Institutional Reforms to Attract Foreign Direct Investments (FDIs) as a Strategy for Economic Growth
What has Tanzania done?

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INTRODUCTION

> "From Namibia to Ethiopia, from Sri Lanka to Columbia, I have encountered the same question from bewildered government officials: How do we get more foreign investment to come to **our**[1] country?"
>
> Louis T. Wells, Jr. (Harvard Business School).

Most countries have recognized the importance of FDI inflows for their economic growth, poverty alleviation and development in general. FDIs are widely acknowledged to be crucial engines of growth especially in the developing countries. It is recognized that FDIs are capable of creating employment, transferring technology, increasing government revenues and contribute positively to the capital formation process of host economies (Ngowi; 2002). As a result of these and other potentially positive roles that FDIs can play in host economies many countries wish to attract more FDIs.

The would-be host economies need to make various efforts to attract more FDIs. This is because FDIs are scarce relative to the demand for them. Countries have to compete for the limited FDI projects from Multinational Enterprises (MNEs)[2]. Those countries that choose appropriate strategies to attract FDIs are more likely to succeed than those, which do not. There are several approaches/strategies to attract more FDIs into a country. This work focuses on institutional reforms as one of these important strategies. It documents some institutional reforms that have been undertaken in Tanzania as a strategy to attract more FDIs which are engines of economic growth.

FOREIGN DIRECT INVESTMENT

FDI is an investment made to acquire a lasting interest in a foreign enterprise with the purpose of having an effective voice in its management. It is an investment in business of another country, which often takes the form of setting up local production facilities or the purchase of existing business.

FDIs are normally undertaken by MNEs in different countries. They may take the form of new investments, also known as green field investments. Alternatively they may take the form of acquisitions of existing projects through mergers and acquisitions (M&A).

FDIs IN TANZANIA

FDI is still in its infancy in Tanzania. It is still a relatively new concept in this country which had a socialist orientation until in the recent past (early last decade or so). Efforts in the past have been

[1] Bold and underline are the author's own addition to emphasize.
[2] Also known as Transnational Corporations (TNCs) or simply multinationals. The terms will be used interchangeably in this work to mean one and the same thing unless otherwise specified.

made by the Tanzanian government to attract more investments from abroad. The early intention of the government was shown in 1963. Foreign Investment Act was passed in order to persuade FDI in the newly independent Tanganyika – the then name of mainland Tanzania before the 1964 union with the island of Zanzibar (Green, 1982). Such efforts were somewhat unsuccessful since the government opted for a socialist path of economic development.

This socialist policy decision led to the implementation of the political manifesto called the Arusha Declaration in 1967. The Ministerial Order under the Industrial (Acquisition) Act Number 5 of 1967 required all Multinational Enterprises (MNEs) operating in the country as well as big private businesses owned by Tanzanias in Mainland Tanzania to make the government of Tanzania the majority shareholder of such companies. Hence, from 1967 to 1972 the majority of the MNEs and big local companies operating in Tanzania since independence were nationalized. The Public Corporations Act Number 17 of 1969 was created to put all nationalized companies under the government control and management.

There were minimal FDI activities taking place in Tanzania between 1970 and 1985. The majority of the investments were made by the State directly or indirectly. By 1980 there were about 400 public owned corporations and companies. The majority of these were owned by the Tanzanian government with 100 per cent shares. In some of them it owned between 49 and 100 per cent. Foreign investors owned the rest of the shares in companies that needed large capital investments. Examples of such companies include the Tanzania – Italia Petroleum Refinery Company Ltd (TIPER); Aluminium Africa; Shell and British Petroleum (BP).

The revival of the foreign investment attraction came in 1985 when, among other things, Tanzania found that it could not cope with the ailing and ill-managed public enterprises and companies. Deliberate economic liberalization policies were initiated and implemented. Reforms in the financial institutions; public sector; civil service; and other areas were made and are still underway to fine-tune the attraction of FDIs in the country. A law was passed in 1997 in order to promote local and foreign investments in the country. (See National Investment Act 1997).

FDI OVERVIEW IN TANZANIA

FDI Flows

BOT, NBS and TIC (2001: 9) gives the following official estimated FDI flows (in Million US$) in Tanzania for the period 1992 – 2000.

Table 1 FDI flows

Year	1992	1993	1994	1995	1996	1997	1998	1999	2000
FDI inflows	12.0	20.0	50.0	150.0	148.0	157.8	172.2	183.4	192.8

Source: Bank of Tanzania.

The table shows an increase in FDI inflows into Tanzania over time. This can be attributed to, inter-alia, the many reforms that have been initiated and implemented. The monetary value of FDI inflows into Tanzania increased sixteen-fold from US$ 47 million in 1990 to US$ 768 million by 2000.(ibid) FDI volume in Tanzania.

According Tanzania Investment Centre data, 854 FDI projects were approved in Tanzania between 1990 and September 2000. Of these, 683 (79.98%) were executed.

Sectoral distribution of FDI projects in Tanzania.

BOT, NBS and TIC (2001) survey found that FDI stocks are skewed in favour of mining (about 40% in 1999), manufacturing (22%) and tourism (13%). See Ngowi (2002) for details.

Geographical distribution of FDIs in Tanzania.

According to BOT, NBS and TIC (2001: xii), by the end of 1999, over 75% of FDI stock was found to be located in Dar-Es-Salaam, Mwanza, Shinyanga and Arusha regions. Pull factors in Dar es

Salaam include the fact that most of privatized manufacturing companies are located there. Pull factors for Mwanza and Shinyanga include endowments of mineral deposits that attract mining companies, and Lake Victoria which attracts fish processing companies.

FDI DETERMINANTS

Institutions and institutional reforms are discussed in this paper as among the essential FDI determinants. FDI determinants are the factors that determine or influence FDI inflows into a given geographical location. They give investors the confidence needed to invest in foreign markets.

UNCTAD's 1998 World Investment Report presents some host country FDI determinants. These include:

Policy framework for FDI: Economic, political and social stability; Rules regulating entry and operations (of FDIs); Standard of treatment of foreign affiliates; Policies on functioning and structure of the markets; International agreement on FDI; Privatization policy; Trade policy (tariffs and non-tariff barriers and coherence of FDI and trade policy; Tax policy.

Economic Determinants include: Business facilitation; Investment promotion (including image-building and investment-generating activities and investment –facilitating services); Investment incentives; Hassle costs (related to corruption and administrative efficiency); Social amenities (for example quality of life) and After-investment services.

ECONOMIC GROWTH

Economic growth refers to the growth of real output of a nation over time. It is usually measured in terms of an increase in real Gross National Product (GNP) or Gross Domestic Product (GDP) over time or an increase in income per head over time. FDIs are said to be engines of economic growth because they have great potential to increase a country's GDP thereby contributing positively to poverty reduction and development in general, ceteris paribus.

INSTITUTIONS AND INSTITUTIONAL REFORMS

" …However, the level of transaction costs depends on the institutions in a country, its legal system, its political system, its culture and so on. This is why we must include the influence of these institutions in our study of the working of an economic system"
Ronald Coase
(Newsletter of The International Society for New Institutional Economics, Spring 1998)

This subsection borrows much from the perspective and challenge of Ronald Coase' Institute (www.coase.org), Shaffer (1995) and Douglas North's ideas on institutions and institutional reforms. Institutions are the formal and informal rules which govern or at least influence the behavior of participants of a society as they interact in political and economic activities. They include such things as laws, customs and social norms. The formal rules include laws and regulations as interpreted and enforced by political authority. The informal rules are the shared beliefs about acceptable and unacceptable behavior enforced by conscience, a result of socialization, based upon the actual and expected reactions of other members of the society. Both the formal and informal rules reflect or embody views about fairness, legitimacy, good and evil, right and wrong.

It is the author's view that institutional reforms, meaning a planned and purposeful change of institutions, are extremely important in reducing transaction costs of, among others, investors. A country should reform its institutions as frequently as possible so as to reflect the changing realities of time. In this work a focus is placed on the role of institutional reforms in attracting more FDI inflows. FDI is a relatively new phenomenon that is closely related and necessary part of the current globalization phenomenon. If countries are to benefit from this relatively new phenomenon, they have to reform their institutions.

The institutions should be reformed in a way that will influence the behaviour (decision-making) of MNEs that carry out FDIs in a way that will lead to more FDI inflows into reforming countries. Institutional reforms should result in reduced transaction costs for investors in the reforming countries. This in turn should be seen as incentive by MNEs to locate their investments and/or retain them in these countries

Reforms, whether social, political, structural or economical should aim at creating, maintaining and improving enabling environment for businesses. Among the elements of economic reforms that may lead to attraction of more FDI inflows include relaxation of entry restrictions in various sectors; deregulation in various industries; abolition of price controls; privatization; independence of the central bank; elimination of import licensing; removal of: foreign exchange-, exchange rate- and interest rate controls; easing of controls over mergers and acquisitions (M&As) and trade policies.

INSTITUTIONAL REFORMS TO ATTRACT FDIS IN TANZANIA

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

Tanzania has implemented many far-reaching reforms in the political system; economic management; and government administration. In 1992, a multiparty democracy system was introduced and successful multiparty elections were held in 1995 and 2000 and hopefully in 2005. Tanzania is in the midst of implementing some of these far-reaching reforms in its economic management

The economic reform programmes that commenced in 1986 have converted the command-based economy into a market one. Trade-, exchange rates- and interest rates are now fully liberalized. The reform of parastatals has privatized/divested about half of the more than 400 parastatals. (See the Parastatal Sector Reform Commission – PSRC – at www.psrctz.org for details).

The public sector service reform has cut down the workforce in government from 355,000 (1992) to 270,000 (1997); rationalized and streamlined functions and structures and salaries; introduced new management systems (performance/output/contract- based); and strengthened local government through the formulation and implementation of Local Government Reform Programme.

EVIDENCE FOR THE INSTITUTIONAL REFORMS IN TANZANIA

In what follows some of the institutional reforms that have taken place in Tanzania with the aim of attracting more FDI inflows are given and elaborated. Needless to say, the list is not exhaustive and cannot and should not be so in a limited paper of this nature.

Privatization

From Pass et all (2000: 220) we learn that privatization is the denationalization of an industry, transferring it from public to private ownership. The extent of state ownership depends on political ideology. In centrally planned economy there would be more nationalization while under private-enterprise economy there would be little or no nationalisation at all.

Under privatization there is free enterprise over state control. Firms are more likely to allocate resources more efficiently and effectively than in a bureaucratic state monopoly. As a result of this institutional reform in the form of privatization policy of parastatals Tanzania has privatized/divested about half of the more than 400 parastatals. (See the Parastatal Sector Reform Commission – PSRC – at www.psrctz.org for details). Most of these privatized firms have been acquired by foreign investors in the form of mergers and acquisitions (M&As). See Ngowi (2002) for details.

Reforms in the Political System

Political situation in the-would be FDI destination is among the important FDI determinants. This includes political stability and democratic system. Among the investors' measurement of this is to look on whether a country has multiparty or single party democracy. In 1992, a multiparty democracy system was introduced in Tanzania. Successful multiparty elections were held in 1995 and 2000 and hopefully in October 2005.

Reform from Command-based Economy into a Market One

May be of all institutional reforms to attract more FDI inflows into Tanzania, this is the greatest of all. It virtually encompasses all other reforms that are necessary for FDI inflows. Tanzania has practiced controlled economy since 1967 under the Arusha Declaration policy that placed the ownership and control of all major economic activities under the public sector. Under this regime the free interplay of the market forces of supply and demand was not allowed. Without this important institutional reform that now allows, supports and cherishes the private and most importantly, foreign ownership of the major economic activities the question of FDI inflows into this former socialist country would be impossible.

Reforms in the Trade Regime

Tanzania has greatly liberalized its trade regime. Both internal and external trades are fully liberalized. For example, there is now liberalization on both import and export trade. The import and export procedures, rules, regulations and laws are increasingly being simplified. This too is among the important institutional reforms to attract more FDIs into Tanzania. Trade liberalization is one of the important FDI determinants. Among other things, it increases the possibility of smooth and convenient availability of imported factor inputs and export of FDI produced goods and services. Included in the trade regime reform too, is the partial liberalization of the financial account in Tanzania.

Reforms in the Exchange Rates and Interest Rates

Before the ongoing institutional reforms, exchange rates and interest rates in Tanzania were controlled by the monetary authorities of the country – the Bank of Tanzania. These were in most cases artificially and politically determined and fixed. There was no free interplay of the market forces of supply and demand in their determination as is the case today. Now that liberalized exchange- and interest rates are among the important FDI determinants, it is evident that Tanzania has gone a long way in this particular institutional reform to attract more FDI inflows.

Public Sector Services Reform

Before the current institutional reforms, the public sector was typically characterized by over-employment; ghost employees; unrationalised and unstreamlined functions, structures and salaries; performance was not output-based and the local governments were weak. All these resulted to, inter alia, inefficient public sector. Transaction costs of dealing with generally inefficient, bureaucratic and huge public sectors are normally higher than if the sector was otherwise. The role of institutional reforms in the form of public sector reform in order to attract more FDI inflows can therefore not be underestimated.

The public sector reform in Tanzania so far has cut down the workforce in government from 355,000 (1992) to 270,000 (1997); rationalized and streamlined functions and structures and salaries; introduced new management systems (performance/output/contract- based); and strengthened local government through the formulation and implementation of Local Government Reform Programme. All these are expected to play important direct and indirect roles in attracting more FDIs into Tanzania as they essentially contribute to creating, improving and maintaining conducive investment climate.

Establishment of Tanzania Investment Centre (TIC)

Institutional reforms in the sense of changing existing rules, laws and regulations to new ones can be discussed in our context in the case of establishment of the Tanzania Investment Centre. In order to attract more FDIs into Tanzania the government, in 1997, changed the law establishing the then Investment Promotion Centre into one forming the Tanzania Investment Centre. This is a major institutional reform as TIC is more capable of attracting more FDIs given the other institutional changes that have been made in order to make TIC a truly One Stop Shop for investors as described below in the extract from its website. (www.tic.co.tz)

Tanzania Investment Centre (TIC) was established in 1997 by the Tanzania Investment Act No. 26 of 1997 to be *"the primary agency of Government to coordinate, encourage, promote and facilitate investment in Tanzania and to advise the Government on investment related matters"*. All Government departments and agencies are required by law to cooperate fully with TIC in facilitating investors. TIC is the focal point for investors. It is a first point of call for potential investors. It is an efficient and effective investment promotion agency, a "One Stop Facilitative Centre for all investors", engaging in the business of marketing Tanzania as an investment destination.
As a primary agency of the Government in all investment matters, TIC is charged with the following functions: -

- Assist in establishment of enterprises e.g. incorporation and registration of enterprises;
- Obtain necessary licenses, work permits, visas, approvals, facilities or services;
- Sort out any administrative barriers confronting both local and foreign investments;
- Promote both foreign and local investment activities;
- Secure investment sites and assist investors to establish EPZ projects;
- Grant Certificates of Incentives, investment guarantees and register technology agreements for all investments, which are over and above US$ 300,000 and US$ 100,000 for foreign and local investments respectively;
- Provide and disseminate up to date information on existing investment opportunities, benefits or incentives available to investors; and
- Assist all investors whether or not registered by TIC.

In order to strengthen and expedite facilitation services, eight (8) Senior Officers from Government or its Executive Agencies have been permanently stationed at TIC to serve investors under the general direction of the TIC Executive Director. Presently these officers include those from: -

Lands Department; Tanzania Revenue Authority (TRA); Immigration Department; Labour Division; Directorate of Trade and Business Registration & Licensing Agency (BRELA).

From what has been presented above it is clear those institutional reforms in the form of establishing the TIC is an important strategy in attracting more FDIs into Tanzania.

Establishment of Export Processing Zones (EPZs)

Export Processing Zones (EPZs) is a trade policy instrument used to stimulate export-oriented economic activities and to build an export culture. It reduces the relatively high transaction costs facing exporting firms as compared to those operating in the domestic market. It eliminates the need for initial investment in infrastructure and limits capital investments to machinery and equipment (URT; 2003: 130). This is among the FDI determinants that attempts to compensate investors for distortions in an economy pending the emergence of an efficient market system. According to URT (2003: 132) Zanzibar had three EPZs in 2003. A new EPZ has been established in Dar Es Salaam (Ubungo) recently.

CONCLUSION

From what has been presented above, it is clear that Tanzania has undertaken a number of institutional reforms to attract more FDI inflows into the country and retaining those already there. The reforms have created a better investment climate/environment in the country by, among other things, reducing transaction costs for investors. It is evident therefore that institutions matter in determining economic behaviour and performance of agents in the economy. The need to reform institutions so that they reflect the changing social, political, economic and technological realities in time and space, among others therefore cannot be over-emphasised and should not be underestimated.

Policy Recommendations

The author recommends the following to policy and decision makers: There is a need for stakeholders to understand and appreciate the role of institutions in economics in general and their reforms in attracting FDIs. This can be done through sensitisation seminars, conferences, training and workshops. There is also a need to frequently reforms institutions in order to reflect the prevailing situation.

Recommendations for Further Studies

Due to resource limitations this paper has been limited in coverage. Of the many institutional reforms that Tanzania has undertaken, only few ones have been presented in a nutshell in this paper. Further research could cover the same reforms presented here but in more detailed way. Alternatively other reforms that have not been covered here could be added in the list. The study could also be extended to detailed case studies where investors explain the role of different institutional reforms in their investment decisions.

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