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No PB 26/2022 December 2022

REPOA Brief

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Effects of Investment and the Business Environment on Firm Productivity in Tanzania

By Josaphat Kweka

Key Messages

The Blueprint for Regulatory Reforms, which were developed as a collaborative effort between the Government of Tanzania and the private sector, seek to improve the country's ease of doing business through regulatory reforms and to increase efficiency in dealing with the government and its regulatory authorities.

Investors and potential investors note the biggest challenges to investment in Tanzania include difficulties in hiring foreign workers, reduced profits due to unfriendly and opaque tax policies, increased local content requirements, regulatory/policy instability, lack of trust between the GoT and the private sector, and mandatory initial public offerings (IPOs) in key industries.

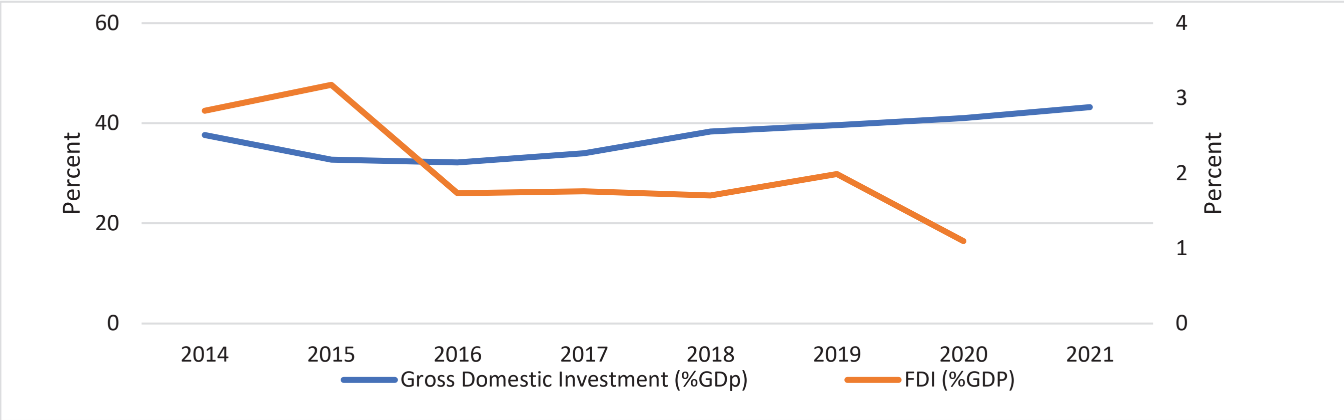
Tanzania needs to improve the quality of education and skills by increasing investment in the capacity of TVETs to help improve the skills of graduates and firms acquire high quality labour and enhance the ability to receive and adopt knowledge.

Introduction

Investment can contribute to productivity and competitiveness of firms in the enterprise sector including investment in capital goods for production, investment owned by foreigners (FDI) and through knowledge transfer from FDI firms. Indeed, investment is an important driver of firm productivity and competitiveness as it helps firms improve production processes through buying new machines and tools, train workers – while spending on R&D can spur innovation and help firms find new markets. Public investment schemes such as construction and improvement of transport and communication infrastructure and production and improvement of utility services can enhance connectivity between markets and improve access to utility services and ultimately improve firm productivity and competitiveness. FDI can have positive benefits in terms of increasing the contestability of host markets, improving the performance of local industry and lowering prices. It may contribute directly to the competitiveness of local firms by being the vehicle by which they penetrate international production and marketing networks. Furthermore, technology transfer from FDI reduces the X-inefficiency of the domestic firms and improves productivity of the local firms (See Gorg and Greenway 2004; Smeets 2008).

The share of gross domestic investment (currently known as gross capital formation) in total GDP has been increasing reaching 43% in 2021 from 37.6% in 2014. This improvement has been attributed to implementation of private sector friendly policies by the GoT which have then created a good investment environment and subsequently attracted domestic investment. Figure 1 shows that Tanzania net FDI inflows (%GDP) generally declined during 2014-2015 period followed by gradual recovery post 2016 then fell down in 2019. In line with this trend, the 2019 World Investment Report reported that while FDI flows to Tanzania increased from USD 938 million in 2017 to USD 1.1 billion in 2018, they have not recovered to pre-2015 levels.

Figure 1: Annual Gross Domestic Investment and FDI Inflows for Tanzania



Source: World Bank Development Indicators 2022.

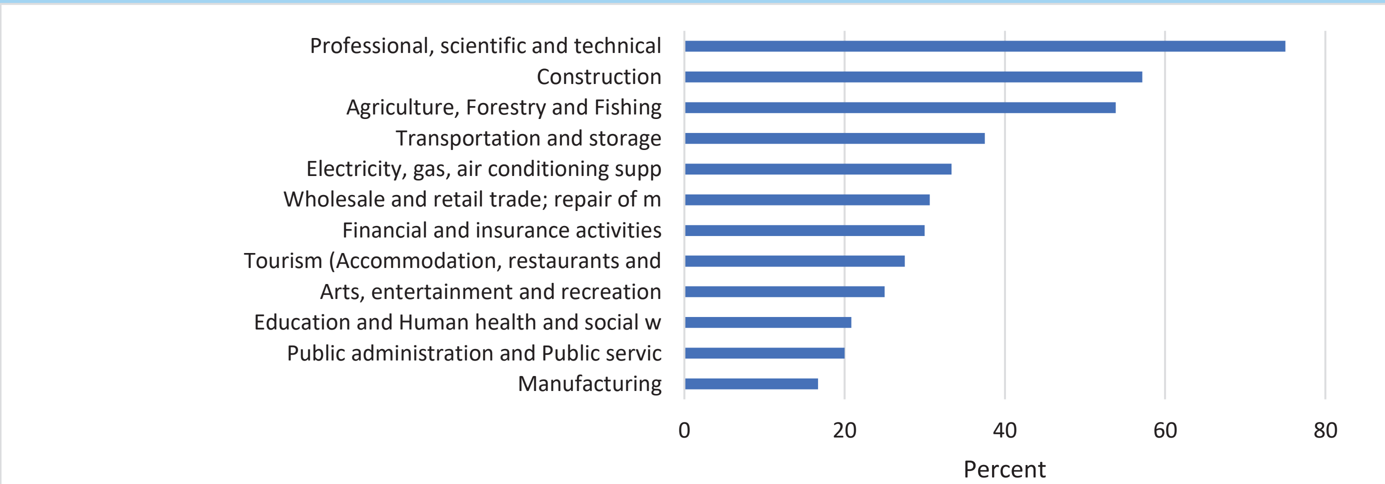
Findings

The declining trend post 2015 was consistent with the general global FDI inflow trend exacerbated by large repayment of loans by investors to the related parties and losses retained particularly in the telecommunications as well as electricity and gas sectors (URT 2018). Investors and potential investors note the biggest challenges to investment in Tanzania include difficulty in hiring foreign workers, reduced profits due to unfriendly and opaque tax policies, increased local content requirements, regulatory/policy instability, lack of trust between the GoT and the private sector, and mandatory initial public offerings (IPOs) in key industries. For instance, in 2017, Tanzania approved new regulations in the mining sector that allows the government to tear up and renegotiate mining contracts, partially nationalise mining companies, introduce higher royalties, enforce local beneficiation of minerals and bring in strict local-content requirements, which undermined investor confidence. In 2016, a large deposit of helium gas was discovered in Tanzania, but its exploration work was postponed (WTO, 2019).

Clearly the extent to which the FDI benefits local enterprises depends on factors internal or external to the firm. However, for technological upgrading to happen, the FDI firm has to have sufficient technological capacity, and that strong linkages have to exist between local firms and FDI (e.g. forward and backward linkages through buying and selling).

Such linkages would promote technology transfer and innovation to local firms through learning by seeing and imitating, and through the labour movement. Indeed, our empirical analysis showed that there are significant productivity gains from learning from FDI firms in both the overall enterprise sector and the manufacturing sector. Zooming in the TES 2022 dataset, we find that firms that have experienced knowledge transfer from FDI firms are more present in professional, construction, transportation and storage sectors while manufacturing sector, public administration and education and human health sector had the least presence of firms that have learned from other FDI firms (see Figure 2).

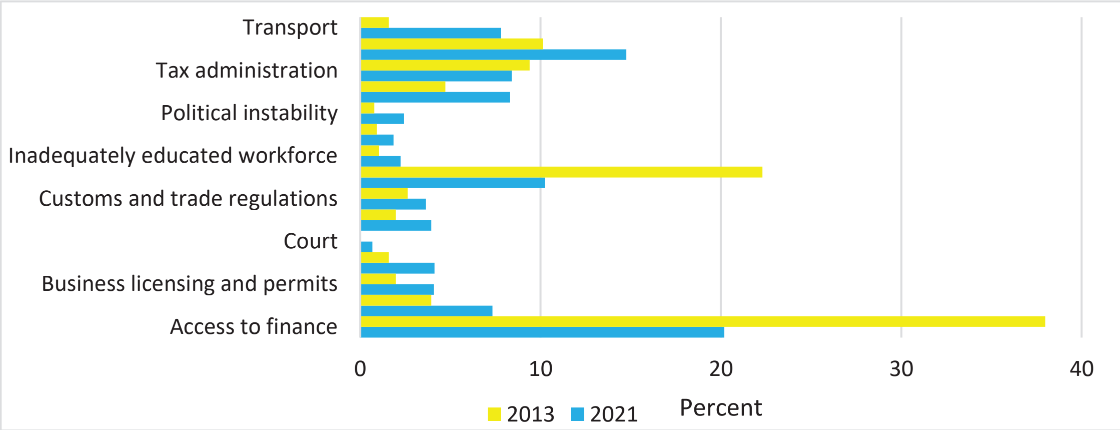
Figure 2: Proportion of firms that have learned from FDIs



Source: Author analysis of Tanzania Enterprise Survey Dataset 2022

Further, Figure 3 shows improvement in only three areas of business environment i.e., electricity, access to finance and tax administration i.e., these areas have been identified by a lower proportion of firms in 2021 than in 2013 (as business environment challenges). This is not surprising given that the GoT has made improvements in corresponding areas including the introduction of online systems for tax payments and implementation of financial inclusion frameworks.

Figure 3: Business Environment Challenges among firms in Manufacturing and Services Sectors



Source: Author analysis of WBES 2013 and TES 2022 Datasets

For instance, electricity access in Tanzania increased from 7% in 2011 to 37.7% in 2020 over the past decade, one of the fastest access expansion rates in Sub-Saharan Africa (World Bank, 2022). This rapid increase in access has been attributed to several factors, including a strong political commitment and support for the rural electrification expansion programs, the introduction of a petroleum levy to finance the NREP; and reductions in connection fees and service charges that were first introduced in 2013 (World Bank, 2022).

In order to enhance access to finance, Tanzania came up with the first financial inclusion framework in 2013 (NFIF 2014-2016). The first NFIF focused on addressing the fundamental broad barriers that constrain financial inclusion in Tanzania by establishing a broad and robust infrastructure to support growth of appropriate financial services and use of technologically driven delivery channels. The Framework targeted access to formal financial services for 50% of adults by 2016. As a result of implementing the NFIF, the adult population using formal financial services improved from 16.7% in 2009 to 65.3% in 2017 while population that is financially excluded declined from 56% in 2009 to 27.9 in 2017. Tanzania is currently implementing the second NFIF (2018-2022) which essentially builds on the first framework. The spirit of the second framework is to advance the vision of NFIF1 so that financial products and services meet the needs of individuals and businesses consistent with supporting livelihood improvement, household resilience and creation of jobs. Given the remarkable progress the country has made in expanding the opportunities for people to access financial service, the second Framework focused on usage of financial services as the next phase of Tanzania's financial inclusion journey (URT, 2017).

On the other hand, transportation, access to land, corruption, crime, theft and disorder, political instability, tax rates, business licensing and permits, labour regulations and inadequately educated work force challenges have all worsened. Surprisingly, transportation has worsened despite the government's efforts to improve both road and railway infrastructures across the country. We believe this is more to do with the recent global fuel price rise which translated to high transportation costs.

Conclusions

This study examined the effects of investment and the business environment on firm productivity in Tanzania. Overall, we find that the Government of Tanzania has move to resolve many of the institutional bottlenecks inhibiting investment and the business environment. Indeed, the GoT is keen to improve business environment and attract more investors both domestic and foreign. The government has adopted the Blueprint for Regulatory Reforms to improve the business environment and attract more investors. The reforms, which were developed as a collaborative effort between the Ministry of Industry, Trade and Investment and the private sector, seek to improve the country's ease of doing business through regulatory reforms and to increase efficiency in dealing with the government and its regulatory authorities.

Further, it is evident that the extent to which the FDI benefits local enterprises depends on factors internal or external to the firm. However, for technological upgrading to happen, the FDI firm has to have sufficient technological capacity, and that strong linkages have to exist between local firms and FDI (e.g. forward and backward linkages through buying and selling). Such linkages would promote technology transfer and innovation to local firms through learning by seeing and imitating, and through the labour movement.

Policy Recommendations

Following our findings, we propose the following three main policy recommendations:

- One, address business environment challenges particularly relating to utility and access to loans. This will help to enhance productivity of the enterprise sector in Tanzania. Furthermore, the government should continue and strengthen implementation of blueprint action plan and increase participation in Regional Trade Agreements/Free Trade Agreements such as AfCFTA and EPA to address the declining trends to FDI in Tanzania. Ultimately, this will increase investment and thus enhance productivity and competitiveness in Tanzania.
- Two, the government should encourage creation of business linkages and knowledge transfer. This can be done by increasing investment public technology intermediaries which can help firms in the enterprise sector find opportunities for creating linkages.
- Three, the government should encourage and strengthen the role of sector associations in finding opportunities for members to create beneficial business linkages. Our findings imply the need to improving the quality of education and skills by increasing investment in the capacity of TVETs to help improve the skills of graduates and firms acquire high quality labour and enhance the ability to receive and adopt knowledge.

REPOA HQs
157 Migombani/REPOA streets, Regent Estate, PO Box 33223,
Dar es Salaam, Tanzania.
Tel: +255 (22) 2700083 Cell: +255 78 455 5655
Website: https://www.repoa.or.tz
Email: repoa@repoa.or.tz

Branch Office
2nd Floor Kilimo Kwanza Building
41105 Makole East, Kisasa,
Dodoma, Tanzania

This policy brief was produced with the financial support of the Foreign, Commonwealth & Development Office (FCDO), through the British High Commission Dar es Salaam.