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The business environment in Tanzania after socialism: challenges of reforming banks, parastatals, taxation and the civil service

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ABSTRACT

In the process of structural adjustment and economic liberalisation, former strong socialist sub-Saharan African countries are experiencing additional challenges in their efforts to develop the private sector, compared to those that had relatively market oriented economies. Tanzania is known for its past strong socialist orientation. This article assesses the country's effort to reform the banking system, state owned enterprises, taxation system and the public services sector, and the emergence of the private sector. Comparisons are made where relevant with the experiences from transition economies in Eastern Europe.

Major reforms have taken place in all the sub-sectors, and there is significant increase in the participation by the private sector in the economy with increased production. Private banks have increased from zero in 1994 to thirteen in 1998. Over 40 per cent of former state owned enterprises have been divested, 50 per cent of which were sold. Some are performing well, contributing to government income and reversing the drain through subsidy. The taxation system has improved. It now recognises the role played by the private sector and has introduced new mechanisms to collect taxes e.g., VAT, and plugging tax evasion loopholes. Private sector investment has increased and major developments are notable in mining and tourism.

Although the overall impact of liberalisation on the areas examined has been positive, significant weaknesses remain, especially in the regulatory frameworks required to prevent abuses of their position by private enterprises. Both corruption and an uncertain legal environment inhibit the realisation of benefits from reform. The 'trickle down' of welfare to poorer sections of society has been inadequate, as has the extension of financial services to small

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businesses and rural areas. Further public investment is required, especially in health, education and infrastructure.

INTRODUCTION

Following the Arusha Declaration in 1967, Tanzania under Nyerere launched a socialist development agenda, guided by an 'African Socialist' philosophy and characterised by policies based on extensive state control of the economy. These policies are now widely blamed for the productivity downswing and macroeconomic imbalance. Excessive state control negatively affected what seemed to be well-thought-out economic plans and social organisation under President Nyerere (Hodd 1988; Baregu 1993; Basu & Morrisey 1993; Hyden & Karlstrom 1993; Boesen *et al.* 1986).

The extent of government control was greater than in any other country in sub-Saharan Africa. The starting point for the introduction of market reforms in Tanzania is different from that in Kenya, Uganda, Zambia, or even Ghana and Nigeria. Tanzania was a strongly centrally planned African economy with a minute involvement by the private sector. A state monopoly characterised Tanzania's economic management. Production by small farmers was strictly under communal rural groupings called *ujamaa* villages. Produce by these small farmers was marketed either by 'top-down-created' co-operatives or state owned crop authorities. Hence, agricultural producers were implicitly contract farmers to the government. Their earnings were a residual price, derived from world market prices (for export crops) or retail prices (for domestic food crops), less marketing costs, taxes, and any other deductions deemed necessary by the government. Deductions included those offering explicit or implicit subsidies to urban dwellers (see e.g. Ellis 1983).

Major commercial investments in all the other sectors and utilities were owned by the state. Private sector involvement was limited to retail business, which was mainly identified with Tanzanians of Asian origin, found in the city and town centres. Even at this level, state owned Regional Trading Companies (commonly known by the acronym RTCs) posed great competition against small private firms in the regions, districts and villages (Lofchie & Callaghy, 1996).

There was thus severe suppression of the private sector. The government and specifically civil servants considered private entrepreneurs to be *mabepari* (capitalist exploiters). Any element of business acumen or profit-seeking effort was dubbed *ulanguzi* (conmanship).

Wealth accumulation, or being rich, was frowned on. The civil service went all out to control the private sector. The nationalisations of the 1970s and impromptu rounding-up of retail traders (e.g. the 1983 'Operation Walanguzi') were suppressive and sent a discouraging message to the business community. As Heilman and Lucas (1997) put it, Tanzania became an economy 'whose entrepreneurial class has been stunted by decades of anti-business policies'. Hiding transactions, non-compliance with government directives, evading tax, and bribing to get licences and permits became pre-requisite skills to do business in the country.

To make matters worse, public enterprises performed badly. They demonstrated great inefficiencies, made large losses and drained government revenue that could have been allocated to social services (Lipumba 1984; Boesen *et al.* 1986). Consequently, provision of welfare services such as education and health deteriorated. Most of the schools and health centres built and widely popularised in the 1970s became unsustainable. In the late 1970s, these services received support through international aid and loans, part of which contributed to the country's large external debt (see Rugumamu 1997 for patterns of aid to Tanzania in this period).

The bad performance of parastatals became a disincentive to other production entities and society as a whole. The domestic market had a scarcity of essential commodities. Town dwellers especially became accustomed to rationed essential commodities, partly a strategy to contain unrest. 'Virtually all basic household goods including clothing, soap, edible oils, sugar, salt, batteries, kerosene, corrugated iron sheets, soft drinks, beer and cigarettes were scarce or non existent' (Sharpley 1985: 85). In the wake of reforms, Collier and Gunning (1990a, 1990b) attribute the observed increase in production by small farmers following partial liberalisation in 1986 as simply a response to availability of consumer commodities (radios, bicycles, clothes, etc.) in the shops. With respect to the business environment, what Tanzania needed by the mid-1980s was not simply an adjustment but an overhaul and a complete structural transformation.

Since 1986, the government has been undertaking broad-ranging formal economic reforms including the Economic Recovery Programmes I and II supported by the International Monetary Fund (IMF) and the World Bank (WB). The government has worked to dismantle the system of state control and promote private sector expansion. The first stage entailed adjustment and stabilisation measures – mainly focusing on fiscal management and putting in place monetary policy instead of financial planning. This article focuses on the second round, i.e. liberalisation, particularly the emergence of institutions in financial markets, taxation, and the civil service, and changes in state owned enterprises.

It has been common in many reform studies to consider policy changes and correlate these with developments in production sectors (agriculture, manufacturing etc.) and emerging macroeconomic indicators to deduce their overall impact. Such approaches often fail to account fully for what takes place in the process. As correctly noted by the World Bank (1996), reforms through liberalisation, privatisation and stabilisation are not enough to create a vibrant economy. Building on such reforms requires major consolidating strategies to develop strong market supporting institutions, and to encourage the political economy environment in which they operate. We here attempt to explore in detail operational changes in regulatory and institutional mechanisms that affect the development of a private sector. These are (i) the banking system; (ii) the state enterprises sector and its privatisation; (iii) the taxation system; and (iv) the civil service sector; we then consider the political economy environment. We deliberately do not present the data by production sectors, but draw useful insights from them into our discussion.

THE FINANCIAL SYSTEM: FROM FINANCIAL PLANNING TO MARKET FINANCE

The financial system in socialist Tanzania was very narrow. It essentially comprised: (a) the Bank of Tanzania (the central bank); (b) three state-owned commercial banks (The National Bank of Commerce, The Co-operative and Rural Development Bank (1986), and the Peoples Bank of Zanzibar); (c) three state-owned development finance institutions (Tanzania Development Finance, Tanzania Investment Bank and Tanzania Housing Bank); and (d) state-owned non-bank financial institutions (e.g. the National Insurance Corporation and the National Provident Fund).

This system survived even after the 1986 reforms and up to 1992. Only three banks had the task of providing regular financial services to the business sector. The rest were highly specialised and sector specific institutions. Furthermore, the government controlled the financial system and the banks functioned as fiscal agents of the government for all practical purposes, rather than as providers of services to depositors and borrowers. The quality of services given to depositors was poor,

TABLE 1

Comparison of commercial banks before and after socialism

1992	1998	Assets US$mill	Assets %
National Bank of Commerce	National Bank of Commerce (1997)	494·68	34·4
Coop and Rural Dev. Bank	National Micro-Finance	208·57	14·5
Peoples Bank of Zanzibar	Peoples Bank of Zanzibar	18·84	1·3
	CitiBank	136·92	9·5
	CRDB (1996)	229·41	15·9
	Diamond Trust Bank	15·67	1·1
	Eurafrican	14·32	1·0
	Greenland	10·55	0·7
	Kilimanjaro Co-operative	2·51	0·2
	Stanbic	115·58	8·1
	Standard Chartered	142·92	9·9
	Trust Bank	32·28	2·2
	Akiba Commercial	3·85	0·3
	Exim Bank	7·20	0·5
	Kenya Commercial	3·04	0·2
		1,436·34	100

Figures converted from TSh at US$1 = TSh 680.
Source: Bank of Tanzania (1998).

characterised by long waiting times at the counter, negative real interest rates and lack of secrecy. Clearance time exceeded 45 days for up-country cheques and took up to three weeks for those transacted within Dar-es-Salaam. Customer account management systems were unsatisfactory and the manual system was riddled with mistakes (USAID/PWC, 1998).

The solution adopted for these problems was to liberalise the financial system. This involved opening up the market to new, local and foreign banks, and deregulating interest rates and foreign exchange control. The first reform measure was the enactment of the Banking and Financial Institutions Act of 1991, which essentially removed barriers to entry by private and foreign banks. Interestingly, not much happened until follow-up legislation was put in place in the shape of the Foreign Exchange Act of 1992, the Foreign Exchange Control Ordinance Act of 1992, and guidelines for operation of Bureaux de Change. These paved the way for development of the sector. Following these later changes, thirteen commercial banks both foreign and locally owned, opened branches in the country (Table 1).

The NBC, still the largest commercial bank in the country, is under divestiture process, has been split into two banks and is scheduled for full privatisation by the year 2000. The former Co-operative and Rural Development Bank has been very successfully privatised. It is now named CRDB Bank Ltd. Its ownership constitutes over 11,000 shareholders, with private individuals holding 41·1 per cent, co-operatives 16·5 per cent, private companies 13·9 per cent, and DANIDA 28·5 per cent. DANIDA is a Danish development agency that has also provided managerial technical assistance and supported the installation of a new IT system. CRDB Bank Ltd. was prepared to float 684,000 shares for public trading at the Dar-es-Salaam stock exchange in 1999/2000. The bank has twenty-one branches, spread all over the country. It has managed to open two up-country branches and an additional one in the capital city since its privatisation and is recording profits.

Citibank, Eurafrica, Greenland, Stanbic, Standard Chartered and Kenya Commercial are all wings of foreign banks. They have branches mainly in Dar-es-Salaam and the two relatively commercial up-country towns of Arusha and Mwanza. The significance of each bank in the market is indicated by its share of the total assets of commercial banks in the economy (see Table 1). The others (Diamond Trust Bank, Akiba Commercial, Exim Bank and the Kilimanjaro Co-operative Bank) are new private local banks.

The Kilimanjaro Co-operative Bank (KCB) is a new model of rural financial institution in Tanzania. It is an up-country bank fully owned by coffee growers on the slopes of Mt. Kilimanjaro. Shareholders are farmers, primary cooperative societies, and regional apex cooperatives. It has managed to mobilise savings effectively. It also employs various non-conventional banking practices to serve its customers, such as the use of local leaders to screen borrowers, input credit and human capacity development at ambulatory Savings and Credit Societies (see Temu 1999 for further details). Concerning up-country banks, there are also three registered community banks in Kilimanjaro, Mbeya and Arusha. These are not included in Table 1 because they have yet to meet the minimum capital requirement for a commercial bank. Liberalisation has thus opened up room for innovation in designing alternative financial institutions for rural areas; there is however some way to go, because the current coverage is still limited. It is now clearly recognised that conventional banks do not suit rural financial markets, and that reforms are opening doors for institutional innovations to cater for this market. This is a healthy development and was not possible under socialism.

TABLE 2

Trends of development indicators in the financial sector

	1992	1994	1995	1996	1997	1998
Number of licensed commercial banks	3	11	12	12	15	16
Number of state banks privatised	0	0	0	1	1	1
Number of days taking to clear cheques	45 (21)	14 (10)	14 (10)	14 (7)	7 (3)	7 (3)
Forex Inter-bank Mean Exchange Rate US$/TSh		335	523	558	600	665
Ratio of commercial loan to total assets (per cent)				15·7	18·9	Est 20

Figures in brackets are for Dar-es-Salaam.
Source: Bank of Tanzania (1998).

The broadened range of operating banks has instilled a sense of competition and there is evidence that the sector is improving (see Table 2). Customer services have improved and banks have upgraded their information technology. Counter services have improved in all banks and waiting times have fallen from 2 to 3 hours to 30 to 10 minutes. The time needed to clear cheques has fallen significantly from 45 days to a week up-country, and three days in Dar-es-Salaam (USAID/PWC, 1998; BoT 1998).

Among other changes, lending to previously troubled parastatals has stopped, and the Loan and Advances Realisation Trust (LART) has been established, designed specifically to bear responsibility for and collect bad debts so as to relieve banks (NBC and CRDB) for reform and privatisation. Interest rates are by and large determined by market forces and have adjusted to more realistic values (Table 3). A close look at interest rate spread, particularly for 1995/96 (the year of real opening-up), suggests that the market became less efficient, which is counter-intuitive. The reality is that interest rates were not market determined in 1993. In the wake of the reforms, the spread widened to reflect a more commercial position. Over the last three years, the spread has been narrowing and the trend towards enhanced efficiency is clear, thanks also to the steadily falling rate of inflation, reaching a single digit (7 per cent) by the end of 1999 (BoT 1999).

The stock market has started operations with selling of shares for two enrolled companies. This is at a very early stage of development, and there is a close link between development of the stock market and

TABLE 3
Tanzania: Interest Rate Structure and Trend (per cent)

Year/Type	1992	1993	1994	1995	1996	1999	1998
Central Bank: Discount	22	22–27	27–67	39–50	15–40	11–20	15–20
Savings	26	24	24–26	15–27	11–22	7–23	20–22·5
Short term lending	16	16	16–19	13–33	2–33	3·5–13·53	5–13
Fixed: 3–6 months	17–30	22–25	17–30	15–35	8–34	2·5–29	4–12
Lending: short term	18–31	22–31	28–39	28–45	28–46	21–28	15–25
Medium and long term	29–31	21–39	24–39	31–90	29–38	21–32	20–32
Inflation Rate	–	–	25	33	28	20	12

Source: Bank of Tanzania (1998).

TABLE 4
Exchange Rates (TSh per US$)

	Informal	Bureau	Official
1992	480–580	414	335
1998 (Nov.)	–	662	665

Source: Bank of Tanzania – various Issues (1990–1998).

privatisation. The listed firms (Tanzania Oxygen Co. Ltd. and Tanzania Breweries Ltd.) and those scheduled to join soon (e.g. CRDB Bank and Tanzania Cigarette Company) are all products of the on-going divestiture.

Foreign exchange is now available with no restrictions. One improvement in this area has been the introduction of the Inter-Bank Foreign Exchange Market (IFEM) since 1994. Since then, foreign exchange trade between banks has been increasing steadily. For example, there was an 8·2 per cent increase in inter-bank foreign exchange trade between 1997 and 1998 alone (USAID/PWC 1998). A relatively simple indication of the success of the measures geared towards unifying exchange rates is the absence of black market foreign exchange dealers on the streets of Dar-es-Salaam (see also Table 4 for trends). There is also an apparent indifference amongst the business community to receiving payments in either dollars or shillings.

Liberalisation has also led to the establishment of venture capital funds. The Tanzania Venture Capital Fund was launched in 1993 with a capitalisation of US$ 7·6 million. Investors include the Com-

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monwealth Development Corporation (CDC-UK), the Tanzania National Provident Fund, Proparco and Swedfund. Its management is under Equity Investment Management Ltd. USAID/PWC (1998) reports that the fund is fully disbursed and performance is good. Other smaller funds include the Fedha fund with a capital of Tsh. 0·9 billion and Tanzania Social Action Fund (TSh. 0·6 million). These trust funds are viewed as an alternative source of capital for local investors who cannot access commercial bank loans.

The Bank of Tanzania (BoT) Act of 1995 streamlined the role of BoT (the central bank) and empowered it with a single policy objective of price stability and supervisory power over financial institutions. In the past, BoT had diverse responsibilities including fiscal tasks. Since 1996/97, a monetary policy review has been tabled in parliament once a year. A set of new market-oriented monetary policy instruments (e.g. repurchase agreements and seasonal credit instruments) has been introduced. BoT workers have been trained, their job descriptions streamlined, and their remuneration, autonomy and working environment improved.

Consequently, bank supervision and regulation has improved. Testimony to this is the way BoT has handled three cases of bank failure. It managed to liquidate the bankrupt state-owned THB, and ensured clients incurred no losses. BoT also handled prudently the failures of two foreign banks (the South African Meridian Biao and the Ugandan Greenland Bank). In both cases, BoT managed to read warning signs and intervened early enough to preserve clients' interests. Needless to say, each of the failures raised some anxieties. However, BoT's swift response to early signs of problems and protection of depositor's interests has instilled confidence in the country.

In general, a more market driven financial system is emerging, and this is a healthy development for the private sector and business community. The four recommendations made by the World Bank (1996) on how to go about developing a financial system have been adhered to: strengthening existing institutions, inviting in new ones, reinforcing the regulatory system, and putting in place an effective supervision mechanism.

Current challenges in the financial sector

The first stage of the financial sector liberalisation has been satisfactory. However, it is apparent that services are still biased, available to only few areas, and accessible mainly by the larger trade and commercial entities. Small and micro enterprises both in rural and urban areas still face access difficulties. In early 1999, the media reported President Mkapa directing the Dar-es-Salaam city commission and the regional commissioner's office to establish a Community Bank to serve small enterprises (*The Guardian*, 17 March 1999). This is testimony to the frustration caused by confined services currently provided by banks. The level of lending as a percentage of total bank assets is still low, indicating the low number of credit-worthy customers and the selective nature of the banks in dealing with risk. The savings ratio in Tanzania is also very low at 6 per cent of GDP (BoT 1998). Other countries have managed ratios as high as 40 per cent.

Furthermore, developments in the sector clearly need to focus on ensuring the availability of sufficient services to the rural economy and a broader geographical coverage, reaching the disadvantaged up-country population. The financial and capital market is still at its formative stage and needs strengthening. Experience of capital markets in Africa does not raise much optimism. According to ADB (1997) Africa's total market capitalisation was US$ 309·4 million in 1995, of which South Africa accounted for 91 per cent. Other countries, even those with long term capital markets, constituted small portions, e.g. Zimbabwe and Nigeria 2·0 per cent each and Kenya 1·9 per cent. The message is that reforms of macro-economic policies and regulatory mechanisms that will nurture its growth are required.

Banking business itself appears to have a bright future. For example, CRDB Bank reported profits for 1997/98 of TSh. 2 billion (CRDB 1999), and the Citibank TSh. 164 million (*The Guardian*, March 1999). Other banks, with the exception of the NBC, are also breaking even. However, all the banks operating in the country need to be extra cautious. The future will be very competitive and financial institutions are likely to face problems commonly encountered by banks in emerging markets. The experience of Meridian Biao and Greenland banks are evident lessons. Local banks will have to work hard towards adequate capitalisation, be lean in cost structures and employ professional managers. Moreover, although banking services have been assessed for the new VAT Tax, banks have not been able to pass this on to customers. This is one of the reasons that banking services in Tanzania appear more costly than in neighbouring countries.

PRIVATISATION OF STATE-OWNED ENTERPRISES

Public business ownership through State Owned Enterprises (SOEs or parastatals) had become very important in socialist Tanzania. By 1988, Tanzania had 413 public enterprises, of which 339 were commercial, and 56 non-commercial (e.g. higher learning institutions), plus several holding companies (Due 1993). The only country in the region with a larger number of SOEs was Mozambique with over 1,000. This statistic when compared with those presented by Grosh and Mukandala (1994) for African countries, portrays the extent of centralisation achieved in Tanzania. Senegal had 188, Ethiopia 180, Ghana 130, Guinea 181, and the majority including Kenya, Uganda and Zambia had fewer than 100. Privatisation has therefore been a relatively bigger task in Tanzania. It has entailed formation of the Parastatal Sector Reform Commission (PSRC) in 1992. This organ has had to supervise the identification of SOEs for privatisation, their valuation, the bidding process, development of memoranda of understanding, liaison with former parent government ministries, and handing over to new owners.

In 1988, the parastatals sector in Tanzania accounted for 24 per cent of non-agricultural wage employment and 13 per cent of value added. SOEs were sole operators of utilities and railroads. They were also present in agriculture, especially in areas such as crop marketing, input supply and milling, mining, manufacturing and banking (Temu & Due 1998). The original reasons for having parastatals included the need (a) to ensure that the public sector was the vehicle for growth as well as the leader in industrial entrepreneurship; (b) to ensure that the economy was under the control of the government and its nationals; and (c) to provide grounds for training indigenous manpower (Msambichaka & Bagachwa 1984; Grosh & Mukandala 1994; Tanyi 1997: Pedersen & McCormick 1999). The costs of maintaining these objectives rendered invalid the populist egalitarian goals.

Between 1976 and 1979 one third of the parastatals ran at a loss (Msambichaka & Bagachwa 1984). In the 1980s and early 1990s, the majority of parastatals had negative net returns, and this trend was accelerating. In 1988, more than 180 parastatals reported losses totalling TSh 33 billion (US$ 56·9 million) which were being financed directly and indirectly by the government. Direct subsidies to parastatals accounted for 11 per cent of the total government expenditure and these were increasing over time, particularly following changes taking place under ERP I and II in 1986 and thereafter. These changes entailed liberalisation of price controls, devaluation of the

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TABLE 5
Disposition of Tanzanian SOEs at 30 June 1996 and 30 June 1997

Sales of shares or assets	To 30 June 1996 *1996*	June 96–June 97 *1997*	30 June 1997 *Total*
To major multinationals	9	3	12
To other foreign firms	8	4	12
To indigenous buyers	21	2	25
To other local buyers	17	4	19
Unknown	3	12	15
Sub-total	**58**	**25**	**83**
Liquidations	42	11	53
Liquidations under LART	20	0	20
Closures	13	1	14
Sub-total	**75**	**12**	**87**
Leases	23	1	24
Performance management contracts	**3**	**2**	**5**
Sub-total	**26**	**3**	**29**
Total	**159**	**40**	**199**

Source: Temu and Due (1998).

shilling, flotation of interest rates and foreign currency rates, and introduction of a hard budget, essentially removing government subsidies to state enterprises. These were the pillars of survival for the parastatals (Due 1993; Temu & Due 1998; see also Killick 1988, comparing Tanzania's SOEs' performance with those of other African countries). Privatisation in Tanzania was therefore inevitable. Its assessment needs to be viewed in terms of reversing these negative effects on the economy.

By December 1998, 200 parastatals had been privatised by either outright sale to local and foreign investors, lease, share sale (where the government occasionally maintained some ownership), management buy-outs, liquidation or closure. Table 5 presents a summary of the divestiture structure by 1999. Note that even after such an effort, Tanzania was still the only country with over 200 state owned enterprises in Africa. Table 6 lists some firms selected for the following round of privatisation scheduled to start from January 1999. It is interesting to note the broad range of SOEs, and the kind of businesses that were being run by the state – including rice, wheat, dairy and poultry farms, livestock breeding, transportation, hotels and lodges. Most would seem more suited for the private sector in a liberal economy. The last column of Table 6 presents the nature of privatisation proposed for each firm.

TABLE 6
Privatisation: firms under process

Name of the company	Agreed diversity strategy
(a) Major and significant – High Priority	
Water & Sewerage Services in 18 towns	Joint Venture
Tanzania Electric Supply Limited (TANESCO)	To be Decided
Tanzanian Telecommunications Company Limited	Joint Venture
Tanzania Harbours Authority – Various Business Units	Concession/Leasing/ Joint Venture
Tanzania Railway Corporation (Marine Operation)	Outright Sale
Tanzania Railway Corporation (Main Operation)	Concessions
Air Tanzania Corporation (ATC)	Share Sale
National Bank of Commerce (as Restructured)	Share Sale
(b) Other enterprises listed for privatisation	
Cashewnut Board of Tanzania (12 Factories)	Assets Sale
Hotel Seventy Seven Ltd	Assets Sale
Kapunga Rice Farms	Assets Sale
National Ranching Company Ltd (8 ranches)	Assets Sale
Serengeti Safari Lodges: Soronera, Ngorongoro, Lobo, & Lake Manyara.	Assets Sale
Zana Za Kilimo Mbeya (ZZK, Farm implements factory)	Assets Sale
Hanang Wheat Complex	Joint Venture
Kitulo Complex (Diary)	Joint Venture
Southern Paper Mill (Paper Factory)	Joint Venture/Outright Sale
Tea Processing Estate Factories (Seven)	Organized Assets Sale
Kilimanjaro Machine Tools Company Ltd	Outright Sale
Dakawa Rice Farm	Share Sale
Furaha ya Visiwani Hotel (Zanzibar)	Share Sale
Kagera Sugar Limited	Share Sale
Mafia Island Lodges	Share Sale
Manawa Ginnery Limited	Share Sale
Mount Meru Hotels Ltd	Share Sale
Pesticides Manufacturers Ltd. Moshi	Share Sale
Regional Transport Companies (in 8 Regions)	Share Sales
Tanganyika Planting Company Ltd (TPC) (Sugar)	Share Sale
Tanzania Tea Blenders Ltd	Share Sale
West Kilimanjaro Livestock Breeding Co. Ltd.	Share Sale

Source: PSRC (1998).

Achievements in privatisation

Considering that the major reason for privatising parastatals was their failure to contribute to GDP and directly to government revenue, rather than draining it through subsidies, the privatisation of commercial parastatals is succeeding in reversing this trend. The privatised firms have yielded great benefits to the economy in terms of tax revenue (discussed further below). The net transfer from the

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government to parastatals has almost halted, except for the remaining ones that are yet to be divested. In 1988, this loss stood at US$ 56 million (Temu & Due 1998: 318). The sale of shares and companies has also provided the government with direct income estimated at 3·2 per cent of average GDP over the period of privatisation (White & Bhatia 1998: 82).

Successfully privatised parastatals have also demonstrated to the private sector their competent, accountable and efficient management structures, together with cultures centred on business acumen. According to USAID/PWC (1998), the firms have managed to access finance via foreign investment, acquired modern technology, ensured consistent and constant plant and machinery maintenance, and improved workers' welfare. Good examples of these are the brewery and cigarette companies. This demonstration of efficiency is a helpful contribution to the development of the private sector emerging from socialism. Privatisation has also been an indication of government commitment to broader reforms.

Most of the anxieties raised prior to privatisation seem to have been addressed. The government was anxious as to whether it would manage to tap taxes, and hence earnings from privatised firms, but this is happening (see below). Some leaders, including the first president, feared strikes and worker resistance. There has been no major resistance by workers. Employees understood the predicament of their commercial SOEs. Their concern has been with appropriate lay-off benefits, rather than maintaining firms under public ownership. There was a fear that privatisation would mean people losing 'their companies' and long-term investments. As shown by Table 5, privatisation has not led to outright denationalisation. An appreciable number of indigenous companies have bought former SOEs; 53 per cent (43 out of 83) of completed divestitures have been to indigenous and other local buyers. Most of these were of lower value enterprises; multinational and international firms bought shares in the large and relatively profitable firms, such as the brewery and cigarette companies. However, even in these the government has maintained between 30 per cent and 40 per cent of shares with a goal of floating them in the stock market at a later date. This points to the political imperative of serving the interests of local Tanzanians.

An important point is that most of these firms were running below capacity and plants were in badly dilapidated condition. Privatisation did not only entail handing over firms for a set price, but required large investments in rehabilitation, new equipment, meeting outstanding debts particularly for utility services, and training of personnel. Only international capital could afford this. Temu and Due (1998) present an account of an individual firm's privatisation process and what the new owners had to incur to revive most of the plants. The impact of the strategy and how much it is being appreciated by the common man, however, requires consideration of the welfare distribution mechanism. We discuss this elsewhere, nevertheless overall this is an area that has yet to yield fruit and much effort is needed. Overall there is a need to translate currently achieved successes in reforms into tangible wellbeing improvement for the common man.

Remaining challenges in SOE privatisation

After the privatisation of the more straightforward commercial industrial parastatals, Tanzania now faces a big challenge with the state farms, major utilities and infrastructure parastatals. The aim is to privatise electricity generation and supply, telecommunications, water and sewerage, railways and harbours. The impact of privatising utilities will have a different dimension of effects in the process of developing the private sector, and there are potential negative consequences. Utility charges constitute the largest portion of the cost for business firms. The profitability and relative competitiveness of business and manufacturing industries in the economy depends greatly on the provision and cost of utility services.

It is currently argued that the social and economic cost of inefficient or sub-optimal utility services and their slow progress in improving power, telecommunications, water, ports, and railway impact negatively on the thrust towards a private sector economy. However, haphazard privatisation may lead to a situation where parastatal inefficiencies are replaced with private sector excesses. Neither of the above scenarios is desirable. Arguments made by Chang and Singh (1983), Rodrick (1991) and ADB (1997) are appropriate here. There is potential for a rush to privatise utilities in response to IMF and World Bank conditionalities, but such a move might not be adequately comprehensive and time-consistent, and failures would create a bad precedent. Privatisation is now irreversible, and a high-speed process is recommended for commercial firms such as those listed in section (b) of Table 6. However, for reasons given above, there is a need to be cautious in the approach adopted for utilities. Adequate, effective institutions, and accompanying by-laws to regulate the industries are also important aspects that need consideration.

Privatisation versus regulation

Economic reforms and privatisation are essentially a process of dismantling old and building new institutions. Any institution constitutes organisations, rules and regulations within which various parties operate. The past four years' experience of reforms in Tanzania has shown that regulation of the private sector did not receive adequate consideration. Extensive coverage in the media of malpractice and abuse of liberalisation is evidence of the effects of the lack of adequate regulatory mechanisms. A few examples may demonstrate this aspect. Import liberalisation was pursued without adequate rules, by-laws and checks in place. This has resulted in the importation of sub-standard material and food. News articles regarding thousands of tons of imported food being condemned as unfit for human consumption (particularly wheat, oil and rice) are common. Privatised manufacturing and processing plants have often violated fair trade principles. For example, edible oil refinery plants licensed and taxed on the basis of processing oil from raw products (cotton seed, sunflower etc.) have super-profited by importing already refined oil, documenting it as raw material and simply bottling it. In doing so they have evaded taxes set for imported processed oil, denied a market for local produce, and denied employment to local people.

The liberalisation of petroleum oil importation has seen various forms of abuse. There are news reports regarding sub-standard imports sold at lower prices. Transit oil, cleared at the Dar-es-Salaam port as cargo destined for the landlocked neighbouring countries of Rwanda, Burundi, Zambia, Uganda and Malawi, finds its way into the local market, and is sold at a lower price because of evaded tax. Cases of unpaid or delayed payments to workers of privatised parastatals, without compensation for loss of value due to inflation, are common. Privatisation has taken place without comprehensive guidelines for reimbursing laid-off workers.

With the exception of the banking sector, where BoT was well prepared as a regulatory organ and its principles put in place, inadequate regulatory frameworks are evident in many of the liberalised sectors. Furthermore, if any regulatory initiatives were taken early, they focused more on giving incentives to new investors rather than ensuring that firms were efficient or adhered to certain (health, consumer rights, fair-business) standards. This is apparently an observed phenomenon in many of the reforming African countries (White & Bhatia 1998: 48).

We emphasise the policy and regulatory frameworks governing liberalised sectors, because the criteria for assessing success or failure of privatisation cannot be limited to only seeing a smooth transfer of assets and business from public to private enterprises. The price received by the government is also an inadequate measure. Most important is whether the change of ownership will produce a net return and benefits to the economy as a whole. The criteria for success ought to be the sale price of the firms, plus a net present value of future government revenue through taxation etc., and all these must be greater than the amount generated by public sector ownership. To achieve this goal across all production sectors for a considerable future period would require efficient regulatory frameworks to be in place. This is a major task remaining ahead for Tanzania's policymakers.

A comparison with the transition economies of Eastern Europe

The World Bank (1996) has considered privatisation in Eastern Europe. It reckons, as observed in Tanzania, that analyses of performance before and after privatisation strongly argue in favour of private ownership. Intermediate ownership, which Tanzania has adopted for the large commercial firms like the cigarette and brewery corporations by maintaining 30–40 per cent of the shares, is also recorded in China. Likewise experience in transition economies shows that it is more difficult to privatise large utility firms than smaller commercial ones. The difficulties as seen by the Bank are relevant for Tanzania. Proper regulatory mechanisms to effect significant returns to capital are crucial. Net returns must surpass the social and economic opportunity costs.

In relation to individual firms' performances, as mentioned earlier, change of ownership in such utilities is inadequate. What is required is change in managerial behaviour. New owners must gear up for profitability, and have the power to change the top management, and hence spur deep restructuring in the companies. This is easier with smaller firms and more difficult with large ones. Another area where similarities can be drawn is on sales of firms to outsiders. Here a common experience is that such privatisation has led to injection of foreign capital and efficient governance of the companies. The peculiar difficulties of privatising utility firms have also been noted in the transition economies. Despite a variety of approaches that have been adopted across countries, the need to pay due attention to regulation of price and quality must be emphasised.

TAX SYSTEM REFORMS

Tanzania did not have an effective tax system during the era of socialism. Because the government owned and managed the major means of production, taxation ought not to have been the principal revenue earner. Ideally, the government was supposed to earn dividends from its investments in parastatals. However, there was a tax system that relied heavily on income tax (with extremely high marginal rates), customs duties and excises and, after 1969, the sales tax. The latter tax covered a wide range of goods, with rates ranging from 25 per cent on some foods, to 50 per cent on luxury goods such as televisions, refrigerators and vehicles (Due *et al.* 1990; Due 1999). The irony is that the collected revenue was very low and unable to meet recurrent government expenditure. During the five-year period of the early reforms, 1986–1992, the annual deficit of central government expenditure averaged 10 per cent of GDP, increasing to 14 per cent in 1993 (Fjeldstad 1995). Major enterprises in production, marketing, and international trade, i.e. the parastatals, were making big losses and had no taxable profit. Instead, as observed earlier, they were draining the government budget through subsidies. Other factors apparent in the system were weak tax administration procedures and pronounced tax exemptions. These weaknesses, in turn, encouraged widespread tax evasion, including the use of Zanzibar port which had lower import duty rates (sometimes by 50 per cent), to get goods to the mainland. All of this was to the detriment of government income.

Tanzania has gone through changes in tax administration, and particularly so in collection mechanisms. Early attempts to reform the tax system were limited to adopting a 'low-tax-broad-base' system in 1991. Tax rates were lowered, but neither was the broad base captured, nor the administration improved, and hence the efforts yielded negative results. Major changes took place in 1996; taxation is now mandated to the Tanzania Revenue Authority (TRA). This new body provides incentives, e.g. high quality training and higher salaries for its personnel and a new corporate culture. Disciplining, employing, and firing of staff has been made easier to increase efficiency and avoid corruption. A Value Added Tax (VAT) system was introduced in 1998 to replace the old Sales Tax. VAT is charged at a flat rate of 20 per cent. All businesses with an annual turnover of TSh 20 million are eligible. The new system recognises the significant role played by the private sector, and it is effectively reversing the reliance on parastatals.

According to the TRA annual report of 1997, the government

TABLE 7
Revenue collection in 1996/97 for Mainland Tanzania

Department	Target Mill TSh	Actual Mill TSh	Performance (%)	Contribution (%)
Income Tax	137,662·50	128,997·6	94	26
Sales Tax	206,888·80	205,562·6	99	40
Customs and Excise	178,530·50	174,908·6	98	34
Total	523,081·80	509,468·8	97	100

Source: *TRA Annual Report* (1997).

registered a substantial increase in revenue collection. During its first year of operation, 1996/97, it earned TSh 509·4 billion (US$ 700 million), 26 per cent above the collection in the previous year (TRA 1998). TRA surpassed all its benchmarks in terms of collection versus targets set by the Government. These included actual collection in comparison to preceding years and in terms of the extent to which the fiscal benchmarks of the Enhanced Structural Adjustment Facility (ESAF) were met. Targets were very ambitious when first set by the government, particularly considering the bleak history of revenue collection in the past, and this was a big task for which to envisage such early success.

Evaluations made of the new tax and VAT system are positive (Due 1999). Furthermore in March 1999, the TRA reported that collections were 11·7 per cent higher than targets for the first seven months of the financial year 1998 (BoT 1999). Another achievement in 1998 was the introduction of VAT in Zanzibar at a 20 per cent rate and eligibility at TSh 15 million annual turnover. This will help to harmonise taxation between Zanzibar and the mainland. Worries such as those expressed by Fjeldstad (1995) regarding the capacity to manage VAT have not materialised. Instead, VAT has improved the tax system in various ways. It has widened the coverage of the former sales tax; resolved the tax cascading problem rampant in the sales tax method; enforced proper record keeping amongst business enterprises; and prevented tax evasion, because it is a self-enforcing system.

However, in view of the development of the private sector, some issues need mentioning. The above data shows that before VAT, revenue collections were 40 per cent from sales tax, 34 per cent from the Customs and Excise Department, and 26 per cent from Income Tax (Table 7). This means that 74 per cent came from

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consumption taxes. This draws a picture of the tax environment, which has to improve over time. The regional distribution of collection presents a gloomy picture, pointing to the limited areas where taxable economic activities are taking place. Tanzania has twenty regions, among which Dar-es-Salaam, one of the smallest regions (2 million people) but housing the capital city and major port for the whole country, contributed 75 per cent (TRA 1998). Arusha, the centre for the northern tourist circuit, contributed 6 per cent; Kilimanjaro 3 per cent; Tanga, which has the second most important harbour, 4 per cent; and Mwanza, a locus for the north western and lake zone area, 5 per cent. The other sixteen mainland regions contributed only 7 per cent. There is a need to broaden incentives for income generation in the country to expand the base for revenue collection. The above data points to the uneven development of the country.

Problems in tax collection remain. Small firms, which are the majority in Tanzania, are often not fully knowledgeable of the various levies and fees they need to pay. In the course of business, they fail to comply with the tax requirements. With the tightening of tax administration, complaints are widespread within the business community regarding the level of taxation and costs of compliance. In 1997/98 Corporate Income tax accounted for 43 per cent of all direct taxes (TRA 1998), as against only 13·7 per cent in 1991/92 (Fjeldstad, 1995). Private firms are definitely feeling the pinch, particularly those that have not built tax provisions into their business forecasts. Tax education is therefore important in Tanzania. Other claims regarding high tax rates are raised when comparing tax levels in Tanzania with neighbouring countries. For example, VAT is 16 per cent and 17 per cent in Kenya and Uganda respectively, compared to Tanzania's 20 per cent. Another complaint is about many points of tax registration in the system. When one combines taxes at district, regional and national level, there seems to be a heavy burden. A question that needs to be addressed is whether a simplified structure, harmonised registration and lower rates can lead to increased collection and higher compliance levels.

Lastly, the government, eager to report achievements of the on-going reforms, has used the growth trend of revenue collection as a parameter to demonstrate success. This has led to a big challenge to the government, in that it has not been able to translate economic improvement and particularly the increased revenue into improved services for citizens. A current major expenditure is servicing the international debt incurred mainly during the central planned economy era. Cancellation of this debt would assist the government substantially. However, a crucial measure is to put in place mechanisms to manage an economy with a small debt with sound debt management. Overall there is an urgent need to address the issue of low investments in health, education, and rural infrastructure, and reflect success in terms of improved well-being of the people, so that the reforms continue to receive popular support. Contrary to the expectation that these benefits would automatically trickle down, experience shows specific efforts need to be put into ensuring such benefits reach the people.

Unlike in the Eastern European transition economies, where one could build upon the already existing high quality and good access to basic education and health care (World Bank 1996: 123), the systems in Tanzania are fragile and need more direct investment. If special efforts are not made in this area, it is easy for reforms to throw away the minimal and rudimentary achievements made in education and health during the past central planning system.

CIVIL SERVICE REFORM

The civil service in Tanzania has long been known to be overstaffed, with many under-qualified civil servants. Pay levels from the early 1980s could not support the families of most civil servants, who had to enter into other types of employment during or after hours to provide a minimum level of living for their families. This created the paradox that civil servants were trained to follow socialist principles of government operation of the economy, but had to break those rules and enter into private enterprise in order to survive! Even as the government moved to encourage more private enterprise, public servants were unnecessarily slow in supporting private business initiatives. The relationship was often antagonistic and suspicion prevailed between the two parties.

Civil service reforms started as early as 1982. A major stride was taken in 1991 with the launching of the Civil Service Reform Programme (CSRPI). The overall aim of CSRPI was to develop a civil service sector with the requisite professional culture and managerial capacity, and with pay scales to recruit and retain such professionals. The ultimate objective was to improve efficiency and effectiveness in the delivery of government services.

Since 1992, the government has retrenched over 80,000 employees. The workforce fell by 47,297 between 1992 and 1995, including 14,700 ghost workers (Olowo 1999: 8). Overall, the total number of central government employees declined from 335,000 in November l992 to 255,000 in 1998 (Kweka 1998). Up-country the number has fallen from an average of 700 to as low as 80 per region. The remaining employees had high expectations regarding their remuneration after reforms. Civil service salaries increased 75 per cent from 1991 to 1997 (*ibid.*); however, the increases did not keep pace with annual inflation, leaving the workers no better or even worse off. Workers also see new challenges, such as enforcing legislation in a market economy, for which they were not trained. The vast majority of Tanzania's civil servants have no experience of the needs of the private sector, and do not identify with the benefits generated by better services to entrepreneurs. The tight margins and high cost of finance and time do not figure in the average public servant's thinking. Putting off a decision for a week or a month is not unreasonable in the public eye but the impact on a business can be immense. Also, since changes in macropolicy are often not followed by adjustments at the grass roots, information and guidance does not always reach the lower echelons, resulting in confusion to the business community over issues such as land rights, immigration and customs, and export permits.

As a result of low motivation and lack of understanding of the needs of the private sector, the civil service fails to articulate and implement private-sector-friendly policies. Manifestations of this situation are many, the worst being increasing corrupt tendencies. Lowly paid, unmotivated workers are highly prone to corruption. In turn, corruption is bad for business as it imposes implicit taxes in the economy. In 1998 Tanzania was rated as amongst the four most corrupt nations from a sample of eighty-five countries by Transparency International (Cooksey 1998). The statistics, and particularly the relative magnitude, have been bitterly challenged locally. However, it is commonly known that petty corrupt tendencies are widespread; senior officials collude with businessmen over contracts, government services are provided via illicit payments which the poor cannot afford, and natural resources are plundered. We agree with Wangwe (1998) that corruption is bad for business. It raises transaction costs and discourages investment decisions. It leads to inefficient economic outcomes by distorting the priorities of the economy, misallocates talent in rent seeking activities, and reduces the state's ability to raise revenue and provide public goods such as health and education. A more serious effect is if these inefficiencies are in the judicial system. At times, in combination with corruption, the uncertain legal environment provides opportunities for selective and repressive implementation of the law against entrepreneurs. Lessons from Eastern European transition economies are instructive in this case. Whereas in general staffing levels are not seen to be too high, public sector pay is very compressed (World Bank 1996). This leads, as in Tanzania, to poor morale, absenteeism and moonlighting, low productivity, petty corruption and loss of good staff to the private sector (*ibid.*: 113), which plague public administration in the transition economies.

To deal with the situation the business community has formed business associations. To date there are more than 100 registered associations in the country. Most of them, however, are not active and are underfunded. The most vocal and active association is the Tanzania Chamber of Commerce, Industry, and Trade. Each sub-sector in the business area, such as mining, horticulture, and tourism, has its own association. Most of their funding comes from the donor community rather than from private businesses. As a result of their being young and under-funded, associations have had little impact in influencing policy formulation or civil service behaviour. The end-result of such obstacles is a growing informal private sector and unregulated business practices. Even those enterprises that have made profits and grown deliberately refrain from graduating to formal businesses that can be taxed and regulated, as they expect unfavourable treatment.

In 1998 and 1999, efforts were directed to form a federation of business associations, the Tanzania Private Sector Foundation. Such an enterprise could become effective in articulating private sector needs and improving economic conditions of the country. However, a crucial task remaining is to build a public sector that is responsive to the needs of the private sector. There is also much to learn from experiences in Latin American developing countries as presented by Grindle (1997). Despite prevailing economic weaknesses, Tanzania has room to improve its public organisations by building cultures that emphasise commitment to organisational goals, a strong sense of professionalism, efficiency and elitism. Over time, due to wrong policies and economic difficulties, Tanzania's civil service lost organisational characteristics that promote positive work cultures. Civil service reforms have to incorporate this ingredient on top of the ongoing retrenchment.

THE POLITICAL ECONOMY DIMENSION OF THE REFORMS

Hyden and Karlstrom (1993) argued for the importance of grounding reforms in political realities. In their analysis, they used a policy process approach in which notions of 'ambiguity' and 'conflict' explained the interplay between technical, political, institutional and ideological factors to influence reforms. Morrissey (1995) followed the same procedure. Both studies successfully demonstrated the importance of politics in reforms.

The reform period in Tanzania has imposed many difficulties and challenges. As explained earlier, many of the achievements from reforms in a macro-economic context have not led to the improved well being of the people. One would expect this to lead to political resistance against reforms. To understand why Tanzanians have embraced reforms even after facing difficulties in the transition period, one has to accept that pressure to change came from both inside and outside the country, from outside especially in the form of prerequisites for support (conditionalities) posed by international financial institutions. Internal pressures for reform came from diverse sources. These included direct policy recommendations made by academics and a few 'daring' government workers (see Barkan 1994; McHenry 1994). At the small farmers' level, pressure for change was exerted by withdrawing from growing cash crops. This led to abandoning *ujamaa* farming and liberalising domestic markets. Currently, the rural dwellers are free not to participate in communal farms and some have gone back to their original land. Where the government took coercive measures to force farmers to continue growing such non-profitable crops, management of the farm plots was poor and farmers diverted production to other income earning activities. Hyden (1980) viewed this predicament as a failure by the government to capture smallholder farmers and coined the term 'the uncaptured peasantry'. The liberalisation of internal food markets in 1982 (see Temu & Ashimogo 1997) and the unsuccessful 1982/83 National Economic Survival and Structural Adjustment Programmes, were all responses to internal pressure and realities. Therefore, despite the transition difficulties, even rural dwellers embraced the reform process.

'Quiet resistance' was also apparent amongst urban dwellers. Before reform, individuals, including civil servants, resorted to informal businesses. They also provided supposedly public services for cash. Examples include unlicensed petty trade, food vending, commuter services (*daladala*), tuition for school children, neighbourhood watch (*sungusungu*) and medical services. There was minimal physical sabotage of government property, but extensive non-compliance with obligations such as licensing and tax submission was the order of the day, and this exerted pressure on government to reform. Civil servants, while expected to enforce compliance, faced conflicts of interest between employment obligations and profits from their private informal businesses. Even employees of debilitating SOEs could not make ends meet from their salaries and had to join, though unwillingly, the quiet resistance. Tripp (1997) estimated that informal businesses earned civil servants over 80 per cent of their incomes in the 1980s. Overall, the net effect of informality and non-compliance led to a deteriorating economy to which the government had to respond, accommodating what people were already doing; hence liberalisation.

The political pluralistic changes of 1995 also contributed to the process. These led the country to hold its first multiparty presidential and parliamentary elections. The opposition has a significant representation in the parliament. The ruling party won only 186 seats in the parliament out of a total 382. Politics and party ideologies currently focus on support for, or opposition to, liberalisation. The largest opposition party (NCCR) advocates pro-liberalisation policies, but with great sympathy to the low income, poorer enclave 'walalahoi'. The heavy hand of the state on small-scale entrepreneurs has become the new target for its rhetoric. The second largest opposition party, UDP, is pro-capitalist. UDP leaders are rich Tanzanians with investments even in other SADC countries. It wins popularity by advocating reforms in land tenure, private ownership and entitlement to land, which is still state owned. Although the ruling party (CCM) has not openly denounced its original socialist orientation, it has inclined to the popular liberalisation policy and wins constituencies by implementing reforms. Politics has therefore contributed as a pressure compelling the government to stay in the reform course. Scholars pessimistic about the effects of SAPs also contend that changes in Tanzania were inevitable and that the internal political economy has had a role in the change (see Wagao 1992). Mkandawire and Soludo (1998) concur with on-going reforms and view a need to 'widen the road ahead', so as to capture human resource development and other 'fundamentals' (basically social development and wealth distribution aspects) for African development.

HOW SHOULD WE JUDGE THE TRANSITION?

From 1991 to 1997, substantial reforms have taken place in Tanzania towards dismantling socialism. This article has concentrated on describing changes that have taken place to increase the role of the private sector – i.e. liberalisation. However, liberalisation has taken place after a formative stabilisation process, and the emerging business environment is a product of both stabilisation and liberalisation. In summary, the business environment and private sector participation (our major concern) have changed for the better.

The private sector contribution to GDP in 1991 was about 64 per cent. This rose to 84 per cent in 1997/98 (USAID/PWC 1998: 71). In addition to such figures, other anecdotal indicators also show an increase in private sector participation in the economy. There is growth in advertising particularly in urban areas. There is an increase in the number of restaurants, cafes and hotels. There is also increased competition in business and a broadened range of alternative sources of almost every consumable. The number of private TV stations, dependent on private sector advertisement, has risen from none in 1993 to seven in 1998, and the variety of information providers are further evidence of growth of the private sector. Over ten new daily and weekly independent newspapers have been established over the reform period.

Looking at it from another angle, there is an evident withdrawal of the government from direct business undertakings. The government has withdrawn completely from the import and export business; 200 state-owned firms have been divested, 83 privatised variously: 53 liquidated, 20 placed under LART and 14 closed; 29 are either under leases or performance management contracts. Some of the privatised firms are now performing very well and contribute significantly to government revenue. New management, changed corporate culture and efficiency of privatised firms are very apparent lessons for the business community. Privatisation has also reassured the business community about the government's commitments to reforms.

Regarding international capital, in the past foreign investors had neglected Tanzania. It is only after reforms that many international private investors have started to investigate Tanzania's potential. According to the UNCTAD (1996), foreign direct investment into Tanzania increased from zero in 1994 to US \$27 million in 1995. The investment promotion centre (IPC) approved over forty-four foreign investment projects of economic significance in 1996 alone. Altogether these were valued at US \$500 million. The majority are in the manufacturing sector, but other investments include petroleum, tourism, natural resources and service projects.

Furthermore, an emerging trend suggests that the private sector may provide the engine for diversifying the economy and reducing the dependence on agriculture. The Tanzania Chamber of Mines reports that in 1998 Tanzania posted a unique record by attracting more exploration than any other country in Africa including traditional big miners like South Africa and Ghana. Spending in exploration has shot up to US $58 million per year. It is estimated that by year 2000 gold production in the country will have reached 15 tonnes a year. Exploration and interest is not only for gold; nickel has a potential production of 100,000 tonnes a year. In 1998, Tanzania exported diamonds worth US$15 million. There are also major developments in the exploration of coal, gas, salt, phosphates, kaolin and tin (see USAID/PWC 1998; ESRF 1998). The GDP growth of major sectors of the economy between 1995 and 1998 shows that mining is performing relatively better compared to the past. It constituted 17·1 per cent of the total GDP in 1997, against the 1·5–3·5 per cent recorded in the past. The growth rate is 85 per cent, higher than that of agriculture (BoT 1998).

Similar stories can be told for other sectors. In the case of tourism, the USAID/PWC 1998 report using data presented by ESRF drawn from the ministry of tourism, reports that private investment has already started to grow and has increased by about 13 per cent since 1993. Since reforms over twelve foreign companies, including Serena and Sopa Lodges, Hainan of China, Stock Hotels of South Africa, Gencom Corp of USA, and Feraham Holdings of Gibraltar, have indicated interest in Tanzania's tourism sector. Individual investments by such firms are high, exemplified by the Aga Khan Serena group who have invested over US$ 32·5 million in wildlife resorts. For the months of December 1997 up to February 1998, the Tanzania Investment Centre approved seventeen new international investment projects in tourism.

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This article has reviewed changes taking place in the banking, parastatal sector, taxation system and in civil service in Tanzania. The goal has been to assess changes that have taken place and the response by the private sector. The constraints and challenges of the process have been pointed out. Our assessment of the transition period is a positive one. The transformation of the financial system – the one area in which an effective regulatory framework has been in place – has generally been successful, despite the need to extend access to small businesses and rural areas, and the capital market is at its formative stage. Privatisation of former state-owned enterprises has reversed the drain that they previously constituted on government revenues, and contributed to investment, especially by foreign companies. Changes in the taxation system have effectively refocused the government's view as to the source of revenue and accorded more respect to the role played by the private sector. Tax revenue is increasing, the system has become more efficient, and the tax base broadened. On another front, we have noted a slow emergence of a market-oriented civil service despite retrenchments. Reforms in the public service have succeeded in reducing the government workforce, but not much has been achieved in changing the work habits and hence the efficiency of employees.

However, the achievements made need to be consolidated and measures to address observed shortfalls pursued. In other words, reform prescriptions by the World Bank and IMF, though in principle inevitable for Tanzania, need not be taken blindly. The appropriateness of each measure and change should be articulated. It is now clearer that the reform process requires more time and has to be a long-term task, because of the many distortions that were built into the system during the socialist era. Limitations and hence challenges discussed in this review point to the dynamics of reforms, in that one step of reform calls for additional action. A critical priority is that of the major gaps in the regulatory framework emerging after liberalisation of a sector. For the changes to bear fruit, institutional development both in the form of organisations and of rules and by-laws needs to be established. Otherwise, excesses of the private sector can easily replace inefficiencies of the public sector, a danger that is especially great in the privatisation of utilities.

The major failure of reform, as it has developed to date, lies in the apparent lack of tangible benefits for many of the poorest sections of Tanzanian society. In addition to securing adequate regulation of a market-oriented economy, rectifying this failure calls for increased revenue earnings to be translated into investments in public services that will improve people's well being, notable in health, education and infrastructure. While the inadequacies of Tanzania's former socialist economy have been very clearly demonstrated by the achievements of the reform process, the management of an equitable and effective market economy still requires a key role for the state.

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