 41628

Dar Es Salaam Merchants Chamber
"the Indian Chamber"
POB 12
Dar Es Salaam
tel 22267

Packaging Association of Tanzania (PATA)

Southern Highlands Tobacco Union Ltd
POB 76
Iringa
tel 2177

TAFIA Tanzania Forestry Industries Association

Tanga Chamber of Commerce
POB 311
Tanga
tel 3231

Tanganyika Association of Chamber of Commerce
never dissolved, but inactive
POB 41
Dar Es Salaam
tel 21893

Tanganyika Coffee Growers Association
POB 102
Moshi
tel 2201

Tanganyika Law Society
POB 2148
Dar Es Salaam
tel 21907

Tanganyika Farmers Association Ltd
POB 3010
Arusha
tel 3191
tlx 42141

Tanganyika Native Medicine Association
POB 253
Iringa
tel 2795

Tanganyika Tea Growers Association
POB 2177
Dar Es Salaam
tel 22033

Tanganyika Textile Association

Tanzania Association of Tour Operators
POB 3178
Arusha
tel 3173

Tanzania Association of Worker's Education and Training
Edda Sanga chairman

Tanzania Chamber of Commerce, Industry and Agriculture
Mr. Donat Mgeta
Honorary Secretary
tel 30556

Tanzania Drivers Association
POB 15120
Dar Es Salaam
tel 21742

Tanzania Translators' Association
nine years old; promotes training of translators & interpreters
wants tech terms in Kiswahili
Dr. Z.S. Mochiwa-chmn
Dr. H.J. Mwansoko - vice chmn
D.L. Masoko - treasurer
C.M. Bwabge-secretary
I.A. Katanda - exec comm
O. Kiputiputi - exec comm
S. Yahya-Othman - exec comm
J.T. Kibwana - exec comm

UNDP's Mrs. Soma C. Goonetilleke told the Team that it was not yet clear to her, because of the disorganization and internal wrangling of the Tanzanian business community on the issue of organizational primacy, that UNDP should agree to provide the technical assistance planned for TCCIA at its formation two years ago. She would know more after April 1992.

Under the assumption that business associations are required to aid Tanzanian entrepreneurs and enterprises to gain access to the services they need individually and the policy changes they need collectively, **it is recommended that USAID encourage the establishment of member-supported business associations through a technical assistance fund** to which applications may be made for specific projects or short-term programs on the basis of plans which define needs and goals to be attained. Examples include management and skills-development workshops, reference materials, technical assistance for the creation of membership publications, development of data bases, etc. It is further recommended that no funds be expended to hire, establish and equip administrative staffs, but rather be granted on a matching basis under some formula of cash for level of effort.

J. TANZANIA'S BUSINESS GROUPS

Tanzania's indigenous business community is largely organized in holding companies. These holding companies may be simply central administrative points controlling several (semi-)autonomous operating companies. In other cases, there is direct cross-participation between the companies. Given Tanzania's past indifference to the private sector (which sprung out of the conviction that the private sector would soon wither away under the competition of the public sector) there is little or no available - or accurate - statistical data on the performance of these closely held, limited liability companies.

Three basic models describe these groups: import-substitution manufacturers; import-substitution coupled with commodity exports; and pure export.

Mac Holdings and The IPP Group [See Appendix J for a list of Tanzanian Groups] are examples of the import-substitution model. This model predicts that low-cost local production of inexpensive consumer disposables will generate a revenue stream sufficient to self-fund expansion into increasingly sophisticated enterprise as the Tanzanian economy expands. Whereas Mac Holdings is well established, we will examine the newer IPP Group as an example of indigenous business establishment. IPP began in reaction to the wave of nationalizations as an attempt to create an independent livelihood. with home assembly of ball point pens, and then injection molding of pen bodies, then of thermos flask bodies, then plastic household utensils, then household paper products from low technology waste paper recycling, then soap. From the soap came a franchise to produce Colgate-Palmolive brands. The Northeast regional Coca-Cola franchise was gained in order to increase the revenue stream.

The revenue stream had to be increased because of the need to finance forex-funded capital equipment purchases. And the less favorable the exchange rate, the greater the need for a TShilling revenue flow to cover it. In theory, with excellent timing, very tight financial control and insightful management, this model ought to work. Mengi admits that he has financed expansion through debt. Independent analysis has indicated that the local economy is sufficiently liquid to permit success, and that Mengi's products are well-priced and niche dominant. Several of his operations are performing profitably on operations, but others with higher debt servicing requirements are sucking revenue out of the profitable into the unprofitable.

The main problem with this model of entrepreneurial growth is that it lacks a solid export product to generate the forex required to service internal debt.

D.M. Investments, run by Antony Diallo [see Appendix J] has misjudged the import substitution model by basing its operations on local assembling of imports. D.M. Investments concentrates in metals, engineering and assembly of household hardware and semi-

durables. Without the necessary second leg of forex generation through exports, D.M. Investments is apparently doomed to collapse under the weight of increasing forex debt without extremely fortuitous and creative access to re-financing. Since the firm does not operate in a GOT priority sector, it is unlikely to be able to access, for instance, DCP money, or OGL.

The second model provides for a mix of local production for the local market to generate TShillings along with low-cost local production or processing for the export market to generate the required forex for capital investment and market development. Several Tanzanian groups fit this model, including IPS, JV, and Sumaria groups. The largest, the IPS Group was the creation of the Ismaeli community in 1945 (with branches in Kenya, Uganda and Tanganyika) is a successful group, but not typical of the Tanzanian situation. First of all it is the creation of a narrowly focussed religious community which has very strong principles of common help for fellow believers, and, it is a local branch of a world-established group (a multinational in practice), with all of the advantages for marketing and capital investment linkages such a situation offers.

That the IPS organization and the Ismaeli's were not regarded as completely inimical to Tanzanian nation-building in the 1960s may be assumed from the fact that there are cross-investments between GOT institutions and Ismaeli institutions (Kilimanjaro Textiles, and other "associated companies" listed below being examples). Another indicator is the fact that the Ismaeli's community-based financial institution, the Diamond Jubilee Investment Trust Ltd, was the sole "foreign bank" not nationalized but treated with a hands-off policy. For these reasons, the IPS Group, while apparently successful, may not be a model for indigenous Tanzanian company building in this model.

The J.V. Group [see Appendix J listing for Juthalal Velji Ltd] lends itself better for this discussion. The JV Group, despite its obvious Indian origin, has committed capital investment and business activities in Tanzania. It has extremely close links with the indigenous Tanzanian community, including intellectual, political and business leadership.

This group's activities are based in TShilling revenue streams (a national PepsiCo franchise) and forex through exports such as textiles and garments, sisal and timber. It also combines key sectoral activities such as freight forwarding and warehousing with vehicle imports and sales, civil engineering for agriculture and industry. This group is reputed to be one of the most solid financially and well organized managerially.

Export oriented groups include the Fidahussein group, which is a branch of a worldwide organization, Rajani industries, and a few other single-unit entities active in extracts, horticultural products, gems and spices. Few indigenous Tanzanian entrepreneurs have penetrated this business segment. Ultimately, the success and health of Tanzania's economy will depend on the simultaneous

development of a domestic market and an export market. In the first place, the learning process leading to the successful production of world market quality goods depends on practical experience at home. In the second place, being able to sell on the world market also depends on pricing at prevailing world prices. This implies having access to inputs at world prices. Mechanisms to allow this can include duty draw-backs on the export of imported inputs, bonded warehouse and Export Processing Zones, to name only two.

A significant USAID intervention would be the provision of world marketing expertise and contacts for those Tanzanians who are capable and willing to enter this specialized area. Given the investment requirements to own and operate agricultural estates, timber properties and mines, it may be that the initial effort should be directed to brokers and traders, or, at the most, contract farmers. One efficient mechanism to achieve the initial stages of export expertise is intervention by IESC. The Team recommends a buy-in focussed on the establishment of the preconditions required to bring inexperienced but potential exporters especially of non-traditional agro- and horticultural products.

In addition, the IPC will require adequate statutory authority, a clarified relation with other GOT bodies, technically adequate staff, and expansion of its role into areas now held in theory by the Board of External Trade: international trade fair participation, promotion of exports, fostering of market linkages. The Mission may wish to consider funding a feasibility study into developing export promotion schemes or "point franc." In order for such regimes to be effective, however, other interventions of a more fundamental nature will be required at Customs and Excise and tax authorities.

K. SUMMARY OF SECTORIAL CONSTRAINTS

(1) Leadership Ambivalence - Political awareness of the need for reform is not unanimous and thus commitment is not total. Some Treasury officials want to maintain profitable parastatals as sources of revenue. Certain economic policy reforms are delayed for fear of unrest (due to increased consumer prices, unemployment and loss of covert opportunities), undesirable when there is a simultaneous debate on political reform. This ambivalence stimulates low confidence by foreign and domestic investors that the reforms will be broad based and long term encourages focus on short-term, high-return or risk-free opportunities.

(2) Reform Donor Driven - Market liberalization has been promoted largely by foreign organizations such as the IMF and World Bank. Liberalization may be somewhat resisted until it is considered truly Tanzanian. Conditionalities without domestic commitment may produce averse results. An example is the 1991 Co-operatives Act which tried to separate the activities of the Government from those of the co-operatives.

To date, the level of interference is greater than before the enactment of the Act. Donors are concerned that Government officials have been forced into undertaking reforms which they do not accept and which they are unlikely to maintain once funds are no longer available. To date, the political and civil service leadership has shown a reluctance to take the lead or accept responsibility for managing most parts of the reform process. Some donors state that the restructuring process has not yet begun.

(3) Antipathy for Informality - Government attitudes toward the informal sector must become supportive of the sector which has demonstrated the most potential for growth and ability to absorb workers. The lack of a clear policy and action plan to develop the small and informal sectors constrains further development. Indigenous entrepreneurs, as well as urban youth and women, are found mainly in the informal sector. A policy framework to formalize the informal sector would lead to opportunities for this group to participate more fully in a free market economy.

(4) Ad hominem Application of Law - Lack of clarity in rules, regulations and modus operandi leaves ample opportunity for uneven enforcement of responsibilities and application of benefits. It also permits those so inclined to take advantage of others who are not aware of the rules. The approach to date to improve clarity lacks an overview of the entire process and has resulted in inconsistencies remaining in the regulatory environment. There are numerous examples where change has occurred in one area, such as the liberalization of grain trade, while the pertinent legislation which prohibits private traders operating in this area has not been rescinded.

Disincentives to promoting exports are still found whereby exporters must obtain licenses for such activities. Export crop marketing has still to be liberalized with the consequent autonomy required for private sector entry, particularly where processing is required. The privatization of the agro-processing cells is vital to entry of the private sector in such crops as coffee, tea, tobacco and good grains.

In general, there is concern over the comprehensiveness, timing and sequencing of reforms. While complaints are heard about the slow pace of implementing reform, at the same time there is concern that the implications of accepted reforms have not been thought through carefully.

(5) Exchange Rate and Convertibility - The failure to date to allow the exchange rate to find its equilibrium position ensures that money outside the official system will stay outside. The new Foreign Exchange Act is silent on the sale of foreign exchange which may be dealt with in subsequent guidelines issued by the Bank of Tanzania. It is clear however that access to foreign exchange will still be controlled by the Government.

(6) The Tax and Customs Systems - The present system of applying sales tax at each point of sale discourages other than vertically integrated companies which can avoid numerous sales points and thus achieve a price advantage over competitors, thus creating unfair grounds for competition. Customs administration is complicated by the numerous layers of bureaucracy and the lack of clarity of what exactly is required. This leads to long delays in customs clearance and to substantial storage charges.

(7) Land Tenure - The current land tenure system places constraints on long-term investment in land which is vital to increased agricultural productivity.

(8) Civil Service - Civil service reform may be a prerequisite for ensuring an effective regulatory environment for enabling the development of the private sector. Conditions of public service have left an apathetic and sometime corrupt civil service which, in its regulatory role, hinders the efficiency of business operations through delays and the increased cost ("lubrication") of doing business. Labor laws are viewed as not being conducive to the efficient running of a business given the protected position of the employee and the difficulty in getting rid of unproductive workers. The regulations on employing and giving residential status to foreign labor should also be streamlined to ensure that they are efficient where transfer of technology and training of local manpower is concerned.

(9) Licensing of Business - Contradictions in related laws and regulations still exist for such areas as exchange control, company dividends and the company ordinance. The registration and licensing of businesses in Tanzania is a lengthy and complicated process which has not been addressed within the package to promote investment. Customs duty and sales tax are an essential source of revenue for Government and are equally an essential tool for effective protection of efficient local businesses. Concern has been expressed that the incentive package may be too generous and may lead to subsidies to inefficient enterprises. An initial study to "debureaucratise" the investment process and another to ensure harmonization of rules and regulations is being undertaken. The Investment Promotion Center does not have the power to act as a "one stop" center and is viewed by some as one more layer of the bureaucracy.

CHAPTER V
STRATEGY AND RECOMMENDATIONS

A USAID strategy to assist Tanzania's movement toward a market economy must assume that the present political leadership has decided upon and taken steps to reverse its past quarter century of policy. The first limitation is the leadership. Success will be measured at first in the margins, and will be achieved fully only when a new generation of administrators and entrepreneurs takes control of the leadership of the country.

A second limitation is the present commodity-export base of Tanzania's economy. It is unlikely that Tanzania will quickly move away from the production and export of agricultural commodities (cotton, tea, coffee, fruits) and mineral commodities (ores or semi-finished mineral products). National income will depend directly on the country's ability to differentiate and create demand for specifically high-value, Tanzanian commodities. As the country has been inward looking (self-sufficiency) rather than outward toward potential buyers, exporters will have to develop better links with and understanding of the psychology buyers.

A third limitation is the size of Tanzania's domestic market, both in absolute numbers and in purchasing power. It is inevitable that lower-cost imported finished consumer goods will be attractive to Tanzania's consumers in terms of price, quality and brand-participation (in which the consumption of a world-branded product provides the consumer with intangible benefits of an emotional nature). Production behind a tariff barrier will be an attractive option for donors, national leaders and manufacturers. There are no examples, however, of any country that has created viable and competitive businesses by so doing. The contrary is indicated by comparing the examples of India and the NIC's.

This suggests that the establishment and development of Tanzanian industrialists (here defined as any entrepreneur who seeks to transform raw or semi-finished materials into a consumer product) will depend on extraordinary conditions of: successful deep-pocket, long-term financing of projects in a risk-averse market; early control of a majority domestic market share by a debutante product; successful regional export of sufficient quantities to achieve production and distribution economies of scale; successful identification and closure of international distribution opportunities.

Job creation (both direct and in indirect services) depends on the success of the industrialists.

An intangible in the mix is the nature of race relations in Tanzania. The population pool is too small to permit barriers between sub-groups. Moreover, foreign investors may be loathe to invest in a country whose residents are unable or unwilling to deal with each other. A successful Tanzanian entrepreneur will be one able to mobilize available local expertise and financing behind his project. This suggests that Boards of Directors will be filled out

on the basis of the actual contribution of directors to the enterprise and not of race. This suggests that private commercial banks will lend and borrow across racial, ethnic and religious lines.

Developing private sector opportunities requires several preconditions. The first is the successful conversion of informal liquidity into formal and its investment and/or lending into private enterprise. Measures already taken by GOT, and recommendations for USAID intervention have already been discussed. Equally interesting is that the availability of formal lending will demand-pull improvements in public rating of enterprise credit-worthiness. Not only does this create opportunity for the establishment of various service firms (credit rating, collection agencies, investment pools) but it will also demand the improvement in public sector record keeping and information provision.

Other measures include:

revision of the law on tenancy
revision of land ownership laws
revision of the leasing and hire purchase regulations
legislation specifically permitting private enterprise
harmonization of laws on business registration

The Team's strategy recommendations focus on a few manageable projects and programs in the three sectors outline for its consideration: Financial Institutions, Parastatal Reform, and the Business Environment.

Once Tanzania moves into a further stage of industrial development, more complex and sophisticated interventions may be indicated.

A. FINANCIAL SECTOR REFORM: Recommendations

Research, especially that conducted by J.E. Austin Associates in other countries, indicates that about 75% of all business people view lack of financing as their major constraint to business establishment and growth. A closer view of the situation, however, reveals that the same people have not, are unwilling, or are unable to create a bankable business plan. Some business people are informal and thus unwilling to commit salient details to paper. Reform of the regulatory environment may encourage these operators to formalize. Others are established formally but cannot afford the time or cost of developing a business plan. A smaller number already have access to financing but not on the terms or in the quantities they desire.

In all cases, understanding that a bankable business plan is not only a ticket to financing, but also a sound way of analyzing their own enterprise is important to the healthy development of a private sector. While this issue had not surfaced during the Team's research, it will become more important to the degree

Tanzania moves into a market economy. It is recommended that USAID lay plans now for technical assistance to aid entrepreneurs, whether new private sector starts, or parastatal spin-off, with the creation of bankable business plans.

BARRIERS AND SOLUTIONS

Barrier #1: Lack of fully-implemented prudent regulations and practices.

The major legislation and regulations described in Chapter II Section C are extremely encouraging to prospective domestic and foreign bankers because they show a commitment on the part of GOT to make major policy changes. However, due to their memories of nationalization and government interference in the past, these prospective bankers may remain on the sidelines until GOT shows a commitment to advance these policies to the implementation stage and to consistently apply them.

Solution to this barrier:

Continued multilateral (for political and financial reform) and bilateral support (financial reform) of GOT efforts to improve the supervisory capacity of the BoT, foster legal reforms and revise the BoT Act and NBC Act. Specifically, enhancement of the capacity of the BoT to efficiently implement the necessary regulations, and properly supervise the banks which will operate under those regulations, is the most sensible way to prove that the most effective means of resource mobilization and credit allocation is under an independent and efficient central bank.

The passage of the Foreign Exchange Act (which is a major attempt to move away from several exchange rates to a market determined rate) in January 1992 provides an opportunity to assist the BoT in the implementation of regulations and guidelines (license requirements, operating procedures, etc.) which are in the process of being developed. BoT's Director of Exchange Control indicated they expect the Act to receive Presidential Assent sometime in March and they have already received notification from more than twenty individuals or groups interested in opening foreign exchange bureaus ("Bureau de Change") allowed under the Act. BoT officials have indicated they need assistance in training new Bureau de Change operators as well as monitoring their activities. The Foreign Exchange Act of 1992 is attached.

Recommended role for USAID:

USAID is already providing assistance to BoT by funding a Price Waterhouse evaluation of NBC's loan portfolio, with a view toward determining which loans should be transferred to LART and the amount which GOT will need to recapitalize NBC, CRDB, PBZ and TIB. Additional USAID support could be used to extend this review, or begin separate reviews, to cover: 1) the loan portfolios of other financial institutions (THB, POSB, NIC, ZIC); 2) other key balance sheet accounts such as contingent liabilities, suspense

accounts (ODA is currently funding a Coopers & Lybrand reconciliation of NBC's interbranch suspense account activity), foreign exchange pipeline and related accounts.

USAID could play a vital role in moving some of the major policy changes in BFIA relating to bank supervision (vital to private banking development) closer to full implementation. For example, Mr. S.K. Juma, BoT's Director of Supervision, values the knowledge and insights gained during the highly-regarded Federal Reserve/World Bank Washington-based seminar for bank supervisors. He has expressed interest in obtaining funding/sponsorship for some of his staff (recently increased from five to twenty) to be able to attend. A strengthened BoT Suspension Department (soon to be raised to the Directorate level) will be the most effective tool to measure the implementation and application of prudent banking policies and regulations.

Additionally, although the IMF has been funding a technical advisor (for policy matters) to Mr. Juma, this department would benefit from two additional measures of great importance to expanding its institutional capacity. The first would be to bring a Federal Reserve bank supervisor to Tanzania on secondment for at least one year. The Fed would continue to pay his or her salary while USAID could agree to cover living expenses. The second measure which USAID could fund would be the initiation of in-country seminars/workshops led by former or current U.S. bank supervisors. These would be several weeks in duration and would take bank examiners through the intricate steps of thorough bank supervision.

USAID will be able to facilitate the implementation of foreign exchange regulations by providing technical assistance for the training and guidance of the new foreign exchange bureau owner-operators. BoT is planning in-country seminars for which it may need USAID-funded guidance, which could include sponsoring visits to neighboring countries with successful foreign exchange operations.

USAID assistance to LART would accelerate its development so that it is fully functional when the time comes for it to receive non-performing loans transferred from NBC, CRDB, PBZ, TIB and other financial institutions. Since its Administrator was only recently appointed and is so far its only employee, LART would benefit by the provision of one or two USAID-funded technical advisors to hire and train competent staff (this could be coordinated with proposed USAID assistance to BoT's supervision activities) to properly perform LART's role of recovering value from non-performing loans. These advisors may include individuals from the Resolution Trust Corporation (U.S.) or similar recovery agencies from other developed or developing countries.

Barrier #2: Public perception of financial institution services.

The Tanzanian banking public does not perceive banks as responsive to their own financial needs. people wait in line for hours to access their savings or to inquire about accounting mistakes made by their bank. They wait for months for a check to clear because of an outdated method to clear checks is used. There is a general perception that bank secrecy is non-existent; depositors assume that the government is always watching them and their affairs.

As business managers, they have watched their businesses suffer as they miss another necessary purchase (tour bus, truck, tractor) because NBC often is very slow in processing LC requests or because they require an excessive amount of cash cover. When one asks a worker or shopkeeper why they do a large portion of their business outside the formal financial sector, they simply say they are tired of the poor service and inefficiencies associated with this sector. These people wonder "why the financial institutions cannot be as efficient as the informal financial markets." Some of these same doubts about the financial services market has, and may continue to, frighten prospective bankers from entering Tanzania.

Solution to this barrier:

The assistance USAID is already providing in the area of loan portfolio review are the first steps to improving the financial health of the financial institutions but public confidence in these institutions will only increase when service improves. For example, a construction company that needs thirty thousand shillings for petrol to complete a seventy million dollar contract on schedule will be far more concerned about the speed of disbursement than about the rate of interest. Continued multilateral consultation with GOT senior officials will help to ensure that they remain committed to reform. Computer assistance, basic business training and management training (discussed later) will assist the financial institutions in improving their service to customers.

The entry of new private banks will provide the technology transfer, bank management skills and the necessary competitive pressure to induce GOT to assist in the continued development of methods to improve the range and quality of service offered by Tanzanian financial institutions.

Recommended role for USAID:

USAID could bring in successful U.S. bankers (i.e., from small, regional or money center banks) to offer customer service training courses and workshops.

USAID could provide the linkage between programs successfully designed by ACCION International, with USAID/PRE/I loan guarantee assistance, and potential business opportunity for financial institutions in Tanzania: lending to microenterprises. If set up along commercial guidelines similar, such a program would be an

excellent way for USAID to use a relatively small amount of funds to link Tanzanian financial institutions with Tanzanian entrepreneurs and then be able to transfer progressive amounts of the loan risk to the local financial institutions.

Local institutions, including TIB and DJIT, have indicated that their recent efforts to tap this market show many signs of being a profitable, efficient and prudent (ACCION reports a payback rate of 98%) banking service for which there is tremendous demand. NBC and CRDB are also exploring the idea of microenterprise lending and have contacted some donor agencies, as well as the local Entrepreneurs Development Fund, to discuss funding. ODA is studying prospects of developing a Grameen Bank-type of financial institution.

USAID/PRE/I has an excellent relationship with ACCION International (based in Cambridge, MA) and could arrange for a feasibility study regarding the possible application of this method of microenterprise lending in Tanzania. The World Bank financial sector team currently visiting Tanzania has expressed interest in funding assistance for such a study.

Barrier #3: Capital requirements difficult for local groups to meet.

The Banking Act, BFIA, established a paid-in capital requirement of one billion shillings (US$4.3 million) for new commercial banking entrants and TSh 500 million (US$2.2 million) for new non-bank financial institutions (allowing existing local banks two years before they must meet these requirements). The capital requirement could make it difficult for any local group to be able to set up a private bank.

While the thought of lowering the requirement comes to mind, in that it would indeed make it easier for an indigenous group to establish a private bank in Tanzania, it carries the risk of undermining the GOT's recent efforts to improve the health, performance and efficiency of the banking sector. Also, given the requirement that core capital must be greater than 6% of total assets, a smaller capitalization requirement would not permit the volume of operations necessary.

Discussions with local business groups in mainland Tanzania and Zanzibar began with the comment that foreign banks will most likely focus initially on export and trade finance types of activities. Therefore, these local business groups are considering joint venture banks, or possibly a 100% local bank, to be formed to serve particular sectors of the economy which do not currently have much access to credit (SMEs) or which have been "crowded-out" of the borrowing market (larger private sector companies) by the parastatal sector's dominance of formal financial sector credit.

Solution to this barrier:

Assist local groups in their efforts to locate joint venture partners who will agree to a transfer of needed technology and the offering of management and staff training.

There is tremendous demand for small business lending in Tanzania. For this reason, the Tanzania Investment Bank (TIB) has recently shifted some of its focus (the GOT recently said TIB could explore its desire to expand its activities beyond its traditional DFI role) to small and medium-sized business lending since the loans are more manageable and there is more flexibility to work-out any payment problems. TIB is mentioned in this discussion of solutions because it has an extremely qualified staff and could easily expand its range of services to include merchant banking. Since there is currently no capital market in Tanzania, TIB could then play a vital role in developing pools of local investment capital, assisting local business groups develop financing proposals for investment in new local banks and equally important, TIB could take the lead role in the distribution of shares in NBC, CRDB, PBZ, POSB, THB and other local financial institutions (including TIB itself) when the GOT decides to privatize all or part of these institutions.

Recommended role for USAID:

USAID could assist TIB in its attempt to expand its range of services to include merchant banking and lease financing, as well as its desire to shift its lending focus to small and medium-sized enterprises. The current discussions regarding eventual privatization of some local financial institutions could also provide USAID with an opportunity to offer low risk support through USAID/PRE/I's Worldwide Privatization Guarantee Facility. The USAID/Tanzania Mission can coordinate this activity with USAID/PRE/I.

USAID should also study the operations of savings and credit societies in Tanzania. They have relatively good reputations and have been successful by remaining small and providing efficient service to their members. Technical assistance in the form of basic business training and management training could strengthen their links with existing members as well as forming links with local entrepreneurs intending to begin microenterprise operations.

Barrier #5: Concern that existing local banks will receive preferential treatment over new private banks.

New private banks may remain on sidelines until they are convinced that there will be a level playing field. They will need assurance that, as foreigners, or as partners with foreigners, they will not be treated differently from existing banks.

Solution to this barrier:

This will require effort on the part of GOT to foster transparency in the banking and other business legislation which may impact the operations of a bank. It must follow that such

legislation and regulations are enforced without bias toward any particular group. In addition to the improvements to BoT supervision assistance mentioned earlier, legal advisors may be able to assist the BoT and MOF in developing a legal framework for such issues as bankruptcy, loan recovery and collateral registry. Further assistance could be provided in the implementation of policies related to these and other legal issues.

Recommended role for USAID:

USAID could provide legal assistance to MOF, BoT or other ministries involved in drafting and implementing bank-related legislation. Technical assistance, in the form of funding of U.S.-based and in-country seminars and workshops by U.S. bank supervisors and experienced bankers, would provide useful guidance to the bank regulators whose task it is to enforce all regulations fairly and equitably. The GOT could be informed that attempts on its part to favor local banks over new private institutions will negatively impact the financial sector reforms as well as USAID assistance.

Barrier #7: Absence of communications network and shortage of necessary computer technology.

The existing financial institutions in Tanzania currently use manual methods to maintain their records and produce reports and financial statements. This method of bookkeeping prevents these institutions from operating efficiently and is one of the main reasons for the slow and error-ridden service which alienates many of their customers. The absence of computer technology to monitor the use of loan proceeds and the financial condition of borrowers limits a financial institution's ability to control loan arrears.

An additional drawback of their use of manual accounting procedures is the length of time it takes for checks to clear. It is not unusual for many customers to wait for several months before a deposit by check is credited to their accounts. Even worse, businesses often wait months for a payment by check to work its way through the archaic method of clearing, only to discover that the check they received as payment was refused by the paying bank.

There is no computer linkage between bank branches or with the BoT (which has no organized check processing facility) and, to complicate matters further, communication between branches is reduced to reliance on a telephone system which is obsolete, lacking in capacity and functions intermittently.

Solution to this barrier:

The best way to improve the communication of data between bank branches, as well as to the BoT, would be to improve the quality of the phone system. As this is nothing close to a short-term or inexpensive solution, it is recommended to explore the feasibility (with other donors) of establishing some form of microwave or VHF

cellular system of communication. This solution is discussed in more detail in Chapter IV.

Regarding the inefficient manual accounting, loan monitoring and report generation methods, immediate improvements in the ability to offer fast and efficient service to customers can be made through a coordinated donor effort to provide computer hardware, software and related training. Monumental costs can be avoided by focusing on key branches and departments. For example, departments responsible for lending, accounting, internal auditing, treasury and clearing (checks, LCs, etc.) would show dramatic improvements in the speed and efficiency of their operations. Branches in the major cities and Zanzibar could be linked for communication and clearing purposes.

The BoT should be assisted in establishing regional check clearing centers, similar to the system used by the Federal Reserve Banks, whereby a check drawn on an NBC branch in Mwanza and deposited in a branch in Tanga would not have to make the trip all the way to, and through, the check processing labyrinth of NBC's headquarters in Dar Es Salaam. The computerization of the check clearing process, and key departments and branches of financial institutions, would be instrumental in improving the level of service to the point where it would convince many people to return their savings and business dealings to the formal financial system.

Recommended role for USAID:

USAID could take a lead role in coordinating this effort with multilateral and bilateral donors. It is necessary to coordinate efforts in order to avoid duplication of equipment or different bank departments receiving software or hardware which is not compatible. A steering committee of senior officials from the MOF (Mr. Kipokola, Deputy P.S.) and BoT (Mr. Mgonja, Director of Economic Research & Policy) has been formed to coordinate efforts to computerize financial institutions.

A critical component of an efficient financial system (and one that is very important to prospective private investors and bankers) is the accuracy and reliability of financial statements. USAID could play a role in the eventual privatization of the Tanzania Audit Corporation (TAC), the state-owned entity responsible for auditing all parastatals. Although BFIA authorized financial institutions to choose private auditors instead of TAC, the local accounting firms (including affiliates of Coopers & Lybrand and KPMG) may not currently be ready for this task. SIDA played a role in linking KPMG up as an advisor to TAC, whereby KPMG offers training and other assistance to TAC staff. USAID could assist in bringing private sector discipline to TAC's operations by exploring KPMG's possible interest in acquiring some ownership interest in TAC.

USAID should review the findings of an ODA-funded study, currently underway, of accounting and auditing procedures in Tanzania. The World Bank is quite interested in the outcome of

this study as it will provide valuable insight into the evaluation of financial institutions and their value to prospective investors.

Barrier #8: Absence of capital and money markets and related financial instruments.

The lack of an organized financial market (comprised of two distinct types of markets: a money market and a capital market) in Tanzania limits the flexibility, profitability and services of existing financial institutions (in short, it limits their ability to operate according to truly commercial principles) and could discourage the entry of new private banks. The absence of a stock exchange is a vital missing link in current efforts to privatize financial institutions and parastatal organizations.

The absence of any type of forward foreign exchange market limits the ability of a borrower to hedge the risk of devaluation during the life of a loan which must be repaid in hard currency. This has a ripple effect since a large devaluation can cause a company earning impressive profits in local currency to default on a bank loan. The bank now has a loan on its books which is non-performing not as a result of the borrower's profitability or financial health, but instead due to his lack of options to hedge his currency risk.

Solution to this barrier:

The Minister of Finance, Mr. Steven Kibona, recently announced that "an Act establishing a Capital and Stock Exchange Market would be presented to Parliament to coincide with the envisaged change in the Interim Constitution of the United Republic in April."[56] A Coopers & Lybrand (Toronto) study to explore the feasibility of establishing a stock exchange in Tanzania is being funded by CIDA Incorporated.

The creation of a stock exchange may take some time but there are some relatively short-term steps which could be taken in coordination with the MOF and BoT to assist in the development of a money market. Since Tanzania already has the main instruments normally employed in a money market (short, medium and long-term government securities), the first step should be the creation of a secondary market in Tanzanian government securities, possibly modeled after the Open Market operations conducted by the Federal Reserve. This would provide flexibility to financial institutions wishing to manage their liquidity position more efficiently (since they currently have little alternative but to hold government securities to maturity) as well as offering BoT a tool with which it can manage monetary policy. An IMF-sponsored monetary policy advisor is expected to begin working in the BoT by early March 1992.

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[56] "Holding companies to be 'engines of growth' - Kibona", Business Times, 5 February 1992, page 5.

Another way to assist banks in managing their liquidity and create another monetary policy management tool for the BoT would be to assist in the creation of an interbank market. While there may currently be too few financial institutions (especially those with excess funds) to follow a model used in developed countries, it is possible to establish an informal network whereby a financial institution with excess deposits (i.e., which cannot be put to immediate use as loans) could contact another local bank directly. The institution with surplus cash would then use the BoT as a central electronic settlement facility so that the physical cash would not have to be delivered from one bank to another. This has worked in other developing countries and its feasibility should be studied here.

While it may be premature to create a forward foreign exchange market in Tanzania, it may be possible to develop some variation of this idea. The World Bank may be interested in this development in connection with its Financial Sector Adjustment Credit. An alternative to this would be for GOT (with donor assistance) to offer businesses some form of foreign currency devaluation insurance.

Recommended role for USAID:

USAID could bring in a U.S. financial market expert(s) with experience in developing money and capital markets in developing countries. While the interbank system discussed above may not be extremely active at first, it will be instrumental in convincing prospective new private banks that the Tanzanian financial market is gaining depth. The liquidity which these new entrants bring to this market will serve to accelerate continued financial market development.

USAID could also play an important role in the success of these new markets by providing technical assistance in the form of the computer and other training discussed below.

Barrier #9: Lack of private banking experience and tradition among Tanzanians.

High cost of expatriate staff, in the absence of a pool of experienced indigenous bankers, is a barrier to staffing a foreign private bank. It is an even greater barrier to establishing an indigenous bank along the lines of the African Bank in South Africa, an idea that appeals to the Tanzanian business chamber. Bankers in Tanzania need to develop a competitive banking environment by learning to act in response to market forces rather than government directives.

Solution to this barrier:

Management and staff of local banks will gain prudent banking expertise and experience by working with established international banks and participating in their training programs. Local financial institutions need several forms of training, including

management training (strategic planning, decision-making, staff motivation methods, personnel management, marketing, new product/service development, regulatory matters, etc.) and the training of staff in accounting, statistics, record keeping, computer operation, internal auditing, lending, customer service, loan monitoring, credit analysis, and other areas critical to efficient financial institution operations.

Recommended role for USAID:

In addition to assistance provided to BoT's staff to improve loan portfolio evaluation, and supervision capacity, recommended elsewhere in this report, in coordination with other donors, USAID can play a major role by initiating training programs which will dramatically improve the efficiency and customer service of financial institutions, and thus the investment climate in Tanzania. The assistance can be in the form of in-country seminars and workshops by U.S. accounting firms, bank rating agencies, bank examiners, college faculty and computer training companies.

Barrier #10: Concerns About Lack of Creditworthy Borrowers.

Most prospective bankers have enough confidence in their knowledge of banking to see the funds currently circulating in the informal financial markets (for reasons described earlier) as potential deposits in their banks. They realize that if GOT continues to implement the financial sector reforms described earlier, including interest rate liberalization, bank supervision and other measures to restore confidence in financial institutions, the general public and businesses will bring their funds back into the formal financial system. However, they also have been able to obtain enough information (reports produced by multilateral and bilateral agencies as well as local and other independent sources) about the poor financial condition of Tanzania's parastatals and cooperative unions to make them concerned about whether Tanzania's market may be too limited in large volume business to justify the investment in fixed assets that would be needed for a serious commercial banking operation.

Solution to this barrier:

One option would be the creation of a guarantee mechanism to stimulate investment in venture capital companies and related funds. This option is one of the most promising possibilities since it would attract the types of investors willing to make a long-term commitment to Tanzania and the progress of its financial sector reforms. Traditional venture capital is temporary start-up financing in the form of equity capital or loans, with return linked to profits and with some measure of financial control and has been identified as an alternative to development finance institutions.[57] Since venture capital investors desire liquidity in addition to profits, the network of business contacts in Dar Es

[57] Financial Systems and Development, The World Bank, 1990, page 89.

Salaam and Zanzibar should be an adequate substitute for the lack of a secondary stock exchange.

Encourage repatriation of capital by Tanzanians through an amnesty scheme. An example of this would be the MOF bearer bonds currently being offered by BoT. They are available in one, two and three year maturities and no questions are asked concerning the former location of the cash brought in to purchase the bonds. They offer a tax-free return and the MOF is hoping it will bring in a lot of the cash currently circulating in the informal financial sector.

Many of the other efforts discussed and proposed solutions recommended in this report will hopefully increase public confidence in the formal financial sector to the extent that the informal financial sector will lose much of its appeal. Combined with improved financial institution health and private sector business development, these changes will serve to convince prospective outside and local investors that there is measurable progress in developing a creditworthy private sector client base. The planned parastatal reforms and privatizations will hopefully result in the expansion of the pool of creditworthy industrial and commercial borrowers in Tanzania.

Recommended role for USAID:

USAID can begin by assisting in the formation of venture capital funds and the necessary location of investors. This can be coordinated with the IFC's Capital Markets Department, which has established these funds in several countries and may be able to develop additional options such as lease financing.

USAID can become directly involved in the development of creditworthy borrowers by expanding the training proposed for financial institutions to include the training of prospective local borrowers in accounting, bookkeeping, business plan development, cash management and other key areas.

B. PRIVATIZATION AND THE PARASTATAL SECTOR - Recommendations

Privatization is not an end in itself. It is part of a broader program to promote a better allocation of resources, encourage competition, foster a supportive environment for entrepreneurial development, and develop the capital market.

Privatization is not necessarily synonymous with private sector reform and deregulation. A government objective of raising the maximum from the sale of public enterprises, for example, may require tariff protection or direct subsidies. Wherever possible, the recommendations detailed below suggest actions generally supportive of the overall objective of private sector development and economic liberalization. As is the case throughout this Chapter, actions suggested for USAID take into account the plans of other donors as described in Appendix I.

Institutional Enhancement Recommendations.

It is absolutely critical that the GOT Parastatal Reform Commission be clearly defined and strengthened by implementing the following actions:

Recommendation 1: Provide technical assistance to develop a comprehensive privatization program.

Immediate technical assistance is recommended to aid the GOT in implementing the actions outlined in Haggerty's proposal to the World Bank, namely:

A. Categorize enterprises. Review the progress made in categorization of the parastatal enterprises, and group them according to viability, select and prioritize enterprises for alternative courses of action (possible criteria suggested include: the need to stem losses; ability of enterprise to be self-sufficient within a set period; maximization of divestiture proceeds; need for investment for rehabilitation; level of interest from potential joint venture partners; ease of privatization in relation to the condition of the enterprise). Apply these criteria to classify the enterprises (to retain in public sector, joint venture, partial or full divestiture, liquidation, restructuring, leasing or management contracting).

B. Develop specific guidelines for privatization action. For each of the major categories of enterprise, assistance can then be provided to develop operational guidelines defining basic parameters and minimum standards for each type of potential transaction.

C. Depending on the importance of the enterprise, undertake firm-level actions to prepare the enterprise for privatization. Actions that may be necessary include enterprise preparation (asset rehabilitation, collection of accounts and debts, divesting loss-making activities, debt resolution, efficiency and quality improvements, provision of adequate documentation and titles); regulation or deregulation (if an enterprise is a de facto or natural monopoly); undertake valuation; preparing enabling legislation (if necessary); revising the capital structure.

D. Implement the privatization deal. Depending on the SOE, and the privatization method chosen, implementation would involve developing necessary project proposals, identifying potential partners, negotiating/implementing the deal, and developing and monitoring system.

Recommendation 2: Provide long-term technical assistance to the commission.

It is recommended that at least two long-term expatriate advisors be placed in the commission. These individuals should have extensive experience with planning and implementing

privatization programs. One person would be principally responsible for devising with GOT the overall policies and framework for the privatization program as a whole, defining and establishing the relationship between the various institutions, and in developing appropriate monitoring and control procedures. The second expert would have a more "hands on" deal-making focus, and would oversee enterprise-specific actions such as restructuring and valuation.

Recommendation 3: Establish a technical assistance fund for short-term technical specialists.

This fund would finance short-term technical specialists (local and foreign) that would participate in specific deals, negotiate with investors on behalf of the GOT, identify potential joint venture partners, and the like.

Recommendation 4: Undertake a short-term study to establish the structure and functioning of the commission and the technical secretariat.

A study recommending the structure, operating procedures and responsibility, line of communications, funding, relationship with other institutions, etc., should be undertaken. Study should make specific recommendations for the elimination of specific institutions such as holding companies, SCOPO, etc.

Recommended role for USAID:

Discussions with the World Bank, ODA and the Commonwealth Fund for Technical Assistance seem to indicate that the Bank and these other donors are well along the path of implementing many of the recommendations listed above. In particular, it is likely that the ODA will provide the long-term technical specialists listed, and develop operational guidelines, and the like. In this light, it is recommended that USAID provide funding into the short-term technical assistance fund, to fund U.S. consulting and investment banking expertise, in areas of specific competence.

Recommendations to Accelerate Policy Reform.

In conjunction with the actions recommended to enhance and deregulate the business climate, the following actions are recommended to remove remaining SOE privileges and facilitate entry of private firms.

Recommendation 5: Undertake a study to identify actions to implement announced deconfinement measures.

In the agriculture sector, this would include: deconfining the role of export crop marketing boards, allowing private distribution of farm inputs and demonopolizing the Tanzania Fertilizer Company, suspending current budgetary support to non-performing large-scale farms, further the move towards indicative prices for food and

export crops, and permitting private seed companies in competition with the Tanzania Seed Company.

In the industrial sector, a number of actions need to be taken, including: phase out direct GOT subsidies to SOEs (except that necessary for privatization), removal of monopoly rights for some industrial SOEs, relieve SCOPO of its responsibility of personnel matters, make recommendations for elimination of the holding companies, assist in the development of a time-table to for discontinuation of all direct and indirect subsidies.

Recommendation 6: Develop supporting legislation and regulations.

For the private sector to compete with parastatal enterprises, develop enabling regulations in bankruptcy, land acquisition and building construction, labor hiring and other conditions, and other areas.

Recommended role for USAID

USAID should concentrate its efforts on creating an enabling environment for the development of new private sector activities. To that end, it is recommended that USAID support recommendation 6 by funding technical assistance to develop regulation on bankruptcy, land acquisition, building construction, labor and hiring practices.

Recommendations to Offset Technical Deficiencies.

Recommendation 7: Provide assistance in enhancing accounting standards and practices.

A short-term effort, reviewing the adequacy of SOE accounting standards and control procedures should be undertaken to upgrade them. The analysis should be followed-up with several in-country training exercises for TAC, parastatal enterprise managers, and bank managers.

Recommendation 8: Establish a privatization fund.

To facilitate private sector take-over of enterprises, a venture capital fund should be established in Tanzania. The management of fund would be in the hands of a professional firm, overseen by a Board of Directors. The fund would provide equity and long-term loans on a commercial basis to purchase equity in a parastatal enterprise or rehabilitate a privatized enterprise. Other possible applications could be to purchase shares on behalf of a "public trust" for re-sale to the public, or to purchase commercial debt for a debt/equity conversion.

Recommendation 9: Facilitate private bank lending for privatization by using the PRE/I Privatization Guarantee Program facility.

Once private banks begin operations in Tanzania, USAID can work with PRE/I to provide a 50 percent guarantee on debt provided by eligible financial institutions to fund the purchase of shares in SOEs, or to facilitate privatization through other means. The facility could be tailored to just funding employee purchases of shares in a privatized company.

Recommendation 10: Convene seminar to discuss privatization valuation approaches and provide technical assistance in valuation techniques.

It is recommended that a seminar with international experts be convened to discuss the practical application of earnings-based and asset-based valuation methodologies. Specific attention should be paid to identifying practical methods that can be applied to the valuation of assets in the absence of organized capital market. Technical assistance from professional valuation specialists can be provided through the technical assistance fund (see recommendation 3).

Recommendation 11: Develop options for removing or reducing parastatal debt.

In order to facilitate the sale of enterprises, it is recommended that a study be undertaken to develop concrete methods for management of debt. Debt restructuring could include: debt to equity conversions; rescheduling and re-financing of debt; direct buy-back of debt at a discount; allowing a trust fund to service debt (as part of an interim arrangement) for a SOE; direct assumption of the debt by GOT. Particular emphasis should be paid to the viability of setting up a private trust funded by counterpart funds for ESF program to SOEs. The trust can then assume the debt of specific SOEs for a grace period before transferring the debt back to the company.

Recommendation 12: Revise debt/equity conversion program to focus on privatization transactions.

Debt equity swaps can be an important tool to attracting foreign investment for privatizing public enterprises. They are an investment incentive as well as a debt management tool. Commercial debt could be bought at a discount and swapped directly for equity in the company. This has the advantage of a non-inflationary impact, and will not burden the government's budget. The current debt swap program in Tanzania would have to be broadened to specify eligible debt, conversion procedures and eligible investments.

Recommended role for USAID:

Clarification of specific technical issues, is the area of focus within privatization activities for USAID. Specifically, it is recommended that USAID sponsor recommendations 8, 9, and 11. Both the World Bank and DEG are planning to set up venture capital funds to finance privatization activities. DEG's approach is different in that they focus on setting up a management

consultancy, and have a total capitalization of about US$5 million. As their plans develop, it is recommended that USAID consider contributing to the activity. Other areas -- debt/equity conversion, capital markets development, deal negotiation skills -- are currently planned by different donors. The World Bank is focussing on the debt/equity program; CIDA is already sponsoring a study on capital markets development; and ODA is likely to provide practical assistance with investment negotiations, as mentioned earlier.

Recommendations to Offset Socio-Political Constraints

Recommendation 13: Devise practical methods to avoid concentration of ownership.

There are a number of possible methods to try to broaden ownership of SOEs in Tanzania. One approach is to set up a trust to purchase shares in target SOEs. The trust could then lend money to the public to purchase the shares, with the shares as collateral. Another possible approach is to encourage the formation of employee stock ownership plans (ESOPs). Creditor banks could then convert their debt into equity and lend money to the ESOP to purchase the shares. The primary drawback of these approaches is that they (in effect) swap one liability for another, and do not generate a new cash investment which is what is sought. Also spreading share ownership among a large number of small investors can be very risky, unless sufficient effort is spent providing necessary information, analysis and regulation. The purchasers of stock in a SOE may assume that the government is providing an implicit guarantee of their share value, and indeed the government may feel obliged to intervene if the value falls. Broad ownership may not also assure the strong guidance to turn a firm around.

Recommendation 14: Devise a comprehensive public education campaign to offset perceptions of "giving away national assets."

It is recommended that a publicity campaign be devised to prepare the public for the privatization program. This program would involve clearly letting the public understand the true costs and benefits, from the national perspective, of various parastatal enterprises, and the advantages and disadvantages of various privatization actions. The experience of other countries, and the results of past deals can be examined. Individual deals can be facilitated by conducting an open valuation of the enterprise, and publicizing the results. Experience has shown that privatization will be debated regardless of whether information is hoarded or released. The challenge is to make the debate an informed one: the public should know more about how much implicit and explicit subsidizing goes on with state ownership, and the costs of foregone activities, and the like.

Recommendation 15: Establish a fund to facilitate the retrenchment of laid-off SOE employees and managers.

The fund can finance a number of activities including training courses in entrepreneurship development that will enable SOE employees to survive in the informal sector, and basic contribution to the GOT budget to finance provision of severance packages, retirement benefits, and the like. These approaches have been successfully utilized in reducing worker opposition to privatization in Ghana, Tunisia and Philippines. Severance packages are very important where there is no social safety net, and retraining and re-deployment schemes have a very poor track record.

Recommended role for USAID:

It is strongly recommended that USAID undertake the activities described under Recommendations 13, 14 and 15. Government simply does not have the resources to re-train and re-deploy redundant SOE workers and managers. Existing courses focus on management and administrative training; there is no practical source of training and expertise in entrepreneurship skills development. These activities also have the greatest potential for contributing to the development of a viable indigenous private sector, which is an important goal.

C. BUSINESS ENVIRONMENT - Recommendations

Constraint #1 - The Policy Framework

Tanzania has never had a particular body of law on private sector business. The present code, inherited from East African common law, was taken over at Independence without fundamental revision. The present regulatory environment is the accretion of a series of Acts: the 1967 nationalization of banks, 1970 nationalization of properties (which had a great psychological impact on foreigners and locals), and the 1984 measures on liberalization of trade.

Regulatory and legislative changes, especially to the procedure to establish both Tanzanian and foreign enterprises, are underway. The Investment Promotion Centre has commissioned and received recommendations on "Facilitating The Investment Process In Tanzania," apparently to be implemented by the National Assembly at its April 1992 sitting.

But, as noted above under Chapter V.B., as a result of a quarter century of contrary practice, major revisions of the constitution (mid-April 1992), legislation and regulation on such issues as business establishment, taxation, land rights and employer-employee relations will also be required to create sufficient conditions for wide development of private sector business.

Additional policy reform needs focus on the constitutional and regulatory role of Ministers to issue approvals for business establishment, access to financing, and allocation of property. As

Mr. Nyerere stated in his keynote address to the CCM National Executive on February 18, 1992: "CCM was formed, and its leaders elected on the basis of its ideological commitment to ujamaa and self-reliance. It has not changed its policies on that aspect. Nor has there been any discussion or complaints by Party members in the country demanding change." Parties advocating capitalism, however, could be voted into Parliament. "If the people favour a party advocating such a fundamental change, and it gains a two-third majority in Parliament, then the constitution could be changed."

Recommended role for USAID:

USAID should consider funding a technical study of Tanzania's legal code as it relates to private enterprise, by a team including specific expertise on international, European Community and domestic business law. Specific texts suggested for review for revision, harmonization, or elimination, are noted in Chapter IV. The end result of this study should be a set of recommendations or even model legislation offering the conditions precedent for Tanzania's private sector to have an opportunity to compete.

USAID should also consider policy interventions at the highest level to encourage leading political figures to speak at least neutrally on the subject of the market economy, and to formalize the numerous informal businesses they are widely assumed to operate. This last intervention relates directly to:

Constraint #2: Attitude toward private enterprise

Being in business in Tanzania now equates with low intellectual and ethical status. Private sources of wealth are viewed with suspicion by the (present) single Party, as well as by regulatory officials, as evidence of improper conduct. There are very few manufacturers or industrialists in Tanzania. The majority of business is trade and commerce. One effect of the increased informality of the Tanzanian economy has been the wholesale complicity of consumers and tradesmen in illegal commerce. It is now to the point that to admit to being a businessman is as much as to admit to being a crook.

Capital formation is problematic within this cultural context. Private businesses tend to cap their growth at a level of revenue and employment judged to be below the perceptive horizon of both self-seeking family members and Inland Revenue in an effort to husband resources. Expansion, if any, is horizontal through the formation of additional businesses with their own overhead structures. The constraints of this cultural predisposition on enterprise building are self-evident.

The Indigenous African - Asian issue plays an important role in the attitude of most Tanzanians toward business. The Asian community in Tanzania has displayed cultural behaviors contrary to those of Indigenous Africans: group support of individual

initiative, forward planning and savings. The conflict between the two cultural assumptions may be intractable.

Recommended role for USAID:

First, USAID should adopt and publish a straightforward eligibility standard for access to all its funds, programs and projects of historical residence and demonstrated investment commitment to Tanzania rather than a racial one.

Second, USAID could stimulate the improvement of the spirit cooperation and competition within the Tanzanian business environment through a long-term program of information and model transfer through lectures, symposia, conferences and luncheon club meetings. Venues will probably include the various business associations, but should also include a specific "American Business Forum" to be created by the Mission, and which ought to be convened in such cities as Arusha, Moshi, Dodoma, Mwanza, etc., as well as Tanzania's major economic center of Dar es Salaam.

The goal is to expose Tanzanians to American business people and concepts to which they now have no access due to the country's isolation, e.g., that OECD economies have room for, and are built upon the mobility of, corporate giants, medium sized companies and individual entrepreneurs. Recognizing that free enterprise includes the freedom to fail, a key subcontext, that will take on increasing significance as the opening process continues, is that business failure is evidence of an attempt to accomplish something which is technically difficult as well as of mistakes made, and that individual effort is laudable.

Constraint #3 - Absence of Accurate Data

No complete and accurate picture of Tanzanian business activity is available. It is not possible to disaggregate individual enterprises from sectoral data. This lack of accurate or even available data is the result of GOT past policy which was hostile or indifferent to, and thus completely ignored, the private sector in the expectation that it was not expected to exist for long. Secondarily, it is the result of the lack of a credit market. With only the State lending (albeit via a number of institutions as discussed previously), and then for policy purposes, there was no need for the financial industry to develop accurate, independent sources of financial data on potential customers. The vigorous informal credit market lends on a personal basis and collects in the same way.

The only potentially accurate source of company information are the files of The Registrar of Companies, the Registrar of Business Names and The Registrar of Industries. The condition of these records is so abysmal as to be useless. Perhaps prior to implementation of the Registrar's ideas to improve the regulatory environment, described in Chapter IV, a necessary pre-condition to the establishment of the basic conditions to do business in

Tanzania is to straighten out and make accessible the records as do exist.

Accurate records are necessary for GOT revenue collection, for financial institution credit-worthiness decision, for business-to-business sales, and for investment both in terms of foreign or domestic equity purchases and determination of competition and market potential.

Recommended role for USAID:

USAID could provide technical assistance to restructure and bring The Registrar's Office into utility by application of computer technology to its data base. This will: reduce the sheer confusion of paper; free space for more useful pursuits; permit accurate and timely research for various legitimate business purposes. In addition, the professional and clerical staff should be offered professional seminars and training to aid them in the more efficient performance of their work.

As recommended in two other sections, technical assistance in revision and harmonization of relevant laws is required.

This assistance will:

o reduce the opportunities for rent-seeking behavior and blackmail inherent in the present system;

o eliminate an important barrier to business establishment and operation;

o create a useful database of business activity;

o improve Tanzania's attractiveness as a place where foreigners and Tanzanians will consider conducting business.

Constraint #4 - Check Clearing and Cash Management

Closely related to the absence of basic business information is the structural deficiencies of the financial sector. While the lack of efficient check clearing makes it very difficult for the bank(s) to operate as efficient businesses, the rudimentary business community has actually paid the cost of the banks' inefficiencies. Their specific impact on the formation, sustainability and expansion of business is described in detail in Chapter IV, supra.

In April 1991 the Tanzania National Assembly passed an amendment to Cap. 16 of the Penal Code, which makes the issuing or delivering of a check that will bounce for lack of fund's in the drawer's account a criminal offense, punishable by a maximum of ten years imprisonment if the issuer fails to pay the banker or the beneficiary the equivalent amount of money after 30 days notice of dishonor of the check. In its commentary on this revision of the law, "The Accountant" notes that "the monopolistic public banks

(are) one source (of bad checks), greedy traders the second source and dishonest bankers/individuals the third... The unpleasant state of affairs has continued despite the protective Cheques Act 1969 which guard banks from losses out of forged or stolen cheques."

There are two other foci to assist Tanzania implement a more efficient payments system. First: enforcement and prosecution in the courts must be impartial and rapid. The court system will have to be assisted.Second: eliminating the opportunity to kite checks present in the completely inadequate communications, and thus clearing, system will be still more efficient.

Recommended role for USAID:

USAID should assist in the installation of adequate backroom bank operations of the present and future banks in Tanzania; assist the BoT in a more adequate supervisory role; aid enterprises in more efficient cash management, by conducting a feasibility study into the creation of a data network independent of the TP&TC landlines dedicated to inter-branch communications.

One approach to the technical solution is described in Chapter IV.H. The Team selected this approach due to its relatively low cost, rapid implementation potential, and relative ease of access to the technology for Tanzanian bankers.

Constraint #5 - Lack of viable business associations

It must be assumed that all present business associations are nascent. For twenty five years there have been no active business associations in Tanzania, as all efforts were directed to the support of the public sector, while private sector activity was tolerated until the inevitable triumph of the parastatal economy. Private sector business associations were ignored and left to wither rather than being legally disbanded or dissolved.

When the GOT found a need to address itself to Tanzania's private sector, The Dar es Salaam Chamber of Commerce took on the role of designated window to the private sector. As a result, the head of that body felt himself to be legitimized as "spokesman for the private sector." Then a few years ago the umbrella Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA) was called into being for the purpose of grouping all the remaining city chambers of commerce. The city chambers, however, did not want to lose their direct role and fought the change. After some political manoeuvering, the present solution finds the TCCIA as well as the old city specific chambers of commerce, and a of the Confederation of Tanzanian Industries (CTI) which groups public and private industrial enterprises, and the Dar es Salaam Merchants Chamber (known as "the Indian Chamber").

None of these bodies presently provides the range of business services which we understand to be their main purpose. Business associations need to be strengthened if the potential private sector is to flourish and provide itself with the services it will

require. It is the Team's view that not one of the present potential organizations has emerged as the leading group. The Confederation of Tanzanian Industries appears to have adequate funding but has not articulated a program. The TCCIA has articulated its objective but does not have adequate funding. The only chamber of commerce which is generally knowledged to have provided true member services over the past twenty five years is the Dar es Salaam Merchants Chamber.

Once the law is revised to permit the establishment of political parties in addition to CCM, some of the business associations may transform themselves into parties.

Recommended role for USAID:

The Team recommends that USAID maintain links with all business associations. The Team recommends against USAID direct funding of association start-up and maintenance costs. The Team recommends USAID not champion one association over the other. USAID should rather encourage further development of associations which demonstrate internal support (through membership dues, etc) and a program of services. That encouragement could take the form of assisting linkages with counterpart professional and business associations in the US and elsewhere in order to assist Tanzanian business in the development of international markets.