An Emperical Study on the Strategies to Attract Foreign Direct Investments in Tanzania

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Abstract

This paper dwells on the investment strategies in attracting FDI into Tanzania, the investment reforms have been expected to become a major factor responsible for the increased FDI inflow in to the country, these reforms including political system, economic management and government administration. Despite of the several efforts such as the far reaching reform in the economy done by Tanzania to increase FDI inflows in the country, the results are far from satisfactory. It has been revealed that the unsatisfactory FDI inflow into Tanzania is primarily caused by the improper strategies resulted from the inadequacy of FDI determinants in the country. The study found that Tanzania lacks the adequate strategies due to poor FDI determinants that would attract a substantial FDI inflow into the country. This makes it necessary for the country to make sure that the determinants like better infrastructure, adequacy of government agencies; favorable macro economic, political conditions are available in adequate amount and quality. It is concluded that proper strategies in influencing investment regulatory frameworks, policies that promote macroeconomic stability, improved physical infrastructure and institutional reforms are important in attracting more FDIs into a country and therefore are highly recommended.

Key words: Foreign direct investment; Policies; FDI attractions and investment strategies.

1 Introduction

Most countries have recognized the importance of FDI inflows for their economic growth, poverty alleviation and development in general. It is recognized that FDIs are widely acknowledged to be crucial engines of growth especially in the developing countries in creating employment, transferring technology, increasing government revenues and contribute to the capital formation process of host economies[1].

Regarding that, most governments have been actively promoting their countries as investment locations to attract scarce private capital and associated technology and managerial skills in order to help achieve their development goals.

They have increasingly adopted measures to facilitate the entry of FDI. Examples of such measures include liberalizing policy and regulations for the admission and establishment of foreign investment projects; providing guarantees for repatriation of investment and profits; and establishing mechanisms for the settlement of investment disputes[2], foreign investment projects; providing guarantees for repatriation of investment and profits; and establishing mechanisms for the settlement of investment disputes[3].

Tanzania has taken various strategies and initiatives to attract FDI. These initiatives include a general improvement in the investment environments. Tanzania has put in place a number of proactive measures to facilitate the business that foreign investors undertake in the country [4]. These include the promotion efforts and investment incentives of foreign direct investors, reducing corruption and improving administrative efficiency, after-investment services and the provision of social amenities[5]. The business environment for foreign investors has been restructured through initiatives such as the reduction in bureaucratic "red tape" and state interference in private business, improvement in investment facilitation and the establishment of investment promotion agencies[6]. Despite of that several efforts to increase FDI inflows in the country, the results are far from satisfactory, thus there fore more efforts should be putting in place to improve this scene[7].

(1)Tanzania economic and financial indicators

Macroeconomic stability directly affects the return to capital. More indirectly, it provides some certainty as for the future path of economic policy and thereby also for the ability of firms to repatriate profits or conducts other operations. It can also be seen as a sign of the underlying strength of the economy in the most general sense.

Table 1 below shows selected economic and financial indicators for Tanzania. Domestic savings are about 12 %of Gross National Disposable Income. Although this might seems to be high, one can observe that the rate of saving is somehow very small. With this small saving rate, the Tanzanian economy needs support from outside. FDI could be a better way for injecting the much needed capital for rapid economic growth.

Macroeconomic and investment policy measures undertaken by the government in the 1990s have been very instrumental in creating conducive environment for the promotion of private sector businesses even though more efforts should be taken to improve the investment climate[8].

Table 1 - Tanzania Economic and Financial Indicators

Indicator	Unit	2002	2003	2004	2005	2006
Change in GDP at Factor Cost	%	6.2	5.7	6.7	6.7	6.2
GDP Per Capita-Current prices	$	267.9	276.2	303	319.8	354
Inflation	%	4.5	3.5	4.1	4.4	6.2
Saving to GNDI Ratio	%	12.7	11.8	12.3	12.5	12.9
Population(TZ Mainland)	Mill	33.6	34.2	34.8	36.2	37.5
Total External Debt as a % of GDP	%	75.9	83.5	77.5	77.5	72

Source: Bank of Tanzania

(2) Policy guideline model for the host country toward FDI inflows

At least ten policy guidelines that offer sufficient or even necessary guidelines for Sub-Saharan African countries like Tanzania wanting to have shortcut way to attract FDI.

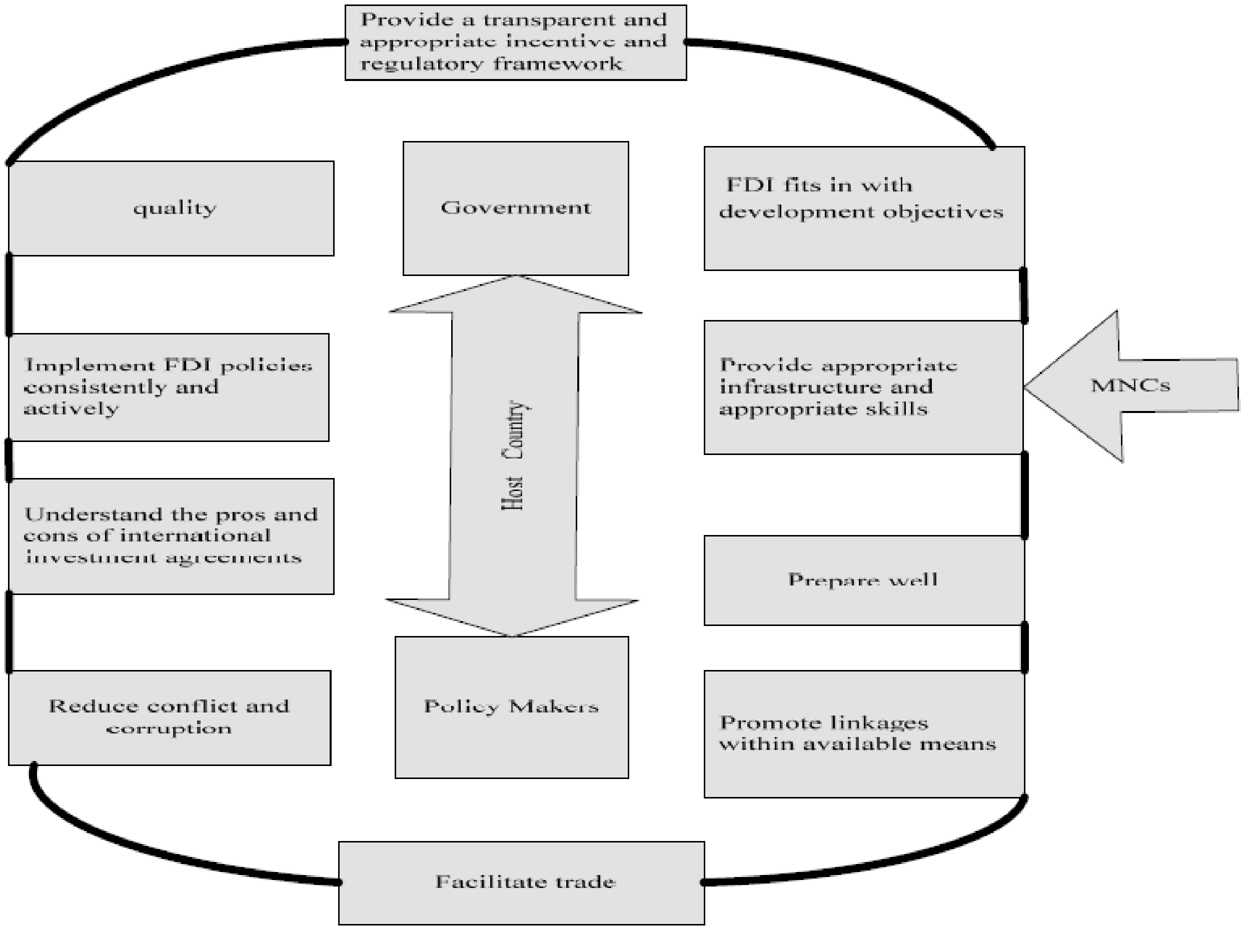

Figure 1 - Policy Guidelines Model for the Host Country Aligned with FDI Inflows

Rather, it is a checklist for the countries in need of appropriate FDI policies and strategies for country's development. These ten policies guidance are shown in the figure 3 below; that is the host country, it's government and policy makers are placed as the core of the model surrounded by at least ten policies in which the country has to properly working on it before the outsiders (FDIs) are entered in to the host country to contact the government and the policy makers.

Knowledge and skills are necessary tools to enable the host country to acquire the bargaining power to the interest and sustainable development of the country and effective usage of their available natural resources and human resource.

2 Methodology

This paper aimed at exploring the scene behind success and failure of Tanzania as a destination for FDIs inflows by investigating Tanzania as a host country under her policy notably motivating factors, offering necessary incentives, main problems in operating business, government agencies causing difficulties and the Tanzania future economic outlook.

Designed set of questionnaire has been sent out to about forty Companies as our primary respondents. These companies are both Domestic Enterprises (DE) and Multinational Enterprises (MNE) in order to find out the outlook on both two scenarios.

The analysis of data facilitated by the statistical analysis tool and the results are based on frequency analysis. A total of 44 companies have been participated to empirical investigating the Tanzania as a host country for FDIs inflow.

3 Findings, Analysis and Discussion

Domestic policies and strategies along with FDI fall into two broad categories; promotion and regulation, both of which have been used in Tanzania. With respect to the regulation of FDI, the general trend over the past decade has been for the gradual liberalization of rules governing foreign investors and their investments.

(1) Promotion strategies

In this context promotion category includes all factors that determine or influence FDI inflows into a given geographical location. They give investors the confidence needed to invest in foreign markets and we categorize it into two parts i.e. Motivation/incentives factors, and macro-economic out-look which are explained here under.

(2) Favorable environment

Foreign investors' are primarily concerned with fundamental factors, that is, favorable macroeconomic and political situation, together with credibility of policy reforms. It is found that all of the company surveyed agreed that stable and sustainable macroeconomic environment boosts the confidence of private investors to invest in to Tanzania as the Table 2 below indicates that 77.3% show their strongly agreement and the remaining 22.7% agreed on this factor.

Table 2 - Investors Perceptions on Favorable Environment

		Freq	%	Valid %	Cumulative%
Valid	Strongly Agree	10	22.7	22.7	22.7
	Agree	25	56.8	56.8	79.5
	Neither Agree or Nor Disagree	9	20.5	20.5	100.0
	Total	44	100.0	100.0	

This implies that policies that are conducive to macro-economic and political stability are essential elements of an enabling investment environment as promotional activities of countries to have a positive influence on FDI inflows. In the Political environment point of view political stability is among the important FDI determinants. This includes democratic system which operates in transparency manner. The general message from this survey and empirical findings is that, from the viewpoint of attracting investment, the macroeconomic and political stability and policy consistency are much more important.

From the macroeconomic viewpoint, the key policy implication is that to encourage the investment response to incentive schemes, macroeconomic stability and investor's confidence in the sustainability of the policy framework are essential. Thus, the government must correct the unsustainable macroeconomic imbalances - such as large public deficits - because they are a primary cause of macroeconomic instability and uncertainty about future policies. Institutional reforms to ensure policy predictability, effective property rights, can contribute significantly to the investment response.

Table 3 - Investors Perceptions on Promotion/Incentives Offered in Tanzania

		Freq	%	Valid %	Cumulative%
Valid	Strongly Agree	34	77.3	77.3	77.3
	Agree	10	22.7	22.7	100.0
	Total	44	100.0	100.0	

(3)FDI and trade facilitations

The size of the host country market is a relevant determinant to the extent that the FDI is destined to serve the host market and not merely to set up an export platform. Larger markets should attract FDI because firms face economies of scale as FDI entails sunk costs (for example, in terms of adapting management to local conditions or getting familiar with host country legislation). Market growth should work in the same direction as some literatures proposed earlier.

In this research found that most of FDI sells their products and services in Kenya and Uganda (the East Africa member states) accounted to 46 percent over the total market surveyed where as domestic and Europe market with 36 Percent and 18 percent respectively. (See fig 2 below)

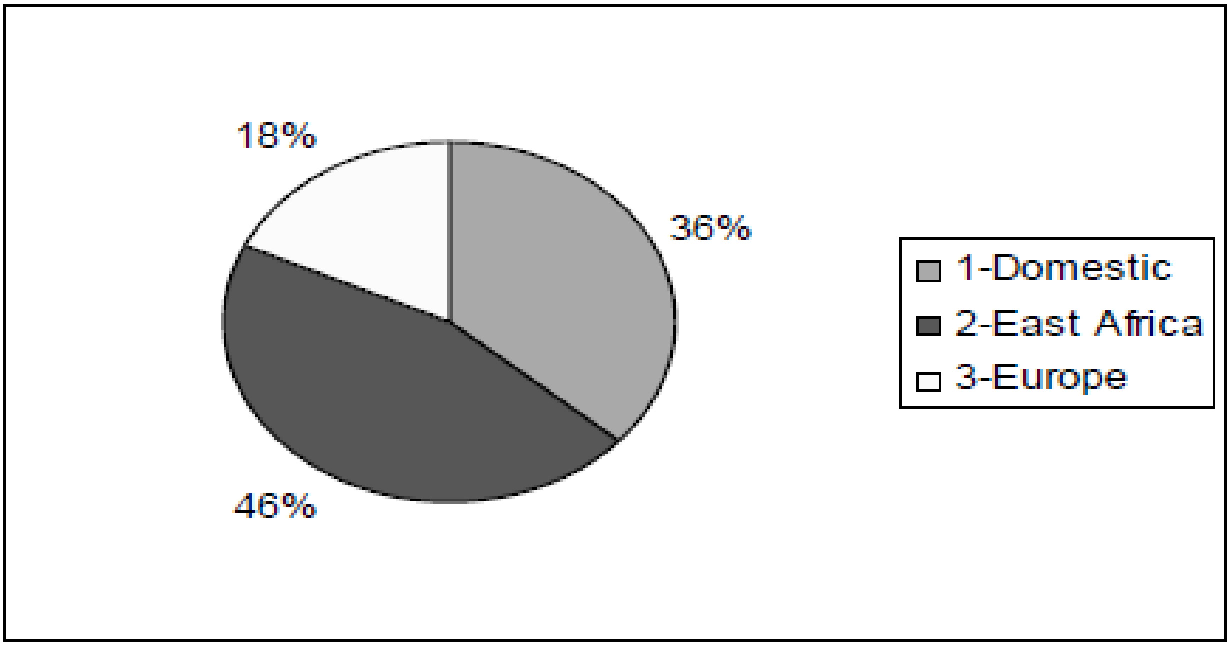

Figure 2 - FDI in Tanzania it's Major Market

(4) Incentives offered in Tanzania

In order to attract more FDIs into Tanzania the government, in 1997, changed the law establishing the then Investment Promotion Centre (IPC) into one forming the Tanzania Investment Centre (TIC). This is a major institutional reform as TIC is more capable of attracting more FDIs.TIC is the primary agency of Government to coordinate, encourage, promote and facilitate investment in Tanzania and to advise the Government on investment related matters i.e. is the focal point for investors engaging in the business of marketing Tanzania as an investment destination.

The surveyed data shows that 79.5% respondents are influenced to invest in to Tanzania due to the promotion and incentives offered by Tanzanian government and 20.5% came to invest into Tanzania for other reasons apart from promotion and incentives offered as shown in the table 3 below.

This implies that despite of the several efforts taken by TIC in attracting FDIs inflows into Tanzania there is still a significant percentage (20%) came to Invest into Tanzania without being influenced by promotion and incentives offered to them.

This indicates that Tanzania is not sufficiently known abroad and it is therefore needs to do a better job marketing itself in European capitals and investment centers. This is because promotional activities for the country's potentials have not reached many potential investors and the business community at large.

(5)Cost of production in Tanzania

It has been found that Tanzania Labor costs are much higher compare to most other African countries. The cost of employees' benefits and in Tanzania is not in line with those of other developing countries. Fringe benefits ratio in Tanzania is approximately 45%, as compared to 25-35% which is typical in most developing countries. Higher wages with low quality labors are substituting provision of rent and transport allowances globally, but not yet in Tanzania.

Tanzania has 28 compared to 5-15 days in many developing countries, and 14 public holidays. The various benefits raise the costs of hiring and retaining workers. This is not desired by firms in this age of fierce competition where cost is among the very important factor for competitiveness.

The following table shows that 72.7% of the investors disagree that Labor cost is a motivating factors for them to invest into Tanzania and there fore is costly for them

Table 4 - Investors Perceptions on Labor Cost in Tanzania

		Freq	%	Valid %	Cumulative%
Valid	Strongly Agree	22	50.0	50.0	50.0
	Agree	19	43.2	43.2	93.2
	Neither Agree or Nor Disagree	3	6.8	6.8	100.0
	Total	44	100.0	100.0	

Labor factors, were not favorably by many investors because labor legislation over- protects employees, there is limited availability of highly educated and skilled labor.

To attract more FDI Tanzania should restructure the aspect concerning with labor issues including retrenchment packages and reducing annual leave days as those FDIs that look for low labor costs among others are likely to be scared away from Tanzania in favor of the more competitive countries, ceteris paribus.

6)Adequacy of infrastructure

It is found that infrastructure is a key factor in motivating foreign investors, the sustainable availability of electricity, water, adequacy of transportation and telecommunication system is vital for the country to receive more FDIs

The table below shows that most of the respondents came to invest in Tanzania due to the strongly believing that the country offer them a better social services, where as 50% strongly agreed, 43.2% agreed.

Table 5 - Investor's Perceptions on Infrastructure

		Freq	%	Valid %	Cumulative%
Valid	Strongly Agree	3	6.8	6.8	6.8
	Agree	9	20.5	20.5	27.3
	Disagree	32	72.7	72.7	100.0
	Total	44	100.0	100.0	

However, the infrastructure in Tanzania is still poor (therefore high transport costs), utility services are expensive and unreliable, labor market conditions are not in a good shape (labor productivity is low with high wage demand), access to export markets is still difficult in many major regions. Tanzania has an infant private real estate market. There is no serviced industrial estate that offers ready to occupy buildings. Most investors therefore, have to go through the lengthy process of identifying land, obtaining title, undertaking construction and connecting utilities before operations can start.

7)Tariff protection, corporate tax, VAT and import duty

The process is typically bureaucratic, full of procedural complexities, less transparence and consistence. Result shows that 88.6 respondents seems that Duty exemption and rebate on plants, machineries and construction materials are necessary incentives and there fore are highly demanded by the investors.

Under a zero tariff system, Tanzania is not likely to be able to compete with her east member states 17% and 16% Value Added Tax (VAT), compared with 20% in Tanzania also the corporate tax of 30% (Table 6) are too high for the investors. The provisional tax system in Tanzania makes unrealistic assumptions that cause cost pressure on businesses at their early phases, hence discouraging new ones. For example, it is assumed that businesses become profitable as soon as they begin operations. This is unrealistic for long-term investments such as manufacturing operations.

Table 6 - Investors Perceptions on Tariff Protection, Corporate tax, VAT and Import Duty

		Freq	%	Valid %	Cumulative%
Valid	Strongly Agree	21	47.7	47.7	47.7
	Agree	22	50.0	50.0	97.7
	Disagree	1	2.3	2.3	100.0
	Total	44	100.0	100.0	

Table 6 shows that most of the foreign investors surveyed during the study agreed by 97.7% that Tariff protection, corporate tax, VAT and import duty reduction are important in their investment process.

The requirement that businesses pay estimated corporate taxes in advance and VAT on their sales monthly is hard on the cash flow of firms and is therefore likely to scare away investors. If a company overpays tax in the provisional tax system, it does not receive a refund. Rather a credit towards future tax liabilities is issued, which is less attractive.

A generally hostile internal environment for production in Tanzania does not do any good to the country as it results to industrial affliction and may hamper FDI inflows.

8)Tax holiday and exemptions

Those who qualified for the incentives were given a Certificate of Approval under the Act. Holders of the certificates were allowed to import plant, machinery and construction materials for the investment projects without paying import duties for the whole period of the project implementation. In addition, investors were granted 5 years income tax holiday from the date of commencement of production.

In the table 7 below shows that 90.9% strongly agreed and 9.1 agreed that the tax holiday and exemptions are necessary incentives for the foreign investors which indicates as most preferred incentives for the investors and there fore the government of Tanzania should take necessary actions on this to make sure they satisfy the existing investors and attracts the new ones.

Table 7 - Investor's Perceptions on Tax Holiday and Exemptions

		Freq	%	Valid %	Cumulative%
Valid	Strongly Agree	40	90.9	90.9	90.9
	Agree	4	9.1	9.1	100.0
	Total	44	100.0	100.0	

However, tax incentives on foreign direct investment appear ambiguous. More important are such factors as basic infrastructure, political stability, and the cost and availability of labor. Both analysis and surveys have confirmed that tax incentives are a poor instrument for compensating for negative factors in a country's investment climate. But that does not mean that tax incentives have no effect on foreign direct investment

9)Economic outlook

The table 8 below shows that 54.5% of the foreign investors focus economic development in the future periods while 31.8% predicts to be uncertain and the remaining 13.7% declining.

Table 8 - future Economic Outlook to the Investors

Prospect for	Frequency	Percent
Development	24	54.5
Decline	6	13.7
Uncertain	14	31.8
Total	44	100

Future Economic Outlook is very important as it can determine the future perceptions and trends of investors to continue investing in the country. As more than 31%f investors predict uncertain and decline economy, the government should conduct more macroeconomic reforms aimed at simplifying business regulations, strengthening property rights, improving labor market flexibility, and increasing firms' access to finance in order to retain the existing investors and attract more FDIs as this is the most important determinant that makes them confidence of investing in the country.

Competition, education and technology policy are required to raise the capacity of the local economy to absorb positive spillovers and mitigate negative aspects.

4 Recommendation

The study found that basic infrastructure, macroeconomic stability, efficient institutional setup, political stability and a good regulatory framework, are essential element in attracting FDI inflow into Tanzania. Some of government agencies (related to foreign investment perspective) contribute to lower the performance of foreign investors' operations due to poor services, lack of transparency and bureaucratic system including unnecessary excessive regulations which also discourage new investments

In Tanzania the infrastructure is poor (therefore high transport costs), utility services are expensive and unreliable, labor market conditions are bad (labor productivity is low with high wage demand) and access to export markets is difficult so that discourage the existing and new investors and therefore effort should be exerted to tackles the general findings of this study.

5 Conclusion

To improve the strength of having a larger internal market, Tanzania should improve both macro-economic and micro-economic policy in order to increase purchasing power of its citizens so as to be benefited from the FDI existence, and the other strategies to expand the market include entering into regional integration agreements.

Marketing a country for FDI inflows is necessitated by the fact that in the ever-globalizing world economy competition for FDI inflows is a global affair. Almost all countries are competing for limited FDI inflows from MNEs. If a country does not market itself for FDIs it is likely that it will be by passed by those that do.

Government should consider reviewing the labor legislation to take into account the concerns of employers. Opportunities for training technical and managerial staff should be expanded and the private sector should be encouraged

On top of the length of time used to get utilities hooked, there is lack of competition in the supply side, high connection fees, sporadic-supply (in case of electricity, for example), lack of customer oriented focus, inaccurate and untimely billing and records keeping procedure and poor levels of service.

Policies that are conducive to sustained growth and macro-economic stability are essential elements of an enabling investment environment. They are as important to foreign investors as they are to domestic ones, as they determine risks and profitability of investment.

Tanzania has to provide better physical infrastructure-both traditional one like ports, roads, constant availability of energy power (electricity) and telecommunications and nontraditional ones like Internet needed by investors. National infrastructure should be of superior quality compare to those competitors for FDI inflows.

Tanzania is not sufficiently known abroad as most of the investors came to invest into Tanzania by having their reasons apart from the trade relationship exists between their countries and it is therefore needs to do a better job marketing itself as an excellent competitive investment location.

Notes

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