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# 18102

Distr.
LIMITED

PPD.193(SPEC.)
22 April 1991

ORIGINAL: ENGLISH

UNITED NATIONS
INDUSTRIAL DEVELOPMENT ORGANIZATION

# THE REGENERATION OF TANZANIAN INDUSTRY: LIBERALIZATION AND PRIVATIZATION

## ISSUES AND POTENTIAL

*Studies on the rehabilitation of African industry*
*No. 15*

V.91-23580

## PREFACE

As part of the programme of the Industrial Development Decade for Africa, UNIDO's Regional and Country Studies Branch is issuing a series of diagnostic rehabilitation surveys determining both the major problems of African manufacturing and the potential for regenerating the sector. The aim is to outline policies and measures that may result in overall improvements and to identify individual plants for assistance.

The rehabilitation surveys are economic and policy diagnoses of the industrial sector in selected countries. They provide estimates of resource requirements for selected industrial plant rehabilitation, as well as assessments of expected results from such rehabilitation. The surveys also provide contributions towards the formulation of sectoral, national and regional policy measures and institutional developments, and the identification of full feasibility studies and advisory services which may be required as part of the follow-up.

So far, diagnostic surveys have been carried out in six African countries.[1] A common finding in these surveys is that the issue of privatization is intricately linked to rehabilitation. Almost all the countries surveyed are confronting the complex issues of rehabilitation and regeneration of their industries. In doing so, African decision-makers are increasingly having to address the question whether rehabilitation should precede privatization of public sector industries or vice versa. In all of the countries surveyed privatization is firmly on the declared policy agenda. However, none of them have made any significant progress in this direction. A major reason for this has been the lack of a realistic assessment of the requirements and capabilities needed to carry out successful privatization - in terms of financial support, policy initiatives, investment promotion and most importantly, human resource development. This report is a first attempt to highlight these issues - particularly the relationship between rehabilitation and privatization - in the specific context of a country case study rather than in the abstract.

Tanzania has followed a socialist development path since 1967. As a result, it is a country which has a large public/parastatal sector and also a long history of significant government intervention in the economy.

The Government is now seriously considering privatization as a means of galvanizing industry and agricultural processing into regeneration. However, at present there are particular difficulties for liberalization and privatization policies.

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[1] The Agro-based Industries in **Zambia**: Key Characteristics and Rehabilitation Issues, PPD.102, 29 December 1988;
The Agro-based Industries in **Angola**: Key Characteristics and Rehabilitation Issues, PPD.103, 29 December 1988;
The Agro-based Industries in **Tanzania**: Key Characteristics and Rehabilitation Issues, PPD.125, 11 July 1989;
The Agro-based Industries in **Liberia**: Key Characteristics and Rehabilitation Issues, PPD.127, 17 July 1989;
The Agro-based Industries in **Morocco**: Key Characteristics and Rehabilitation Issues, PPD.151, 12 March 1990.
The Agro-based and Other Major Industries in **Kenya**: Key Characteristics and Rehabilitation Issues, PPD.190, 27 March 1991.

Tanzania is thus chosen as a case study to highlight the major issues that have to be confronted in an African context before privatization can be seriously considered as a viable policy option for rehabilitation and regeneration of industry.

At the request of the Government of Tanzania, UNIDO undertook a diagnostic survey mission to Tanzania in February/March 1989. As a result of this field mission a report was issued: The Regeneration of Tanzanian Manufacturing Industry with Emphasis on Agro-Based Industries, PPD/R.26, 14 June 1989. This report is a follow-up to this study.

The report consists of two parts. Part I presents the major issues involved in the privatization process and surveys the progress that has been made towards privatization in Tanzania.

Part I consists of four chapters. Chapter 1 reviews the policy issues involved in privatization in an African context and in Tanzania, in particular. The most important public industries in Tanzania are devoted to agro-processing and manufacturing. Chapters 2 and 3, therefore, examine the constraints and potential for privatization in these major industries. Specifically, Chapter 2 presents an overview of the political, economic and social interests with a stake in the public sector in Tanzania. Chapter 3 reviews the most recent initiatives by the Government to attract private investment - local and foreign - to manufacturing industry. Chapter 4 provides a brief examination of some of the problems facing the agro-processing industries and cash crop-production.

Part II presents an in-depth examination of the pre-requisites for the mobilization of the private sector, especially in terms of the re-orientation of Development Finance Institutions (DFIs), financial support, investment promotion, human resource development, information on the nature and extent of the private sector, and the development of action orientated strategies and policies to support the privatization process. Thus, Chapter 5 considers the problems of generating and supplying the venture capital required to finance the rehabilitation of Tanzanian industry. Chapter 6 looks at the experiences of two private sector enterprises to highlight privatization issues. Chapter 7 examines the constraints to further progress towards regeneration of the private sector in Tanzania. Chapter 8 outlines an action plan to facilitate privatization.

It is important to stress that this report does not attempt to examine all the issues involved in the privatization process in Tanzania. Rather, it highlights the major issues. As such, the report is limited in nature and scope. It should, therefore, be seen as setting the stage for a more comprehensive examination of the constraints and potential for privatization in Tanzania.

This report was prepared by UNIDO's Regional and Country Studies Branch in conjunction with UNIDO consultant, Dr. John Henley who also undertook a field mission to Tanzania from 9 to 20 December 1989. The mission would like to express its gratitude to the Government authorities of Tanzania, UN and donor agency representatives, national and commercial banks, DFIs and various private enterprises and organizations for their assistance and support. The mission would particularly like to express its gratitude to Mr. B. Demeksa, UNDP Resident Representative and Mr. J. Rasmussen, UNIDO Junior Professional Officer for their guidance and assistance.

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| | |
|---|---|
| AMSCO | African Management Services Company |
| BIS | Basic Industrial Strategy |
| BOT | Bank of Tanzania |
| CCM | Chama Cha Mapinduzi |
| CDC | Commonwealth Development Corporation |
| DEG | Deutsche Finanzierungsgesellschaft für Beteiligung in Entwicklungsländern mbH (German Finance Company for Investments in Developing Countries) |
| DFI | Development Finance Institution |
| EEC | European Economic Community |
| EIB | European Investment Bank |
| EPZ | Export Processing Zones |
| FMO | Netherlands Finance Company for Developing Countries |
| GDP | Gross Domestic Product |
| ICDS | Industry Council for Development Services |
| IDA | International Development Organization |
| ILO | International Labour Organization |
| IMF | International Monetary Fund |
| IPC | Investment Promotion Centre |
| IPP | Investment Promotion Policy |
| ISI | Import Substitution Based Industrialization |
| MIT | Ministry of Industry and Trade |
| NBC | National Bank of Commerce |
| NDC | National Development Corporation |
| NIC | National Insurance Company |
| NORAD | Norwegian Agency for International Development |
| NPF | National Provident Fund |
| OECD | Organization for Economic Co-operation and Development |
| OGL | Open General License |
| PER | Public Expenditure Review |
| PREFUND | Project Rehabilitation Fund Limited |
| RAS | Rehabilitation Advisory Services |
| SAP | Structural Adjustment Programme |
| SIDA | Swedish International Development Authority |
| Skr | Swedish Krona |
| DFL | Tanganyika Development Finance Company Limited |
| TIB | Tanzania Investment Bank |
| TKAI | Tanzania Karatasi Associated Industries |
| TSh | Tanzanian Shilling |
| UN | United Nations |
| UNCTC | United Nations Centre of Transnational Corporations |
| UNDP | United Nations Development Programme |
| UNIDO | United Nations Industrial Development Organization |
| USAID | United States Agency for International Development |

# *SUMMARY OF FINDINGS AND RECOMMENDATIONS*

## FINDINGS

### 1. The nature and extent of the private sector is unknown

A major impediment to the privatization process in Tanzania is the fact that the nature and extent of the private sector is largely unknown.

### 2. Privatization should precede rehabilitation

The major finding of the report is that no significant progress towards the privatization of manufacturing industry in Tanzania will occur until appropriate state enterprises can be rehabilitated as viable concerns prior to transfer to the private sector. At the moment, all firms - private and public alike - with significant debt are undergoing a severe liquidity crisis. The worst placed are those with outstanding loans denominated in foreign currency. The crisis stems from the World Bank/IMF Structural Adjustment Programme (SAP) and the introduction of realistic exchange rates and positive interest rates since June 1986. While the liquidity crisis was engineered to facilitate the phasing out of non-viable activities, there appears to have been little thought given to the creation of institutional mechanisms to mitigate some of the more arbitrary effects of the policy. Thus, most Tanzanian managements are preoccupied with survival on a day-to-day basis. Few can see where the funds will come from to finance the investment in rehabilitation that they believe is required.

### 3. A substantial part of the funds for rehabilitation will still have to come from donors/external services

Since Tanzania currently receives in foreign assistance more than twice its total export earnings, a substantial portion of the finance for rehabilitation is dependent on donor priorities. Hence, whether or not donors are willing to offer support both to rehabilitation and to privatization are important influences on government initiatives to transfer public assets to private owners. There seems to be little evidence of a consensus amongst donors about the merits of privatization and a good deal of scepticism.

### 4. The need for greater donor co-ordination

There is clearly a need for greater donor co-ordination of rehabilitation activities and pooling of experiences. Rehabilitation projects appear to have been biased towards investment in hardware and expatriate management. Insufficient attention has been paid to local human resource development. This bias seems to be a structural characteristic of the foreign assistance process that requires attention in view of the shortage of high-level indigenous manpower in Tanzania.

### 5. The need for greater government co-ordination of external assistance for rehabilitation

UNDP is providing technical assistance to the Government to help improve its capacity to manage and co-ordinate external assistance but so far this assistance has not apparently had any impact on industrial rehabilitation activities. It is to be hoped that when the World Bank funded subsectoral studies of textiles, leather and agro-processing (edible oils and meat packing) become available, they will be used as a basis for concerted efforts towards co-ordinating rehabilitation and privatization efforts. Since the finance for rehabilitation and restructuring will primarily be sourced from the donor community through the development finance institutions, it is also important to build up the capacity of these institutions to evaluate in a coherent and consistent manner the bankability of rehabilitation and other projects.

**6. The Ministry of Industry and Trade (MIT) does not yet have the capacity to fully support industrial rehabilitation**

Much of Tanzania's industry needs rehabilitation. As yet, the MIT does not have the capability to fully assess or support rehabilitation projects and proposals from donors and other entities. This is a major limitation on the Government's ability to support the rehabilitation process in Tanzania.

**7. The Government's recent Investment Promotion Policy (IPP) is a step in the right direction**

The Government's recently published IPP represents a decisive break with past policies towards the private sector. It offers a useful framework within which government institutions can work to re-establish the credibility of Tanzania as a suitable home for private investment, whether it be of local or foreign origin. It is of paramount importance that officials who deal with private investors are seen to honour the spirit of the policy, in particular, its welcomed emphasis on equal treatment of all investors. Reputations of investment locations tend to be established through word of mouth advertising from existing investors to newcomers. It is also crucial not to forget the needs of established firms in the drive to attract new investment. In this regard, the Government's decision to reconstitute the Tanzanian Chamber of Commerce and seek UNDP assistance to develop its services, is a sensible way of ensuring that the authorities are kept well-informed about the concerns of the private sector.

**8. Substantial investment in the short- to medium-term appears doubtful**

Despite the very real positive steps the Government is making towards liberalizing the economy, it appears doubtful that there will be substantial interest from the international business community in the short- to medium-term. Increased world competition for inward foreign investment implies that new entrants to the market face considerable difficulties in establishing their reputation. There are, however, a few opportunities that are immediately attractive to foreign investors, for example, the brewery, the tobacco industry, the northern tourist circuit and some natural resource based investments. Care needs to be exercised in negotiating the transfer of ownership and/or management control to foreign investors in these industries. Once precedents have been established they are difficult to undo. No doubt, other niche opportunities will be identified by resourceful local entrepreneurs that can be exploited through licensing or management service agreements or production under contract.

### 9. The Tanzanian economy faces enormous structural problems

The Tanzanian economy faces enormous structural problems that are independent of the issue of privatization. It has many of the classic symptoms of an economy that has pursued a policy of import substitution industrialization. The negative effects of this policy have been compounded by the selection of many investments without much regard for market considerations. Until the fundamental structural problems have been resolved, inward foreign investment flows are likely to remain modest.

## RECOMMENDATIONS

### 1. An inventory of the private sector's strengths and weaknesses

The scope and nature of the private sector in Tanzania is largely unknown. There is an urgent need to establish and detail the potentialities of existing medium- and large-scale private enterprises. This is a major constraint on the development of an economically rational privatization programme. Without this information, policy makers cannot make informed decisions as to how best they might support and encourage the development of local private enterprise. UNDP and UNIDO and other international agencies may be in a position to assist the Tanzanian authorities in carrying out an extensive audit of the strengths and weaknesses of the private sector in Tanzania.

### 2. A review of development finance institutions

It is axiomatic that the private sector will only expand if there are commercial opportunities available to it. The two major constraints on expansion are:

- uncertainty about the policy environment, in particular, the commitment of the Government to a policy of encouraging the private sector;

- the severe liquidity crisis facing all enterprises which is a direct consequence of the SAP.

The most immediate need is to develop a framework for improving the working capital of viable enterprises regardless of whether they are privately or publicly owned. This implies a radical review of existing development finance institutions, their existing loan portfolios and lending procedures, to be followed by a substantial injection of new financial resources. New lending by donors is likely to be conditional on further elaboration by Government of its IPP. There is an obvious need for substantial improvements in the capacity and capability of DFIs if they are to take on prime lending responsibility for the rehabilitation of Tanzanian industry. Technical assistance is most needed to enhance the capability of DFIs to evaluate the commercial viability of projects and monitor projects in operation. UNDP and UNIDO may be able to assist in this regard.

### 3. Financial restructuring and rehabilitation before privatization

Collapsed or collapsing public sector enterprises in Tanzania are of no interest to investors except as a source of second-hand machinery. This means that any realistic policy of privatization must include provisions for financial restructuring and rehabilitation before disposal. To ensure that there are long-term efficiency gains to the economy following privatization, it is also important to ensure that monopolistic privileges are not automatically transferred to the new owners. While there may very well be persuasive arguments in favour of licensing a limited number of producers on economies of scale grounds, this should not imply protection from competition as well.

## 4. The need for rehabilitation of both human resource and plant

Tanzanian public sector enterprise managers are not experienced enough to make do with inadequate resources. The long-term efficiency gains from liberalization and privatization can only be obtained by managers who have the capacity to re-orient these enterprises to the market. There is, therefore, a need for a case-by-case review of the technical and management development needs of each enterprise in the run-up to privatization, paying particular attention to the requirements for engineering, marketing and financial management training. This review of human resource development might be usefully co-ordinated with the review by development finance institutions of the financial requirements of individual enterprises.

Any pre-privatization audit should include the human capital as well as the fixed assets. In the past, technical assistance and project financing has paid inadequate attention to the training of competent local staff. All rehabilitation proposals must in future be designed around the need to re-invest in both plant and manpower

From the available evidence, very serious questions can be raised about the capacity and motivation of existing managers to carry through an effective privatization programme without substantial investment in management training and incentives. At the present time, therefore, there is a strong case for the Government with the support of UNIDO, UNDP, ILO and other relevant international institutions to draw-up a comprehensive manpower development programme in support of moves towards liberalization and privatization. This programme could then be used as a basis for co-organizing a donor conference to co-ordinate the execution of the programme.

## 5. The need for technical assistance to the MIT to support industrial rehabilitation

There is a continuing and pressing need for technical assistance in support of industrial rehabilitation. In this connection, it is very important that the MIT develops an enhanced capability to effectively evaluate donor and other proposals and also to provide diagnostic and other support for rehablitation. Otherwise many of the mistakes incurred when projects are originated will be repeated.

## 6. Development of the investment promotion policy and institutions

The proposed Investment Promotion Centre (IPC) should be positioned to assume a strategic role in facilitating the reformulation of the Government's relationships with a substantially privatized economy. Its location in the President's Office, although unconventional, provides access and accountability to the key decision makers in the political system. In the last analysis, the effective liberalization and privatization of the Tanzanian economy depends on political will.

A promising start has been made towards reforming the Government's IPP but further amplification is required. There is an urgent need for technical assistance to help develop the necessary institutions required to support the new policy. In particular, work needs to be carried out on developing policies and procedures for evaluating licensing and joint venture proposals and for monitoring them in operation. The behaviour of government institutions responsible for dealing with private sector investors will be interpreted widely as indicative of the Government general attitude to investment. It is vital that staff are carefully selected and well-trained.

### 7. The need to encourage the formation of widely based institutions to represent the private sector

Ultimately, the Tanzanian Government is also dependent on the co-operation of senior management implementing a privatization policy. There seems to be no good reason for believing they will be any more enthusiastic about competition than their counterparts in the developed countries. Hence, there is a real danger that a newly privatized public sector will be dependent on political connections for a wide variety of monopolistic privileges. To help forestall this possibility, it is important to encourage the formation of widely based institutions which can represent the interests of the private sector, such as the Chamber of Commerce or manufacturers associations, for the political system lacks people with commercial experience or knowledge. The more pressure is applied to try to speed up the process of privatization without due attention to liberalization and competition policy, the greater the risk that opportunities to improve performance of many industries will be missed.

### 8. The need for strong political will in support of the privatization process

While industrial regeneration requires domestic political initiative, it also needs to be supported by multilateral and bilateral assistance. Privatization as a policy will only work if the environment is conducive and clear benefits can be demonstrated to flow from the policy. To start the process moving, Tanzania requires a number of carefully planned and executed demonstration projects in which donors and local and/or foreign industrial interests collaborate to rehabilitate selected existing enterprises. A new venture capital fund needs to be created with adequate financial resources and professional manpower to select and finance viable rehabilitation projects without political interference.

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# PART I

## PRIVATIZATION ISSUES AND PROGRESS

*Part I presents the major issues involved in the privatization process and surveys the progress that has been made towards privatization in Tanzania.*

*Part I consists of four chapters. Chapter 1 reviews the policy issues involved in privatization in an African context and in Tanzania, in particular. The most important public industries in Tanzania are devoted to agro-processing and manufacturing. Chapters 2 and 3 thus examine the constraints and potential for privatization in these major industries. Specifically, Chapter 2 presents an overview of the political, economic and social interests with a stake in the public sector in Tanzania. Chapter 3 reviews the most recent initiatives by the Government to attract private investment - local and foreign - to manufacturing industry. Chapter 4 provides a brief examination of some of the problems facing the agro-processing industries and cash crop-production.*

# *CHAPTER 1*

# *PRIVATIZATION ISSUES IN AN AFRICAN CONTEXT: THE CASE OF TANZANIA*

## 1.1 Introduction

Tanzania presents some interesting challenges to policy-makers concerned with developing strategies for rehabilitating and regenerating African agricultural processing and manufacturing capacity. Between 1967 and 1986, the Tanzanian Government pursued a strong interventionist industrialization policy. This included nationalization of the majority of existing productive capacity and state promotion, financing and management of new large-scale projects. Until the adoption of the Economic Recovery Programme in June 1986, the private sector was crowded out of official thinking, access to loan capital and foreign exchange allocations. Moreover, the majority of new state investment initiatives were financed through official loans from bilateral and multilateral agencies. Foreign lending agencies must, then, accept some of the responsibility for the subsequent performance of many of these investments[1].

## 1.2 Privatization issues

### 1.2.1 Revenue benefits

One of the principle benefits to be obtained from privatization in a developed market economy is the transfer of funds from the private sector to augment public revenues when state assets are sold. This benefit is unobtainable in a poor socialist economy such as Tanzania where the financial market is undeveloped and domestic private savings are limited and dispersed. Gains to public revenues are more likely to arise because public enterprises which are presently a drain on expenditure cease to be so. In due course, if privatization is successful, the firms should generate surpluses and pay income taxes. At the very least, bankruptcy becomes politically feasible if an enterprise continues to lose money.

This raises a key policy issue. Should further public revenues be spent on rehabilitating state enterprises prior to privatization? Generally, private investors are only interested in taking over a state enterprise that can be said to be viable according to conventional commercial appraisal techniques. However, there is considerable scope for bargaining over the value of assets, various forms of tariff and non-tariff protection, the availability of loan finance, the provision of additional infrastructure, dispensations from a variety of other government controls and so on. Each

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[1] Total foreign assistance flows to Tanzania were US$ 764.4 million in 1987 compared with total export earnings of around US$ 350 million. Bilateral technical assistance amounted to US$ 226.4 million and principal donors were Sweden (24.4 per cent), Denmark (12.2 per cent), Finland (11.1 per cent), Norway (9.7 per cent) West Germany (6.8 per cent) and Japan (6.6 per cent). Capital assistance amounted to US$ 492 million and principal donors were the World Bank (20.5 per cent), Sweden (10.4 per cent), The Netherlands (9.1 per cent), IMF (8.9 per cent) Norway (7.3 per cent) and Japan (6.9 per cent).

concession needs to be carefully evaluated by both parties. The Government is liable to be at a relative disadvantage in these negotiations, particularly in dealing with foreign investors. This is because it will usually not have access to as much expertise or detailed commercial information as the private investor. Indeed, senior managers of state enterprises will be tempted to try to secure their position in advance of privatization by assisting potential private investors.

### 1.2.2 The ownership question

While financial considerations tend to be upper most in a government's mind, the ownership question also needs to be settled. The 'property rights' school of institutional economists base their case for privatization on the argument that it is the incentive effect of a change in the beneficial ownership of enterprises which results in enhanced economic efficiency.[1] The change to private ownership, it is argued, creates an interest group with a direct and strong interest in efficiency. The new owners therefore insist on introducing a system of managerial controls and incentives that ensures all employees are dedicated to economic efficiency. This, it is maintained, is the obverse of the managerial culture that typically prevails in enterprises operating in a classical socialist economy.

Under socialism, the State is the 'good father' with an obligation to protect the livelihoods of its citizens so that bankruptcy is politically inconceivable. As a consequence, financial constraints are ultimately 'soft' to the extent that a minimum level of resources will always be found to prevent an enterprise going under. Management is thus partially insulated from the harsh discipline of the market place and the constant need to improve efficiency and responsiveness to changing patterns of consumer demand. It is production rather than market-oriented.

The 'property rights' school predicts that efficiency gains are not simply a product of the transfer of ownership rights from the public to the private sector but depend crucially on the extent to which the new owners have a direct interest in managerial efficiency. In short, something more is required to secure improved efficiency than merely the conversion of a public monopoly into a private monopoly. Unfortunately, the typical African country has a relatively small economy which is usually oligopolistic in structure and heavily protected. This presents the economic policy adviser with a dilemma. In order to attract private buyers for ailing state enterprises, it may be necessary to offer 'sweeteners' in the form of protection from competing imports or tax breaks. However, high effective rates of protection may create a policy environment in which private investors have no more interest in economic efficiency than had their predecessors.

Of cours , in many African countries in the 1990s, the ability of policy-makers to offer concessions to private investors is fairly tightly constrained by the requirements of a World Bank/IMF SAP. Under such a programme all that is supposed to be on offer to investors is the prospect of a 'realistic' and progressively lower local exchange rate, tariff neutrality,

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[1] See S. Commander and T. Killick, "Privatization in Developing Countries: A Survey of Issues" in Privatization in Less Developed Countries (eds. P. Cook and C. Kirkpatrick) Brighton: Wheatsheaf, 1988, pp. 91-124.

real local interest rates and access to foreign exchange for the purchase of essential inputs. This kind of policy environment is unlikely to be attractive to foreign investors interested in manufacturing consumer goods for the domestic market. This is perhaps just as well given the lack of obvious comparative advantage in the manufacture of goods that rely on extensive use of imported materials. In any case, the property rights school would have a clear policy preference for local private ownership over a joint venture arrangement or direct foreign investment involving a multinational corporation. This is because it is hypothesized that the efficiency gains of privatization depend on the strength of the direct financial incentive available to owners and managers. From this perspective, portfolio investment by a local financial institution might also be expected to suffer some efficiency loss from excessive attenuation of property rights.

### 1.2.3 The provision of finance

The place of equity finance, or its equivalent in the capital structure is clearly affected by issues such as whether privatized units are to be transformed into companies with shareholders or into some form of mutual organization owned by employees and/or customers. The ownership question is also linked to the kind of financial sector that develops. The absence of organized capital markets is typical of sub-Saharan African economies. There are formal stock markets in Côte d'Ivoire, Kenya, Nigeria and Zimbabwe but these markets are only in the incipient stage of development. In these markets, new issues are rare and trading is thin. Stocks are normally bought for dividend yield rather than the expectation of capital appreciation. Unsurprisingly, debt financing is presently the most common method of raising funds.

The questions then arise as to who will hold the equity of enterprises after privatization and what relationship will equity holders have with the financial institutions that lend to these enterprises. A country adopting the British or US methods of industrial finance would require equity to be held by non-banking institutions. By contrast, promoters of the German or Japanese 'universal banking' approach to finance would expect banks to retain cross holdings in major enterprises in order to create a captive customer base and provide a basis for close monitoring of performance of major borrowers. This latter approach is said to encourage lenders to adopt a long term view of investments which, in turn, enables enterprise managements to adopt longer term strategies for developing the business. The British/US system of banking fosters greater specialization of function and a more competitive market for capital but is claimed to promote a short-term view of investment.

The most likely transitional arrangement on the road to privatization is the formation of financial institutions that hold the capitalized government debt of different state enterprises. When investors are eventually invited to tender for equity, the problem then arises as to how to stimulate demand in the absence of substantial concentrations of private savings in politically acceptable hands. Not only do investors need capital to acquire the assets of a state enterprise, most also require substantial additional resources to finance rehabilitation. Inevitably, further loan finance will have to be provided by state financial institutions, unless firms can be sold in their entirety direct to foreign investors. However, most foreign investors are likely to prefer some form of joint venture arrangement, at least until they are confident about the new policy environment.

In the transition from lending according to the priorities set through a planning mechanism to lending through a capital market, there is likely to be a continuing need for an 'honest broker' between state, private foreign, and private local interests. Clearly, expectations about the profitability of the enterprises concerned enter into considerations. Where a state enterprise has a well-established record of profitability there should be few difficulties in raising loan finance but these may not be the first candidates for privatization. The capacity of financial institutions to assess risk and supervise loan disbursement will be critical in ensuring good money is not thrown after bad.

The record of DFIs in Africa has so far not been good. Part of the poor performance of DFIs is undoubtedly attributable to the consequences of inappropriate national macroeconomic policies. In particular, the sharp adjustment of unrealistic exchange rates and negative to positive interest rates in the 1980s caused havoc in the loan portfolios of DFIs lending to local firms against foreign exchange borrowings. Even so, their technical capacity to evaluate bankable projects has frequently been inadequate and investment decision making processes have been overly influenced by political considerations. Increased donor dependence since the onset of the 1981-83 world economic recession has introduced a range of additional external administrative and political factors into the decision making process.

International banks will continue to be reluctant to re-establish commercial foreign lending operations in Africa. The combination of political risk and the high overhead costs of making loans in unfamiliar markets will remain a powerful deterrent in the medium-term. By contrast, it should be relatively easy to privatize retail barking by inviting in foreign banks with the necessary expertise and capital base. The security implied by an international reputation should attract sufficient domestic deposits to generate surpluses to more than cover local administrative overheads associated with trade financing, supplier credit operations and aid flows. From the perspective of the corporate headquarters of international banks, the main interest in a country such as Tanzania, is in the access that retail banking gives to commercial foreign exchange transactions. The prospect of dividend remissions generated from local operations will be a relatively minor consideration.

### 1.2.4 The effect of privatization on innovation

Much of the debate about privatization in Africa is understandably preoccupied with the productivity of existing assets. However, in a world increasingly dominated by accelerating rates of technical change, shorter product life-cycles and rising research and development costs per unit of output, it is also important to consider the impact of ownership on sources and rates of innovation. Here the evidence is unclear. Overall, Africa has a dismal record of expenditure on research and development and its dependence on OECD economies for its technology requirements needs no further elaboration. If, as is likely, technological dependence will continue at least in the medium-term, the policy issue then becomes the capacity of public sector enterprises to adopt and adapt imported technology.

It is difficult to believe that African state enterprises in their present form can be effective innovators as they are so often net consumers of state revenues. A critical constraint on the development of innovative capacity is the availability of high-level scientific and engineering manpower. Once state enterprises become locked into a downward spiral based on insufficient working capital and rates of re-investment, low capacity utilization and overmanning, they inevitably have difficulty in rewarding their high level manpower sufficiently to retain them. The rigidities of a centralized state wages and salaries structure compounds the problem.

Dynamic efficiency gains, particularly through improved human resource management, are difficult to estimate. Nonetheless, they are likely to be the most important source of improved economic efficiency to be obtained from privatization. Improved human resource management depends crucially on the competence and quality of managers and skilled technical personnel. With shortages and low levels of capacity utilization widespread in Tanzanian enterprises, the priority for management has, of necessity, been to keep production going. Product and process development, marketing and financial management skills are likely to have been neglected in the struggle for survival. On the positive side, there is some evidence that state enterprises spend more on human resource development than comparable firms in the private sector, especially on management and technical training. However, it is often difficult to establish the extent to which this training is economically justified. Sometimes it seems to be distributed as a reward for loyal service and/or is provided as highly subsidized or 'free' technical assistance from aid agencies.

### 1.2.5 Disposal of public assets

Disposal of publicly-owned assets is complicated by technical and political factors. In an administered economy, there are no 'real' measures of the costs of inputs and outputs. There are substantial distortions in the pricing of capital, labour and material inputs. Output prices are subject to manipulation. Domestic production is often highly concentrated, if not monopolistic. Consequently, the benefits to be obtained from increasing the influence of market determined prices are difficult to estimate and diffuse. By contrast, the losers from the short-run income distributional effects of privatization are likely to be a narrowly defined section of the community and can be expected to resist strongly.

It is also important to remember that any move towards privatization is superimposed on existing underlying structural problems. In Tanzania's case, these are derived from previous policies such as the Basic Industrial Strategy (BIS) which aimed to promote self-reliant industrialization based on import substitution. The cumulative effect of these policies has been increased import dependence. As a result, Tanzania is likely to face severe foreign exchange constraints for some time to come. Yet foreign investors want guarantees that it will always be possible to repatriate interest payments, dividends and royalties. Without prior and substantial structural adjustment private production will remain dependent on government licensing and therefore exposed to the possibilities of political interference. Will this vitiate the dynamic effects of increased managerial autonomy?

Experience of privatization in mature industrial economies, such as the United Kingdom, suggests that it is difficult to maintain a commitment to the promotion of competition. It is easier to sell off monopolies, while it takes time and is complicated to prepare monopolies for competition. Perhaps more importantly, governments depend on the senior management of state enterprises for information, expertise and co-operation in formulating the privatization arrangements. While those managers may be keen to reduce government interference in their affairs, they are unlikely to be so enthusiastic about exposing their newly privatized industry to competition.

Ultimately, the Tanzanian Government is also dependent on the co-operation of senior management in implementing a privatization policy. There seems to be no good reason for believing they will be any more enthusiastic about competition than, for example, their British counterparts. Hence, there is a real danger that the newly privatized public sector will be dependent on political connections for a wide variety of monopolistic privileges. To help forestall this possibility, it is important to encourage the formation of widely based institutions which can represent the interests of the private sector, such as the Chamber of Commerce or manufacturers associations, for the political system lacks people with commercial experience or knowledge. The more pressure is applied to try to speed up the process of privatization without due attention to liberalization and competition policy, the greater the risk that opportunities to improve performance of many industries will be missed.

# *CHAPTER 2*
# *BARRIERS TO ECONOMIC LIBERALIZATION AND PRIVATIZATION*

## 2.1 Introduction

In order to assess the true potential for privatization in Tanzania, it is important to have a clear understanding of current barriers to economic liberalization and privatization. Many of these barrier steps from the socialist programme adopted in the Arusha Declaration of February 1967 and its resulting implications for ownership and control of industry, the discouragement of privatized enterprises and non-individual ownership of land, subsidization and support of inefficient public enterprises, compression of public sector salaries and the collapse of work incentives, public sector retrenchment, and the negative attitude of trade unions towards liberalization and privatization.

## 2.2 The Arusha Declaration: Background to the socialization programme

Until Independence in 1961, Tanganyika was administered by the British colonial government with relatively little intervention in economic matters. Unlike its neighbour, Kenya, which was governed very much as a European settler political economy with various economic privileges carefully parcelled out amongst settler and foreign business interests, Tanganyika had a relatively shallow state structure. Britain had never intended it to be a settler economy so there was no pressing need to create an elaborate system of internal redistribution. Such economic development that did occur was largely the product of private initiative, particularly by migrants from South Asia. Foreign investments were generally managed as an adjunct of regional operations headquartered in Nairobi, Kenya. Thus the brewery, the cigarette factory, the cement works, the oxygen plant, a major shoe manufacturer and the metal can plant, among others, were incorporated as subsidiaries of Kenyan-based operations. Even five years after Independence, only 10 per cent of parastatal assets were in manufacturing, while the majority were in mining and electricity with scattered investments in financial services, tourism and plantation agriculture. The First Five-Year Plan (1964-69) assumed a private investment share of 75 per cent of the industrial sector albeit with the anticipation of a substantial public sector investment programme.

The first interventionist programme, moderate by 1960s standards, was superseded by the publication of the Arusha Declaration of February 1967 which heralded the adoption of a full socialist programme of economic development. The influence of Soviet and Chinese thinking of the 1950s and 1960s on Tanzanian economic development policy is reflected in the emphasis on self-reliant industrialization. It is sometimes forgotten that the Arusha Declaration also called for greater emphasis on rural development though, in the event, priority was assigned to industrial self-reliance. A process of substantial resource transfer to the manufacturing sector was started in 1967 relying on public investment in state-owned enterprises. This policy continued until the economic crisis of the early 1980s. The manifest absence, in 1967, of an educated and skilled industrial class or indigenous technological capabilities embodied in a capital goods industry does not seem to have deterred policy-makers. Indeed, policy-makers seem to have simply assumed that the expansion of the public sector would stimulate the creation of these missing social formations and, moreover, that there would be no significant efficiency losses while they were being created.

## 2.3 Ownership and control of industry

An attraction of state ownership was the expectation that profits would no longer go to private sector shareholders, most of whom were either non-indigenous residents or residents abroad, but would be available for domestic investment. In an attempt to ensure that accumulation was restricted to the State and there would be no conflict between private and public interests, the Government introduced a Leadership Code. This officially forbade public employees from having second sources of income from private businesses or from renting property. Tanzania's economic development strategy thus became sharply distinct from Kenya which was pursuing a vigorous policy of attracting foreign investors through joint venture arrangements with government DFIs. Kenyan civil servants were openly encouraged by President Kenyatta to have sideline businesses.

The subsequent economic history of Tanzania has demonstrated that far from generating a re-investable surplus, state-owned enterprises have been net consumers of resources - TSh 7.8 billion between 1981-82 and 1985-86, if corporate taxes are deducted from current account transfers.[1]

There has been a significant shift in the composition of imports towards intermediates and capital goods - the share of consumer goods in imports has declined from around 30 per cent in 1970 to below 20 per cent in the 1980s. However this trend reflects increased import dependency and probably hides considerable repressed demand for imported consumer goods. According to the World Bank, imports minus exports as a per cent of GDP have been above 9 per cent for 11 of the past 15 years; it was 10.5 per cent in 1985 and 14.5 per cent in 1986.[2] Value added and production in the manufacturing sector, where investments by parastatals have been concentrated, actually declined between 1976 and 1986, from TSh 3.1 to TSh 1.0 billion (in 1976 prices), a decline of 68 per cent. In addition, the composition of output has not changed significantly towards capital and intermediate goods production despite heavy investment in chemicals, fertilizers, rubber, plastics and metals.

## 2.4 The politics of manufacturing under government license and the discouragement of private enterprise

While the economic consequences of Tanzania's development policy between 1967 and 1986 may have been poor, the experience might be expected to have stimulated the search for alternatives. Unfortunately, a programme of nationalization also has its social impact. One of its effects is to discourage, and in extreme cases, criminalize private accumulation.[3] What was left of the private sector was suddenly placed at a disadvantage relative

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[1] State-owned enterprises would have, in all probability, paid the same taxes if they were privately owned. The World Bank estimates a net transfer on the current account of only TSh 991 million in the five years 1981/82-1985/86 (World Bank, 1989, Parastatals in Tanzania Towards a Reform Program, Report No. 7100-TA, pp. 11-13).

[2] World Bank, 1989, op. cit.

[3] The Leadership Code was introduced to prevent leaders having two incomes. This meant members of the managerial and civil service elite were not supposed to participates in any private business. It was never very successful but it resulted in a stigma being attached to private sector activity. Officials who broke the Code were forced to employ all sorts of indirect means in pursuing their sideline interests.

to the public sector over a whole range of business relationships. This is of particular importance in countries such as Tanzania where the government is pursuing a policy of industrialization through import substitution. Under these conditions, investors rely on the domestic market and a wide range of licenses negotiated with government for their profitability - from quotas on competing imports and favourable treatment by the price controller to import licenses and foreign exchange allocations for the purchase of essential inputs. Overnight, hard won concessions may be lost to the public sector which, by definition, usually has superior political support. People are encouraged to believe that private ownership is suspect, and if anyone is clever enough to accumulate capital, the State is liable to expropriate it. This in turn discourages entrepreneurial investment. As might be expected, there are very few local industrialists today in Tanzania. Equally, there are very few civil servants who have any experience of negotiating with private sector business interests - local or foreign.

### 2.5 The disruption of agriculture: villagization and non-individual ownership

Another argument advanced in support of the Arusha Declaration and, in particular, the policy of villagization or ujamaa vijijini, was that the traditional land-holding systems of communal farming prevalent in Tanzania did not involve individual ownership of land. Cultivation was a man's right within the vicinity of his home village. Therefore, it was argued, greater efficiency could be achieved in agricultural production with little social disruption by the expedient of moving the dispersed rural population into villages with new communal land-holdings, now designated by the State. This concentration of the rural population was supposed to facilitate the delivery of extension and social services. On the contrary this policy led to a progressive decline in agricultural production in the 1970s - the annual growth rate of agricultural GDP declined from 2.4 per cent during 1970-75 to 1.0 per cent during 1976-80.

The poor performance of parastatal marketing boards, expanded to rationalize the marketing and distribution of crops, exacerbated the social disruption caused by villagization by further undermining individual incentives. Fortunately Tanzanian farmers seem to be resilient. With a series of good harvests in the mid-1980s, the transfer of responsibility for crop purchases to primary co-operative unions and the licensing of private traders in agricultural produce, agricultural output has increased sharply to an annual growth rate of 5.4 per cent during 1984-87. The lesson from agriculture seems to be clear - centralized direction of production and marketing does not work well in a large country with a scattered population.

While there has been a retreat from forced villagization, all land is held on a leasehold basis from the State, either 33 or 99 years. This would seem to be one barrier to the development of a freehold property market that could be used for collateral for industrial investments. In its favour, the land tenure system probably discourages over-investment in land and reduces inflationary pressures. Another factor in Tanzania and in many other African countries that inhibits the development of an active property market is the complexity and political sensitivity of property law and its application. This often discourages banks from accepting land titles as collateral for commercial loans.[1]

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[1] For example, in Kenya and Zimbabwe, which otherwise have relatively well-developed financial institutions, property and development companies make up a very important part of the smaller stock markets of South-East Asia and, although often of a very speculative nature, are successful in mobilizing private savings for industrial development.

## 2.6 The political significance of state employees and reduced incentives for efficiency

Another result of state socialism was the creation of a major political constituency - the bureaucratic bourgeoisie - that is dependent on the State and its political leadership.[1] The adoption of state socialism also justifies the incorporation of the trade union movement as a subordinate wing of the ruling party, achieved in 1964 in Tanzania.[2] Paradoxically, one of the features of state socialism, namely the tendency of state institutions in the absence of a price mechanism to suck in scarce resources until physical limits are reached, has worked to undermine the dependency of employees on the State.

Under socialism, the paternalistic state cannot permit a state-owned enterprise to go bankrupt, so there is a tendency for financial constraints to be what Kornai refers to as 'soft'.[3] In theory, more resources will always be found to underwrite the solvency of state institutions, so the rational manager continues to accumulate resources, human and material, until physical scarcities are encountered. In developing countries, shortages of imported inputs and machinery are invariably encountered before those of human resources. There are, however, often shortages of skilled and experienced manpower and attempts by managers to substitute inferior human capital results in additional inefficiencies.

## 2.7 Public sector salary compression and the collapse of work incentives

What has happened in Tanzania, as in many other developing countries, has been severe compression of public sector wages in parallel with substantial expansion of the number of employees. Figure 1 reproduced below demonstrates this effect graphically. By 1984, public sector employment totalled some 302,000 or 77 per cent of formal sector wage employment. While employment in the public sector has increased at around 5 per cent per annum since 1970, the index of real average wages has declined from 100 in 1969 to 19 in 1986. The index for top salaries has declined even more dramatically, to <u>6</u>. Differentials have also been compressed sharply. A top salary that was nearly 30 times the minimum wage in 1969 was only about <u>6</u> times the minimum wage on the 1987-88 pay scale and <u>4</u> times after tax.[4]

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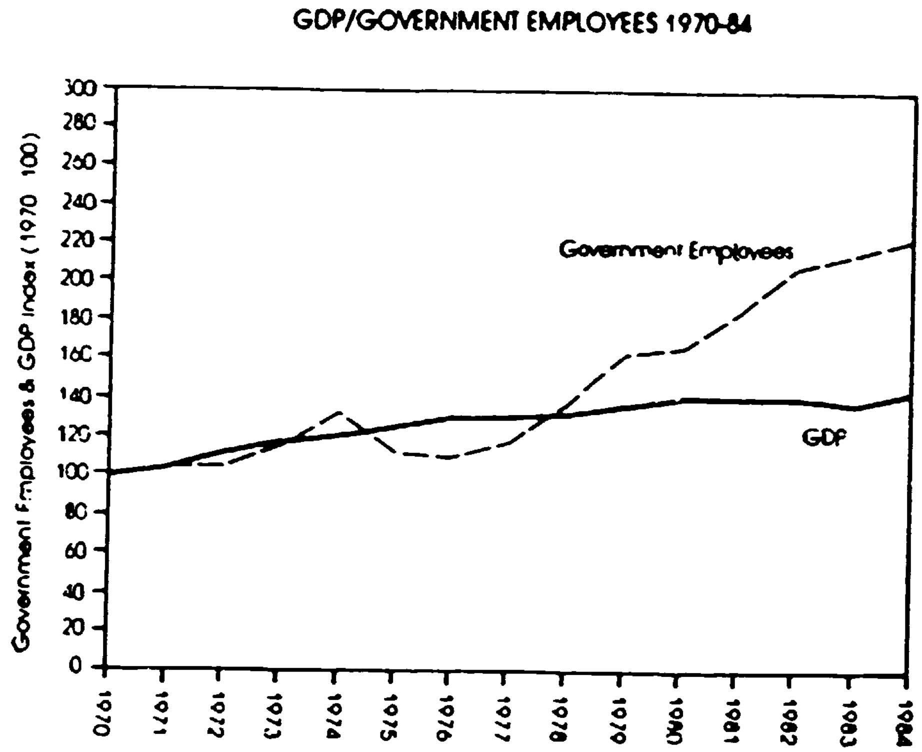
1 See Issa G. Shivji, 1976, <u>Class Struggles in Tanzania</u>, Monthly Review Press, for a full account of this concept.

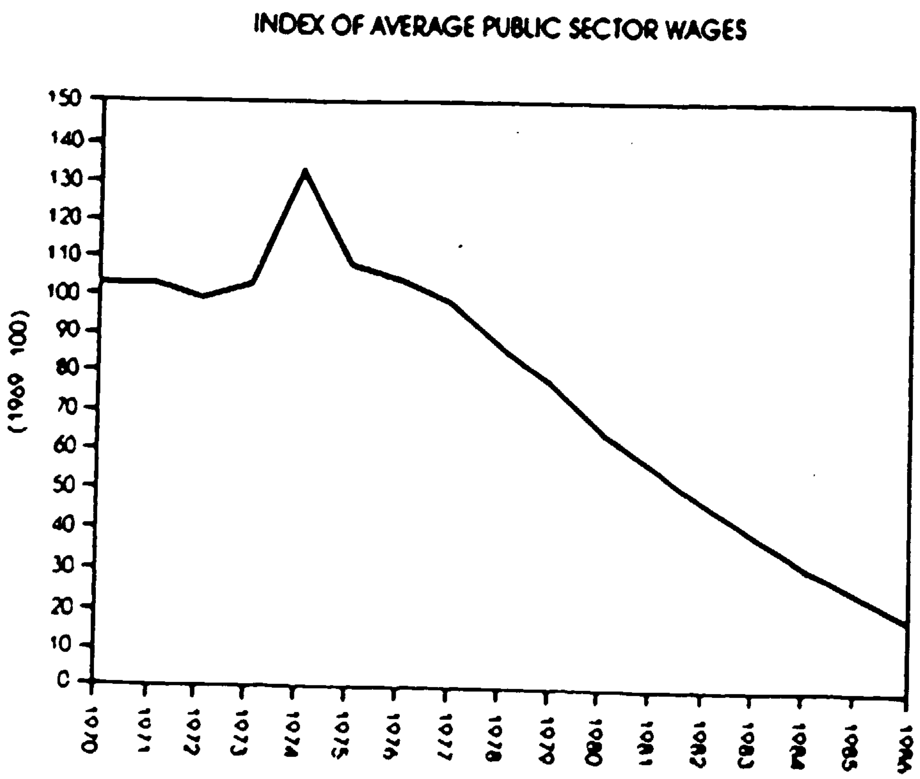
2 The National Union of Tanganyika Workers (Establishment) Act 1964 abolished the independent Tanganyika Federation of Labour and reconstituted the trade union movement as an affiliated organization of the ruling Party, TANU, with nine industrial sections.

3 Janos Kornai, 1980, <u>The Economics of Scarcity</u>, North-Holland.

4 World Bank, 1989, <u>op. cit</u>., p. 55.

Figure 1: Public service expansion and decline of real pay




Source: World Bank, 1989, Public Expenditure Review (PER), Volume II, Technical Report No. 7559-TA, Chart 4, p. 56.

Unsurprisingly, the World Bank's PER found random evidence of departmental supply votes being used to compensate for low pay through benefits in kind. Evidence was also found of attempts to supplement pay of more senior public employees with increased fringe benefits. Middle-level officials seemed to have suffered most over the last ten years. As might be expected, many public servants have alternative sources of income, notwithstanding the Leadership Code. The World Bank's PER proposes a 30 per cent reduction in the number of staff on the payroll of both central and local government.[1]

## 2.8 Public sector retrenchment and possible political resistance

Without substantial retrenchment, it is not clear how the efficiency of the Tanzanian civil service or parastatals can be improved for there is no prospect of a rapid expansion of the Government's revenue base. Also, without sufficient supporting expenditures proper levels of efficiency cannot be obtained. Yet the Government's ambitious plans for an expanding role for the private sector implies increased competition for scarce managerial and technical skills and substantial increases in income inequality generally. Without adequate incentives, those public servants with scarce skills will leave to join the expanding private sector or, will increase the effort they put into income generation from secondary employment to achieve what they consider to be a reasonable income level. Clearly, privatization without retrenchment is also not viable. Doing nothing to reduce public sector employment and failure to increase wage levels will result in increased loss of talent, inefficiency and corruption as those who remain seek to 'tax' those who quit.

In considering possible forms of resistance to liberalization and privatization, it is also necessary to take account of political structures and processes in Tanzania. While a broad analysis of the political debate is beyond the scope of this report, and political factors may be very important, one arena in which argument and resistance may be fierce is in the enterprise itself. It is here that the social consequences of retrenchment are going to be felt and where the losers and winners are going to be concentrated. While real wages may have declined very sharply over the last ten years, some guaranteed income is better than no income and where primary employment often forms the basis of secondary sources of income. Primary employment provides a buffer to absorb the shocks of the more uncertain and competitive secondary labour market. Some argue, however, that because most people already have a 'second line' in the private sector, there is very little ideological attachment to the public sector. The latter, in the popular mind, is synonymous with queues and shortages.

Management are not insensitive to disparities in the labour market and will indulge valued skilled tradesmen in various ways. For example, they may permit them to use the company's machine shop facilities to earn extra income carrying out work on behalf of private companies or individuals. Again where production in parastatal enterprises is subject to sharp fluctuations in capacity utilization with periods of forced idleness due to shortages of energy, water, components or raw materials, management are probably only too willing to relieve the obvious hardship of their workers by turning a blind eye to secondary employment. In other words, public sector employment cannot be assumed to be an individual employee's sole source of income. While those

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[1] World Bank, 1989, Tanzania PER, Volume I: Executive Report, p. 20.

most wanted by newly privatized enterprises will probably have the widest range of secondary sources of income the poorly educated, young, inexperienced and unskilled workers and, therefore, most dispensable will have few alternatives.[1] Moreover, the unskilled are also most likely to have been hired on the basis of the personal recommendations of influential politicians and officials.

## 2.9 Managing retrenchment and management skills

The quality and skills of management undertaking specific privatization exercises will be an important factor in minimizing the political back wash from the process of disposing of parastatals. The Government will have to place heavy reliance on particular enterprise management to oversee the transfer of assets and oversee the restructuring of the labour force. Unfortunately, the World Bank's PER is not very encouraging on the matter of the quality of parastatal management.[2]

> 'Enterprise management is weak as evidenced by the fact that a substantial percentage of managers cannot run their firms with a minimal level of financial discipline. In 1985-86, a third of the parastatals were delinquent in producing basic accounts and of those that did, three-fifths were deficient; of those with clean audits, one-fourth were making losses. Few Tanzanian parastatals carry out regular inventories of their assets, controls over use of credit and cash are weak, records on procurement and transactions with subsidiaries are often missing or incomplete, internal auditing procedures are often weak or non-existent, and allegations and proven instances of fraud, corruption and theft are common .... Good managers exist in Tanzania, but they appear few in number.'

Apparently, twenty years after the Arusha Declaration and the creation of over 410 parastatals, the public sector management cadre is still very weak. Clearly, if the World Bank's PER is correct, a major management development programme is required in support of any privatization programme. UNIDO's recent rehabilitation survey of Tanzania also supports the World Bank's findings about the weaknesses in enterprise management.[3] In addition to an absence of real managerial skills, the UNIDO survey found that many plants had a large number of vacancies in key management positions and at the intermediate level. This is particularly so with respect to production and accounting functions.

Alternatively, the management cadre may be more competent than the World Bank gives it credit for. Present behaviour could be a consequence of the prevailing system of incentives and level of managerial rewards. Being rational people, Tanzanian managers may have decided to devote their energies to other income generating activities to the detriment of their primary employment. There is some evidence to suggest that the bureaucratic and

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[1] In 1980, when the Bureau of Statistics last classified Central Government employees by whether they were 'regular' or 'casual' employees, over 14 per cent or 31,000, were classified as 'casuals'.

[2] World Bank, 1989, PER, pp. 123-25.

[3] The Regeneration of the Tanzanian Manufacturing Industry with Emphasis on Agro-based Industries, especially pp. 156-158, PPD/R.26, 14 June 1989.

hierarchical management structure in parastatals discourages initiative and decision making. However, in the absence of reliable empirical evidence of public sector management motivation and time budgets, it would be foolhardy to make predictions as to the likely outcome of a radical change in the incentive system. More to the point, what evidence there is available does raise some very serious questions about the capacity and motivation of existing managers to carry through an effective privatization programme without substantial investment in management training and incentives.

## 2.10 Trade union attitudes to privatization

Every public corporation employing more than ten workers has to have a Workers' Council that is serviced by JUWATA, the workers' organization affiliated to the Party. Any privatization or retrenchment proposal for a parastatal would have to be considered, at enterprise level, by the Workers' Council and debated within the Management Committee. The functions of the Workers' Council are formally limited to advising a Management Committee. Sixty per cent of committee members are drawn from senior management and outside appointees and up to 40 per cent of members are workers' representatives elected by the Workers' Council. Parastatal management and Government appointees normally command a majority on the enterprise Management Committee but, with the prospect of serious retrenchment, some managers might be tempted to side with the workers' representatives or even organize the opposition.

Theoretically, JUWATA is bound to uphold Chama Cha Mapinduzi (CCM) Party policy. However, as events in Poland have demonstrated, workers may sidestep institutions which do not receive their support. At the present point in time, the general opinion is that JUWATA is not a very significant organization at enterprise level, but it does provide a possible base for organizing opposition to major changes, particularly if policy reforms do not receive full backing from key Party members.[1] So far there has been no clear statement from the government on privatization. At least in formal terms the Arusha Declaration still forms the bedrock of Government policy and acts in various ways to inhibit the trend towards liberalization and privatization.

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[1] Some 7,000 civil servants were laid off between 1983-84 and 1984-85 without any major unrest and this was at a time when the economy was in deep recession. By contrast, Tanzania today is experiencing real per capita economic growth largely as a result of improved agricultural output so that the absorptive capacity of the rural economy should be much greater than in the mid-1980s. However, the World Bank's PER anticipates a reduction of 30 per cent of the public sector payroll of 291,841, that is nearly 90,000 people or over 10 per cent of the total formal sector labour force excluding the Armed Forces.

# *CHAPTER 3*

# *THE ENVIRONMENT FOR PRIVATE INVESTMENT: TANZANIA'S INVESTMENT PROMOTION POLICY*

## 3.1 The move towards economic liberalization, privatization, and the promotion of private investing

The path to economic liberalization has not been smooth. At the same time as the Party and a section of the Government has continued to assert its belief in national plans, the Government with the Ministry of Finance as the lead Ministry has been engaged in developing a progressive liberalization programme since 1982. To be sure, it has taken some time to build up the political and administrative momentum behind this reform programme as evidenced by the protracted negotiations over the SAP with the IMF/World Bank from 1982-85. However, the launch of the Economic Recovery Programme, in June 1986, and subsequent events would seem to indicate the ascendancy of liberalization and reformism over state control and socialism.

Despite the Government's espousal of the Economic Recovery Programme, the CCM propounded its industrial development policy through the Party Programme (1987-2002). This was more or less a reiteration of the BIS of 1975-78. The Party document proposed further development of basic industries such as iron and steel, coal, chemicals, metal and engineering industries. In response, the Government produced the Second Union Five-Year Development Plan (1988-89/1992-93) but this seems to be already largely disregarded in the struggle for economic recovery. Nevertheless, there is some evidence of a continuing rearguard action with the Ministry of Finance and the Bank of Tanzania (BOT) identified as bastions of economic liberalism and the Party as defender of the principles of the Arusha Declaration. The formation of the Planning Commission, in July 1989 outside the Ministry of Finance but in the Union President's Office, would seem to reflect the need to establish an arbiter between those who favour the public sector and those who favour the private sector. Further evidence of continuing debate about the direction of economic policy and its political sensitivity is provided in the proposals contained in the draft IPP. This is discussed below.

## 3.2 The rediscovery of the virtues of private investment

The IPP statement has been the subject of much advance publicity and has been advertised as unambiguous evidence of a change in government policy towards private investors - both local and foreign. A draft of this policy, dated November 1989, was in restricted circulation at the time of the UNIDO mission.

In the opening paragraph, the IPP quotes the Arusha Declaration of 1967, and 'the Nation's commitment to the policy of Socialism and Self-Reliance, under which control of the commanding heights of the economy is vested to the public via the Government, parastatals and co-operative organizations'. It continues 'During the whole period following Independence, foreign investment had played a key role in the development of various sectors of the economy' almost as if the nationalization programme that followed from the Arusha Declaration had not been of any significance. Paragraph 2 reveals the government's recognition of the shift in bargaining power in favour of foreign investors' interests at the expense of host governments as a result of increased competition for inward investment. Tanzania, in particular, has to make good for its post-independence history of nationalization, blocked compensation funds and dividends and reticence towards foreign investors. In the 1990s, the IPP promises that transparency and clarity of investment rules and regulations will characterize the new policy environment.

### 3.3 The Investment Promotion Centre (IPC)

Probably reflecting continuing struggles over liberalization policies between the Government and the Party, the Government is proposing to establish a new Investment Promotion Centre under the Planning Commission.[1] The more usual institutional arrangement is to locate a 'one-stop' investment promotion agency under the Ministry of Finance. This is because the Treasury is the senior economic ministry with executive responsibility for monetary and fiscal policy, the Central Bank and the management of the balance of payments. Any investment agreement involving significant foreign exchange transactions is normally subject to final approval by the Treasury or its agent, the Central Bank. Investment policy in Tanzania is considered to be a politically sensitive (a reversal of longstanding policies associated with the Arusha Declaration and Party Chairman Nyerere) issues. Final decisions on investment policy are made in the President's Office so that Party consent can be obtained to endorse decisions by the executive. Given the existence of this cleavage within Tanzanian politics, it makes political sense to assign responsibility for perhaps the most sensitive aspect of liberalization - IPP - to the Planning Commission. The Commission itself is responsible directly to the President of the Union Government.

While the institutional arrangements may be politically correct it remains to be seen whether this is administratively sensible. Experience elsewhere suggests that the key to success depends on sustained and consistent high-level support. What discourages investors most is being interrogated by a panel of representatives from different ministries all trying to score points off each other by being hypercritical of investment proposals. The unfavourable impression created by this kind of hostile reception may then be compounded by procrastination and indecision in negotiating details of investment agreements. Clearly, a lot will depend on the quality of the working relationship that evolves between the Planning Commission, the Ministry of Finance, the BOT and the relevant sectoral ministries.

The policy advisory functions of the IPC, specified under paragraph 5, are wide and cover: (1) the role, scope and need for investments in Tanzania, (2) the appropriate investment and priorities for the country, (3) the rights and obligations of investors,(4) the economic and financial incentives offered by the government, (5) the security of investment. Judging from the breadth of the IPC's advisory functions it seems clear that the government does not consider the IPP to be the last word on investment policy, rather it expects policy to evolve over time and with changing circumstances.

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[1] The Commission, itself, was only split off from the Ministry of Finance in April 1989 through the Planning Commission Act No. 11 of 1989. It became operational on 1st July 1989 under the President's Office.

## 3.4 Investment priorities

The section that specifies the priority sectors for investment indicates that the Government's preference is for investment by Tanzanians and/or collaborative joint ventures involving the public sector. However, somewhat contradictorily, paragraph 6 of the IPP states that 'foreign and local investors will have as far as possible equal access to all other (non-reserved sector)[1] priority investment areas, and will enjoy comparable incentives under the Investment Promotion Act (to be published in 1990)'. Significantly, the IPP specifically states that the Government 'will not impose any predetermined proportion of equity holding between foreign and local investors' (para 14) though foreign investors are to be excluded from a number of minor service and manufacturing activities where their employed capital remains below US$ 250,000.

Eight priority investment areas are identified by the Government: agriculture and livestock development, tourism, natural resources, mining and petroleum development, manufacturing industries, construction, transport, and transit trade. The IPP, however, makes it clear that the list may be extended by the IPC. In view of Tanzania's daunting infrastructure needs it is eminently sensible that the Government is proposing to open up construction, transport and transit trade to private investors.[2] An obvious omission is the financial services sector currently entirely within the public sector. This is probably to avoid appearing to preempt the outcome of the Presidential Commission of Enquiry into the Monetary and Banking System appointed in April 1988 and due to publish its report in early 1990.[3] Notwithstanding this consideration, further on in the IPP, paragraph 16.3 states:

> 'The Government of Tanzania attaches great importance to the creation of an appropriate domestic banking environment that offers a full range of financial services expected by, and normally available to, competitive investors .... It is expected that the findings of the (Banking Commission) study will pave the way for corrective measures on the current monetary and banking system, including allowing private participation (foreign and local) in banking in order to provide competitive and specialized services like the financing of foreign trade as well as investment promotion.'

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[1] The IPC is to stipulate areas of strategic importance which will be reserved for the public sector. The IPP indicates armaments as an example of a reserved sector.

[2] A sign of serious intent in the transport sector must be the decision of the Government to permit Air Tanzania to wet lease MD-83 aircraft from British Island Airways for the 1989/90 tourist season.

[3] It appears likely that the monopoly of the National Bank of Commerce is to be ended in the near future. It has a reputation for inefficiency, poor internal control and supervision and inadequate use of modern banking methods. It employs in excess of 6,000 staff in over 160 branches nation-wide. Apparently more than half of the branches show losses.

Certainly, one of the severe burdens that many developing countries shackle their manufacturing sector with is an over-regulated, inefficient and predominantly state-owned services sector. Frequently, political priorities and mistaken beliefs about the role of private financial institutions in encouraging capital flight override any consideration of the implications of inefficient financial services for transaction costs. The Tanzanian economy probably suffers from one of the more extreme versions of this syndrome. There is a desperate need for competition in the banking system. The sole commercial bank, the National Bank of Commerce (NBC), operates more as a government department than as an autonomous financial institution so that its lending decisions are too often influenced by political or administrative considerations.

## 3.5 Taxation and foreign exchange provisions

The tax holiday of five years offered to foreign investors is highly competitive with neighbouring countries. For example, Kenya offers no tax holiday for new investors. However corporate taxes remain high: 50 per cent on taxable profits from non-residents' investments and 45 per cent for residents' investments. Withholding taxes are to be reduced to more competitive rates: on dividends, 10 per cent and 5 per cent for non-residents and residents respectively. On royalties, 20 per cent of the gross amount payable and on interest on foreign loans, 20 per cent of interest payable.

The tax on interest payments still seems to be excessive, particularly when it is added to the foreign exchange risk that Tanzania-based companies face. For example, the exchange rate has declined from TSh 120 to 1 US$ in December 1988 to TSh 190 in December 1989. The comparable withholding tax in Kenya is 12.5 per cent and the forex risk is less, around 10 per cent depreciation per annum. While it is understandable why the Government wishes to discourage debt financing and prefers to promote dividend remissions that reflect profit performance, this is to ignore the perceived political risk attached to investment in Tanzania. In any case, there is a well-established trend away from equity investment by foreign companies in what are perceived to be the more risky economies developing world and towards non-equity forms of participation. The tax may merely deter prospective investors. It is by no means certain that loan repayments are necessarily more onerous than dividend streams. There is perhaps a danger that it will signal to foreign investors that the Government wants to retain the option of being able to turn dividend remissions on and off to meet short-term balance of payments problems.

The concessions the Government is offering on indirect taxation are considerable, including customs duty-free imports or duty claw back. These concessions have to be negotiated on a case-by-case basis in relation to the Government's priority areas. The provisions under the export earnings retention scheme are particularly generous. Once confidence has been fully restored in the stability of the new policy environment they should provide a very significant boost towards export-oriented investment. The expansion of the Open General License (OGL) scheme with a World Bank supplementary credit of US$ 60 million has proved an enormous success in removing a serious bottleneck in the supply of capital equipment in support of rehabilitation exercises and reducing shortages of imported inputs. The IPP also anticipates direct servicing of term loans, dividends and other approved remittances through up to 50 per cent of export earnings retention funds. This would appear to imply a discount on official exchange rates equivalent to the withholding tax. Where foreign exchange needs to be rationed, the authorities envisage a system of evaluating the net economic and social benefit of the relevant project in assessing priorities.

### 3.6 The pipeline of blocked funds

One of the most interesting features of the IPP is the provision, should the owner choose, for using blocked external payment arrears or pipeline funds, as they are known in Tanzania, for investment in approved projects. When such funds are used for investment purposes the authorities will re-categorize them as new foreign investment. Presently there is no accurate record of the size of this pipeline - one estimate puts it at US$ 500 million.[1] Originally, it was proposed to include an inducement for investors to bring in new money but it was decided that, in practice, it would be very difficult to take over a company or start up a venture without investing new money.[2] Clearly, determining what exchange rate to use is also a major technical conundrum, for it might well be asked how much should a foreign investor be able to benefit from the over-valued exchange rates of the 1970s and early 1980s in the 1990s. The optimum rate at which pipeline funds can be released into the economy without contributing to inflation, already running at 28 per cent is another technical problem to be solved.[3]

### 3.7 Growth centres and export processing zones (EPZ)

The IPP proposes that Tanzania join the International Centre for Settlement of Investment Disputes and the Multilateral Investment Guarantee Agency. A final provision allows for the designation of growth centres to which will be attached special additional investment incentives. Dodoma, the future capital of Tanzania, is so designated. There is no specific mention of plans to introduce EPZ though clearly it would be possible to create an EPZ scheme by combining the export retention scheme and the growth centre provision.

In sum, recent moves to economic liberalization, and to create an investment climate conducive to private investment, are a step in the right direction. A promising start has been made towards reforming the Government's IPP but further amplification is still required. There is a particular need for technical assistance to assist the development of the institutions required to support the new directions in policy. Special attention needs to be paid to develop policies and procedures for evaluating proposals for licensing and joint ventures and for monitoring their operation.

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[1] USAID is providing technical assistance to the Bank of Tanzania to draw up a comprehensive register of who owes what and to whom.

[2] It appears that some people are already exploring the possibility of selling discounted pipeline funds to interested investors but it remains to be seen whether the BOT will permit the transfer of pipeline funds between individuals or companies.

[3] Otherwise the Government will be in violation of its agreement with the IMF.

# CHAPTER 4
# LIBERALIZATION IN THE AGRICULTURAL PROCESSING SECTOR

## 4.1 Introduction

The processing of agricultural produce is an important activity in Tanzania's economy. Also, as a result of Tanzania's earlier programme of socialist development, the agricultural processing sector contains a significant number of parastatals. However, in recent years agricultural parastatals have been a major financial drain on Tanzanian economy.[1] For example, in 1982 eleven agricultural parastatals lost over TSh 2.2 billion and in the same year accounted for 80 per cent of the total overdraft facilities of the NBC. The parastatals involved with cotton, cashewnuts, sisal, tobacco and tea made substantial losses between 1983 and 1985. Many relied heavily on bank overdrafts to finance their operations, never having had an adequate working capital even when they were first established. In the most extreme case the cotton parastatal in 1983 ran an overdraft of TSh 1.5 billion on total sales of just TSh 726 million and, in 1984, the cashewnut parastatal had an overdraft of TSh 550 million on sales of TSh 370 million. It is not surprising, therefore, that there are at present significant moves towards liberalization in the agricultural processing sector.

There appears now to be a significant trend towards reducing the influence of agricultural marketing boards by restricting their functions to that of a marketing agency and buyer of last resort.[2] Producers now sell to the local primary co-operative which then sells to any willing buyer. This means that private traders are beginning to handle an increasing proportion of marketable crops. Horticultural products have always been marketed on a free trade basis. Oil seed crops were completely liberalized in 1986 and it is planned to privatize all cotton ginneries. The National Milling Corporation still exists as a major buyer but its equipment is in poor condition. It is undergoing a rehabilitation programme funded by the World Bank.

## 4.2 Cashewnuts

Of the twelve cashewnut factories constructed with the aid of World Bank loans in the Mtwara Region in the 1970s, only one is still operational. While it may have been correct of the Bank, in 1988, to blame a large part of the poor performance of agricultural processing parastatals on the effects of an overvalued Tanzanian shilling and the fall in international commodity prices, the question still remains why these factors were not drawn to the

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[1] See, especially pp. 83-84, World Bank, 1988, Parastatals in Tanzania Towards a Reform Program. Report No. 7100-TA.

[2] Agreement was reached between the IMF and the Tanzanian Government, in November 1988, over restricting the role of the National Milling Corporation to that of buyer and seller of last resort.

attention of the authorities or taken account of in evaluating project lending in the 1970s.[1] Other general factors that the Bank's report mentions, such as inefficient stock control and working capital management, clearly reflect deficiencies in internal management that no private enterprise would be able to tolerate for long without risk of bankruptcy.

Specifically, in relation to cashewnut production, factors that have contributed to the collapse of the industry include villagization of agriculture, the abolition of private ownership of cashewnut trees, decline in standards of tree management and the rapid spread of disease among the existing stock. While the World Bank feasibility study estimated a potential output of 250,000 tonnes, the maximum that has ever been achieved was 134,000 tonnes. In the three years 1985-86 to 1987-88 official purchases averaged just over 18,000 tonnes. The World Bank is presently funding a Cashew and Coconut Tree Crops Project in an attempt to revive the industry. If production is increased successfully, cashewnut factories will be available for leasing. Some, at least, are said to be still in working order.

## 4.3 Sugar

A major agricultural processing industry that is causing significant bottlenecks in the food processing industry is sugar refining. Perhaps even more important, sugar is an 'incentive good' for cash crop peasant farmers so that sugar shortages have a knock-on effect on cash crop production. Tanzania's five refineries and associated estates have an installed capacity of 230,000 tonnes but actual output is only 100,000 tonnes and demand is estimated at over 400,000 tonnes. The Ministry of Agriculture estimates it requires an investment of US$ 103 million to rehabilitate estates and refineries. The Dutch Government has offered to fund one-third of this amount. The World Bank's study of the sugar industry approved rehabilitation of four refineries but considered the fifth refinery, the Kagera Sugar Company, to be beyond salvation. It is located near the Ugandan border and was bombed and vandalized during Idi Amin's regime. The refinery has an installed capacity of 58,000 tonnes.

The Government is currently making great efforts to resurrect the Kagera Sugar Company. One of the objections of the Bank was that the nucleus estate required irrigating but could not be sure of reliable electricity supplies. However, a power line has since been installed connecting Kagera to the Ugandan grid. This will permit pumping of water for irrigation of the cane fields. Booker Tate was commissioned to re-examine the project. Their preliminary assessment is that rehabilitation would show an internal rate of return of 17.5 per cent on the £ 50 million required. The Government is presently looking for £ 390,000 to pay for Booker Tate to carry out a full rehabilitation exercise including identifying potential private investors. Kagera could probably export to Rwanda, Southern Uganda and Eastern Zaire but sugar prices are still controlled which could mean that most foreign exchange benefits would go to smugglers.

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[1] World Bank, 1988, op. cit.

## 4.4 Tea

There are a number of other agricultural projects for which the Ministry of Agriculture is seeking foreign finance. The Commonwealth Development Corporation (CDC) has bought a 60 per cent controlling stake in a 1,400 hectare tea estate in the Usambara Mountains for £ 2.7 million from the Tanzania Tea Authority which retains 40 per cent of the equity. The CDC insisted and obtained control of the management of the joint venture. Lonrho also has a tea joint venture in the Southern Highlands, the Mufindi Tea Company in which it holds 75 per cent of the equity. This estate was nationalized in 1967 and Lonrho returned in 1986. Unilever has retained a continuous presence in tea production but runs its estates with no expatriate staff since there has been no remission of dividends for a number of years.

## 4.5 Other Projects

The Commonwealth Secretariat is currently trying to find a joint venture partner to revive Tanganyika Packers, the former Brooke Bond (Unilever) meat packing factory.[1] Another project that is awaiting rehabilitation is the Dodoma wine industry. The Government signed an agreement with Bulgaria but the resources have never materialized. The Dodoma Region can produce two grape harvests per year and wine production would provide a valuable cash crop. Dodoma is singled out in the IPP as a special development area.

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[1] Tanzania currently imports tallow for the manufacture of washing soap, a by-product of the meat packing industry.

# PART II

## MOBILIZING THE PRIVATE SECTOR

Part II presents an in-depth examination of the pre-requisites to mobilize the private sector, especially in terms of the re-orientation of DFIs, financial support, investment promotion, human resource development, information on the nature and extent of the private sector, and the development of action orientated strategies and policies to support the privatization process. Thus, Chapter 5 considers the problems of generating and supplying the venture capital required to finance the rehabilitation of Tanzanian industry. Chapter 6 looks at the experiences of two private sector enterprises to highlight privatization issues. Chapter 7 examines the constraints to further progress towards regeneration of the private sector in Tanzania. Chapter 8 outlines an action plan to facilitate privatization.

# CHAPTER 5

# FINANCING PRIVATIZATION: THE ROLE OF DEVELOPMENT FINANCE INSTITUTIONS IN THE PRIVATIZATION PROCESS

## 5.1 Introduction

A critical pre-requisite for the successful launching of the privatization process in Tanzania is the availability of an adequate supply of funds for financing the restructuring and rehabilitation of manufacturing industry and agricultural processing. In the past, a major share of Tanzania's public investment programme has been allocated to the industrial sector. However, the share of the MIT in the Development Budget has declined sharply, since the adoption of the Structural Adjustment and Economic Recovery Programmes. The allocation of expenditure to the industrial sector declined from TSh 1,482 million in 1980-81 to TSh 1,086 million in 1987-88; 21 per cent and 6.3 per cent of the Development Budget respectively.[1]

The MIT currently has no forward investment plan, so there is an hiatus in government investment proposals for parastatal industry. The World Bank envisages the MIT changing its role, in the longer run, to that of a facilitating agency on lending aid funds to the development banks. The DFIs, in the World Bank's scheme of things, would expand their role to act as the main source of local and foreign capital for firms investing in rehabilitation or expansion. While this arrangement may create a convenient institutional framework for multilateral and bilateral donors it implies a significant transfer of responsibilities from the MIT and enhancement of the capabilities of the DFIs. In this connection, any assessment of the potential for privatization would be incomplete without an evaluation of the current and future role of DFIs in the privatization process. Consequently, this section of the report examines the immediate financial needs of the industrial sector and provides an overview of the current scope and operation of the industrial development banks.

## 5.2 The liquidity crisis and crowding out

Tanzanian industry is currently facing a severe liquidity crisis. Dependence on imported raw materials, intermediate goods and machinery and the sudden, substantial and continuing devaluation of the shilling has put an enormous strain on the cash flow position of enterprises - private and public alike. The 100 per cent cash cover requirement for imports and the credit squeeze imposed by the NBC as part of the IMF's SAP are additional factors that have made it difficult for companies to finance the rehabilitation of their plant. The availability of OGLs has increased competition from imports and it is said that the export retention scheme has encouraged the growth of the parallel market and smuggling putting profit margins under pressure. While the move to a positive interest rate - presently a nominal rate of 32 per cent compared with inflation of around 28 per cent - should improve

[1] World Bank, 1989, <u>Tanzania PER</u>, pp. 132-134.

domestic saving, it is a matter of conjecture whether the need to finance Government expenditure will continue to crowd out all but the most favoured parastatals from access to borrowings.[1]

In the absence of a capital market, credit controls inevitably impact on industry's investment in new equipment and inventory in a crude and undifferentiated manner. Tanzania desperately needs some mechanism by which investors in viable enterprises can raise finance. At the present juncture, there is clear evidence of a long history of the public sector crowding out private borrowing and an institutionalized inability to distinguish between commercially viable investment and inappropriate, 'pet' projects. The World Bank observes:

> 'While there is no official policy discriminating against private credit applicants, the effect of the credit allocation process and access to guarantees by parastatals has been to provide parastatals with most of the credit that is made available at official interest rates, which have been negative in real terms. In addition, parastatals have been able to expand credit through arrears to the banking system with greater impunity than can the private sector.'[2]

The scale of the problem of crowding out is indicated by the proportion of the loan portfolio of the Tanzania Investment Bank (TIB) and the NBC invested in the public sector. At 31 December 1986, 72 per cent of loans outstanding from the TIB and 65 per cent of the loans from the NBC were to the parastatal sector, while the proportion of loans to the private sector were 28 per cent and 13 per cent respectively. The picture is more complex when examined by sector. Seventy-three per cent of NBC lending went to public sector agriculture, while industry received only 12 per cent (31 per cent to the parastatal sector and 69 per cent to private industry) from a total loan portfolio of TSh 35,983 million. The TIB's loan portfolio was different. Sixty-three per cent of the amount outstanding was lent to parastatal industry and 27 per cent to private sector industry. The manufacturing sector as a whole received 61 per cent of loans or TSh 2,504 million.

It is not possible from these figures to deduce whether the demand for long-term loan finance from the private sector is actually repressed or whether the distribution of lending merely reflects the preponderance of large-scale enterprises in the public sector. However, in commenting on the 1985 pretax profit figures of the National Development Corporation (NDC) and associated companies, the World Bank notes the insidious influence of repressed interest rates and over-valued exchange rates on apparent profitability: 'the return on investment (9 per cent) reflect the access of these companies to relatively cheap imports and inexpensive credit'.[3] Since 1985, of course, Tanzania has devalued by 1,120 per cent and introduced positive interest rates causing severe cash flow and loan financing problems

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[1] The brewery and cigarette company head the list of favoured borrowers because of the Government's dependence on tax revenues from beer and tobacco.

[2] World Bank, op. cit., pp. 24-25.

[3] World Bank, 1988, op. cit., p. 81.

for all companies with foreign exchange debts. For example, the textile industry was able to operate profitably in a sellers market until 1985 concentrating on volume production with little concern for quality. With the credit squeeze and the relaxation of import controls, some private companies have found the situation even more difficult to adapt to than public sector firms because of their inferior machinery and inability to borrow.[1]

In large part, the solution to the crowding out problem lies in political will. The consequences of diffuse foreign exchange and credit controls and rising prices are politically less risky than a sharply focused policy that cuts the income of particular groups displaced from the public sector payroll. Having said that, there would still seem to be a clear need for special financial provisions to mitigate the effects of the structural adjustment programme at enterprise level regardless of whether a particular firm happens to be publicly or privately owned. Certainly, a private investor will only be willing to takeover a firm with a reasonable cash flow position and the expectation of receiving a positive return fairly quickly. DFIs suggest themselves as the agencies that ought to be actively involved in evaluating and funding bankable rehabilitation investments on a non-discriminatory basis. In Tanzania, there are two DFIs that lend money to large-scale industry and commerce - the TIB and the Tanganyika Development Finance Company Limited (TDFL).

## 5.3 Tanzania Investment Bank (TIB)

The TIB is currently in a critical condition caught between its own obligations to foreign creditors and its borrowers who are unable to service their loans. At the end of 1986, 54 per cent of its loans to the parastatal sector were in arrears and 27 per cent of loans to the private sector (TSh 1,565 million and TSh 319 million in arrears on the total amount outstanding of TSh 4,080 million). The situation was somewhat better in the manufacturing sector where 40 per cent of loans were outstanding in the parastatal sector and 21 per cent in the private sector. An indication of the impact of devaluation on financial transactions is conveyed by the TIB Annual Report for 1987-88 when US$ 1 = TSh 97.7. Loan approvals net of cancellations and at exchange rates ruling on the respective dates of approval reached TSh 2,647 million, while the cumulative total of loan approvals at exchange rates prevailing on 30 June 1988 was TSh 14,940 million.[2]

Lending operations have been severely curtailed. Thirty-eight long-term loan applications were carried forward from the previous financial year and 8 new ones were received during 1987-88, making a total for consideration of TSh 1,612 millions. Four loans were approved that were worth TSh 361 million. The amount of funds available for new lending paled into insignificance when compared with the provision for doubtful portfolio investments and interest payments. This was entered at TSh 2,723 million.[3] The only new source of finance available to the TIB was a grant of

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[1] The World Bank is carrying out sectoral studies of the textile industry, leather and footwear, oilseed crop processing and the furniture industry. The first study, of the leather and footwear industry, was completed in December 1989 and proposes privatization of the sector.

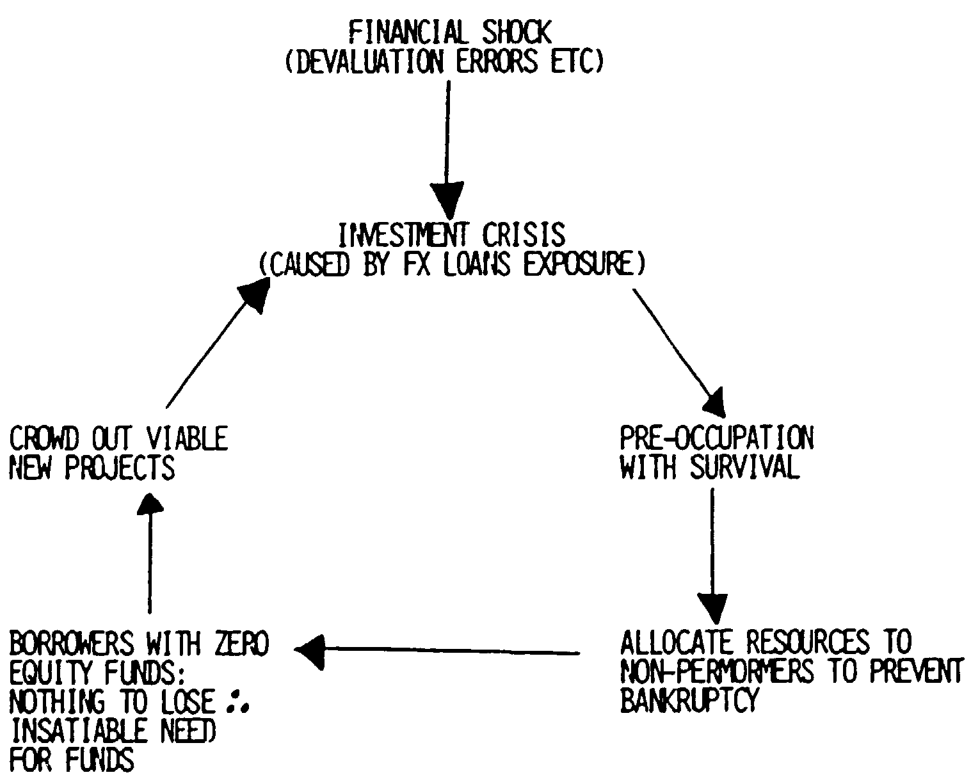
[2] Annual Report, July 1987-June 1988, TIB, p. 9.

[3] TIB Annual Report-1987/88, p. 14.

SKr 35 million from Swedish International Development Authority (SIDA) for rehabilitating export oriented industries and an International Development Organization (IDA) line of credit for paying for appraisal work where necessary. Otherwise it had no new lines of credit.

Under conditions which amount to an internal debt crisis, it is impossible for the TIB to function properly. The TIB is locked into a vicious downward spiral only partly of its own making (see Figure 2).[1] Investment banking tends to be biased towards financing the purchase of capital equipment, particularly when a project is underwritten by a specific donor. When there is a severe credit squeeze, less well-established enterprises with outstanding loans lack sufficient working capital. The final blow, for which conventional project appraisal and sensitivity analysis techniques do not allow, is devaluation of the magnitude that has followed in the wake of the SAP. As a result, TIB lending officials find themselves in a situation where the majority of clients survive hand-to-mouth, on bank overdrafts from the NBC, or indulgence of unpaid contributions to the National Provident Fund and or income taxes, hardly a strong position from which to insist on loan repayments.

**Figure 2: The internal debt crisis of DFIs**

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[1] The problems of one bank may be compounded by the actions of others. For example, there is sometimes poor co-ordination between the TIB, the NBC and the BOT in monitoring corporate clients so that the NBC has lent money to companies in default to the TIB.

The TIB has tried to put pressure on companies to service their loans but, in the last resort, has been reduced to taking companies to court to force them into receivership. There were six cases in process in December 1989. The TIB itself is probably technically bankrupt because very few of its clients are performing on their loans although it continues to declare a modest accounting profit.[1]

## 5.4 Tanganyika Development Finance Company Limited (TDFL)

The TDFL is a joint venture development organization that provides finance in the range US$ 30,000-1,000,000 either in the form of a term loan or a mixture of equity and loan finance. TDFL equity is held by the TIB - 24 per cent; the Commonwealth Development Corporation (CDC) - 16 per cent; the German Finance Company for Investments in Developing Countries (DEG) - 21 per cent; the Netherlands Finance Company for Developing Countries (FMO) - 24 per cent; and the European Investment Bank (EIB) - 15 per cent.[2] The TDFL had 13 per cent of its investments in the form of equity out of a total investment portfolio of TSh 388 millions as at 31 July 1987 compared with the TIB which had only 2.5 per cent of its net portfolio investments in the form of equity out of a total of TSh 1,119 million. The TDFL's equity portfolio includes 48 different companies, compared with the TIB which has equity in 8 companies. Disbursements to new projects amounted to TSh 109 million from the TIB and TSh 23 million from the TDFL in 1986-87 which in US$ terms was trivial.[3] The TDFL's provision for loss of value of investments amounted to TSh 79 million.

Clearly, both the TIB and the TDFL currently lack funds to make a significant contribution to the rehabilitation of Tanzanian industry and therefore to assist in a major way in moves towards privatization. Neither is permitted to take time deposits from investors though this may be permitted after the findings of the Banking Commission are published. In addition, the absence of a financial market in Tanzania makes it difficult for the TDFL to sell off any of its equity holdings. In any case, it is dependent on its few profitable investments to generate funds for its own survival. The issued and fully paid share capital of the TDFL was to have been doubled to TSh 500 million in 1990. The current situation is known at the time of writing this report.

The TDFL Annual Report for 1986-87 records the particular problems of its borrowers as follows:

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[1] The provision for bad debts was sharply increased from TSh 360 million in 1987 to TSh 2,700 million in 1988 though accounting profits increased from TSh 8 million to TSh 92 million.

[2] The European Investment Bank became a reluctant equity holder as a result of capitalizing some of TDFL's debt to the EIB in 1985.

[3] It is very difficult to compare the financial performance of the two DFIs because of the different accounting procedures they follow, in particular, the TIB's annual reports are unclear about the performance of its loan portfolio. The exchange rate for US$ 1 was TSh 52 in December 1986.

> "... most of our portfolio experienced poor liquidity and low production. As a result, for those that made profits, these profits were just marginal and servicing of loans - especially the foreign currency ones - became more difficult. In the process it became necessary for the Company to increase, by over 100 per cent of 1986 levels, provisions against diminution in the value of its investments."

An examination of the reported performance of its investments confirms this dismal picture, in particular, the increasing dependence on debt financing. Thus it is not unusual to find companies with debt equity ratios of over two. In the agricultural and fishing sector the debt - equity ratio ranged from 1.3 to 11 with a weighted average of 7.4.[1] While high debt equity ratios do not indicate the net asset value of companies, they do indicate a reluctance on the part of investors to take out new equity investment and the vulnerability of Tanzanian companies to liquidity crises during recessions.

A modest but important proposal the TDFL is considering is the introduction of an import financing scheme to ease the liquidity problems of firms required to provide 100 per cent cash cover for imports. Without some relief, import-dependent firms with poor capacity utilization and cash flow problems face the prospect of ever decreasing capacity utilization leading eventually to bankruptcy. In the longer term, the TDFL plans to split its new lending roughly two-thirds for rehabilitation and one-third for new projects. While everyone would like to encourage export-oriented investment, most projects are expected to be in import substituting industries. Another trend that is emerging is the view that rehabilitation is a long term process which involves providing a package including financial assistance, consultancy and training services. To this end the TDFL is seeking to expand its consultancy services. Whether private sector clients accept that such services are essential and will be willing to pay for the extra costs themselves is doubtful. There seems to be a good case for donor support for such activities, since it improves the efficiency with which capital is invested, and fosters the long-term credibility of systematic investment appraisal and monitoring procedures. In many industrial economies, this type of activity in support of programmes to finance small businesses is funded through government grants. For example, the Scottish Development Agency relies on government grants to pay for two-thirds of its activities. The remainder of its income is generated from dividends and sale of equity in successful companies.

## 5.5 The development banking crisis

Some might argue that the process by which DFIs become chronically insolvent yet continue to lend good money to loan defaulters arises purely as a consequence of public ownership of major enterprises. Undoubtedly, it is more difficult to distinguish between illiquid and bankrupt projects where there are all kinds of distortions in the economy brought about by state intervention. However, it is rather clear from experience elsewhere in

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[1] The agricultural company with the worst debt equity ratio - 11, Amboni Limited is a subsidiary of Amboni Estates Limited incorporated in the Channel Islands.

Africa that DFIs are subject to enormous pressure regardless of whether the economy is primarily socialist or capitalist. These pressures tend to become unmanageable when exchange rate parities are altered radically. In this regard, the situation in Tanzania is not different to that in other African countries.

As might be expected, there was considerable skepticism in the DFIs about the practicality of privatizing public sector enterprises. The general opinion was that it was not feasible for the majority of Tanzanian parastatal companies in the medium-term. As one person explained, 'There are only losses to command'. Few local private firms, if any, have the financial strength to turn around an ailing parastatal though some might be interested in leasing equipment.

From a banking perspective, the priority appears to be to develop mechanisms for refinancing illiquid but potentially viable firms. This suggests there is a need for a greatly enhanced role for the development banks to act as 'honest brokers' between the public and the private sector. It also implies an enhanced technical and management consulting capacity, for successful rehabilitation depends on careful attention to technical factors, marketing and human resource development, as well as realistic financial provision. Tanzania is presently littered with derelict projects that have failed to take account of the totality of business enterprise.

# *CHAPTER 6*
# *THE PRIVATE SECTOR*

## 6.1 Introduction

A major impediment to the design of appropriate support to the private sector and the privatization process in general is the fact that the nature and extent of the private sector in Tanzania is largely unknown. The World Bank has done some preliminary work in this area but it is not completely satisfactory. For example, the World Bank estimates that private firms generated 53 per cent of both value added and wage employment in the manufacturing sector in 1985.[1] However, there are serious discrepancies in the statistics that purport to describe private sector activity. It would appear that overall investment by the private sector was dwarfed by the parastatal sector until around 1975 when the private sector overtook the parastatal sector. This, of course, does not fit easily with the thesis put forward elsewhere by the World Bank, of 'crowding out' of the private sector by the public sector.[2] The Bank suggests that, either the parallel and unregulated market had developed to such an extent that it stimulated an investment boom in the private sector or, that the true cost of public sector investment is understated in official statistics because of the effect of various subsidies. Either way, it would seem timely to carry out a systematic census of production. Otherwise there will not be a benchmark against which to assess the effects of economic liberalization on the industrial sector.

In order to obtain some feel for the current policy environment from the point of view of the private sector the UNIDO mission made visits to the National Chamber of Commerce and two important private sector firms.[3]

## 6.2 The Tanzania National Chamber of Commerce, Industry and Agriculture

The National Chamber was established by the Government in 1988 as a forum and think-tank to mobilize the private sector behind the new economic policies.[4] It presently has over 600 members. It has been possible to keep membership fees low - TSh 3,000 (US$ 16) - as a result of a grant US$ 1 million over three years from UNDP.

The Government seems to see the Chamber as a means of creating awareness in the private sector of investment opportunities and thereby stimulating new private investment. Previously industrial promotion was left to politicians who went round to various donor agencies with a 'shopping list'. Whether a particular project was funded depended as much on donor interests as on Tanzania's needs, often very little consideration was given

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[1] World Bank, 1988, <u>Parastatals in Tanzania</u>, p. 8.

[2] The Bank's presentation of trends in fix capital formation is unclear. Table A 4.1 on p. 70 does not reconcile with the graphs on p. 5. World Bank, <u>op. cit.</u>, pp. 5 & 70.

[3] See also, <u>The Regeneration of the Tanzanian Manufacturing Industry with Emphasis on Agro-based Industries</u>, PPD/R. 26, 14 June 1989.

[4] The old regional Chambers of Commerce still exist but have tended to disintegrate through lack of resources and access to the authorities.

to the commercial viability of the project. In the new policy environment, the Government's role is to be limited to creating the overall policy framework for investment.[1] The Chamber sees its role as that of an intermediary responsible for identifying and promoting projects in the private sector both locally and overseas. It is perhaps unsurprising that the Chamber is taking a close interest in the appointment of staff to the IPC. It was made clear to the UNIDO mission that the Chamber expected their membership to be well represented on the IPC advisory committee. This seems desirable in order to avoid duplication of investment promotion activities.

The Chamber seems to be constituting itself as a lobby for the indigenous (African) business class which at the moment is very small. Examples of the kinds of issues it is likely to campaign on are: preferential soft loans for Africans; the provision of stock options for African executives employed in Asian and foreign firms; and partial divestment of parastatal assets through the formation of joint ventures that benefit private African interests.

## 6.3 IPP Limited

The IPP group of companies is the largest enterprise owned and managed by indigenous Tanzanians. The managing director started the business with his wife, in 1978, assembling ball point pens in his sitting room. He then progressed to packing liquid detergent and wax polish, manufacturing tissue paper first by converting waste paper then processing pulp. He then obtained the franchise to bottle Coca Cola in the Arusha Region. Subsequently, the plant has received an award from Coca Cola for all-round performance.

The company has recently obtained the license to manufacture toothpaste and soap from Colgate Palmolive. Production of toothpaste is presently restricted to putting paste sourced from Nairobi into tubes but the company is facing fierce competition from parallel imports from Kenya. When finance is available to purchase the necessary plant, it is intended to formulate using locally sourced base materials and import the flavour direct from Colgate. Colgate's Kenyan subsidiary also wanted to export soap chips for tableting in Tanzania but IPP insisted on making soap from tallow. This is currently imported as a result of the collapse of the meat packing industry. The installed soap making capacity will soon be 2 tonnes per hour. The company packages a range of other consumer goods and manufactures furniture and metal products. A glass container factory is being completed to make bottles for soft drinks and the brewery.[2]

The company considers that domestic demand is strong and rising but organizing distribution in the rural areas is difficult. While technical training was provided by the franchising company for new equipment, there was felt to be a need for technician training in rehabilitation skills before IPP would be in a position to contemplate taking over any of the rundown parastatal companies. There was also a need for management training. It was also suggested that the company could benefit from advice on buying industrial equipment and how they might build up their own internal capability to do so in the future.

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[1] World Bank, 1989, PER, pp. 133-134.

[2] The company reported that the OGL system was working smoothly - it takes 3 days. The company required US$ 350,000 for payments to Coca Cola and US$ 1 million per annum to Colgate.

## 6.4 Tropical Foods Limited

This company, located in Dar-es-Salaam, was visited in order to obtain some insight into the operational problems of food processors in Tanzania. The first thing that was very apparent was the key role of the MIT in ensuring the continued operation of private firms. For example, at the time of the mission's visit, there was a sugar shortage in the Dar-es-Salaam region. The MIT was responsible for allocation between users. Again, the company had benefitted from NORAD assistance in purchasing a juice extraction plant on the recommendation of the MIT.

Second, food processors are heavily dependent on monopolistic packaging companies. The inadequacy of supplies of glass containers had prompted the company to install a plastic bottle making facility but this type of packaging was unacceptable in export markets. The metal can manufacturer would only supply up to 3.5 kilo capacity cans, while the export market for orange juice normally requires 200 kilo capacity drums. Third, the duty drawback scheme did not apply to food processors using locally made packaging materials, since the scheme only applied to the primary exporter. Since two-thirds of the cost of canned food was in the packaging this represented a significant loss in competitiveness.

Fourth, there still remained severe problems with the supply of water and electricity. This could be particularly damaging for the food processing industry if failures of supply occurred during harvest periods.[1] The company claimed that on occasions it had achieved 60-70 per cent capacity utilization but, on average, it had only been possible to achieve 35 per cent over the year. Management said that local demand was sufficient to justify running the canning lines on a 24-hour, three-shift basis during harvest seasons if all inputs were available. In addition to water and power supply problems, the company was only receiving 30 tonnes of preserving sugar a month while they need 200 tonnes for three-shift working. Labour flexibility was not a constraint on production. The company retained 50 permanent employees and could draw on up to 200 casual workers when raw material supplies permitted full capacity operation.

The company's management believed the market had become significantly more competitive since the introduction of the liberalization programme. It had encouraged them to innovate with disposable packaging materials and new product lines. When asked about whether they were interested in taking over any of the parastatal canning firms, it did not seem that they were actively assessing any particular company. However, it was indicated that they might be interested in a joint venture arrangement or sub-contracting production of their excess demand to enable the company to extend its product range. It was pointed out that with the currently prevailing commercial interest rate of 32 per cent the company would expect a minimum financial rate of return of 50 per cent on any new investment.

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[1] During the mission's visit the company had ceased production due to the failure of water supplies. Fresh produce that had been delivered that morning was rotting in the yard.

## 6.5 Are the needs of the private sector different from the public sector?

Clearly, it is dangerous to seek to generalize on the basis of very limited evidence from only two private sector firms. However, what was most striking was the extent to which both companies were dependent on various forms of government rationing and monopolistic suppliers of intermediate goods. Where there are shortages in an economy either the Government has to intervene and ration or the price of the shortage good rises. From the point of view of the consumer of intermediate inputs, where local production is highly concentrated and monopolistic, but where demand by international standards is minute, it is unclear whether they are better off relying on the price mechanism to suck in imports or government rationing of what local supplies are available.

The World Bank and the IMF's preferred solution is to reduce government intervention, to rationalize import tariffs, and to maintain positive interest rates and realistic exchange rate based on purchasing power parity. The price mechanism is then supposed to deal with problems of 'shortages'. Unfortunately this set of policies does not allow for the political objectives of key decision makers nor their concern for maintaining social cohesion and political legitimacy. Put simply, politicians are expected to be able to deal with shortages. Nor does it take account of the monopolistic power of many suppliers and producers that is a function of actual availability of inputs and outputs at the factory gate and in the local Tanzanian market. It is no consolation to the factory manager of a Dar-es-Salaam food processing firm to know that preserving sugar is available on the world market if no one is willing to deliver it to his factory. He expects the Government to do something about it. This raises some of the more general issues of the meaning of liberalization and privatization in the context of a developing country such as Tanzania.

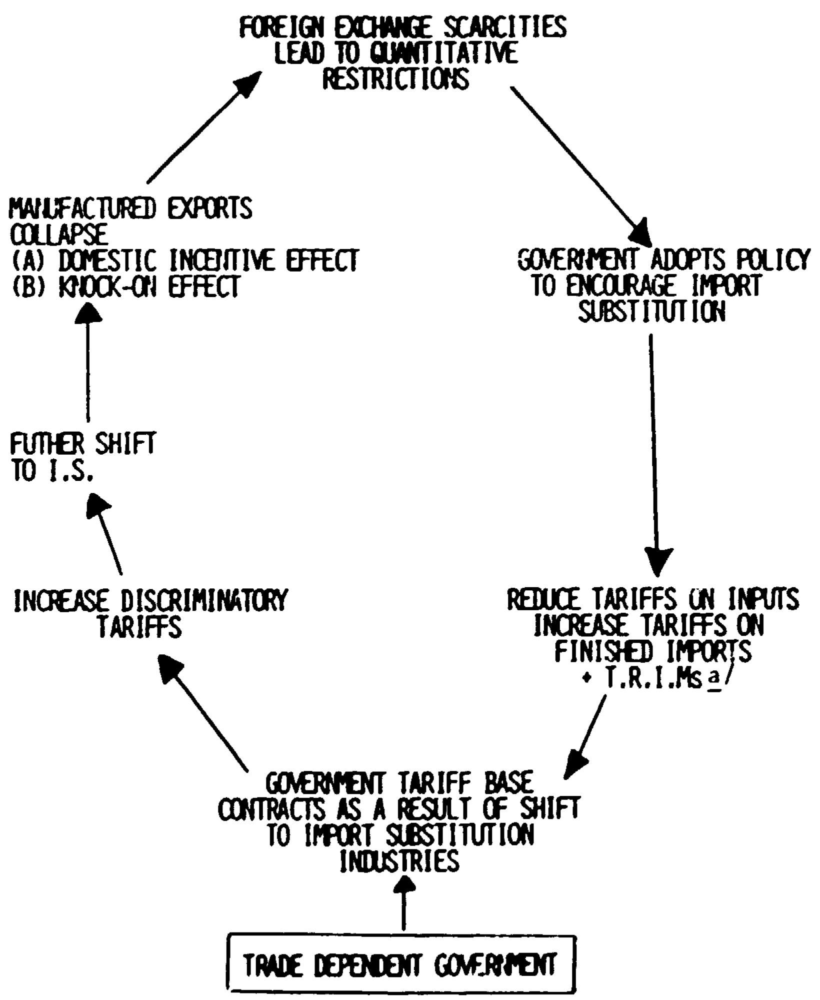
# CHAPTER 7
# LIBERALIZATION, PRIVATIZATION AND REHABILITATION OF TANZANIAN INDUSTRY

## 7.1 Import substituting industrialization and indebtedness

In the debate about the failures of Tanzania's industrialization policy most attention has been focused on the role of public ownership and the quality of public sector management. Relatively little attention has been paid to the underlying policy of Import Substitution Based Industrialization (ISI) and the implications of that policy for liberalization and privatization. The limited evidence gathered on the private sector for this report raises some rather disquieting questions about the supposed 'liberality' of the policy environment in which the private sector operates.

The cases of illiberality in an economy pursuing industrialization through ISI are straightforward. The dynamics of an import substituting industrialization policy are outlined in Figure 3. The diagram shows clearly the way in which an ISI policy creates its own shortages and pressures on the authorities to introduce discriminatory tariffs and, ultimately, rationing of import licenses. These in turn encourage the growth of smuggling and corruption of the licensing procedures.

**Figure 3:**
**<u>The dynamics of an import substituting industrialization policy</u>**




a/ Trade Related Investment Measures

At present, the OGL system financed under the SAP is relieving the pressure on the authorities. It is a matter of conjecture as to how long the OGL scheme is sustainable. If privatization proceeds on a significant scale, this implies substantial re-investment in capital equipment and increased capacity utilization. While some of the re-equipment costs may be externally financed, the new private investment will also contribute to increased imports of raw materials and intermediates.

Moreover, the Government is going to find it extremely difficult to persuade local or foreign investors to buy public sector enterprises without offering some concessions on import protection. Once these are conceded, privatization merely means the transfer of monopolistic privilege from public servants to private citizens. While private firms may be expected to exploit these privileges with greater vigour than their predecessors, the fundamental structural problems of industrialization based on import substitution will remain. The only way such a policy can be sustained is through expanding the export base which is primarily agricultural or through increased donor support. While there may be some opportunities for the development of export-oriented manufacturing industry, they are likely to be limited in the short to medium term.

## 7.2 Financing privatization

One of the main political factors that contributed to the initial popularity of the Arusha Declaration was the way it was presented as a solution to the problem of establishing national control of the 'commanding heights' of the economy. The problem still remains. There are not enough indigenous Tanzanians with the financial resources to takeover more than a very small proportion of parastatal enterprises. Most enterprises that are successfully privatized will be joint ventures between private interests (local and or foreign) and quasi-public portfolio investors such as the National Insurance Company (NIC) the state insurance monopoly and the National Provident Fund (NPF) and the DFIs. Foreign investors are likely to insist in some Tanzanian owned equity.

The problem, then, is how to open up the public sector to new capital investment in a way that reflects whether a project is truly bankable. Where profitability of an import substituting parastatal depends substantially on government protection and licenses, valuation of assets is going to be very difficult. It is essential that the project appraisal process is 'ring fenced' from political interference yet existing institutions are organized for just that purpose, as all projects involving parastatals need ultimately to be approved by the Planning Commission and CCM. Experience in other African countries of DFIs lending to the private sector is not very encouraging. Too often, public investment funds are squandered on 'privately sponsored' white elephants. This suggests that scarce investment appraisal and financial management skills should initially be concentrated in the development banks and also that NIC and NPF should create supervisory committees to oversee the use to which the DFIs put their investment funds. A further requirement of the DFIs and the recipients of investment funds must be the provision of enhanced management accounting and information systems.

One view of privatization is that the key issue from the point of view of the Government is one of finance. In the absence of any alternative way of rehabilitating industry, private share ownership is acceptable. Thus, if the financial requirements to turn an enterprise around is so large that the State's share declines below 50 per cent then loss of control is no longer an issue. Ultimately, ownership is not as important as exposing managers to the pressures of the marketplace and providing them with the incentives to respond to those pressures.

While it is not possible to anticipate the outcome of the Presidential Banking Commission, there is an obvious need for substantial improvements in the capacity and capabilities of the DFIs if they are to take on prime lending responsibility for the rehabilitation of Tanzania industry. Technical assistance is most needed in providing expertise in evaluating the commercial viability of projects. Indeed much of the evaluation work is likely to take the form of consultancy to existing enterprises focusing on business plans relating to marketing, production and human resource development. UNIDO could play a major role in this regard.

Institutions such as the African Management Services Company (AMSCO) and the Industry Council for Development Services (ICDS) suggest themselves as sources of expertise in what amounts to venture capital management. The DEG has also created an interesting agency to provide support for rehabilitation investment called Project Rehabilitation Fund Limited (PREFUND). These various institutions are designed to respond to the need for a package of measures to turn around enterprises facing a wide range of difficulties right across sub-Saharan Africa. The TIB and the TDFL need to establish counterpart capabilities.[1]

## 7.3 Joint ventures

There are a few joint ventures involving foreign investors operating in Tanzania. However, since dividends have been blocked for several years, it seems most likely that profits have been obtained through transfer pricing arrangements need careful auditing by the IPC to discourage foreign partners from obtaining profits off the balance sheet. Of course, if dividends and fees are blocked because of a balance of payments crisis it would be unreasonable to expect investors to accept the situation passively. It would be particularly perverse of the authorities to seek to attract foreign investment because of foreign exchange shortages and the urgent need to rehabilitate machinery, and then to impose a block on remission of the process of those investments.

Foreign partners in joint ventures are likely to insist on majority control because of the perceived political risk attached to investing in the Tanzanian economy. Instability in the exchange rate and continuing import dependence makes it very difficult to estimate long run costs and bankability of projects. However, as the Government is dependent on trade taxes, local ISI is always taxed but, with liberalization, competition from imports is not always on a fair basis. Imported goods may be smuggled in duty free. A few potentially highly lucrative companies such as the brewery and the cigarette company, where the Government is an implicit stake holder through its tax take, might sensibly be auctioned off to the highest international bidder. Without an open competition there is a strong probability of private individuals collecting substantial rents.

Alternatively, various kinds of non-equity forms of participation may be attractive, particularly licensing manufacture of branded consumer products and management contracts. Increases in the number of these so-called new forms of investment will make substantial new demands on the

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[1] DEG, in co-operation with EEC and other donors, has also set up a similar PREFUND company to assist in funding diagnosed rehabilitation needs in Kenya. PREFUND is part of the Rehabilitation Advisory Services (RAS) concept. See, The UNIDO Integrated Approach to Rehabilitation in Africa, PPD.168, 10 July 1990.

regulatory agencies. Once mistakes have been made, it is notoriously difficult to eradicate them because precedents have been established. Hence, it is important that manpower and administrative arrangements are developed and in place as soon as possible, if Tanzania is to create a positive investment environment that yields optimum benefits for the national economy.

## 7.4 Experience of rehabilitation exercises

There is now widespread recognition of the need for investment in rehabilitating existing projects because of the short-term requirements for immediate income. Exercises have to be focused both on the hardware - capital equipment and financial structure - and on the brainware - human resource development. There is clear evidence of failures of both hardware and software. Part of the fault, many agencies argue, is that project funding has been overly biased towards hardware and not enough attention has been paid to management development. Local management styles have tended to oscillate from relaxed to authoritarian as organizations lurched from calm to crisis. As a consequence, it has proved difficult to sustain financial controls and maintenance programmes have not been adhered to. Nevertheless, Tanzanian engineers have a good reputation for being able to improvise when machines breakdown.

It must also be borne in mind that studies of technical assistance programmes in Tanzania have highlighted a general failure to develop independent parastatal companies that are capable of self-sustained growth. At the same time, almost all parastatals in Tanzania have been assisted by donors either in the preparatory and pre-investment stage or in actual project implementation. This implies that in many cases foreign technical assistance personnel must take a substantial part of the blame for managerial failures in parastatals. Moreover, as Ngowi points out, it is hardly reasonable to expect Tanzanians to rush forward to assume full managerial responsibilities from expatriates who may earn more than 100 times what their local counterparts earn.[1] In short, it is vital to design rehabilitation programmes that discourage the continuing dependence of enterprises on donor inputs and that adequate consideration is given to the transition to self-reliant existence.

Technical inputs to rehabilitate plants have generally been successful. For example, SIDA has assisted with the rehabilitation of the Tanzanian Portland Cement Company by funding a consulting company to manage the company on a five-year contract. Output has increased from 100,000 tonnes to 380,000 tonnes, capacity utilization is now averaging around 70 per cent and the company is trading at a profit - TSh 169 million in 1987. Attempts to persuade the holding company, Saruji Limited, to rationalize cement production and distribution in the country as a whole have been less successful. So far Saruji has not produced a long-term financial plan and doubts remain about the company's ability to continue the re-investment programme when Swedish aid ends. Both the TIB and the TDFL are involved in the loan financing of the company.

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[1] See D. Ngowi, January 1989, Parastatals in Tanzania: An Assessment. A study commissioned for USAID/Tanzania, for a fuller account of technical assistance in parastatals.

Another rehabilitation project which has been funded by SIDA through TIB and TDFL is Zana za Kilimo, an agricultural tools company, in Mbeya. This has been less successful, returning a trading loss of over TSh 50 million in 1987. Attempts to restructure the financing of the company and sell off surplus machinery are currently stalled in the holding company, the National Development Corporation (NDC). SIDA has also been involved in rehabilitating the constituent companies of Tanzania Karatasi Associated Industries (TKAI). The group's liquidity has been eroded by the Government's failure to pay its debts to the two operating companies, Printpak and NPC, which print the English language newspaper and the Party Kiswahili newspaper. SIDA has notified the MIT that it will withdraw support for further rehabilitation unless debts are paid. The third company in the group, Kibo, which makes packaging materials is operating profitably but suffers from periodic shortages of water and waste paper at its paper mill.

SIDA's experience with funding rehabilitation projects suggests that parastatal holding companies inhibit reform programmes. The World Bank goes further and recommends dissolving all holding companies. While the Government recognizes there is a need to increase the autonomy of parastatal operating companies and reduce political and administrative interference, it remains the case that sectoral policy has to be managed. Given the likelihood of continuing shortages and infrastructure failure, this latter concern is understandable but suggests a more focused regulatory role for the MIT. The relationship between the MIT and the Planning Commission will also have to be worked out.

As seems likely, there is going to be a continuing need for technical assistance in support of industrial rehabilitation, it is very important that the MIT develops an enhanced capability to effectively evaluate donor proposals. UNIDO may be able to assist in this regard. Otherwise many of the mistakes incurred when projects were originated will be repeated. In particular, it is essential that contracts should be tied to stated and sustainable objectives. While it may be expedient, in the short term, to rely on donors to cover recurrent costs and maintenance, in the longer term it will merely replicate past problems of dependency.

## 7.5 Manpower issues

It is generally agreed that there are presently very few Tanzanian industrialists. Clearly rehabilitation and privatization implies a massive manpower development programme in support of enterprises that are left to fend for themselves in a liberal market. For example, the World Bank in its criticisms of the weak information and accounting systems prevalent in the parastatal sector, observed that one of the bottlenecks in any effort to improve industrial efficiency was the shortage of trained accountants. There were only 145 authorized auditors and 382 authorized accountants in 1986.[1]

A variety of projects have been undertaken on different aspects of manpower development in Tanzania by donor agencies but there would appear to have been little inter-agency co-ordination in the past. Many of the benefits of training have been lost as a result of public sector organizations distributing training opportunities as a fringe benefit for poorly paid staff. In an indictment of training efforts by technical

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1 World Bank, 1988, Parastatals in Tanzania, pp. 30-31. The [illegible]ounts of more than 100 parastatals were more than two years overdu[illegible] [illegible]ry year between 1982-83 and 1985-86.

assistance personnel interviewed, only 58 or 17 per cent had any responsibility for training, local staff manpower development or institution building.[1] The same NORDIC study also found that 63 per cent of technical assistance personnel were filling jobs for which there was local manpower available but parastatals were precluded from offering the going rate. Privatization might be expected to improve this unsatisfactory situation, but Forss et. al. are probably underestimating widespread repressed demand for high level manpower.

Some agencies are making moves towards supporting management training. USAID experience of offering two year university level training in management suggests that the private sector is generally unwilling to release staff for lengthy periods so that local management development provisions are more appropriate. USAID is presently designing a programme to assess some of the training needs of the private sector and develop courses through the Faculty of Commerce and the Centre of Continuing Education of the University of Dar-es-Salaam.

At the present time, there is a strong case to be made for the Government with the support of UNDP, UNIDO, ILO and other relevant international agencies to draw up a manpower development programme in support of moves towards liberalization and privatization. This programme could then be used as a basis for co-ordinating a donor conference to organize execution of the programme.

## 7.6 Support for the Investment Promotion Centre (IPC)

There is an urgent requirement for support for enhancing the capacity and capabilities of the IPC. Staff need to be trained in the appropriate appraisal and negotiating skills. A legal adviser needs to be appointed to the Centre. Senior staff would benefit from a study tour of successful investment promotion agencies in order to familiarize the elves with appropriate internal management arrangements for promoting investment and supporting existing investors.

Other agencies centrally involved in inward investment also urgently require staff training inputs. For example, mechanisms for careful and sensitive monitoring of transfer pricing need to be introduced. Presumably the BOT has responsibility for this activity. The various kinds of agreements involving foreign exchange transactions - royalty agreements, technology licensing and management services contracts - all require evaluation and monitoring by the IPC. Again it is vital that the division of responsibility for the control of payments is worked out between the central bank and the IPC. External technical assistance is required to examine the training needed and institutional development required to support the new IPP.

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[1] See K. Forss et. al., June 1987, Evaluation of the Effectiveness of Technical Assistance Personnel. Study commissioned by NORDIC Countries. Also S.M. Wangwe et. al., September 1985, Management Contracts and Transfer of Skills. Study commissioned by the Tanzania Investment Bank.

# ANNEX

## List of principal organizations, companies and individuals contacted during the UNIDO mission to Tanzania, December 1989

| Organization/company | Individual(s) met |
|---|---|
| **I. Government departments and parastatals** | |
| Ministry of Industry and Trade | J.G. Mrema, Senior Industrial Economist |
| Ministry of Agriculture & Livestock Development | W. Ngirwa, Assistant Commissioner, Planning and Marketing |
| The Planning Commission President's Office | R. Mhagama, Deputy Permanent Secretary and Deputy Secretary |
| Bank of Tanzania | L.H. Mkila, Manager, External Debt Department |
| | M. Mbonella, Manager, External Trade Department |
| National Chamber of Commerce, Industry and Agriculture | B.C. Mwenda, Executive Director |
| Tanzania Investment Bank | W.A. Mlaki, Director of Project Supervision |
| | J.L. Magoma, Manager, Technical Assistance Department |
| Tanganyika Development Finance Company Limited | M. Zenker, Director of Special Mission |
| Tanzania Industrial Studies and and Consulting Organization | J.E. Msaki, Director, Division of Engineering Consultancy |
| **II. Private companies** | |
| IPP Limited | W. Malekia, Deputy Managing Director, Commercial |
| K. Agency International Ltd. | H.N. Kida, Managing Director |
| Tropical Foods Limited | K.D. Tripathi, General Manager |

## III. Embassy and development co-operation representatives

| | |
|---|---|
| British High Commission | R.J. Smith, First Secretary, (Development) |
| Swedish International Development Agency | C. Leijon, Senior Programme Officer, Industry |
| United States of America Agency for International Development | D. Ngowi, Economist<br>P. Hjelt |
| World Bank | D. Phillips, Economist |
| Commonwealth Development Corporation | N.C. Payne, Representative |
| Deutsche Finanzierungsgesellschaft für Beteiligungen in Entwicklungsländern GmbH (DEG) | W.P. Diller, Regional Manager |

## IV. Mission from Industry Council for Development, New York

| | |
|---|---|
| Industrial Council for Development Director New York | W.W. Simons, Executive |
| Unilever Plc, London, UK | G. Jones, Member, Overseas Regional Management Department, Africa and Middle East Group |
| Packages Limited, Lahore, Pakistan | T. Hamid, Director and General Manager |