

**Export Processing Zones and Development: The Tanzanian Experience in the Face of  
Neoliberal Policy Prescriptions**

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in Partial Fulfillment of the Requirements for  
the Degree of Masters of Arts in International Development.**

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**By Mehjabeen Amir Alarakhia**

**Abstract**

Export Processing Zones (EPZs) is an economic policy model used to accelerate industrialization and is employed by many countries in Sub-Saharan Africa (SSA) and in many parts of the developing world. It is believed that EPZs can lead to industrialization mainly by increasing exports, diversifying domestic industry and large scale employment creation.

This thesis examines the role of the state in developing EPZs in relation to protecting domestic capital while trying to attract foreign capital. Tanzania's EPZ policies are examined to determine if the policy environment established allows the state to actively engage in directing investment and developing domestic industry in order to promote industrialization.

The thesis demonstrates that although Tanzania aims at emulating the Asian countries success in industrializing using EPZs, Tanzania has not developed an interventionist model and the role of the state has been reduced to be minimalist following neoliberal prescriptions.

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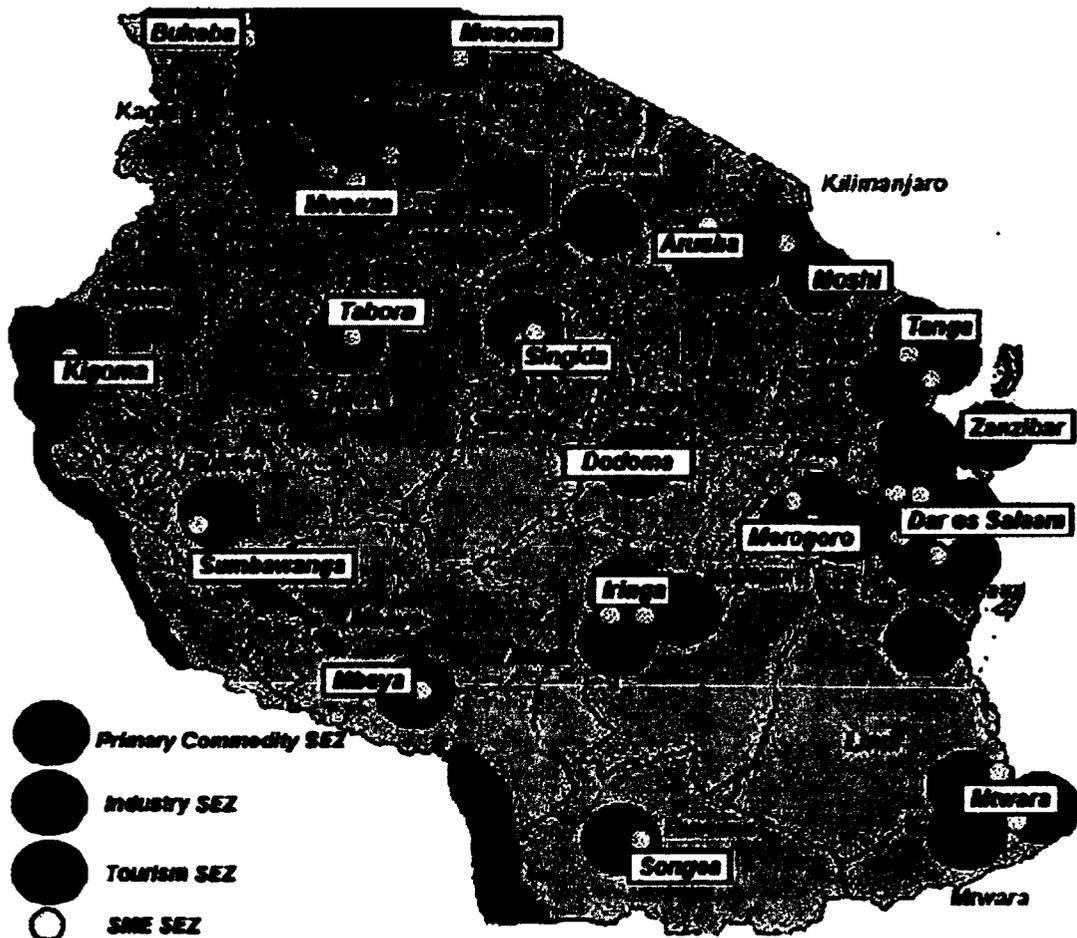
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Map 1



Proposed sites for Special Economic Zones to be established by 2020. (URT, 2004a:Coverpage)

## CHAPTER 1

### *Introduction*

One of the primary strategies of development pursued by countries is industrialization. Industrialization has allowed countries to be able to expand their exports, particularly to increase the value of their products, and increase the employment opportunities within a country. Countries that have been able to develop a viable industrial sector have in turn had more complex economies with higher levels of growth, and more stability in their incomes. As countries have gone through industrialization they have also seen a rise in their rankings in the human development index of the United Nations (UNDP, 2011).

There are many approaches to industrialization and that contest how industrialization may be initiated and sustained as well as the role of the state in this process. While some have argued that the government should be limited to establishing a system where imports are limited and local industries are developed in their place, others have argued that the state should not intervene in this process at all, but rather leave the process to market-forces for industrialization to occur 'naturally' through industries developing through the market to be internationally competitive. Further to this, others have demonstrated that the government needs to play an interventionist and directive role to control and guide investments while nurturing and developing industries for a strong industrial sector to develop in the economy.

What is often misunderstood though is that EPZs do not result in industrial development based on the neoliberal approach where the state is required to play a minimalist role. Rather successes such as those of the Asian countries were a result of a high degree of regulation and direction when using EPZs with the state playing a very active role in industrial development. The EPZ programmes that are being introduced in developing countries currently are being brought in under economic reform policies that require states to deregulate their markets and liberalize their economies. Under these regimes, EPZs turn into a means to subsidize foreign companies to produce goods at a cheap rate as the cost of production is significantly reduced in EPZs through attractive incentive packages. As a result of this, many of these EPZs have failed to contribute to the industrial development of a country when implemented from a neoliberal perspective.

Tanzania has launched the Tanzania Mini-Tiger Plan (2004) which plans for the country to be a middle income country by the year 2020 by replicating the successes of Asian countries that have gone attained rapid industrialization i.e. *the Asian Tigers* which are Taiwan, South Korea, Hong Kong and Singapore and the *Tiger Cub* countries which are Indonesia, Malaysia, Thailand, and Philippines. This strategy proposes that through the widespread establishment of EPZs and/or Special Economic Zones (SEZs), Tanzania will replicate the strategies of the *Asian Tiger countries* to achieve the same levels of industrialization. Like many other developing countries, Tanzania has been compelled through its multilateral agreements to liberalize its economy and deregulate its markets throughout the 1980s and being reliant on foreign direct investment for industrialization.

However, the approach used by many of the Asian Tiger and Tiger Cub countries was one that using an Export Led Industrialization (ELI) model to develop the domestic economy. Thus Tanzania finds itself in a difficult position of wanting to emulate the Asian Tiger model which was highly interventionist while implementing a neoliberal approach.

Theoretically, many EPZs have been established to increase export promotion, diversify the domestic industry base and increase employment opportunities within the country. This thesis will broadly examine the experiences of countries utilizing the EPZ approach under the neoliberal economic policies and will examine how the Asian countries have used EPZs successfully to industrialize. Based on the understanding of the policies utilized to attain the successful industrialization this thesis will examine the EPZ policies of Tanzania to determine if they could lead to the success of the Asian Tigers or if the Tanzanian EPZ programme is doomed to fail like in many other developing countries.

## **LITERATURE REVIEW**

### **Export Processing Zones**

Many countries are introducing or have introduced EPZs as a means of developing the industrial sector. EPZs were one of the main tools of industrialization utilized by the Asian Tigers (Taiwan, South Korea, Hong Kong and Singapore) and the Tiger Cubs (Indonesia, Malaysia, Thailand, and Philippines). Many African countries are now trying to emulate the industrialization successes of the Asian countries by implementing EPZ strategies. As a result of the Asian Tigers success, EPZs are now being promoted in developing countries in almost the same way as neoliberal policies were promoted in the 1980s. However, despite the extensive literature on the policy alterations of the EPZ prescription by the Asian countries, the EPZ model that is being promoted is still the classic neo-liberal policy model. Therefore, it is important to understand the policies used by Asian Tigers in making the EPZs work.

This section will review the potential benefits of the EPZ strategies with respect to increased foreign exchange earnings, diversification of the industrial sector, and increased decent employment. As each of these components is reviewed there will be a discussion on what the failures have been and how the Asian countries mitigated these failures through their policies. This will provide a framework for understanding the types of policies that must be in place to mitigate the potential negative outcomes of EPZ strategies and will therefore inform on what sorts of measures must be taken by the state in order that the EPZs result in development. As foreign direct investment is a major

component of the of the EPZ strategy promoted by neoliberal economists, FDI will be discussed in depth to understand the complexities it poses.

The World Bank (1992) defines Export Processing Zones as:

*“fenced-in industrial estates specializing in manufacturing for exports that offer firms free trade conditions and a liberal regulatory environment”*  
(World Bank, 1992:7).

However the World Bank definition does not encompass all the various types of EPZs that have emerged. The first variation on this is that while all EPZs do have some sort of security system, they are not all fenced-in as the definition alludes to. Some EPZs do have a relatively unrestricted flow of people in and out of the premises; it is only the flow of goods that is restricted. In addition, in several countries EPZs can be situated outside designated zones (Mauritius, China, Madagascar, Tanzania) allowing for existing industrial sites to be converted into EPZs or for strategic location of EPZs such as in border zones or for the extraction of mineral resources (Madani, 1999). Secondly, despite the definition in several countries a certain percentage of the products produced in EPZs are made available on the local market (Dominican Republic, 20 percent; Mexico, 20 – 40%) (Madani, 1999).

The final characteristic of these zones is the economic policies are distinctly different from those within the rest of the country in an effort to establish a truly liberal regulatory environment. Companies established within these zones are often given special treatment – including tax exemptions, superior infrastructural services, and the

special exemptions to several laws, specifically those relating to worker rights and working conditions (Kusago and Tzannatos, 1998). For the purposes of this paper, a more inclusive definition of EPZs will be adopted as most EPZs have evolved into several of the variations defined above. Thus, for the purposes of this study EPZs will imply *any zone or company which is in a fenced-in area, producing for export, with special incentives and where economic policies are different from the rest of the country*. This definition will include special economic zones (SEZs), free trade zones (FTZs), Economic Development Zones (EDZs) and any other term that fits the conceptual definition stated above. There will be a distinction made, when required, if the discussion refers only to one or another kind of zone.

The use of EPZs has exponentially increased throughout the world over the past 20 years. The ILO reports that in 1975 only 25 countries were hosting a total of just 79 EPZs (Boyenge, 2003). By 1997 the number of countries hosting EPZs had increased to 93, with a total of 845 EPZs and employing a total of 22.5 million people globally. However in the five years from 1997 to 2002 there was as drastic increase in the number of EPZs. In 2002, 23 more countries were hosting EPZs resulting in a total 116 countries hosting EPZs, with a total of 3000 EPZs and employing a total of 43 million worldwide (Boyenge, 2003). By 2006, it was reported that the number of countries hosting these zones had increased to 132 with the latest number of EPZs being reported at 5,174 globally (World Economic Processing Zones Association, 2006). Almost all of these jobs are located in labour surplus developing countries and of these, China held the largest

numbers of these jobs with 40 million in over 2,000 EPZs (Boyenge, 2007). Sub-Saharan Africa had over 90 EPZs in 2006 (Boyenge, 2007), no doubt this number has increased significantly since then. More recent comprehensive data has not been collected however it is clear that almost every country in the world has EPZs and a large number of jobs are provided through them.

It is estimated that there are only approximately 700 EPZs in the United States and Western Europe in 2005, and the rest were all in developing countries or emerging economies (FIAS, 2008). In 2005, of the remaining EPZs, it is estimated that 30% are in Latin America, 41% in East and Southern China, 10% in the Middle East and North African Region, and only 4% in sub-Saharan Africa (Farole, 2011). However, this data is relatively dated and a more recent synthesis has not been done. Additionally, many African countries initiated their EPZ programmes in the early 2000's so many of the Zones created in Africa could not have been captured in the 2005 data collection process. The same author estimates that in 2005, the total value of exports from EPZs in developing countries was approximately US\$850 billion, which is slightly less than 20% of all exports from these countries (Farole, 2011). This illustrates that even at that time EPZs were already contributing disproportionately to the exports of developing countries.

Despite EPZs contribution to export ratio, EPZs have not had such a pronounced effect on employment figures in developing countries. Although in terms of absolute numbers it is estimated that EPZs employed about 66million people around the world, in developing countries, EPZ jobs were only about 1 in 40 jobs – approximately 2.5% of all

jobs (Farole, 2011). The nature of these jobs has often been called into question as EPZs tend to employ young women while providing low wages, poor job security, difficult working conditions, and require long working hours.

EPZs have been developed in various forms. Several countries with more sophisticated EPZ programmes, have developed specialized EPZs, such as China have developed zones focused on high-technology products as in Shenzhen, the footwear industry in Wenzhou, or the textile cluster in Guangdong (Zeng, 2010). This has helped developed economies of scale and also to develop local expertise in a particular trade. In other places, the comparative advantage of a well located port has been used to develop a free port, and the local economy has benefited from developing warehousing and other transport services (Zeng, 2010). Globally however, EPZs have had a limited product range. Most EPZs focus on low or medium technology manufacturing which have little scope for technology transfer, or technology creation. Most products from EPZs have been concentrated in textile and clothing production (ILO, 1996); much of this has been fuelled by the Multi-Fibre Agreement (MFA) which limited the quota of each developing country to export to developed countries. The MFA therefore required manufacturers of apparels to establish manufacturing activities in different countries so as to take advantage to the unused quotas. The African Growth and Opportunity Act (AGOA) of the United States which succeeded the MFA allowed preferential access to US markets for apparel produced in African countries.

EPZs have been heavily promoted by the international finance institutions as a formula for rapid industrialization, as well as rapid liberalization. From a neoliberal perspective EPZs are seen as a second best policy option. The best policy option would be to implement country-wide neoliberal economic policies that would remove all distortions in the market and would allow the natural equilibriums to appear. However, in the case that this would be too much reform too quickly, EPZs are seen as testing laboratories where countries can implement reforms which can later be scaled up throughout the country. Amsden (2001) presents an alternative picture. Amsden (2001) proposes that the Asian Tiger and Tiger Cub countries did not use EPZs as testing grounds for neoliberal economic policies but rather EPZs were implemented to enable the country to export products and earn the necessary foreign exchange required for their balance of trade payments without compromising their local industries and market. Thus this model was using an Export Led Industrialization (ELI) model to develop the domestic economy. Similar is the case of Mauritius, where EPZs were not introduced to liberalize the market but rather as a means to create large scale employment for women without jeopardizing the local economy or the local wage rates (Rodrik, 2007). It is important to understand the distinctive approaches as this defines the types of interventions the state perceives itself as being able to implement. In many countries, EPZs were initially introduced as part of the SAPs and most implementing governments see them as islands where pure neoliberal policies must be implemented, thus restricting the range of interventions that can be implemented (Amsden, 2001).

**Increasing Exports**

Many developing countries that implement the EPZs' have economies that are reliant on a few basic agricultural products which then results in serious financial crises when the global markets for those crops falls or when weather conditions cause crop failures. With the introduction of EPZs governments hope to move away from the agriculturally reliant economy to an economy reliant on industrial goods that have higher and more stable global market prices and are not vulnerable to weather conditions. This can then ensure the government can have a steadier income of foreign exchange which is required to make necessary purchases on the international market (such as oil) as well for the purposes of debt-servicing.

It is not a great leap to understand that industrialization requires investment. Countries have struggled to attract and sustain high levels of investment, both domestic and foreign, in industrialization. Studies have shown that outputs booms only after about five years of consistently high investment to GDP ratios for increased production, be it for domestic markets or for export (Rodrick, 1999 in Storm and Naastepad, 2005). Thus high levels of investment are required for long periods of time to see any significant change in the industrialization levels of a country. This can be extremely costly for governments, particularly those in low income countries that have several competing priorities simultaneously and a low capital base.

Some of the most commonly used methods to finance industrialization are national budget support through subsidies, loans and grants, securing loans from

international finance institutions, acquiring aid for industrial development (tied or not) and through the attraction of foreign direct investment (FDI). Budget support and loans from international finance institutions have been discussed elsewhere in this document. An increasingly interesting dynamic is China's investment in developing countries developing EPZs and SEZs. China's aid is not commonly direct financing, but rather is through the provision of services to develop infrastructure through Chinese construction companies and the provision of technical assistance in developing strategies and policies. There has been an increasing trend in the involvement of China in developing EPZs especially in Africa over the past 10 years (Berthelemy, 2011). The key financing mechanism that will be discussed in this section is FDI.

#### *Foreign Direct Investment*

Neoliberal proponents of the EPZ strategy suggest that FDI can be utilized to fund the establishment of industries, to invest in the required technology, and to develop the capacity of the labour force required for industrialization. In an effort to attract foreign investment governments provide superior services for companies establishing within the EPZs (Warr, 1989). Despite the challenges of providing electricity and running water for their population, governments provide all of these at an international standard and a subsidized rate within the EPZs. Governments will also go to great lengths to develop transport infrastructure such as sea ports, roads, railways and airports to facilitate the

export process. This not only illustrates a bias towards the foreign companies but results in a significant cost for the government who not only has to invest in the establishment of these services but then has to continually fund the subsidies to them (Warr, 1989).

With the growing popularity of EPZs globally, countries find themselves competing against each other for a limited supply of international capital. As a result each country attempts to create a more attractive investment environment by providing as many incentives as possible (Amirahmadi and Wu, 1995). It is argued however, that these attempts produce a net result of cancelling out any potential benefits the country could have gained from the EPZs initially. Similarly, developing countries seeking FDI often find themselves competing against each other for investment. The international mobility of FDI further exacerbates this and ignites a 'race to the bottom' between countries. Each country attempting to court FDI attempts to develop a more attractive investment climate and minimizes the potential benefits for its own economy in the process.

One of the primary criticisms for the introduction of FDI focused EPZs within developing countries is the proliferation of the dependence of developing countries on developed nations and trans-national corporations. This re-establishes the centre-periphery relationship that the dependency theorists had criticized and that developing countries had sought respite from in their early post-independence period (see discussion on Import Substitution Industrialization).

It is argued that as the number of EPZs grows within any particular country so does the dependence of the economy of that country upon those EPZs. This then impacts

the governments' regulatory capacities within the country and legislation to regulate the foreign firms becomes harder to establish and implement. In the example of Mexico where almost 2 million workers are employed in the *maquiladoras*, the adoption of any legislation that results in the decline in the amount of factories within the EPZs could result in mass unemployment as well as an immediate decline in the export earning of the state creating a tremendous shock to the economy similar to that of the East Asian economic crisis of 1997 (Bacon, 2004). In addition, with the resulting mass unemployment governments could face a significant amount of civil unrest making the situation more tenuous. Cases have been reported where despite poor working conditions workers do not want their governments to impose stricter regulations for fear of jobs being lost if the factory closes down and relocates. The state's resulting inability to regulate the Trans-National Corporations (TNCs) implies that the state would not be able to prevent any exploitation that may be occurring as a result of the TNCs' activities such as the exploitation of the labour force, or the exploitation of natural resources or the destruction of the environment.

Historical analysis presented by Chang (2002, 2004) has demonstrated that in most of the now-developed countries, FDI was heavily controlled. Some of the biggest proponents of FDI are currently, the US, many of the European countries, and even some of the Asian countries such as Japan. Throughout the late 1800s and early 1900s, economists in these countries were very critical of any sort of foreign ownership of their industries. The scepticism resulted from the lack of trust on the intentions of the foreign

investors. In most cases, foreign ownership of any company was capped at a ceiling level and in the majority of cases foreign investors were not allowed voting privileges in company decision making processes. Similarly, foreign investment in land was banned in many places through legislation (Chang, 2002).

A case in point is the Irish experience as discussed by Chang (2002, and 2004). Ireland is usually given credit as the first countries to introduce EPZs as an industrialization strategy. Even in this initial period Ireland's original approach to FDI was a neoliberal approach. FDI was favoured as it was assumed that foreign firms were more export oriented. Ireland did establish some performance requirements on investors but also provided investment grants to manufacturing firms. After almost 20 years of implementing such a strategy the FDI continued to be in low value added sectors, few linkages to local firms had been made and employment in local firms continued to decline. In the mid-1980s the Irish government recognized the limits to FDI and decided to take a more interventionist approach to industrial development. Contrary to the neoliberal teachings, a more directed approach to improving the performance of domestic manufacturing firms through selective state support and incentives to overcome disadvantages and weaknesses of these local firms was implemented. Domestic firms were monitored using performance-related targets in order to qualify for capital grants and other financing mechanisms. This support was not extended to foreign firms. As a result of this change in approach there was an increase in high quality FDI with more

linkages between the domestic and foreign manufacturers emerging, and there was also a marked increase in manufacturing employment in both domestic and foreign firms.

In the more recent experience of the Asian countries, FDI was initially banned entirely, particularly in Japan (Chang, 2002). When the restrictions on FDI were finally relaxed, the process was very slow and gradual. In some sectors, foreign ownership was limited to a maximum of 50% with joint ventures being allowed only with Japanese companies who were already experienced in the same line of production. Boards of directors were required to constitute at least 50% Japanese representation and brownfield investments were not allowed.

Historically, similar experiences have taken place in many of the now developed countries. FDI had generally been controlled and directed in the early industrialization phase (Chang, 2002). The experience has shown that the liberalization of FDI should only occur at a stage when industrial growth has already been started – and even at that point liberalization should be limited and the process should be gradual. However, despite these experiences, countries that are now implementing industrialization strategies are being compelled to do so with a neoliberal approach to FDI with no restriction or control of FDI.

EPZs were originally envisioned as a means to accelerate the development the domestic industry base within any particular country. In the neoliberal model of EPZs the main focus has been shifted from developing local industries to attracting foreign direct investment (FDI) for the development of industries. When companies were domestic in

nature, the access to working capital, tax breaks and duty drawbacks could be seen as investments by the state in the industrial sector. However, when the firms are foreign firms, these incentives act like subsidies foreign companies resulting in a net loss of capital from the country (Amsden, 2001).

When goods are produced in any industry within the country and exported, the government is the net earner of foreign exchange. This is theoretically also true for factories that may be operating with EPZs. However, the neoliberal approach requires that there is no control on the mobility of capital. Countries are encouraged to attract foreign direct investment (FDI) as the major type of investment in EPZs as these foreign firms will bring with them advanced technology and know how that will contribute to the diversification of the industrial sector (see next section). Therefore as the firms are foreign firms operating in a neoliberal environment, companies have full privileges to repatriate all their earnings and profits out of the host economy therefore there is little or no contribution to the balance of trade challenges the country may be facing.

As incentive for investing within the EPZs (and as a tenet of neoliberal economics) governments commonly grant an initial period within which the corporation, either local or foreign, is exempted for almost all domestic taxes (5 – 10 years depending on country). Although it has long been proposed that the tax incentives in EPZs are key to attracting investors, a recent World Bank study found that reduced taxes are just as effective as tax exemptions in attracting investment and reduced taxes are correlated with higher growth and investment (Farole, 2011). The study suggests that this difference was

because foreign investors who establish companies in EPZs are not infant industries; hence they do not need the total protection from taxes as infant industries do. To these companies, taxes are a part of the operating cost and many of these companies pay taxes in their home economies. However, tax incentives are extremely useful in establishing new infant industries and should be considered an option in encouraging local industrial diversification (James, 2009).

In developing countries where individual personal income for the majority of the population is well below the poverty line, the personal income tax base is weak and an inadequate source of funding for the government. Therefore, governments often rely on the corporate tax base for revenue within which the export tax revenue is the greatest. However, with the case of tax exemptions in EPZs, often the only tax paid by the EPZ company is indirectly through the personal income tax of its employees. Thus the tax holidays granted to these EPZ investors who primarily focus on production for export severely reduce the government's revenue base while increasing profits for the corporation. In addition to this, when the initial tax exemption period is over and corporations are subject to paying taxes, it is not uncommon for corporations use transfer pricing so as to minimize declared earnings thus minimizing the amount of taxes paid to the host country, alternatively, corporations move to new EPZs and being their tax holiday again (James, 2009).

While the EPZs have lot of potential to earn foreign exchange for the balance of trade this has not been the common experience in most developing countries

(Amirahmadi and Wu, 1995). Most EPZ firms are international manufacturing firms that import most of their raw materials and then export the finished value added products. As such, the end result is often that the net foreign exchange earning is much lower than originally anticipated (Warr, 1989). In addition, when these EPZ firms are foreign firms profits are repatriated out of EPZ host countries hence the earning potential is further decreased (foreign direct investment will be discussed in more detail in a later section).

As more and more developing countries introduce EPZs, countries and indeed zones within countries begin to compete with each other to attract foreign capital. This ignites the 'race to the bottom' where countries try to reduce the cost of production in their zones in an effort to make their zone more attractive (Amirahmadi and Wu, 1995). As more attractive EPZs are developed, countries risk having empty zones, therefore to maintain their comparative advantage countries with zones find themselves unable to negotiate for increased revenue from companies operating within their own zones. However, as the Asian countries have demonstrated, if part of the focus of the zones is maintained on local industry development, there are several interventions that could be undertaken to encourage these industries to export their products. Unfortunately, in many of the EPZ programmes being implemented currently, local investors do not get the same privileges as foreign investors thus the programmes in reality discourage local industry.

**Diversification of Domestic Industry**

It is expected that through the introduction of the technical know-how from foreign companies, countries that may not ordinarily be able to engage in research to develop technology can benefit and produce developed goods for the global market (Rhee 1990; Rhee and Belot, 1990). One of the ways in which the EPZs are envisioned in helping the economy is through the establishment of linkages between the industries within the EPZs and those in the local economy. Backward linkages refer to the raw materials and intermediate goods the EPZs draw from the local economy. In the theoretical model of EPZs, foreign companies would be partners with local investors either directly or through the supply chain. This therefore would require the local firms to enhance the products they are producing to ensure their products meet global market standards in order to ensure the international firm buys from the local firm and not from another international supplier. Already this would have a positive impact of encouraging local suppliers to better the quality of the goods they produce. In addition, the local firms will also have to increase the amount produced to meet the needs of a large manufacturer in the EPZ therefore also developing economies of scale and increasing profits. It is also proposed that through this partnership local firms will be provided with in-roads into international markets through the international firm – in-roads that would otherwise not be available to the local firm.

Proponents of the EPZ strategy suggest the establishment of these zones will encourage local industries to manufacture and provide inputs; however it must be noted

that the import intensive nature of EPZ production limits the potential of outsourcing to the local economy (Amirahmadi and Wu, 1995). In addition, it is proposed that the local economy will also benefit from the techniques and technologies of the foreign firm. This will happen as the local workers get employed and trained with the EPZs, as these employees get released back into the local economy with the skills they acquired in the EPZs and these would then be transferred to the local economy. Additionally, because most EPZ jobs are targeted towards a young and generally unskilled labour force, proponents suggest that these jobs will train and discipline the workforce instilling in them a good work ethic (Amirahmadi and Wu, 1995). This seems to be somewhat presumptuous and somewhat Eurocentric in the assumption that these individuals are lazy (Chang, 2009). As Chang points out, similar criticisms were made of the Japanese population before its miracle economic development.

Although the neoliberal model assumes that these linkages and developments will happen 'magically' as market mechanisms are allowed to function, the experience of most developing countries with EPZs shows that these have not materialized in reality. Some proponents of neoliberal economics have proposed that it takes a long time for these benefits to materialize and that the short term pain needs to be experienced in order to achieve a long term gain. The Asian and Latin American countries recognized these changes would not happen by default and as such introduced specific and targeted measures to ensure that technology transfer and local skills development actually occurred.

Of particular interest in this respect is the example of EPZs in Mauritius which had been a monocrop economy in the 1960s when it experienced a population boom. The country had a small but vibrant economic sector including some industrial production that had enjoyed a protected market since independence in 1968. During the 1970s, the Mauritian government embarked upon an EPZ strategy so that almost all goods are exported to develop its industry base for export because the small local market would not be able to consume the products of a large industrial sector. The government introduced EPZs to protect local industries from international competition while allowing foreign investment which resulted in both the creation of jobs as well as the stimulation of the local economy through indirect income streams (Rodrik, 2007). This illustrates how the establishment of the EPZs can lead to the expansion of the local economy if the government plays an active role in monitoring and regulating the investors' activities.

Specifically in the Asian countries, there was a constant monitoring of the types of technology that was being imported. There was a system to ensure that obsolete technology was not being imported. Similarly, the government negotiated and enforced a mandatory training programme for certain companies. Industries that grew beyond a stipulated size were required to provide training to their staff to ensure there was enough of a skill base in the country for that industry. Thus, a systematic mechanism to upgrade skills and transfer knowledge was established (Amirahmadi and Wu, 1995).

In China, industry specific EPZs were established. As a mechanism to ensure local knowledge and technical capacity is built, China established sector specific

partnerships between EPZs and local universities. As students got opportunities to research and learn about business strategies, they also learnt about industry specific technology and technological advances (Zeng, 2010). Thus a local knowledge base was built through design and not by default. Similarly, in South Korea's Massan EPZ, 4000 workers were trained in electronics and chemicals deliberately through a requirement by the state. This again illustrates that technology and skills transfer does not occur by default. Also, the industries being developed must be those that require some level of technology to be utilized such as electrical equipment manufacturing, industrial chemical production, metallurgy and rubber (Amirahmadi and Wu, 1995).

As seen above, the technology required to diversify exports cannot just be transplanted from other countries with the expectation that local industries will learn how to use it. Developing countries need to invest in human as well as physical capital to diversity their industry base and to ensure the exports can be competitive on the global market. In addition, these policies often need to be monitored and deliberately implemented on the part of the government as seen in the Asian miracle countries.

Although the argument in support of EPZs suggests that this strategy will draw the domestic firms into international trade, the opposite is also possible. The introduction of a large international trans-national corporation would have devastating effects for a smaller local firm that may be operating in the country (Amsden, 2001). Large international firms often produce large quantities with advanced technology and therefore are able to reduce their costs. In comparison local producers work on a smaller scale with

more labour intensive methods and thus have a higher cost of production. The introduction of the international firm would consequently jeopardize the sustainability of the domestic firm. Supporters of the EPZ strategy would argue this is merely the work of the market in ensuring that the most efficient means of production is achieved. However, the elimination of the domestic firm defies the purpose of introducing EPZs in the first place as it undermines the domestic industries instead of producing an environment where they can prosper. Furthermore, the neoliberal EPZ supporters would argue that as the EPZ firms are only allowed to sell a small percentage (20%-30%) of their products on the local market the local manufacturers would not be negatively affected as this would encourage competition and efficiency in production. However, when comparing the magnitude of production, the EPZ producers are expected to be producing for a global market and thus 20% of their production may be much more than the consumptive capacity of the local market within which they would sell their products and therefore, hindering the success of local producers (Farole, 2011).

Upon studying the experiences of EPZs in various countries, it has been found that the nature of EPZ manufacturing often implies that this strategy is extremely import intensive (Amirahmadi and Wu, 1995). With the spread of the new international division of labour in the post-fordist era, most EPZs tend to merely be assembly plants putting together various parts of a product in order to capitalize on the comparative advantages of cheap labour in the host countries (Baldoz et al, 2001). As a result there is little technology transfer taking place as EPZ jobs are commonly labour intensive and hence

there is little technology involved to be transferred. Additionally, while most TNCs do conduct research and development activities, this research is ordinarily conducted in the home country where a knowledge economy exists and not in the host country (Amirahmadi and Wu, 1995). Thus the spill over effects of this technology development does not commonly impact the local host economy.

Foreign investors prefer to import goods from globally competitive companies. This allows for a guarantee of quality as well as price. From a critics perspective this also allows the foreign firm to relocate as and when it sees fit without disrupting its business connections (Chang, 2009). This has been an increasing problem as the number of export processing zones has increased globally. Committing to local suppliers means that companies must first invest in local technological and manufacturing know-how which is a costly exercise in itself. Secondly, if companies move across borders they must re-develop these local suppliers or else import from the suppliers in the former country. The final barrier to allowing linkages to happen is the enclave nature of EPZs. Locally purchased goods must be imported into the customs bounded enclave of the EPZ hence making it more expensive then the import the inputs from other countries because imports from the local market are not duty free. Hence, the incentives of the EPZ scheme introduced to attract foreign manufactures in reality act as disincentives for the same EPZs to buy from local producers (Amirahmadi and Wu, 1995).

In order to ensure that local companies were not left out of the industrialization movement, some governments have required producers to use local content. This was

done in at least three ways. The use of local content was used in Asian and Latin American countries as a condition for access to credit. Governments established a minimum requirement of local content in an exported product such as in Brazil where the requirement was being 90%-95% of local content. However, in Brazil this proved to be unsustainable as it required technocrats to know in detail the production procedures to understand which industry should be pushed to source good locally. Similarly, it was difficult to judge in some industries the amount of local content being utilized, especially is a portion of the goods were allowed to be imported. Finally, local content is often not globally competitive in terms of price as well as quality and this is increasing problematic as foreign direct investment increases in export industries (Amsden, 2001). The second method that was used was banning the export of an unprocessed product. In the case of Indonesia, wood was banned from being exported in its raw form and had to be process to a minimum level of plywood before it could be exported (Amsden, 2001). The third method that has been used, although not in recent years, was in Tanzania where tax exemptions for imported inputs were only granted for inputs that were not available from local producers and that were going to be used for export products (Rutman, 1968).

The neoliberal approach to diversification of the local industry base has been proven to be ineffective. While the approaches that have been used in some countries seem demanding and complicated to implement, they are required if the country intends to stimulate local industry through the EPZs programmes.

**Decent Employment Creation**

Aside from the revenue generating aspects of EPZs, these zones are intended to provide large scale employment in labour surplus economies (Kusago and Tzannatos, 1998). As the agriculture sector becomes more efficient and more workers are made available for employment in other sectors thus many developing countries are faced with a growing unemployed population (Lewis, 1954). Thus, with the establishment of EPZ factories it is expected that a large number of jobs will be created in the industrial sector providing both skills development for those employed within them as well as income. It is expected that indirect jobs resulting from the EPZ activities and employment will double or triple the income streams outside the EPZ being provided from the direct jobs within EPZs. The issue within the EPZ discussions however lies in the quality of the jobs being provided. As neoliberal theories propose attempts to control the quality of jobs being provided would be interventionist and would distort the magic of the market. Neoliberal economists propose instead the basic supply and demand model proposing that when the availability of labour goes down, the quality of jobs will improve.

**The Labour Surplus Economy**

Sir Arthur Lewis (1954) proposed that as the agriculture sector undergoes technological advancement worker productivity will increase thus decreasing the demand for labour within this sector. In most developing countries, the agriculture sector has been the main mode of employment for the large majority of the population for most of history

thus this increased productivity will release vast numbers of people, making them available for employment in other sectors. However, societies in which non-agricultural sectors are underdeveloped the release of labour usually results in an increase in the unemployment rate resulting in the existence of a large amount of surplus labour. Based on the basic economic postulate of supply and demand, the cost of labour drops as the number of individuals seeking employment supersedes the number of available employment opportunities. With the strain that this puts on the social system, governments are increasingly pressured to provide jobs.

Especially, in least developed countries (LDCs) many labourers are bound to their employers as widespread unemployment or seasonal employment makes workers heavily dependant on employers to remain employed. It is argued that it was precisely due to the shortages of labour in the developed world, that the working conditions as well as the wages are much higher compared to LDCs. Furthermore, in most LDCs the majority of the population works either in agriculture or in the subsistence sector (Lewis, 1954). The low level of wages in the formal sector implies workers will continue to have a subsistence level livelihood, being unable to save or reinvest into the economy (Lewis, 1954). Based on the neo-liberal model, the low wages the workers receive implies that these workers are unable to purchase the goods they make. As a result, the levels of consumption in the economy remain low, thus production is limited to, and targeted for, export. This however, limits the growth potential of the economy as the savings rate is low as is the re-investment rate. Furthermore, in order for modern societies to exist with

the facilities that they do, labour must be productive beyond the minimum subsistence level, with each individual producing more than what they consume for there to exist a surplus to invest. Thus it is proposed that in societies where there is an abundance of labour, the employment standards of labour suffer as a result and the economy will still be unable to grow (Lewis, 1954). It is therefore imperative that governments find a mechanism to increase the incomes of their people.

*Feminization of the EPZ workforce*

There is a disproportionate representation of young women workers, often under the age of 25, who work within these EPZs (Boyenge, 2003). This is a trend that has emerged in almost all EPZs throughout the world (Boyenge, 2003). Employers propose women employees are better suited to carry out the detail oriented work required in these factories, especially in the electronics and textile sectors. Some authors have also proposed that employers prefer to employ women because they are less likely to resist the authority of the employer, they can be hired at a lower wage than men, and because they tend to work for short periods of time (until they get married or become mothers) and are not searching for career development opportunities or job security (Kusago and Tzannatos, 1998). An alternate explanation has been proposed for the over representation of women. It is suggested that the only other form of employment available to women is in the informal sector hence women choose to work in EPZs over the alternative. Men on

the other hand have employment options in the formal sector and thus choose not to work in EPZs (Kusago and Tzannatos, 1998).

### Decent Work

Most countries have a definition of the minimum standard which must be met at any place of employment, as well as some industry specific employment standards. The International Labour Organization (ILO) has developed a decent work agenda (ILO, 2011). This agenda provides a basic list of criteria that individuals strive to attain in their working lives. The strategic objectives for the decent work agenda are the availability of employment opportunities with decent hours which provide adequate earnings and productive work; the entitlement to paid time off including annual leave, compassionate days off and maternity leave; stability and security of work; equal opportunity and treatment in employment; safe work environment including access to healthcare; and entitlement to social security; and social dialogue, workers' and employers representation that can increase productivity and avoid disputes (ILO, 2011).

In 1976, the Organisation for Economic Co-operation and Development (OECD) published the International Investment and Multilateral Enterprises Declaration, which contained guidelines to encourage a positive contribution by TNCs to the economic and social progress of the countries within which they choose to locate (Perman et al., 2004). In 2000, the OECD governments amended this declaration to align it with the ILO Tripartite Declaration of 1977 (Perman et al., 2004). As a result of this amendment

countries must extend the national labour laws to the EPZ areas. Initially, EPZs had several exemptions on the labour standards and laws, however as a result of these global agreements exemptions are no longer permitted.

Despite having good policies on paper countries often fail to enforce them sufficiently within these zones. This has been the case in Mexico where despite having one of the most developed labour legislations in the world, the workers in the *maquiladoras* must accept an inferior working environment because the government chooses to accommodate the needs of the investors' rather than workers (ICFTU, 2003).

Similarly, the most governments around the world have legislated minimum standards which stipulate the number of hours within a work week. Any worker who works more than the stipulated number of hours must be paid a premium overtime rate for each additional hour of work (Perman, et al., 2004). However, because of the vacuum of regulation within EPZs, many workers work more than the national work week without being compensated for it. In addition, many times workers within EPZs are paid a 'piece rate' for each unit they produce, or are expected to produce a required daily quota (Madani, 1999). In these situations workers are not paid an hourly wage at all, thus employers do not care how long it takes workers to complete the work as long as the quota is met. The major drawback of this strategy is that often time workers will work for 10 or 12 hours a day to complete their required quotas (ICFTU, 2003). Studies have shown however, that the longer hours that these workers work, the more fatigued they become (Perman, et al., 2004). The same study concluded that as the fatigue levels rise

the workers are more likely to get seriously injured while at work thus putting at risk their health and safety, as well as their future employability.

The problem however arises due to the exemptions from the labour laws of the companies established within these zones. These exemptions imply that those working within these zones are essentially working in a completely deregulated environment where there exists no means of ensuring a minimum labour standard. It is important to note here that as these are not local firms, it is difficult for the government to hold them accountable and insurance companies may or may not be accessible to the worker if they were injured.

Thus while these jobs may be providing income to those that would otherwise be unemployed or those employed in the informal sector, the social costs of working in these EPZs coupled with the minimal economic benefit call into question the developmental contribution of this form of employment (Cling et al, 2005). The low wages of the workers implies workers would be unable to save or consume goods, thus the extent of the income stream provided is questionable. The domestic market remains small and profits for local firms also remain small due to the resulting low levels of consumption. A recent World Bank study finds that it is higher wages (not lower) that correlate to higher growth and investment (Farole, 2011). There do exist some studies that claim that wages of EPZ workers surpass those of non-EPZ workers in the same country and in the same sector, however many have argued that this statistical appearance is a result of long working hours that defy the maximum work week allowance, or a result of workers taking extra shifts to earn enough money to cover their expenses, or as a result of very high quotas on

piece meal contracts (Kusago and Tzannatos, 1998). However the net result of the low wages is that while these zones could potentially be contributing to the growth of the economy, the exemptions to foreign firms often hinder the manifestation of any of these gains.

In the case of Mauritius, two particular interventions are interesting and need to be discussed. As the introduction of the EPZ strategy in Mauritius was voluntary and not required by any external actors, the government was about to develop the programme as was most appropriate for its people. In order to mitigate the known adverse effects on health and social welfare through employment in the EPZs the government established a EPZ Labour Welfare Fund (now the Manufacturing Labour Welfare Fund) which provides funding for day care and education services for children of EPZ workers, and leisure activities for EPZ workers and their families. This fund was contributed to on a monthly basis by both EPZ operating firms as well as employees of EPZs based on profits and incomes (Rodrik, 2007).

Mauritius being an island state had a limited number of employment opportunities in the local market. The government wanted to provide employment for women without disrupting the employment opportunities available for men. This was one of the objectives of the EPZ programme that was implemented. Knowing that EPZs tend to employ women, Mauritius utilized this as an affirmative action opportunity for women.

In some cases the financial exemptions in zones have prompted companies to move factories that were originally outside the zone to inside the zone, with a net result

of no new jobs created, thus merely shifting jobs and defying the EPZ objective of job creation. Many EPZ programmes now require investments to be *new* investments to be eligible for EPZ status thus in many situations this issue is being addressed.

Poor working conditions within the zones have long term repercussions on the health of the workers. Once the workers health deteriorates they will have no savings and with no social programs being provided in the country these workers are left as burdens on their extended families, again causing stresses on those who are in the workforce, spreading resources thin, and causing an inability to break out of the poverty cycle.

Because of the 'race to the bottom' of EPZs these standards are often not enforced or waived entirely, thus employees work in a vacuum where there are few, if any, government regulated minimum standards and there is often little regard for workers health and safety. However, if the investment is a local industry, labour laws are not exempted thus protecting both the country's financial resources as well as its people. Again, the neoliberal policy prescriptions create an environment that is potentially hazardous to the populations that work within the EPZs. Some mitigation strategies have been developed and utilized very successfully in some EPZ programmes and should be utilized in other countries.

### **Export Processing Zones and Industrialization**

Countries have struggled with industrialization strategies from the pre-industrial period in the 1500's. Europe's industrialization occurred almost by default. During the

period if European industrialization there was no previous global experience on how to industrialize, or what fiscal and economic policies promote growth and facilitate investment. Even the benefits of industrialization at this point were unknown fully, all that was known is that mechanising processing will make the processes easier, increase productivity, and cost effectiveness. The process of European industrialization took approximately 200 years (Chang, 2002).

Many of the proponents of 20<sup>th</sup> century industrialization argue that with the right policies and the creation of the right environment, the 200 year industrialization process that Europe underwent can be speeded up. No doubt, the Latin American countries seemed to have accomplished this process in a period of 50 years and some of the Asian countries have taken even less time.

In order to speed up this process the main challenge that state policymakers face is how to sufficiently create an environment that stimulates industrial development without compromising the other sectors of the economy or society. This section will review the literature on three approaches to industrialization: Import Substitution Industrialization (ISI), Export Led Industrialization (ELI), and the mixed economy approach. These models have been selected as they have been used by many countries to various degrees of success. The objective is not to analyse all the literature with regard to these approaches as this is beyond the scope of this paper but to understand the context from which the EPZs discussed above have been emerged.

***Import Substitution Industrialization (ISI)***

Although ISI strategies had been used in the industrialization of many countries for over 200 years, it was only in the 1950s and 1960s that the concept was formally articulated and written about. The structuralist school of thought emerged mainly from Latin America and the dependency school to which they belong was informed by global events during that period including the independence of many African countries (Martinussen, 1997). The dependency theorists proposed that economies at the peripheries of the global chain of production remained underdeveloped because their products were mainly unprocessed goods which have a low value. These economies were developed as providing the raw materials that were exported to the economies at the centre where most of the processing and manufacturing took place. These processed goods were then sold back to the economies at the periphery at a price several times higher than what it was bought for because value had been added to the product through the processing. Thus the major profits were retained in the economy at the centre where the processing happened. In order for the periphery economies to re-import and consume value added products, the economy must have the capital to buy the products. However, due to the low earnings from the export of unprocessed goods, these economies are consistently faced with a deficit in their trade budgets due to a scarcity of the required foreign exchange.

At the onset of independence several developing countries (usually at the periphery) were faced with the challenge of developing their economies. Leaders of most

of the newly independent countries found themselves with populations that had low skill levels, low levels of formal employment and low levels of productivity. Some countries were endowed with high levels of natural resources but lacked the technical, human and capital resources to extract these natural resources and to benefit economically from them. Thus, leaders were faced with a challenge of *how* to industrialize rather *why* to industrialize. The structuralists proposed that to overcome the problem of the uneven terms of trade was to produce industrialized goods in the periphery countries. This would also decrease the dependency on the centre that had been created through centuries of colonization.

It is not surprising that most economies that emerged in the post-independence period were modeling similar systems with strong centralized state control rather than the neoliberal economic policies implemented in later times. Krugman (1995) states that at the time "... it was widely taken for granted that centrally planned economies, whatever their other weaknesses, were good at generating industrial growth."

Prebisch (1959:252) also proposed that "industrialization is an inescapable part of the process of change accompanying a gradual improvement in per capita income". From the experiences of Britain, Germany and others this had been evident (Chang, 2002). Countries in the periphery were often producing and exporting primary commodities while countries at the centre, the more developed countries, were producing industrialized goods. Primary commodities do not have as much value on the global market as do processed goods.

The economic system during the colonial periods in Africa, Latin America, the Caribbean and Asia established a centre-periphery relationship with little benefits to colonized populations. There were high levels of international trade, which were mainly based on a system of extraction and forced production benefiting the colonizers economies. Most systems were centralized with high taxation rates to fund the infrastructure developments that in turn facilitated the transport of goods from the periphery to the centre. Competition by local merchants, such as local farmers who wanted to grow coffee, was systematically discouraged and in some cases colonial industrialists were allowed to exist as monopolies.

After centuries of colonization, many of these leaders were faced with a popular demand to reduce the dependence on the former colonial powers. Many developed a popular development strategy where economic development focused on the people and that would change the center-periphery imbalance.

The United Nations Economic Commission for Latin America (ECLA) formally proposed ISI as a means of stimulating domestic industry. It was proposed that government must implement specific policies to support key capital inputs for industrialization through introducing:

“Protective tariffs and/or exchange controls; special preferences for domestic and foreign firms importing capital goods for new industries; preferential import exchange rates for industrial raw materials, fuels and intermediate goods; cheap loans by government development banks for favored industries; the construction by governments of infrastructure especially designed to complement industries; and the direct participation of government in certain industries, especially the heavier industries, such

as steel, where neither domestic nor foreign private capital was willing or able to invest (Baer, 1972: 98).

**For newly-independent countries pursuing an Import Substitution**

**Industrialization (ISI) model meant an economy that would allow the infant industrial sector to develop by providing it a confirmed market that would by products and enable to industries to develop in a protected market until their products are good enough and until the economies of scale have been achieved for them to be competitive on the global market. In addition, the ISI model provided much needed relief to the problem of balancing payments in situations of low foreign exchange as only essential industrial inputs would need to be imported. Bruton (904:1998) states “To industrialize, given the existence of already industrialized and highly productive economies (the North), the countries of the South must protect their economies from imports from the North and concentrate on putting in place new activities that will produce an array of manufactured products currently imported”.**

**Many countries adopted the ISI strategy to varying degrees in the 1960s and 1970s, and many of these countries saw some growth in their manufacturing sectors during this time (Easterly, 2001). However, many countries also experienced significant challenges when utilizing the ISI strategy leading to much debate on the effectiveness of the model in achieving industrial growth.**

**One of the challenges being faced at this juncture was the nature of goods being produced. The ISI strategy aims at nurturing infant industries for several years to become**

more efficient in production by protecting local markets from foreign competition. Although, export was not discouraged, the ISI strategy provides little incentive for export because it guarantees an available market for consumption. Thus, during the implementation of the ISI strategies, for most countries, the make up of exports did not significantly change from the traditionally exported unprocessed agricultural products. Krueger (1980) as the balance of payments became more strained, countries focus on saving foreign exchange and reducing imports while they should have focused on diversifying their exports. Rodick (2006) argues that countries must produce non-traditional goods in order to attain higher earnings and experience the growth effects – many of these require higher levels of technology and capital investment. Diversification of the export base would make countries more resilient to shocks in the global markets. While the aim of the ISI approach is to develop the local industries, it provided little opportunity for the country to earn foreign exchange to buy required inputs for industry as the economy is not producing goods for export.

The oil shocks of the 1970s are attributed as the key events that negatively affected many of the countries utilizing ISI at the time. As the newly-independent countries utilized scarce foreign exchange earnings to buy fuel, the oil shocks of the 1970s, resulted in extreme increases in the prices of oil. As much of the industrial development depended on oil-fuels, many countries started facing into balance of payments crises as earnings from exports could not create enough capital to buy the required oil-fuel imports. As a result, many of these countries needed to borrow from

international finance institutions (IFIs) such as the World Bank Group (WB) and the International Monetary Fund (IMF).

Critics of the ISI strategy proposed that the failure of the ISI strategy to bring about development was not due to the shocks of the 1970s but rather due to an inherent flaw in the approach. The ISI strategy required a number of what neo-liberals call market distorting interventions such as tariffs, import licenses, exchange controls and inflated exchange rates (Burton, 1998). It is argued that these interventions distort the efficient market systems making the manufacturing sector unable to compete with international producers (Bhagwati, 1978).

The ISI approach created an environment for the implementing state what is similar to that which existed during the time of the European industrialization allowing industries to develop their own technology for production. However, ISI did not take into consideration that many of Europe's imports during its industrialization period were relatively inexpensive raw materials and most of the technology being used was simple non-oil-fuel based technology. In the case of the newly independent countries pursuing ISI strategies in the 1960s and 1970s, manufacturing methods had evolved and were primarily oil-fuel based. Hence, the ISI strategies needed to be able to cater for the need for earning foreign exchange as a necessary industrial input. In the absence of this, there would consistently exist a crisis in the balance of payments.

The newly independent countries needed an approach to industrialization that would minimize their dependence on the centre economies and allow the local industries

to develop without a reliance on external factors. The required time for such industrial development to occur is significant, and the ISI strategies could not provide significant foreign exchange earnings during the period when industries were developing despite the inherent need for oil-fuels during this time. As a result, although the ISI approach is what was used by most European and American economies, the newly independent countries could not use this approach because of the impact of the oil shocks of the 1970s on the prices of fuel oil. Thus the viability of the ISI approach to result in industrialization in the latter part of the 20<sup>th</sup> was unable to be determined as many of the countries had to abandon their ISI strategies in order to survive economically. It did demonstrate however, that any industrialization strategy must include a mechanism to earn significant amounts of foreign exchange from the onset so that the required oil-fuel imports can be acquired for industrialization.

### ***Export Led Industrialization (ELI)***

Development policy took a turn in the 1980s. A general trend was seen with many developing countries abandoning the ISI strategies they had previously been committed to and adopting ELI strategies. The purpose of this section is to review the main components of the ELI strategy and its critiques to the extent that is required to understand the ideological framework of the ELI strategy and to appreciate the perspective within which EPZ strategies that have been implemented by several developing countries including Tanzania are anchored.

As developing countries required more financing after the oil shocks in the 1970s, several loans had already been signed by the leaders of these countries with International Finance Institutions (IFIs). As interest rates began to rise, countries started to require even more financing to meet their debt serving needs. The IFIs at this juncture required a commitment to neo-liberal economic strategies that emphasized, among other things, the Export Led Industrialization (ELI) approach. It was argued by the IFIs that the failing economies of the developing countries were precisely due to the state interventions in the economy through strategies like ISI that had created distortions and inefficiencies in the economy. IFIs therefore set conditions on loans which required countries to shift from the ISI strategies to ELI strategies in order to receive financial support.

This shift was a significant move that involved a complete ideological turnaround from a state-led strategy to a market-led strategy. As explained above the ISI approach allowed the state to develop key industries and nurture them to maturity. However, the neoliberal approach required the government to withdraw completely from direct economic activity and to allow the 'natural market forces' to operate.

Renowned economist, Friedrich August von Hayek (1899-1992), was against any government intervention in economies, as he believed it would lead to totalitarianism. He also argued that in planned economies a group of individuals must allocate resources but these individuals will never have sufficient amount of information to carry out this allocation efficiently. He believed that the price mechanism in free markets was the most efficient in allocating resources, facilitating efficient exchange and use of resources (Yargin and Stanislaw, 2002; Dutt and Ross, 2003; Gillis et al, 1992; Todaro and Smith, 2003). His ideas

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can be traced back to Adam Smith's theories of neoliberal or 'free market' economics, which were fueled by the belief in the 'magic of the market' where the market is perceived as being the most efficient tool in regulating the economy (Simon, 2001; Gillis et al, 1992).

These ideas were incorporated into mainstream policy discourse at the global level in the 1980s by two key political leaders, Margaret Thatcher and Ronald Regan, who were strong supporters of Hayek and advocates of free markets. These leaders established policies that pushed forward privatization and deregulation, which resulted in a global recession that lasted three years. Consequently, these political leaders contended that such policies gave rise to short term pain but long term gain (Yargin and Stanislaw, 2002; Gillis et al, 1992; Cameron, 2004).

Hayek's free market ideas are still very dominant today. This dominance is evident in neo-liberal economic and development policies. Neo-liberal development policies are presented as the only method for developing countries to achieve economic development. Developed countries continually preached to developing countries the need for free markets and government deregulation. Neoliberal policies were enforced on developing countries by International Financial Institutions (IFIs) as conditions for access to funding and loans after the debt crisis in the 1980s. These conditions are referred to as structural adjustment policies (SAPs) (Chang and Gabel, 2004; Simon, 2001; Parpart and Veltmeyer, 2004).

The SAPs included classic neo-liberal policy prescriptions mainly requiring the downsizing of the state and the deregulation of the market. Neo-liberal economics utilize Hayek's proposition that the market is the most efficient mechanism to effectively distribute resources to the most efficient producer. It was proposed that to achieve this level of

efficiency globally, *all countries* must engage in open trade through reduced or eliminated tariffs, although this was only being systematically required from developing countries through the IFI conditionalities. Furthermore, it was preached that this was the only way to obtain long term sustainable economic growth.

On the other hand, Francisco and Rodrik (2001) demonstrated that there is no negative correlation between trade barriers and economic growth. Similarly, Rodick (2007) further argued that open markets and free trade do not help an economy to industrialize unless the other economies in the free trade zone are at an approximately similar economic development stage – in line with the ISI approach. Thus free trading blocks within regions of similar development levels could be beneficial if all the countries were at similar economic levels, however a global free trade system would disadvantage the underdeveloped economies.

In the 1990s, after a decade of implementing SAPs in developing countries, it became increasingly apparent that neoliberal policies had failed to promote development (economic or otherwise) and reduce poverty and inequality (Easterly, 2001). IFIs attributed this failure to weak political institutions who did not effectively implement liberalization policies and not to inadequacies of trade liberalization itself (Meyers, 1989). This argument was based on Anne Krueger's (1980) hypothesis that neoliberal economic policies would lead to a decreased amount of paperwork, delays, bureaucratic regulation and other process that cost both time and money. Thus, reducing the role of the state would reduce the bureaucracy and make the market and institutions more efficient and resulting in increased growth. This

however did not happen, instead poverty and inequality in developing countries remained stagnant, and indeed increased in some (Easterly, 2001).

As discussed above, EPZs are seen as the second best policy option, while the first would be to liberalize the market at a broad scale across the country, neo-liberals propose that EPZs can be stepping stones for countries to liberalize their markets. EPZs would provide the testing ground for liberalization allow the country to see the benefits of liberalization (this has been discussed in depth else where in this paper).

### ***The Developmental State***

One of the pivotal debates has been the role of the state in the development of industry. Neoliberal economics propose that the role of the state would be only to provide for macro-economic stability systems through the introduction of institutions like the central banks that can set exchange rates and control inflation, and taxation regulation authorities. The state would also be required to establish uncontrolled capital markets, and limit monopolies, and develop infrastructure to facilitate trade. The social services that the state should provide would be education and very basic health care so that a productive labour force exists. In sum, the state should create an environment that would attract foreign direct investment that would then fund some of the state's industrialization. Several multi-country studies published in the 1970s supported many of these hypotheses of neo-liberalism such as those carried out by Little et al (1970), Donges (1976) and Balassa (1978).

There are some neo-liberal thinkers that propose that there needs to be some intervention by the state, in particular, when industries grow so strong that they may prevent

the redistributive market mechanisms to function appropriately. This would be the case when countries may want to develop a comparative advantage in a particular industry or when smaller firms are trying to develop in the presence of a large conglomerate. These monopolies restrict competition and therefore do not allow for the efficient distribution of resources to take place and therefore must be prevented by the state.

Some neo-liberal thinkers, such as Dani Rodick (2007) do propose that the industrial sector needs to be rewarded through state subsidies to produce goods so that the technical abilities may develop in the country. Once these abilities have developed the sectors can then develop to higher value goods production. It is also proposed that to encourage and reward internationally competitive production, companies should be also be provided with export subsidies. Governments could also provide subsidized credit facilities to encourage investment. In some cases, governments have used state-owned manufacturing enterprises to promote production and export of high value goods. This perspective is then not ideologically far from some of the structuralists positions who promoted ISI with the exception that ISI was proposing protecting all sectors and developing a few for international production while the state supporting neo-liberals propose that all sectors should be free with the few that are being developed for export getting preferential treatment.

Despite the hegemonic dominance of the market-led ELI strategy and its widespread implementation, little industrial development has resulted from it. Few countries have emerged as newly industrialized since the 1990s when widespread implementation of the neoliberal policies took place. Although these industrialized countries have been used as success stories of ELI policies leading to industrialization, there has been a general failure of

these policies to lead to significant industrialization. This then begs the question of whether market liberalization is indeed the best way to industrialize. One of the unresolved issues within the ELI debate is the role of the state, indeed within the proponents of the ELI approach, there are those who believe the state should have a more active role in the economy. It is clear that the ELI and the ISI approaches are on opposite ends of the spectrum, thus an approach that can be context specific may be the optimal solution.

### ***Hybrid Models of Industrialization***

Experiences from several countries have shown that successful economic policies are context specific. Many of the neoliberal prescriptions have been implemented, often through SAPs or reform programs, in a uniform way – i.e the same policies for every country. It is fair to say that in the majority of these countries there has not been any outstanding success and many would argue that in fact these policies have continuously failed to produce economic growth. This implies that there has to be a role for the state to play as the market forces do not lead to economic growth on their own. This is particularly true to developing countries which function in a constantly changing environment where several external factors over which they have no control effect their economies.

The '*mixed*' economy allows the government to control which sectors or industries will be protected and which will be allowed to trade on the global market, including when, how, where, and how much investment will take place. This essentially produces a hybrid or mixed economy that utilizes some components of the neoliberal

thinking of neoliberal economics allowing some sectors or industries to engage and integrate in the global economy. Simultaneously, it also allows the country to continue using some of the structuralist approaches that allow the government to address the structural challenges in its country and even to continue to use some of the import substitution measures to protect infant industries to allow them to strengthen. This gives the state the ability to adapt policies for specific outcomes, to overcome challenges, and even to get different outcomes. This is important because as Rodrik (2007) explains, policies required to ignite growth and to sustain growth are different. Thus, as countries become successful in igniting growth policies would need to be altered to ensure that growth is sustained.

Policies required to ignite growth have been used by the now-developed countries during their periods of initial industrial development. These were very similar to the policies that neoliberal economics now condemns. Ha-Joon Chang (in Kremer et al, 2009; Chang, 2002), has documented extensively the use of the so-called market interventionist policies in most European countries and North America. Britain, Belgium, United States, the Netherlands, Norway, Finland, and Austria all used tariffs and state subsidies to promote their own industries and protect their local markets from foreign goods. In addition, each of these countries provided significant access to cheap finance to their local industries. This was done through development banks, tax measures, and investment funds.

The Asian Tiger countries, namely Japan, Thailand, Taiwan, China, Singapore,

South Korea, Malaysia, Indonesia and the Philippines, are so called because they have managed to sustain annual growth rates of approximately 10% per year for decades. They have been able to develop large industrial sectors, attract large amounts of foreign and local investment and export large quantities of their products. There have been several postulations of the contributors to the success of these miracle countries.

The neoliberal school of thought proposes that the governments in the Asian Tiger countries got “the basics right” (1997:269). In this case, economists such as Chen, Bhagwati, and Wolf suggest that the states non-intervention in price formation, foreign trade and the functioning of private companies while providing a stable macro-economic, a reliable legal framework and appropriate policies for ELI growth have led to this success. At the same time, economists such as Amsden and Wade from the revisionist

Figure 1: East Asian Anomalies

<i>Institutional domain</i>	<i>Mainstream ideal</i>	<i>East Asian Tiger Pattern</i>
Property rights	Private, enforced by the rule of law	Private, but government authority occasionally overrides the law (esp. in Korea).
Corporate governance	Shareholder (“outsider”) control, protection of shareholder rights	Insider control
Business-government relations	Arm’s length, rule based	Horizontal and vertical integration in production ( <i>chaebol</i> ); government-mandated “cartels”
Financial system	Deregulated, securities based, with free entry. Prudential supervision through regulatory oversight	Bank based, restricted entry, heavily controlled by government, directed lending, weak formal regulation
Labour markets	Decentralized, deinstitutionalized, “flexible” labour markets.	Lifetime employment in core enterprises (Japan)
International capital flows	“Prudently” free	Restricted (until the 1990s)
Public ownership	None in productive sectors	Plenty in upstream industries.

(Rodrik 2007:19)

school of thought suggest that the neoliberal analysis does not provide the deserved credit to the role of the state interventionist policies in promoting exports. This school of thought suggests that the previous ISI approach significantly strengthened industries so that there was a strong base on which to liberalize markets. However, during the transition phase many of these Asian Tiger countries used policy instruments such as direct subsidies of exports, tax breaks, duty drawbacks, import substitution on inputs, and tariff protection to promote local exports. In addition, the countries also used state resources to finance key sectors that were key for future areas of growth but where it was not profitable for the private sector to invest in. The significantly strong position taken by the revisionist perspective led the World Bank in 1993 to publish a report that accepted that selective interventions do contribute to growth but only if there are functioning markets, the 'right' policies, and the government ability to monitor appropriate economic performance criteria. In particular the World Bank report stated that government incentives for export promotion such as tax exemptions and export credit were particularly useful. These interventions have subsequently been a key part of Export Processing Zone strategies in developing countries.

An analysis of their policies for industrialization shows that a very innovative approach was used. The neoliberal approach was not applied in a blanket manner but rather the government repeatedly tweaked its policies to address the challenges being faced by the industrial sector. The figure above shows some of the Asian Tiger anomalies in the economic policies and how they vary from the mainstream neoliberal prescriptions.

Most of the Asian Tiger countries used similar strategies to develop their industrial sectors. Firstly, certain industries were considered key industries to develop as a base. These were chemicals, including industrial chemicals, petroleum refining, petroleum and coal products, plastic and plastic products and rubber and rubber products. Secondly, the machinery production was developed. This includes electrical and non electrical machinery, transport equipment and professional and scientific machinery. And finally, the development of basic metals such as iron and steel was developed. According to Chang (2009:3-4) the industrial policy measures of the East Asian countries included:

- (i) coordination of complementary investments (the so-called Big Push);
- (ii) coordination of competing investments through entry regulation, “investment cartels”, and (in declining industries) negotiated capacity cuts;
- (iii) policies to ensure scale economies (e.g., licensing conditional upon production scale, emphasis on the infant industries starting to export from early on, state-mediated mergers and acquisitions);
- (iv) regulation on technology imports (e.g., screening for overly obsolete technologies, cap on technology licensing royalties);
- (v) regulation on foreign direct investment (e.g., entry and ownership restrictions, local contents requirement, technology transfer requirements, export requirements);
- (vi) mandatory worker training for firms above a certain size, in order to resolve the collective action problem in the supply of skilled workers due to the possibility of “poaching”;
- (vii) the state acting as a venture capitalist and incubating high-tech firms;
- (viii) export promotion (e.g., export subsidies, export loan guarantees, marketing help from the state trading agency);
- (ix) government allocation of foreign exchanges, with top priority going to capital goods imports (especially for export industries) and the bottom priority to luxury consumption good imports.

It is clear from this list that this is not the neoliberal prescriptions nor the structuralist protection but rather a customized combination of the two that has been demonstrated to lead to sustained economic growth. These strategies are discussed in the relevant sections below with respect to export processing zones.

It is therefore clear that there is no standard economic policy 'package' that will lead to industrial and economic growth. The International Finance Institutions (IFIs) such as the WB and the IMF have long stood by a predetermined package enshrined in the Washington Consensus. Many developing countries had resisted integration into the global economy and liberalizing their markets through the utilization of ISI strategies. Due to the economic crises of the 1970s most of these countries were forced to adopt the policy prescription of the IFIs. Through their success the Asian Tigers demonstrated that an alternative combination of policies is more likely to result in economic growth than the policy prescriptions of the IFIs.

Most of the Asian countries who have been successful in developing their industrial sectors through the utilization of EPZs did not implement the neoliberal mode of EPZs. In contrast these countries went much further than what is explained above as the standard EPZ model. These countries utilized a ELI approach with a strong protection of the domestic industries with many similarities to the ISI approach. In the initial stages, ISI was the main orientation of the governments, with exports featuring mainly in agricultural products. But as the industries being developed through ISI became stronger the policies were changed to increase the focus on making the industry internationally

competitive and export oriented. In Taiwan, for example, some industries were required to export 50% of their products in order to be allowed to sell in the local market (Amsden, 2001). Thus there was a marked shift in the perception of the role of export as commonly export was envisioned for surplus goods once the domestic market had been saturated, or for goods that could not be sold on the domestic market. However, this change prioritized production for export. Similarly in other countries, companies who agreed to export 100% of their products were given privileges such as access to working capital, tax breaks, and duty drawbacks. However, in order for there company to be continually eligible for these the export targets needed to be continually met. These incentives were only available for certain key sectors that were being promoted for export. This targeting allowed for specialization and technology development to take place in those sectors.

In recognition that companies faced challenges in exporting their products, many of the Asian countries developed high level state bodies to promote export and to monitor export performance. These groups were often made up of a senior official such a the prime minister, ministers from key ministries concerned with export, representatives from key national financial institutions, and representatives from the private sector. The group met on a monthly or quarterly basis to discuss the performance of exporting first as well as to discuss challenges being faced by these firms in meeting their export targets (Amsden, 2011; Chang, 2002, 2009).

Most countries had highly protected local markets and some even went as far as price control in the local market (India, Brazil). Goods that were already being produced locally was banned from being imported or had extremely high tariffs. When these import substitution industries became good enough, they were pushed into exporting their goods. Some countries also introduced bans on goods that were to be processed before export. In the case of Indonesia, the export of raw timber was banned and all wood products were required to be processed to the level of plywood before they could be exported. The state also protected smaller infant industries in certain sectors. Instead of allowing takeovers the state nurtured emerging industries. In many of these cases, especially if the industry was to produce for export in the future, the state provided subsidies and tax breaks to ensure the company can survive even though the economy of scale has not yet been reached.

Governments also directed private sector investment and played a strong coordination role. The government ensured that investment within sectors was complimentary rather than competing. The government was intent on establishing economies of scale to make production more efficient and to make the price of production competitive on the global market. Thus investments in sectors were controlled and rather than competing industries being developed state mediated mergers were facilitated instead so that companies can grow (Amsden, 2001).

The final role that the state played was that of an investor. With long term industry development plans the state often acted as an investor in key sectors particularly

if the private sector was not investing in these sectors (Amsden, 2001). One of the sectors that the states invested in where the high-technology sectors that were the long term vision of the country but that were not yet profitable for private investors to engage in.

Many of the additional interventions that were implemented by the Asian countries are currently being offered by many EPZ hosting companies as additional incentives to the EPZ package. The main difference between the Asian industrialization and EPZ strategies is that a significant number of the investors and the firms in the Asian countries were local companies.

### **Conclusion**

EPZs have been used widely in the developing countries, being promoted by the neoliberal economists as a means of increasing foreign exchange earnings from increased exports, diversification of the domestic industry base and employment creation.

However, few countries have seen positive outcomes manifesting as a result of EPZs.

The success of the Asian countries has been consistently used as evidence that the EPZ model can produce these results.

This literature review has examined EPZs in terms of their ability to increase foreign exchange revenue through export promotion, EPZs role in the diversification of the domestic industries and EPZs contribution to employment creation. A review was done of these proposed benefits of EPZs as well as what has manifested in various countries where EPZs have been implemented. A special focus was placed in

understanding how particular failures of realization of the benefits of EPZs have been mitigated by policies, especially where policies used have demonstrated a marked safeguarding against negative implications of EPZs. The purpose of this literature review was to offer an analytical framework to analyse the policies of Tanzania as it attempts to industrialize through the utilization of EPZs.

This section has also briefly reviewed some key elements of different economic theories with respect to industrialization. The initially the ELI and the ISI approaches were reviewed with respect to industrialization to present their extreme positions. This was juxtaposed with the approach of the mixed economy where the state plays a significant interventionist role in developing the industrial sector directing investment and nurturing infant industries. Most developing countries have historically moved from ISI to ELI strategies mainly due to the external pressures resulting from financing constraints. However, the utilization of neoliberal economic policies has failed to promote significant industrialization in developing countries. In this regard, the developmental state and a hybrid approach to industrialization are presented which can take advantage of both an export orientation while allowing the state to regulate and intervene in the industrialization process.

The literature review has compared the EPZ model proposed using the neoliberal economists of the IFIs with the so-called EPZ model that was utilized by the Asian countries, which was in reality an ELI approach with strong protection for the domestic industries and not parallel the EPZ model being proposed by the neoliberal economists.

The literature has illustrated that these two models have significant and fundamental differences. As most developing countries have implemented the EPZ model utilizing a neoliberal approach, there have been few resulting success stories. The neoliberal approach proposes that the benefits of EPZs will manifest through the ‘magic-of-the-market’ and that if states want these benefits to be realized they must not distort the market with interventions. On the other hand, the experience of the Asian Tiger, Tiger Cubs and other countries has illustrated that benefits *only* manifest when states intervene with strong policies that target specific outcomes.

### **Thesis Statement**

It has been shown through this literature review that the main reasons that countries introduce Export Processing Zones is to increase exports to benefit the balance of trade payments, diversify the domestic industry base, and to increase decent employment. The heavy focus on foreign direct investment as a key component of EPZ strategies implemented in most developing countries, such as Tanzania, is a major factor in the failure of EPZs reaching their development goals. The nature of FDI in a neoliberal context implies that foreign exchange earnings from exports do not remain in the economy where the EPZ is but rather are repatriated away; and that the ‘race to the bottom’ requires countries to provide incentive packages to attract FDI to the extent that there is no benefit to the host country. Similarly, the import intensive nature of EPZs implies that local products will not be utilized in the EPZ supply chain because it is easier

for the EPZ manufacturer to import inputs from an international supplier and the incentives provided to EPZs make this importation cheaper than sourcing from the local market. Finally, the jobs provided by EPZs are poor in quality and provide little in terms of wages, and technological skills are not transferred to workers as most EPZ jobs are in low skill industries such as textiles production, therefore contributing little to the development of the country's population.

The policy environment is crucial in ensuring that the benefits of the EPZs manifest. The role of the state has to be clearly defined as one that is able to guide, direct, and monitor the industrial sector, being able to attract FDI while protecting and developing the domestic industry.

### **Methodology**

The Tanzanian EPZ programme is the subject of this study. The qualitative approach used allows for an in-depth study of the policies that govern EPZ programme of Tanzania. The historical context which has led to the introduction and implementation of an EPZ strategy, and the laws and policies that govern the EPZ programme in Tanzania will also be examined. Finally, empirical data will be collected to understand the influence of this EPZ programme on the economy of Tanzania to see if there are indications that this programme will be able to contribute to increasing the exports, diversifying the local industry and increasing decent employment. The majority of the

data was collected mainly between January and October of 2011, although some information was collected as early as 2005.

### *Data Identification*

Key events from Tanzania's history from independence to the implementation of the EPZ programme will be documented to understand the economic situation of Tanzania and the experiences of Tanzania with respect to industrialization. This will be done to understand to situation of Tanzania prior to the implementation of the EPZs programme and to understand the rational used in introducing such a programme. This will primarily involve a desk study which will review the literature and identify the key events and strategies in this period.

To understand the approach being used by Tanzania in implementing the EPZs programme and the extent to which the neoliberal approach is being utilized, the laws and policies governing the EPZ programme will be analysed. These will be obtained from the official sources such as the Parliament of Tanzania's website where all enacted are archived. In addition, the relevant policies that govern the EPZs will be collected from online sources and from the respective ministries, departments and agencies (MDAs). These will be analysed from an understanding of the prescribed role of the state, the exemptions utilized to attract investors to EPZs and to understand the approach being utilized by the Government of Tanzania with EPZs to see if a ISI, ELI or hybrid model of industrialization is being used.

Empirical data will be collected on the exports and imports in Tanzania and the balance of trade from the period just before the implementation (2000) of the EPZ programme until the end of 2010. This historical trend will be analysed to see if there has been any changes after the implementation of the EPZ programme and this will reveal the level of success of the EPZs in this regard. Data will be collected both from the Bank of Tanzania official export and import statistics as well as the Export Processing Zones Authority for triangulation purposes. Data on the FDI into Tanzania will also be collected from the same sources to understand the country's dependency on FDI over all and to understand its influence in the EPZ programme.

The diversification of the domestic industry base would take several years to manifest in after the implementation of an EPZ programme. As the EPZ programme of Tanzania was only enacted in 2006, this study will look at the policy context to analyse if there are incentives for investors to diversify the domestic industry base. The laws and policies governing the EPZ programme will be analysed from this angle to understand if the model being utilized encourages domestic investment, and the diversification of domestic industry.

Data on employment in Tanzania will be collected to understand the structure of the economy in this regard. Further to this data on employment within the EPZs will also be collected from the Export Processing Zones Authority (EPZA). Finally academic research done on EPZ employment in Tanzania was also collected to triangulate data from the EPZ authority and to inform on the nature of employment in EPZs in Tanzania.

*Limitations*

As all studies, this study too has its limitations. The availability of empirical data with regards to the EPZ programme has been the major limitation. The EPZA refused to provide data on specific operations of investors (both local and foreign) within the EPZs or disaggregated amounts of investment per investor. Similarly, the academic studies and secondary sources that discuss the performance of the Tanzanian EPZ programme are limited possibly because the programme is relatively young. Thus some information has been available on the employment standards in these EPZs but no information was available about the linkages being developed hence the linkages will only be discussed for a policy perspective.

## **CHAPTER 2**

### **TANZANIA: Struggles to Industrialize**

As the first part of the case study this chapter will cover the almost thirty year period in the history of Tanzania from independence to the introduction of the EPZ policies. This is done with the intention of revealing and understanding the successes and challenges faced by Tanzania in this period. Several different attempts were made to industrialize and particularly to increase exports, diversify the domestic industry base and to increase decent employment. These attempts varied in their rate of success and this chapter will try to identify how or why these strategies succeeded or failed. The chapter shows that many of the policies and structures put into place did succeed initially and growth did take place in the introductory period. However, it illustrates that Tanzania's infant economy was hit hard by the global oil crises, whose effects were magnified by other regional shocks the country faced. These events eventually led to a total economic meltdown that forced the country borrow heavily from International Finance Institutions (IFIs) and to succumb to their loan requirements.

#### **Prior to Independence**

Prior to independence, the Tanzanian economy had largely been ignored by the global economic system thus was extremely weak and underdeveloped. It had only been maintained as the 'periphery to the periphery'. Nairobi in neighbouring Kenya had been developed by the British colonial administration as the main economic centre for East

Africa. Thus, Tanzania found itself ill prepared for the post-colonial development equipped only with a very low skills base, poor infrastructure, and untapped natural resource reserves. Being the largest country in the East African region Tanzania has an area of approximately 945,200 km<sup>2</sup> (Bakobi, 1995:1) which is greater than the combined area of England, France and what was then known as East Germany. Each of whom were then already major economies on the global scale (Bienefeld, 1982:293) and major donors to Tanzania in the early independence period. In comparison, Tanzania's economic output was less than 0.5% of the total output of these three countries and had less than 10% of the combined populations (Bienefeld, 1982:293). Tanzania's small population was dispersed throughout the large land area much of which had vast areas that were either dry, Tse-tse fly infested, or both. Large portions of the population suffered from Malaria and Bilharzia (Bienefeld, 1982:293). Tanzania's main assets at independence included the *lingua-franca* Kiswahili language that united most of the national groups within the geographical boundaries of the young state and the almost universal popularity of the revolutionary party, Chama Cha Mapinduzi (CCM) that came into power at independence. At this point Tanzania's main exports were coffee, cotton, sisal and tea implying that the economy was almost entirely reliant on agricultural exports all of which were at a high risk of global overproduction.

**Early Independence: Defining the Role of the State**

During the period from independence in 1961 to the first oil crisis of 1973, Tanzania's economy grew significantly, especially when its pre-independence position is taken into account. The period also saw the rise and implementation of African Socialism 'Ujamaa' under the leadership of President Nyerere which included strong state control and direction of all means of production in the country. Although the state policies were initially influenced by capital, the state made deliberate moves to direct investment and maintain its autonomy. During this period the state established the National Development Corporation (NDC) to guide investment as well as the Tanzania Industrial Studies and Development Centre (TISDC) to conduct market research and other studies to enhance industrialization. The period saw an overall growth in human development indicators like life expectancy and literacy. Despite its challenges the period also saw a growth in the industrial sector as well as in its export earnings.

At independence as the national government was formulating its development strategies there was the immense example of the success of the industrialized countries that had achieved their development goals and had developed strong economies. A World Bank delegation that visited the country in 1959 published a report in 1961 outlining recommendations for the country's initial program for economic development. This report reinforced many of the colonial economic relationships and dependencies.

Although Tanzania did not officially become a member of the World Bank Group until September of 1962, the first 3-year nationally developed plan spanning from 1961 – 1964

was based heavily on the 1961 World Bank recommendations. The promise of full employment, low inflation and improved health care and education services led Tanzania to implement free market capitalist policies as per the World Bank recommendations. Shortly after independence the Tanzanian government commissioned another group of economists to develop the next 5-year plan to implemented from 1964/5 – 1969/70. However, this plan emerged with few differences to the first 3-year plan (Mittelman, 1980:144). Hence, Tanzania proceeded with a *laissez-faire* economic approach.

During the first 2 years of independence, over 90% of the national budget was provided by the British Government. The level and share from the British government declined after these first two years with the introduction of the USA and the Federal Republic of Germany as donors to the government. Sixty-eight percent of the funding for the first 3-year plan came from the British Government with the US and West Germany providing 11% and 9% respectively. Thus 88% of the government budget was provided by donors. Financing for the next plan covering 1964/5-1969/70 was also expected to be donor led, with expectations of UK, USA, West Germany and the World Bank to be prospective donors. However, relations between Tanzania and the US, as well as the UK soured for various international reasons between 1964 and 1965 which resulted in the UK freezing £7.5 million loan in 1965, no funding from the US and a severing of diplomatic relations by West Germany (Ndulu, 1986). As a result of these events, Tanzania found itself faced with challenges to finance its five-year plan. As a result of approaching other countries to support the 5 year plan, Sweden and Canada supported modestly while China

accepted to undertake a large portfolio of investments in Tanzania including the establishment of a large state farm, construction of a dam and provision of village water supply in southern Tanzania among others (Ndulu, 1986). The financial situation was controlled at the time, but Tanzania remained heavily dependent on external financing.

### **Exports and Foreign Direct Investment**

Both the 3-year plan and the 5-year plan focused Tanzania's energies on developing its cash crop production for export with little emphasis on food crop production to meet domestic needs. Similarly, there was little emphasis on developing Tanzania's industries or any of the local markets. The only reference in the 5-year plan was to increase the share of manufacturing production from 4% to 7.5% (Skarstein et al, 1986). As the government of Tanzania during this period had emerged directly out of the struggles for independence its priorities remained very much in bettering the conditions under which 'the people' lived and reducing its dependence on the colonial powers. Since, the free market policies at this point promised full employment and a general increase in the quality of life for the people, therefore seemed like a viable and promising strategy to pursue.

The 3-year and 5-year plans proposed that industrial development would be highly dependant on foreign direct investment. The Foreign Investments Protection Act of 1963 allowed foreign investors to repatriate capital, guaranteed land provisions for creation of industrial estates, and accelerated depreciation of allowances. In addition,

investors could get tariff protection in the local market by bargaining with the government (Minister of Industries) which in some cases this was almost over 500% of the real price and the government often granted monopolies or close to monopolies. It was believed that without this incentive investors would not invest (Rwenyamamu, 1976).

With the national budget being heavily donor funded and the majority of investors being foreigners there was immense pressure on the government to establish policies that were favourable to the donors and foreigners. This can be seen in the various policies being implemented, including for example, the protection of the domestic market for *foreign* manufacturing firms. Thus there was also an increase in the influence of the foreigners in the local legislation and foreigners were getting the same or better privileges as locals (Szentes, 1973:66).

As explained in chapter 1, many developing countries at this time were struggling with developing their own domestic industry base. However, their infant economies were highly dependant on donor funding and imports. The requirements imposed by these foreign economies implied that foreign industry was incentivized and protected while domestic industry was being disincentivized and discouraged. The Tanzanian government, in an effort to maintain its political and economic sovereignty, strongly resisted any interference with its policies from either private capital or IFIs. In 1965, President Nyerere established the one party state in an effort to curb the influence of corporate sponsorship of political parties through which laws and policies could be influenced in parliament.

The high labour standards established by the revolutionist government, low developed skills base, poor infrastructure and scarce natural resources, coupled with the resistance of the government to create an environment that would attract the investment of private capital resulted in a net outflow of capital rather than an increase in the foreign investment required for growth under the free market model.

The IFIs and Western countries continued to promote the free market model, there was little financial support from them to fund Tanzania's emerging revolutionist philosophies and people centred development strategies. Given this dynamic there was little incentive for the government to continue pursuing development using the free market model which challenged the sovereignty of the state as well as undermined the social conditions under which the populist government wanted to pursue development. As a final and absolute measure to limit the control and influence of capital on Tanzania, the state implemented a self-reliance strategy based on the socialist priorities of the government through the Arusha Declaration of 1967.

Nyerere's African Socialism called 'Ujamaa', in Swahili meaning 'family hood', was based on the notion that all citizens of Tanzania were a large extended family (Nyerere, 1962). Through this, Nyerere took the deep rooted pre-colonial African traditional cultural values that accentuated the importance of families and extended this notion to the entire nation by incorporating it within the state apparatus and therefore crystallizing it into the society (Maluki, 1965). The main tenet of this form of socialism was that the people within the society would care about one another on a social and

personal level. The aim was the establishment of a society that was based on a “social need for human dignity and equality” (Nyerere, 1966 in Pratt, 1976) and in this society every group would be treated equally (Pratt, 2000).

While economic development was indeed a priority within these policies, the emphasis was placed on the personal, social and psycho-spiritual growth of the citizens and the development of a moral responsibility of the individual towards other human beings (Magesa, 1999). The Ujamaa strategy intended to decrease income inequalities and increase the direct participation of individuals in the decision making process of the government. The establishment of village and workers councils as well as rural village party branches enhanced the democratic decision making process through the increased communication channels between urban political centres and the population, the majority of whom lived in remote rural villages .

In the years that the Ujamaa strategy was able to function as planned there was significant improvement in the economy. Between 1967 and 1973 large amounts of foreign investment was attracted, on terms favourable to the government, including a US\$400 million interest free loan from China, previously rejected by the World Bank and the Soviet Union, for the development of the Tanzania-Zambia Railway (Mittelman, 1980:144). The economy performed well, and the political environment was stable especially if both are compared to other sub-Saharan Africa countries. The savings ratio in Tanzania rose and income distribution mechanisms were implemented effectively. The real growth rate was averaging 5% annually in this period and agricultural production

kept up with population growth (Rwegasira, 1987:1322). Similarly, in the human development of the people of Tanzania. Literacy increased from 15% at independence to 70% by 1977 and access to clean water increased from 5% to 45% in the same period (Havnevik, 1993:54).

While growth of cash crop production was slow, there was a steady increase in the food crop production for domestic use (Mittelman, 1980:152). Between 1970 and 1973 Tanzania was able to be almost completely self-sufficient in food production and food imports being almost negligible in this period (Bienefeld, 1982:303). In addition, growth was accompanied with little inflation and a comfortable balance of payments was established (Rwegasira, 1987:1322).

The Arusha Declaration (1967) identified the major means of production as land, forests, minerals, water, oil and electricity, news media, communications, banking and insurance, export-import trade, wholesale trade and major industries. Within industries the major means of production were identified as iron and steel, machine-tool, automobile, cement, fertilizer, and textile. Within production in general, large plantations especially those that would be able to provide raw materials for important industries were also categorized as major means of production. This was all inline with the principle of self-reliance of reducing imports and utilizing local resources as the means for development.

However, the Arusha declaration did not fully clarify the priorities within the industrial sector although it was very clear that all of this would have public ownership

and a strong Import Substitution Industrialization (ISI) approach was undertaken. The second 5-year plan (1969 – 74) had made direct links between industrial development and rural development and created space for the establishment of small scale industries. It prioritized the decentralization of industry to nine towns identified for growth (Dar Es Salaam not being one of them), through the establishment of labour intensive technologies so as to utilize available human and natural resources in an equitable way (Skarstein et al, 1986).

The improvements in the human development experienced in this period are indicative of the potential of the Ujamaa strategy in bettering the conditions of its people. While there were some flaws in the policies and how some of them were implemented. The biggest challenge being faced by the Tanzanian state at this point was achieving their balance of payments. Tanzania had to borrow from the IFI's and bilateral donors and by the end of 1973 had already accrued a debt of over US\$1.1 billion (Easterly, 2001).

There were some challenges that were also developing in the development strategy. The growth of export crops had been exceptionally slow, coupled with the declining terms of trade and the economy's dependence on agricultural products, there was consistently a scarcity of foreign exchange required of essential inputs for industrial production. The declining terms of trade implied that more export crop needed to be produced to purchase the same amount of industrial input. Thus Tanzania began to find itself being unable to meet its balance of payments requirements and the inability to

Figure 2: Export Profile of Tanzania in the 1960s.

Industry	Unit	1963	1967	increase
Textiles	'000s of yards	6,225	18,277	293%
Beer	'000s of gallons	1,962	5,120	261%
Cigarettes	Millions	1,144	2,044	179%
Paints	Gallons	95,357	274,623	288%
Plywood	'000 square feet	2,004	8,808	440%
Wheat Flour	Tons	28,378	41,159	145%
Pyrethrum extract	Tons	99	287	290%

Source: Rweyemamu, (1976).

acquire input for industry was beginning to hinder self-reliance strategy Tanzania was attempting to pursue.

The year 1964 marked the beginning of a period of greater expansion, with manufacturing value added growing over 10 per cent per year between 1964 and 1972 and the share of industry growing from 7.1% per cent to 11% per cent of GDP (Wangwe in Szirmai et al, 2001). Despite the challenges, the five-year plan (1964/5-1969/70) had placed major emphasis on expanding the manufacturing activity for the East African internal market. By 1970, this activity was expected to be twice as large as the primary processing activity in the industrial sector. The plan focused heavily on attracting foreign direct investment however it did not discourage local investment in manufacturing. Tanzania saw increased industrial growth and production in several key sector increased dramatically.

### ***Diversification of Domestic Industry***

Tanzania was not developed by the colonial administration to be a manufacturing centre. At independence Tanzania was faced with three major challenges to increasing

the industrial base. The domestic market was fairly small and therefore couldn't provide enough stimuli to local manufacturing firms that were trying to get established but that were not competitive enough to produce for export. Secondly, Tanzania's labour force was small, unskilled and expensive. Finally, Tanzania lacked the inputs such as iron, coal, and electricity required for industrialization.

In the 1960s, activity in the manufacturing sector included mainly basic processing of agricultural commodities for export markets and the manufacture of import-competing goods for sale in the domestic market. Due to the small domestic market, the development growth of the import-substitution industries was very slow. The agricultural production was the basis for the success of both these activities. If the agricultural production drops there would be a decrease in the raw produce that needs to be processed for export. Similarly, the low agricultural products would also decrease the income of individuals in the local market who are dependant on the agricultural sector for their livelihood. Thus for the industrial sector to be sustained, there was an inherent need for the agricultural sector to be productive.

Tanzania lacked basic mineral resources like coal and iron for inputs into industrial sectors. There were significant coal reserves in the southern highlands but the country had poor infrastructure. Thus, it was impossible to transport heavy machinery to these areas for extraction and similarly, it was impossible to take extracted material to processing centres, markets or ports. These minerals therefore remained untapped and inaccessible to the country.

Electricity production was very low in the period leading up to independence. However, in 1962 the total output increased by almost 400% due to the increased usage of diesel powered generators. In 1962 diesel electricity output was almost 50% greater than the traditional hydropower generation. During this period hydropower generation did not have any significant increase (Tanganyika Statistical Abstract, 1962-1963 in Rutman, 1968) even though there were several locations where hydropower dams would have been very effective. This implied that by 1962, 60% of the electricity was being produced by diesel generators that were completely dependant on imported fuel. Most of this electricity was provided to the economic centers of the country in the Eastern and Northern parts. The government perceived the greatest limitation for the investment in the energy sector (renewable or not) was the lack of a developed industrial sector to demand large sources of energy. As there was no demand, the government decided not to invest in energy production. Similarly, as the availability of power does not guarantee a demand or a spurt in economic activity there were no plans in the early 1960s to electrify the whole country. Rather the priority was to supply the major towns and cities which were the economic centers.

The common East African market posed a particular challenge for Tanzania in attracting the FDI required in the 3-year and 5-year plans. Kenya, which had been the capital of British East Africa prior to independence, offered a much more attractive investment climate for foreign capital. In particular, Nairobi offered the best water supply in East Africa, developed industrial sites, good communications, proximity and direct

link by rail to the largest sea port of East Africa – Mombasa, and the largest pool of skilled labour in East Africa. Kenya's comparative advantage in this respect posed a great threat to Uganda and Tanzania and was a point of great contention between leaders. The common market allowed for the free movement of goods and all factors of production, thus Tanzania's domestic market (regardless of how small) would be accessible to all the countries in the Union. This meant that local industries that Tanzania was trying to develop would have to contend with foreign industries that may have been established in Nairobi. The Union implied that Tanzania could not protect its market in order to develop its own industries. In an effort to maintain the union as well as to allow the weaker economies to develop, each country was allowed to have a monopoly in developing certain products. Although, Kenya did not ratify the Kampala Agreement of 1964 immediately, Tanzania was allowed exclusively production of aluminium sheets, tyres and tubes and radio assembly (Rweyemamu, 1973).

*Government structures to promote industry*

During this period the government established several organizations to develop the industrial sector: the National Development Corporation and the Tanzania Industrial Studies and Development Centre. These are discussed below in detail.

National Development Corporation

In 1964, the government established through an act of Parliament, the National Development Corporation (NDC) which was controlled and financed entirely by the government. The primary objectives of the NDC were to promote foreign direct investment to establish large scale manufacturing and to create and run government enterprises generally in areas of manufacturing such as primary commodity processing and import competing industries. The focus was to invest in industries that would be catalysts in developing the economy as well as the skills base in the labour market. The NDC was led by a board consisting of 10 members including the ministers responsible for finance, industries, commerce, agriculture and tourism and 5 other persons appointed by the President, one of whom being the Chair (GoT, No. 69 Tanganyika Development Corporation (Amendment), 1964). While the NDC was a government entity it functioned outside of the ministries and reported directly to parliament. The NDC was furnished with a Reserve Fund aimed at funding investment in corporations. The government nationalized several private industries in this period and the NDC was given control over these. These included: Nyanza Salt Mines Ltd., Tanganyika Packers Ltd., Williamson Diamonds Ltd., Kahama Nzega Igembesabo Co-operative Union Ltd., Lake Manyara Hotels Ltd., Ralli Estates Ltd., Sikh Saw Mills (T) Ltd., Tanganyika Development Finance Co. Ltd., Tanganyika Meerschaum Corporation Ltd., Tanganyika and Italian Petroleum Refinery Company (Tiper) Ltd., Tanita Co. Ltd., and Uplands Bacon Factory (Kenya) Ltd. One of the major challenges facing the NDC as an infant organization was

the lack of experience in managing large scale industries. The government was acquiring a large number of industries through nationalization and the NDC faced many challenges in efficiency and effectiveness in management while trying to keep up with the high acquisition rate.

#### Tanzania Industrial Studies and Development Centre

To further promote investment in the manufacturing sector, the government established the Tanzania Industrial Studies and Development Centre (TISDC). The ministry of Industry and Commerce in its efforts to encourage investment in industry provided services to carry out market research for new products, technical possibilities for producing these products and information on availability of labour with the appropriate skills, viability of the market, probably of obtaining import tax rebates and the availability of raw material suppliers and outlets for retail sales. However, the research was demand driven and as such investors had to request the ministry to conduct the relevant research.

The center was mandated to enhance new industry formation and the marketing of Tanzania's products to external markets. In order to encourage new industry the following incentives were provided: tax reductions, market and industrial research. In addition to tax reductions, the investors were entitled to claim back 20% depreciation in their first year and 15% per year for the next 6 years, import duty waivers and refunds on duties paid on the importing of raw materials. However, the conditions applied on the last

benefit were that raw materials must not be available on the domestic market thus fostering backward linkages. The second condition was that the benefits to the country must exceed the revenue lost from the tax exemption either through gains in income tax receipts, increased employment or stimulation of further manufacturing activity i.e. forward linkages. This policy is very interesting as it deliberately set conditions that promoted or even required linkages and rewarded linkages when they happened. These conditions have since been lost in the policies in Tanzania as well as in the global economy dialogue with the increased emphasis on liberalization.

In these early years there was recognition that foreign exchange earning was important; however there was a stronger emphasis on self-reliance and import substitution. Thus at this point there weren't deliberate attempts of earn foreign exchange; rather the emphasis was on developing industry.

The TISDC provided small loans to native Africans to establish small scale manufacturing firms. Most of the available local capital was controlled by Asian traders, many of whom had been naturalized to become Tanzanian citizens after independence but were yet to be perceived as "Tanzanian" or local capital.

Both the NDC and the TISDC were efforts by the government to direct investment so that exports can be increase and the local manufacturing base is diversified despite all the challenges to industrialization being faced by the government. In each of these organizations foreign investment was sought but there were systematic mechanisms to direct investment. The NDC controlled large manufacturing companies and reported

their performance to its board and to the Parliament ensuring that there was industrial growth and that the earnings were channelled back to the state. The TISDC applied some of the neoliberal principles of tax reductions, and other financial incentives to both local and foreign investors. At this point Tanzania was utilizing the principle of reciprocity in its incentives where duty waivers and refunds were contingent on local unavailability of raw materials imported as well as the net gains for the country being positive even after duty waivers and refunds are applied. Despite providing some good results in this initial post-independence period these policies were eliminated in later years. These policies were similar to the policies utilized by many Asian Tiger countries in their industrialization strategies as discussed in chapter 1. Tanzania saw significant growth during this period and both human developments as well as economic growth targets were being met.

#### Basic Industry Strategy 1975-1995

After the first oil shock the government developed the Basic Industry Strategy focused on developing industry nationally. In addition to this the government established several research organizations to deepen the knowledge of industry. However, the multiple organizations established created confusions and drew heavily of already scarce resources.

During this period, with the increased focus and discussions at regional and national level on industrialization, the Basic Industry Strategy (BIS) was formulated. It

was intended to cover two decades spanning from 1975-1995. The strategy was very much in line with the principles of self reliance and aimed to ensure that domestic needs for industrial goods would be met primarily by domestic production (Wangwe in Srizmai et al., 2001). There were two sets of emphases placed; the first was on the production of basic needs of the people which included components including food processing, textiles, clothing, footwear, building materials, and materials and facilities to meet the requirements of education, health services, transportation and water supply. The second, consisted of activities which utilize domestic resources to produce and supply inputs for the first set (BIS, 1975). The strategy was designed to have state-led development with a high level of state control over means of production. Although the strategy aimed to minimize the reliance on foreign direct investment, it was ultimately funded by bilateral international aid.

#### Centres of Knowledge and Excellence

In 1976, the Tanzania Industrial Studies and Consultancy Organization (TISCO) was established with the primary intention of developing a center of excellence in Industrial Studies. The organization provided consultancy and advisory services in subjects associated with industrial development, and fostering, encouraging and monitoring the expansion and use of modern industrial techniques and practices, and conducting research to determine which would be the most beneficial industries for the government to invest in. This included conducting training programs, and conducting

feasibility studies to promote the usage of modern technology (URT, 1976). Reporting to the Minister of Industries, this organization was recognition on the side of the government that industrialization required the use of technology and a culture within the industry to develop and evolve the modes of production to more efficient modes. This organization was led by a board of directors that was appointed by the Minister of Industries, however, the qualifications of the board members was never outlined.

In 1979, the Tanzania Industrial Research and Development Organization (TIRDO) was set up and in 1980 the Tanzania Engineering and Manufacturing Design Organization (TEMDO). There was little difference in the structure and mandate of TIRDO and TISCO. Both TIRDO and TEMDO were developed to design and promote the use to technology in economic activities with a focus on utilizing raw materials. Both organizations were mandated to experiment and adapt international technologies to be application to the local operating context and using locally available materials. It is possible, given the timing of the establishment of TIRDO and TEMDO that there were final attempts by the government to develop industry in the face of an economic collapse. These organizations are still operational in 2011 although the extent of their impact has been rather limited.

### ***Decent Employment Creation***

The agriculture sector, which employed the highest number of people, suffered from a low per capita income and a large proportion of the population was employed in

it. In 1964, 43.7% of the employed workforce was either in agriculture, forestry or fishing. This was followed by public service, which employed 29.6% of the labour force, while manufacturing employed only 6.4% of the labour force (Budget Survey, 1965-66 in Rutman 1968).

Tanzania still had a low amount of 'productive' labour as the majority of people worked in the subsistence sector. Formally employed labour force was low making the domestic market for industrialized goods was too small for profitable private sector investment. The manufacturing sector employed approximately 80,000 people in 1961, 45,000 of whom were engaged in primary processing which amounted in 52% of the wage bill of the sector.

The labour force was generally unskilled, undisciplined and had low productivity levels. Agriculture, which was the largest employing sector, was the lowest paying sector. The East African Royal Commission claimed that the productivity increases that would result if the workforce moved to sectors such as manufacturing. It was stated that the work force faced two obstacles: (1) lack of skills and (2) lack of factory discipline. At this point only about 100,000 labourers in Tanganyika could be classified as skilled these included bricklayers, carpenters, clerks etc (Rutman, 1968).

There were also high rates of internal migration within the country. With the high levels of dependence on and low levels of productivity in agriculture, many men from rural areas migrated to find work in urban areas and plantation estates between harvests. These men tended to go back to their homes during harvest seasons. As the employers

need workers all year around, those employees who go away during harvest time loose their jobs. The rural men therefore had little motivation to learn new skills and routines required for non-agricultural employment as it was perceived as temporary. In order to reduce the internal migration, the government introduced monthly wages and abolished the daily waged system. However, the government established the highest minimum wage in sub-Saharan Africa and established high labour employment standards despite having a low-skilled and poorly educated population. The immediate result of this was unemployment, as employers' reduced redundant staff that was intended to compensate for low productivity. However, in the longer term the net effect was to stabilize waged employment.

During this period the government invested heavily in education programmes. Primary education was made compulsory and secondary and tertiary education systems were developed. This resulted in increased literacy and by 1970, 70% of Tanzanians could read and write Kiswahili (Havnevik, 1993). In addition, the government established vocational training and adult literacy programmes (Havnevik, 1993). However, the low skills base was not available during the early independence period when the government was struggling to develop the domestic industry base.

### ***Shocks to the Economy***

Unlike the period between 1960 and 1972 when the growth rate of the industrial sector was higher than the growth rate of the whole economy despite the low emphasis,

starting from 1973 the industrial growth rate was generally lower than the overall economic growth (Skarstein et al, 1986). The oil shocks of 1973 accelerated global inflation and caused a rise in the cost of industrial imported inputs as well as caused a decline in the global prices of agricultural products. For Tanzania this had devastating effects. As Tanzania tried to overcome the first oil shock, it was faced with droughts, floods and wars before the second oil shock. This presented great challenges to the economy and resulted in the reversing of many of the accomplishments of the previous period and ultimately led to a broad scale economic crisis.

Prior to 1973 the economies of the North were prosperous and the high levels of profit earnings were made available for investment in developing countries as loans to governments at very low interest rates. However, with the oil crisis impacting the entire global economy, there was a sharp increase in the interest rates of previous loans as well as subsequent loans. The sharp increases in the interest rates of the loans implied that the government was spending more of its annual revenue servicing debts rather than investing in the development priorities or purchasing required inputs for manufacturing. Due to the revenue challenges of Tanzania, the government found it had to borrow more even at the high rates just to be able to meet prior debt obligations (Mittelman, 1980:162).

The oil shock of 1973 led to an increase of 200% on global oil prices (Rwegasira, 1987:1323). Tanzania imported 100% of its energy at this point and thus was utilizing 19% of its export earnings merely acquiring oil for industrial production, transportation

and other public uses (Rwegasira, 1987:1323). The initial impact of this shock and the resulting balance of payments deficit was absorbed by the government reserves accumulated over the previous years of agricultural self-sufficiency. However the following shocks could not be dealt with in this way.

The oil crises lead to a further worsening of the terms of trade for Tanzania. With 38% of the gross domestic product (GDP) of Tanzania being made up of agricultural exports, the decline in the selling price of agricultural products implied a decreased income level for the country. This in turn led to a severe shortage in revenue thus leading to a balance of payments crisis (Rwegasira, 1987:1321). The balance of payments was further distorted by the increase in the cost of borrowing from IFIs.

The droughts in 1974 and 1975 led to extensive crop failure throughout the country. The food crop self-sufficiency could not be met and export crops were inadequate in earning the required foreign exchange. In order to avoid widespread starvation the government had to resort to importing food for national consumption costing 36% of the export earnings of this period (Rwegasira, 1987:1323). This in turn had detrimental effects on the already strained balance of payments. The general availability of foreign exchange to import necessary inputs for industrial production was much harder to secure. The government attempted to deal with this situation through a decreased expenditure on infrastructure developments, capital spending, and technological investments. In addition, maintenance and replacement of technologies was ignored impacting the productivity of the industrial sector specifically and the country in

general (Bienefeld, 1982:306). The next few years saw little manufacturing taking place primarily due to the decline in investment. The country did request international assistance in dealing with the difficult economic situation however; the assistance provided by the international community was far from adequate to meet the needs of Tanzania (Rwegasira, 1987:1331).

The years of 1976 saw a growth in the economy mainly due to an increase in subsistence farming and the service sector. Due to the increase in subsistent farming there was a sharp decline in export crop production. As agricultural products were the major earners of foreign-exchange mechanism of the country at this stage, the lack of production in this sector resulted in the constraints of foreign exchange to continue as well as the challenge of meeting the balance of payments.

This scarcity in income implied that the Tanzanian government had little available capital to invest in the industrial sector that has been neglected during the oil crisis period. Overall during this period Tanzania saw a general decrease in export earnings and a 10% decrease in manufacturing (Bienefeld, 1982:306). This situation lead to a general shortage of good within the country and resulted in government imposed restrictions on consumption of various products including oil based fuel consumption. The shortages and restrictions resulted in a raise in the level of corruption within the state bureaucracy, demoralization and an increase in taxation. This led to a feeling of discontent arising in the people and a generalized decrease in popular support for the government in power.

As the weather returned to normal in 1976, between 1976 and 1977 there was a 20% increase in food-crop production restoring general food security (Rwegasira, 1987:1322) as well as a 20% increase in cash-crop production (Bienefeld, 1982:307). An increased production of tea and coffee allowed Tanzania to benefit from the temporary boom in the price of these products on the global market due to frost in Brazil (Wobst, 2001:10). Thus there was decreased pressure on the balance of payments and foreign exchange crises. The increase in agricultural production resulted in the real GDP increasing by 13.3% (Bienefeld, 1982:307) and industrial growth reach over 17% for the first time since 1973. In 1977-78 manufacturing value added increased by 14% (Skarstein et al, 1986). Despite some persistent deficits in trade and balance of payments the government reserves and domestic savings that had been depleted in pervious years were restored. Thus this period provided some relief to the financial crises taking place in Tanzania.

The 1977 dissolution of the East African Community (EAC) had major implications for the Tanzanian economy. The EAC had been pivotal in establishing a common market for goods produced within the region. Additionally, the EAC had allowed for the joint financing of several infrastructure facilities such as the East African Railways Corporation (EARC), the East African Harbours Corporation (EAHC), the East African Ports and Telecommunications Corporation (EAP&TC) and the East African Airways Corporation (EAAC) (Eken, 1979:37). In addition, there was the establishment of the East African Development Bank, funded equally by the three states with the main

focus of funding development activities especially in Tanzania and Uganda, but also in Kenya. These corporations allowed all three countries within the community to fund in an effort to increase domestic merchandise development and regional trade. However, primarily due to the differences in political ideologies, relations within the community had been under great strain (Eken, 1979:38). In 1977, Tanzania closed its borders to Kenya thus severely obstructed the opportunities of trade between the two countries. Relations between Tanzania and Uganda had already been strained since 1971 when Idi Amin took over the Ugandan presidency through a military coup. Thus the closing of the Tanzania-Kenya boarder in effect signified the final act in dissolving the EAC and crystallized the already developing fractures within the region.

While it is true as many argue that the dissolution of the EAC had severe negative repercussions for trade within the region, the high similarities between the economies of these countries implied that a large majority their products were similar (Eken, 1979:38). Thus, there was little trade between the countries but rather all of these countries competed for markets in industrialized countries as both the consumers of East African export-crops and the suppliers of East African industrial inputs. The main role of the EAC had been to provide financial support to the economically weaker countries in the region as well as a cost-sharing system for infrastructure services that all three countries used for trade. Thus, it was this withdrawal of support mechanisms that impacted Tanzania the most after the collapse of the EAC. Being unable to maintain the airports,

harbours, and railways further challenged Tanzania in the ability to import and export. The balance of payments began to deteriorate on what seems to be a downhill journey.

The dissolution of the EAC also implied a decreased stability in the region in general due to the decreased cooperation between countries, thus in 1978, shortly after the collapse of the regional organization, war broke out between Tanzania and Uganda. The details regarding the cause of the war are beyond the scope of this paper. But Tanzania could not afford a war at this time and neither was it equipped for it. The war with Uganda lasted over a year and cost approximately US \$500 million. Agricultural production increased by 4.6% during 1978 however, export crop production decreased despite good weather. Coupled with the end of the coffee boom on the world market the decreased export crop production resulted in a 19% decline in export earnings (Balassa, 1990:387). Even though during this period there was a surplus of food crop produced, Tanzania was unable to store this crop due to the lack of facilities and the inability to invest in their creation. Thus food crop was sold for cheap and export crop earnings were used as partial financing for the war. However, the increased costs of the war resulted implied an increased amount of imports thus export earnings in 1978 financed only 41% of imports (Bienefeld, 1982:309).

The major impact on the manufacturing sector of the dissolution of the EAC was the loss of the regional markets from Tanzania. Up until 1977, Tanzania's major manufactured exports were textiles, cigarettes, canned food, cement, non-ferrous metals

and batteries. The main markets for most of these produces were exported to the EAC and access to these was lost with the dissolution of the EAC (Wangwe, 1995).

The resulting financial crisis was magnified by the second oil shock of 1979 as well as crop failure in 1979 due to floods. Thus Tanzania found itself having to import food grains that it could not store the previous year as well as importing energy at high costs. Unable to meet this financial obligations Tanzania made several appeals for international assistance on both fronts. However, potentially due to the global recession caused by the oil shock, the assistance provided by the international community was far from adequate. The food shortage continued due to droughts in subsequent years and Tanzania imported food until 1981.

Despite the shocks to the economy, during this period the government continued to invest in developing industry. The major source of this revenue was international aid flows, thus although the government had made a deliberate move to reduce dependence on foreign investors, this had merely translated into an increased dependence on foreign aid. The 1970's saw an overall increase of 35% in the industrial sector although the growth in production was much slower (Wangwe, 1983). During this period there was a deliberate effort to emphasize industry over agriculture. Agriculture was the dominant sector and accounted for nearly half of the GDP, generating over 75% of the foreign exchange and supporting 90% of the population; it received on average 13% of the development budget between 1977 and 1980. On the other hand, industry received 18.5% of the budget annually for those years. Despite these trends, between 1977 and 1986,

agricultural outputs stagnated while industrial outputs experienced continuous negative growth. The extremely high oil prices<sup>1</sup>, the low agricultural production, the declining terms of trade and the consistent investment in the industrial sector meant that Tanzania had an economy that was dependant of foreign exchange (that it didn't have the means to earn) to purchase fuel and spare parts. This resulted in a deterioration of large factories, water pumping systems, and equipment that the country lacked the money to operate and maintain.

During the period from 1973 to 1980 Tanzania struggled significantly to overcome its economic challenges. The shocks to the economy were severe. The policies that Tanzania brought in were again similar to those that the Asian countries were using, that is focusing on developing local industry through the substitution of imports, utilizing local raw materials in manufacturing and limiting the power of foreign capital. Despite these policies, the significant external factors affecting the country without respite for almost a decade led to a situation where Tanzania had exhausted every means to obtain the required foreign exchange earnings what it required to acquire necessary inputs for the country as a whole. Thus, by the early 1980s Tanzania had to enter discussions with the IFIs for assistance.

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<sup>1</sup> The price of oil rose during the 1973-74 oil crisis and then doubled again during the 1979-80 crisis.

***The Liberalization of the Market: Economic Recovery?***

Throughout the 1970s as Tanzania was experiencing consecutive shocks to its economy help was sought through limited loans from the IMF and bi-lateral donors. The crisis became more acute towards the end of the 1970s' and early 1980s' and was not unrelated to the global crises. However, despite its efforts the Tanzanian government eventually had to apply the neoliberal economic policies as per the requirements of the IFIs in order to survive.

In the 1980s, the IMF began to impose stricter conditionality with its loan agreements. As Tanzania's government continued to attempt to control the environment under which the economy operated, contrary to neo-classical policy prescriptions tensions began to rise as the IMF continued to pressure changes to the government policies. The 1981 negotiations regarding IMF loans ended abruptly as Tanzania refused to devalue its currency at the steep rates required by the IMF (Addison, 1986:81). As a result of the economic situation described above Tanzania was now entirely dependant on bilateral and multilateral trade agreements and loans. However, without the IMF who had been a major creditor during the 1970s', Tanzania could not secure adequate funding to maintain its balance of payments. It is argued that international donors were not forthcoming with funding due to two reasons: firstly the impact of the global recession but more importantly, there was increasing pressure on countries of the south to implement neo-classical economic policies thus the donors were aligning with the IMF requiring policy adjustment policies in return for loans or bilateral aid.

As a result of the international pressure, Tanzania implemented a National Economic Survival Plan (NESP) between the years of 1981 and 1985. The basic tenets of this plan were very similar to those required by the IMF however the schedule of implementation was not as severe as that recommended (Cheru, 1989:87). Tanzania implemented this plan to show its commitment to the neo-classical economic policies however, the shortage in international funding led to escalate the financial shortage. During this period Tanzania built up US \$300 million in trade arrears, US \$100 million in short-term credits from private banks, and US \$200 million in supplier credits as well as US \$20 million delayed debt servicing payments (Bevan *et al.*, 1990:332). In 1985, disbursements to Tanzania from the African Development Bank were stopped due to arrears creating a situation where the capital required for implementing the NESP was entirely unavailable which led to the failure of Tanzania to implement the NESP.

#### *1983-1985: Structural Adjustment Programme*

When the first structural adjustment programme was introduced in 1983, the main objective was to bring the economy back to the 1978 pre-economic crisis level. Agriculture was one of the priority sectors in the SAP and expenditure on agriculture was increased drastically from 11.7% in the 1982 budget to 23% in 1983, and then 28.5 in the 1984 budget. Similarly, producer prices were increase by 80% for food crops and 40% for export crops in the 1983-1984 budget, and increased again in real terms by about 5% in the following budget year. The government also abolished the crop export taxes to

promote export earnings. During this period the General Retention Scheme (1983) was introduced which allowed exporters to retain between 10% and 100% of the foreign exchange they earned to purchase required inputs for further exports.

However, despite these and other measures under the SAP, there continued to be a negative growth (Ndulu, 1986). The GDP rose from zero growth in 1983, to approximately 3% in 1984 and then dropped to 2.3% in 1985. This was below the growth rates of 1978 and resulted in a negative per capita growth when population growth was factored in. The only sector in which the GDP grew was in the services sector but the SAP measures could not halt the downward trend in the agriculture and industry sectors. It is postulated that this was mainly because there was a low amount of foreign capital inflow. In this period only 35% of the predicted foreign investment actually came and export earnings fell short by 33%. As a result, only 64% of the required imports were obtainable and necessary industrial inputs were still not readily available (Ndulu, 1986).

In 1984, the government introduced the 'own funded' scheme. This scheme did not question the source of foreign exchange, due to recognition that a substantial second economy existed, and allowed individuals to import freely into the country. This in turn led to the increased retention of government foreign exchange and resulted in an increased amount of exports (Muganda, World Bank 2004).

The inability of the SAP to increase foreign capital flows and export earnings had led the government to reduce imports in an effort to grow the previously depleted reserves. However, not only the industrial sector but also the agricultural sector was

beginning to see challenges because of the low levels of imported inputs available. The deteriorating physical infrastructure, shortage of transport facilities, working vehicles, and the availability of fuel required for distributing imports, and to bring food crops to urban areas and cash crops required the government to take more drastic measures in managing the economic crisis.

*1986-1989: Economic Recovery Programme*

The Economic Recovery Programme (ERP) was the government's recognition that measures taken in the SAP were not providing the gains expected and that more drastic measures needed to be taken. The ERP introduced incentives for the production of food and cash crops and making even more resources available for infrastructure while improving the marketing structures. There was a major effort to procure required inputs particularly for the industrial sectors to improve the capacity utilization of the industries established after independence.

In 1986, Tanzania signed an agreement with the IMF that incorporated many of the previous measures in the SAP and the ERP measures. The ERP reforms applied the recommendations in the SAP at a more drastic speed and with a greater emphasis on adjustment using various policy instruments to influence economic activity. These included monthly adjustments of the exchange rate, partial import liberalization measures, measures to improve agricultural marketing structures, further relaxation of controls, and increased producer incentives to stimulate agricultural output. These

measures were accompanied by reforms in the fiscal, monetary and interest rate structures so as to control inflation and improve efficiency in the allocation of resources. The ERP period saw deeper and more far reaching institutional reforms, especially in increasing the role of the private sector in various sectors of the economy and scaling down of the quantity of public sector services.

This era marked the deliberate move of the government from Import Substitution Industrialization strategies to Export Led Industrialization strategies. Several schemes were introduced to encourage export. The first of these was to make the domestic market less attractive. This was done through the removal of effective protection mechanisms and the devaluation of the shilling. The devaluation of the shilling reduced the earnings potential on the domestic market and enticed manufacturers to export their products. In 1986, the GRS was replaced by the Seed Capital Revolving Scheme where exporters of non-traditional products were provided with foreign exchange as Seed Capital when starting the business and then were allowed a 50% retention rate of foreign exchange earnings. Between 1985 and 1989 the number of exporters benefiting from this scheme rose to 51 (Ndulu and Semboja, 1996). There also existed various Commodity Exchange Programmes (CEPs) which allowed exporters to exchange goods for required inputs and spare parts abroad. Finally, the government implemented an import duties compensation scheme, the Duty Drawback Scheme (DDS), for duties that are levied when inputs for manufacturing goods for export are imported (Mbatia, 1993). Unlike in previous years,

the DDS did not have a reciprocal mechanism requiring net earnings for the government, therefore it is difficult to assess if this scheme benefited the economy or not.

Direct incentives to promote export were provided through the Open General License (OGL) established in 1988. The only requirements for access to foreign exchange for imports were that a the business have a legal premises, achieves the minimum limit for foreign exchange provision with a 100% upfront cash cover in local currency, and not import items not permitted by the government. Despite the various initiatives, the own funds import scheme remained the most widely used foreign exchange window.

During this time, Tanzania's socialist policies were systematically removed from the government policies. The industry promotion strategy of directing investment and the protection of the local market and of infant industries was also dismantled. Many of the structures put in place survived this period. Therefore the NDC, TIRDO, TISCO, and TEMDO still exist in some modified form.

### **Conclusion**

This chapter has outlined the challenges that Tanzania faced in attempting to industrialize during the period from independence to the official abandonment of the Import Substitution Industrialization (ISI) strategy the early 1980s. The initial 10 years after independence saw economic growth and industrial developments. This period also saw the introduction of the Ujamaa and despite much neo-liberal critique of ISI

strategies, Tanzania saw an increase in exports, diversification of the domestic industry and the creation of decent employment. Tanzania's experience shows that a country can develop industry using this model given a stable global economy.

During this period Tanzania had used many of the interventionist policies utilized by the Asian countries to promote exports for foreign exchange earnings, and the diversification of local manufactures. Tanzania had utilized reciprocal reward mechanisms that ensured that the benefits to foreign investors did not surpass the benefits to the state. It also required that local raw materials should be utilized where available and duty drawbacks were only granted when local raw materials were not available. Thus even during the 1970s, the Tanzanian government was aware that foreign investment needed to be directed and managed, and that linkages would not happen unless specific requirements to establish them were put into place, and that the state had a crucial role to play in nurturing and developing infant industries.

As with the experience of most developing countries at the time, the global oil crises and the subsequent increases in the cost of borrowing, posed great burdens on the young economies. The majority of the challenges resulted from the increasing deficit in the balance of payments as the terms of trade declined. Thus despite having technology development centres and one-stop centres to assist investors (both local and foreign) there was little progress in the industrialization within the country during the period between 1973 and 1980. Tanzania's challenges were further exasperated by the collapse of the East African Union, the subsequent war with Uganda, and the weather conditions in

between. Thus, it was not the interventionist policies or the ISI model that caused the economic collapse but rather the externalities faced by the economy.

The liberalization period which began in the early 1980s was heavily led by the International Finance Institutions (IFIs). Tanzania's dire need for financing to survive implied that the government had little negotiating power. The government therefore implemented systematically the neo-liberal economic policies without reserve in exchange for financing. When these neoliberal policies came into place there was no positive growth during the 1980s but the IFIs attributed this to the long history of 'market distortions' that had resulted from the previous period. It was also explained at the time that these were merely 'short term pains for long term gains' and that growth and prosperity would come once the market distortions were corrected sufficiently. Subsequently, Tanzania has continued to implement the neoliberal policies with little to show for its commitment to them. The growth achieved in the 10 years from 1961 to 1972 period has been greater, in relative terms, than the growth seen in the 30 years from 1980 to 2010.

All in all, Tanzania attempted from independence to 1980 to increase exports, diversify the domestic industry base, and to create decent employment through its industrialization strategies. There was some progress shown in the early independence period but the young economy was unable to stand up to the global economic crises and other shocks to the economy. Hence, when the option of implementing an accelerated industrialization programme that would increase exports, diversify the domestic industry

base and create decent employment, Tanzania took the opportunity decided to incorporate EPZs in its list of attempts to industrialize.

### **CHAPTER 3**

#### **ECONOMIC GROWTH: Export Led Industrialization**

This chapter shows how the Tanzanian policies pertaining to EPZs and SEZs will fail to increase exports, diversify the domestic industry base, and increase decent employment in the long term. The policies of Tanzania are based on neoliberal approach and depend heavily on attracting foreign direct investment (FDI). These policies do not take into consideration the learning from global experiences on the role of the state in developing and nurturing infant industries, mitigating the negative outcomes of EPZs or fostering positive outcomes. This chapter presents an overview of the development of the EPZ strategy in Tanzania illustrating how the process has resulted in EPZ/SEZ programme that is not dissimilar to other EPZ programmes around the world, and where incentives within the EPZs that are not significantly different from investment incentives outside the zones bringing into question the attraction of the zones. The chapter then addresses each of the objectives of the EPZs increasing exports, diversifying the domestic industry base, and increase decent employment individually. For each objective the policies will be analysed to understand the treatment of the objective, and then empirical evidence available on the performance of the objective is presented. However, due to the unavailability of data, some of the empirical sections can only draw broad conclusions at best.

**The Evolution of the EPZ Framework**

Tanzania has struggled at the policy level for almost a decade to develop the policy framework for its EPZ and SEZ programmes. In 2002, Tanzania first enacted the Export Processing Zones Act in 2002. This was followed by the National Trade Policy of 2003 which laid out how EPZs would enhance industrialization. In 2004, the government launched the Tanzania Mini Tiger Plan which provided the framework for the establishment of Special Economic Zones. It was heavily based on the experiences of the Asian countries. In 2006, the Special Economic Zones Act was passed in Parliament establishing a Special Economic Zones Authority (SEZA) to over see the implementation of the Act. At the same time, the EPZ Act was modified to be streamlined to the SEZ Act and establishing an Export Processing Zones Authority to over see the implementation of the EPZ Act. In 2009, the EPZ Authority Strategic Plan was launched. Finally, in 2011 both the EPZ and the SEZ laws were amended to minimize the duplication between them.

There have been two parallel processes ongoing covering the span of over a decade within the government under two separate ministries and the President's Planning Commission to develop these zones. The first policy process was through the Presidents Planning Commission which first mentioned the term 'export processing zones' in the National Investment Promotion Policy of 1996. The President's Planning Commission then incorporated the idea of Special Economic Zones (SEZs) as a mechanism to achieve Vision 2025 launched in 1999. Furthermore, the Planning Commission developed and launched the Tanzania Mini Tiger Plan in 2004 and had the SEZ Act passed in 2006.

The second process was through the Ministry of Industry and Trade, where through various conferences and national level consultative discussions in the late 1990s the EPZ concept was discussed. The EPZ Act was enacted in 2002. The Act was followed a conference where several policy papers on trade were presented out of which the National Trade Policy of 2003 was produced. The National Trade Policy outlined how the EPZ Act would be utilized to develop industry in the country.

The separate processes show that there was a lack of collaboration between leadership at the top levels of government. In the Parliamentary system to Tanzania, for bills to become acts, they must be introduced and discussed in Parliament. There may be several rounds of reading in Parliament following which the bill would be discussed at the cabinet level after which it would get Presidential approval. One of the objectives of this process is to ensure duplication and contradictions can be identified and addressed before the bill is enacted. However, despite this process both the EPZ Act and the SEZ Act were passed although, the EPZ Act was amended concurrently when the SEZ Act was passed.

As many of the stakeholders for both these processes were the same, including national academics, and labour representatives and the processes were on going over the same time period, the two models that evolved were very similar. This was a duplication of efforts and potential source of confusion for investors and policy implementers as they tried to distinguish between the investment incentives of the different processes.

Despite the various processes, the policy documents need to be reviewed to understand how the EPZs and SEZs are to be used to achieve the overall goals of increasing exports to increase foreign exchange earnings, to diversify the domestic industry base and to increase decent employment opportunities. While there are many policies that pertain to these issues, only the National Trade Policy (2003) which describes the utility of EPZs and the Tanzania Mini Tiger Plan which describes the SEZ will be presented below to understand the overall policy context.

*National Trade Policy (2003)*

In 2003, the ministry of Industry and Trade launched the National Trade Policy aimed at establishing a competitive economy and export-led growth. This is the only document that outlines the implementation of the EPZs in a policy document aside from the EPZ Act. In line with neoliberal ideology, the policy document identifies EPZs as an interim mechanism to counter distortions existing in the market while the government continues to establish a liberalised economy, with the regulatory framework and incentives to be provided being guided by the EPZ Act. The policy states that the government will specifically promote forward and backward linkages, and facilitate export. However, a major opportunity was missed as this policy document did not mention how forward and backward linkages would be promoted, or how export would be facilitated.

The policy recognized a wide range of challenges existing in the Tanzanian context from weak implementation of policies to low human skills capacity, low institutional capacity, poor infrastructure, and a small domestic market. The policy went on to explain how these challenges would be overcome through strengthening good-governance, skills development, and infrastructure development. The policy document then provided definitions and justifications from a neoliberal perspective the incentives outlined in the EPZ Act. The document had a strong neoliberal bias and the previous ISI strategy is criticized heavily as being state-centred and as causing inefficiencies in the market.

Finally, the National Trade Policy outlined the various roles for the different actors in the economy presenting, for the first time in an official policy document, the government as the facilitator of trade through the formulation of a sound macro-economic environment where business activity can thrive again in line with neoliberal economics promoting the EPZ model. This marks a considerable shift from previous state control era. The private sector is also presented as the implementer of the policy and was recognized as a key actor in the economic growth process as per the neoliberal prescriptions.

*The Tanzania Mini Tiger Plan (2004)*

The Tanzania Mini Tiger Plan was launched in 2004 and aimed at industrializing Tanzania by 2020 utilizing the models used by the 'Asian Tiger' countries by 'fast-

tracking' industrialization with private sector participation through the establishment of Special Economic Zones. The plan was launched prior to the SEZ Act that outlined the establishment of such Zones. It was envisioned to be an instrument to "get the country out of the poverty trap" through the adoption of the Asian Development Model (Mini Tiger Plan, 2004:87). The model focuses on employment creation by attracting foreign direct investment and promoting exports through the development of Special Economic Zones. Unlike previous government thinking, this plan is based on a 'if you build it, they will come' philosophy reflecting a shift towards neoliberal economics. The plan has a three phased approach: 1) Build SEZs and aggressively promoting most promising industries such as primary and light industry and tourism; 2) improve the balance of payments by increasing exports from US\$1.0 billion to US\$2-3 billion in 3-4 years and then expand infrastructure through long-term borrowing from multilateral and bilateral donors; 3) solving as many bottlenecks by additional borrowing and foreign currency earning plus FDI, expand investment activities further more into high value added sectors and moving into larger investment projects. The plan specifically aims to develop:

- (1) 4 light industry SEZ programs by 2006 and 25-30 by 2020;
- (2) East Africa Machinery Bazaar;
- (3) out-board ship engine project in fishing fleets;
- (4) one ICT Data/Call Centre Project by 2006 and 5 by 2020;
- (5) 3 cash crop based SEZs by 2006 and 50 by 2020;
- (6) one tourism based SEZ by 2006 and 5 by 2020;
- (7) one jewellery cutting and polishing centre by 2006;
- (8) a national biomass energy program by 2006;
- (9) a ship breaking project by 2008;
- (10) a road-side Station and Corridor Development Project by 2008 and 4 by 2020;
- (11) national heritage/cultural park operating by 2006;

- (12) nation-wide program such as ‘One Village One Product(OVOP)’ program, a scholarship village tree planting program, self-help infrastructure development projects and mini SEZs for small and medium enterprise development.

Expected results and targets of the plan by 2020 are as follows:

- GDP to be growing at an average of 8-10 per cent and reach \$40 billion
- Exports expanded from \$1.1 billion to \$20 billion
- Per capita income to be increased from \$280 to at least \$1,000
- Creating 2-3 million new jobs
- Develop at least 25-30 SEZs in the country and attracting FDI aggressively.

In total the plan aimed at developing 14 SEZs within 2 years of its launch and several others in the following 2 years, with a target of almost 100 zones by 2020 (Map 1). There was little experience within the country of what an SEZ was and what was required to establish such an SEZ program. The plan did not contain a work plan nor did it propose a governance structure for implementation.

The Mini Tiger Plan also lacked any mention on how industrialization would be financed other than through US\$21 million in the 2005/6 national budget (which was not allocated). The plan aimed at doubling FDI within two years of its launch but did not elaborate a strategy for this attraction other than marketing tours outside of Tanzania.

The plan refers to incentives provided by the Tanzania Investment Act for promoting investment but does not state whether this is the policy framework that will be applied. As described above the SEZ Act did later outline a different incentive strategy than that of the TIA thus causing further confusion among investors and technocrats alike.

Unlike the Asian countries strategy, the plan did not identify which sectors would be priority within the initial implementation but rather as per the list presented above, the plan envisioned working in multiple sectors and developing multiple industries simultaneously – many of which were foreign to Tanzania.

Similarly, the plan discussed the industrial development potential of every region in Tanzania and stated that SEZs would be created in every region simultaneously, rather than using a phased approach focusing on the geographic areas with a comparative advantage. The Asian countries, had strategically introduced EPZs/SEZs in locations that had key success factors. The Asian countries also used a phased approach and had introduced one or two zones during the initial years of the EPZ/SEZ programmes and then scaled up the number of sites as the management know-how was developed.

Over all, the Tanzania Mini-Tiger Plan was not adequately thought out in terms of its implementation plan and lacked any sort of piloting period to enable learning for the country in implementing this new strategy. Although the plan was launched in December of 2004, with several 2 year targets, the SEZ Act was only passed in 2006, which implied that many of the targets established by the Mini-Tiger Plan were not met during the prescribed time period and indeed many of which still have not been met over five years after the passing of the SEZ Act.

Despite this Plan having been named after the Asian Tigers and including multiple references to replicating the success of the Asian countries, this plan mentions that the incentive package would be the same as that provided by the TIA and does not

discuss other export promotion strategies used by the Asian countries. Thus the plan was a statement of a vision of what could be, with little guidance on concrete steps on how this will be achieved, with little analysis of how this was achieved in other places.

*EPZ Strategic Plan (2009)*

The World Bank funded the development of a *Strategic Plan for Tanzania EPZ Programme* in 2009. The main objective of this plan was to streamline the two approaches of the EPZs and the SEZs into one. This plan attempted to address some of the issues outlined in the SEZ act (discussed above). Along with the two approaches that had been utilized to that point in the EPZ programme: Zone development and stand-alone factories, the plan introduced a third type: the township model which will create towns equipped with a dedicated airport, seaport and housing, and will include a range of activities including SEZ areas, EPZ areas and even free trade zones (which have not yet been defined in the policy context).

The plan attempts to prioritize interventions in a phased and systematic approach to developing zones reducing the chances of failure. It is the first time the government of Tanzania has an industrialization plan that has a work plan with specific operationalized tasks with responsibilities assigned to officers responsible for delivering within set time periods. Four geographic locations are identified for fast track rollout and a further four are identified for medium term development. The remaining regions that were proposed in the Tanzania Mini-Tiger Plan are discussed as potential sites for future development

but not priority for the current EPZ implementation. One of the key initial interventions proposed in the plan was the amendment of the EPZ and SEZ Acts so that both programmes are implemented under one authority (later the EPZ Authority).

Although the plan is not costed, the clear work plan with timelines makes it easier for the Export Processing Zones Authority to implement. The robust monitoring and evaluation framework provided is an additional tool that the government could utilize to measure its success and to strengthen the implementation of the EPZ programme.

Being funded by the World Bank the plan presented little interms of how local investors and industries would be brought into the export promotion strategies. Instead the plan focused on how different EPZ/SEZ sites would be developed, and how the programme would be streamlined.

#### EPZ Act Amendments (2011)

To overcome the confusions that have been created with the creation of evolving programmes over the years and the simultaneous implementation of the EPZ and SEZ programmes, the government of Tanzania decided to amend the EPZ and SEZ Acts to streamline the two and to give the EPZA the jurisdiction over both programmes by removing the SEZA. It has also increases autonomy of the EPZA allowing it to approve its own operational policies and set the remuneration levels for its staff.

There is also a major change proposed in the structure of the EPZA Council which is to be renamed to be a Board. The board is to be revised to be constituted of the

following members: the Minister of Industries; the Attorney General; the Permanent Secretaries of the ministries of finance, water, minerals, local government authorities; the Executive Secretary of the Presidents Planning Commission; the Commissioner General of the Tanzania Revenue Authority; the Commissions for Lands; the Chair of the Tanzania Private Sector Foundation and the President of the Tanzania Chamber of Commerce, Industry and Agriculture.

Despite these changes to bring both programmes under one authority, the discrepancies in the incentive packages remain and are discussed in the next section. These discrepancies are key points of confusion and in some cases also weaken the potentials of the EPZ/SEZ programmes to achieve their goals.

### **The Current EPZ Framework**

The current EPZ framework for investment and incentives is governed by the EPZ and SEZ Acts as amended in 2006, as the EPZ Act amendment of 2009 did not make changes to incentives. Aside from these EPZ and SEZ Acts which provide the framework for investment incentives within demarcated zones, the Tanzania Investment Act (1997) provides with overall framework for all investments in Tanzania outside of the EPZs. An issue that emerges here is that there is a high level of similarity between the TIA and the EPZ and SEZ Acts further causing confusions. Figure 3 below shows the similarities between the TIA of 1997, both the EPZ Act of 2002 and the amendments to the EPZ Act in 2006 (which further brought it closer to the SEZ Act), and the SEZ Act of 2006. The

SEZ Act outlined three categories of investors in the zones. Category A investors were those who would develop the zones; Category B were investors producing for sale into the customs territory; and Category C were those exporting a minimum of 80% of the goods produced. For the purposes of this study only Category C investors will be considered as these are the investors who are producing for export. As seen in Figure 3, the major differences between the TIA and the EPZ/SEZ Acts was that the TIA did not have a minimum export requirement, that only 50% of foreign exchange earnings from local investors would be allowed to be used freely by the investor (EPZ/SEZ have no restriction even if investor is local), corporate tax and withholding exemptions of only the initial 5 years (EPZ/SEZ is 10 years), and the minimum investment requirements for local investors under the TIA is only US\$100,000 while it is unmentioned in the EPZ Act and set at US\$1,000,000 in the SEZ Act. Similarly, the minimum requirement for foreign investors in the TIA is US\$300,000 while it is unmentioned in the EPZ Act and is set at US\$5,000,000 in the SEZ Act. Perhaps the major difference could be that firms governed by the TIA are not exempted from import and export duties, but as there is no export requirement, the firm may produce for the local market hence making the tax issue moot. Thus, an investor can get almost the same incentives albeit for a shorter period of time through the TIA as from the EPZ or SEZ Acts, without being required to invest as much or to export. In addition, there is no difference between an EPZ investor and an SEZ Category C investor except that the SEZ legislation states a required minimum value for investment while the EPZ Act does not.

Figure 3: Comparison of Key Legislation Pertaining to Incentives for Investment.

	Tanzania Investment Act (1997)	EPZ Act (2002)	EPZ Act Amendment (2006)	SEZ Act (2006) Category C only
Minimum export requirement	None	70%	80%	80%
Repatriation of profits and dividends	Unrestricted	Not mentioned	Unrestricted	Unrestricted
Exemption from foreign exchange control	For local enterprise: 50% control of net foreign exchange earnings allowed for foreign unrestricted transactions. For foreign enterprise: unrestricted	Unrestricted	Unrestricted	Unrestricted
Corporate tax exemption	Initial 5 years and thereafter as per the Income Tax Act of 2004 (30%).	Initial 10 years and thereafter a maximum of 25% per year.	Initial 10 years and thereafter as per the Income Tax Act of 2004 (30%).	Initial 10 years and thereafter as per the Income Tax Act of 2004 (30%).
Withholding tax exemption	5 years then: 5% for local 10% for foreign	10 years	10 years	10 years
Remission of customs duty, value added and any other tax charged on raw materials and goods of capital nature related to production	Capital goods exempted indefinitely.	Remitted 100% indefinitely with the exception of motor vehicles, spare parts and consumables	Remitted 100% indefinitely including for importation of one administrative vehicle, ambulances, fire fighting equipment and vehicles and up to two buses for employees' transportation to and from the Export Processing Zones.	Remitted 100% indefinitely including for importation of one administrative vehicle, ambulances, fire fighting equipment and vehicles and up to two buses for employees' transportation to and from the Special Economic zones.
Exemption from pre-shipment inspection	Not mentioned	Yes	Yes	Yes
Access to high quality infrastructure	Not mentioned	Yes	Yes	Yes
Onsite customs inspection	Not mentioned	Yes	Yes	Yes
Work permits for expatriate staff	Automatically granted 5 permits and others approved through justification	Not mentioned	Automatically granted 5 permits and others approved through justification	Automatically granted 5 permits and others approved through justification
Minimum investment	Minimum local investment US\$100,000 Minimum foreign investment US\$300,000	Not mentioned	Not mentioned	Minimum local investment US\$1million Minimum foreign investment US\$5million
Eligibility	New investment or expansions of existing investments.	Existing investments converted to EPZ by stand alone approach	Only new investments eligible.	Only new investments eligible.

After over a decade of discussions and deliberations, the incentives and their requirements were decided as follows: EPZ and SEZ investments have to be larger in initial investment value than TIA investments, and export at least 80% of their products. This makes large investors eligible for the same incentives as those of a lower value and producing for the local market except that these incentives would be applicable for ten years instead of five and would include a waiver on import and export duties. As it is easier for industries to produce for a local market than to produce goods that are internationally competitive there is little incentive for investors to invest in EPZs or SEZs.

The net effect of these policies is that large investors are given longer and more exemptions to taxes, while smaller investors are given shorter and less incentives. On the other hand, domestic investors have to invest less to be eligible for the same incentives as foreign investors. However, the policies do not protect the local market from large foreign investors as there is no maximum investment level in the TIA. This implies that if a foreign investor wanted to establish a US\$5,000,000 industry for the local market there would be no restriction against him. Thus if there were domestic industries in the same sector these would be threatened. Previously, in the Tanzania Investment Promotion and Protection Act (IPPA) of 1990, certain sectors were protected from foreign investment, however, in the Tanzania Investment Act of 1997 these protection measures were removed.

To add to the confusions in the policy environment, despite the first enactment of the EPZ Act in 2002, even as early as 1990 the Minister of Economic Policy and Planning was allowed to designate any area of Tanzania as a Special Growth Area in which enterprises may be provided with special incentives as the Minister may prescribe (IPPA, 1990). Furthermore, Tanzania had first established a special economic zone through the Dodoma Special Investment Area (DSIA) Act as early as 1989. Tanzania had decided to move its political capital to Dodoma, which is geographically in the centre of the country, for political security reasons soon after independence. However, due to the underdevelopment of Dodoma, the government was unable to implement this decision. The DSIA Act was intended to encourage investment in the area to enable the government to move the political capital. The incentives provided through this Act were very similar to those that would be provided within an SEZ. The DSIA Act included a sunset clause of 20 years ending in 2009. It allowed investors in the area total remission of any import duties for goods required in the area, exemptions from income tax and sales tax, 50% reduction on electricity and water costs, and access to credit on charges lower than market value. The Act was aimed at a wide range of business activities within the designated area which included industrial production of mineral processing, glass products, hardware products and electrical products. The area was declared a customs bounded area and any good being sold to entities outside of the area were subject to all duties and levies as per the national economic policies.

The similarities would be a source of confusion within authorities such as the Tanzania Revenue Authority (TRA) regarding which companies were eligible for which exemptions based on their status. In some cases, these similarities have actually led to some companies renouncing their EPZ status and returning to being an investment under the TIA, as the requirement to export is dropped but many of the other incentives remain the same (Dominican, 2010).

Tanzania therefore has several challenges facing the implementation of the EPZ/SEZ programme. The similarities between the investment incentives within the EPZ/SEZ areas and outside the EPZ areas through the TIA and the DSIA provide little motivation to both local and foreign investors to invest within the EPZ/SEZ Areas unless they are purely producing for export. This therefore means that the Zones that have been developed are primarily attractive for the FDI-type investors. These investors would have extensive tax exemptions, few linkages with the local economy and may provide jobs although the quality of these jobs is unknown. Thus the investors would be attracted through the EPZ/SEZ incentive packages are those through whom few of the envisioned benefits will materialize.

The management and implementation of both the EPZ and the SEZ Acts has been put under an independent one stop EPZ Authority. Similar to the Asian industrialization strategies, the Tanzania EPZ Authority is autonomous allowing the authority to approve its own operational policies and set remuneration of its staff. The Authority is overseen by a Board that constitutes of the following members: the Minister of Industries; the

Attorney General; the Permanent Secretaries of the ministries of finance, water, minerals, local government authorities; the Executive Secretary of the Presidents Planning Commission; the Commissioner General of the Tanzania Revenue Authority; the Commissions for Lands; the Chair of the Tanzania Private Sector Foundation and the President of the Tanzania Chamber of Commerce, Industry and Agriculture. In the Asian countries model, the board overseeing the export promotion strategies was made of high level policy makers who could monitor the development of local industries and address the bottlenecks to export. The Board in Tanzania was initially established of Ministers of the respective ministries listed above but in the amendment of 2011, the responsibility of collaboration and oversight was placed at the Permanent Secretaries level as it was understood that this is the level where implementation decisions are made. However, unlike in Korea and other Asian countries, the high level board in Tanzania had been unable to provide adequate oversight on the EPZ/SEZ programme. The lack of coordination evident throughout the parallel processes during the first decade of development has been an illustration of the gap in adequate leadership and coordination. As discussed in chapter 1, one of the key interventions by the Asian governments in ensuring the success of the EPZ programme was the close oversight and follow up from high levels of government. In Tanzania it is now assumed that the policies and incentive packages have been determined and the only level of oversight support required now is at the implementation level. However, as discussed above, there are still a lot of overlap in

the incentive packages making the policies overlapping and confusion. Thus, remains a need to clarify these confusions.

Although, foreign investors are actively being sought for the EPZ and SEZ programmes the provision for a lower minimum value for local investors to be eligible for the SEZ incentives implies that the government does want to promote the local industrial sector into export. This is not being done with the same level of “push” as was done in the Asian countries and the major focus remains on attracting foreign investors to the programme. It remains to be seen if the Board of the EPZA is able to encourage and reward local investors’ attempts to export as was done in the Asian countries.

This section has illustrated that the EPZ and SEZ regimes in Tanzania fall far short of the industrialization regimes utilized in Asian countries with respect to increasing exports for foreign exchange. The strong focus on FDI and the extremely lenient exemption measures means that the country will have significantly reduced foreign exchange earnings. The similarities to the incentives provided outside the zones, and the weak coordination and leadership at the national level means that investors will not be attracted to investing within the zones to the extent that they could be. Finally, the inability to protect the local market from foreign investors that may invest under the TIA means that it would be unlikely for local industry in Tanzania to be to competitive with international firms that may produce for the local market. It seems in this regard the EPZ and SEZ strategies will be unable to replicate the Asian success.

**Increasing Exports**

Since independence, Tanzania has recognized the need to earn foreign exchange through exports. Even during Tanzania's Import Substitution Industrialization period the emphasis on exports and particularly value added exports had remained. As discussed in chapter two during the period from independence to the economic recovery period, significant investment was made in the manufacturing sectors as Tanzania strove to develop its comparative advantage in selected industries within the East African Union.

Both the EPZ Act and the SEZ Act state the increase of exports as one of their major objectives. The EPZ Act goes further to state that the creation and expansion of foreign exchange earnings would be the second benefit. Both the Tanzania Mini Tiger Plan and the National Trade Policy state clearly that one of the key objectives of increasing exports is to increase foreign exchange earnings and the balance of trade. There is also a closely connected discussion in both documents on the importance of exporting value added products.

Tanzania has historically encouraged the use of local technology in the development of the industry base through organizations such as TIRDO and TEMDO (discussed in chapter 2). These organizations have continued to exist but have focused their attention on smaller scale mechanised products such as the production of cooking oil at village level.

Both the EPZ and the SEZ Act are heavily focused on foreign companies being the main source of investment (foreign direct investment – FDI) for the zones. Local

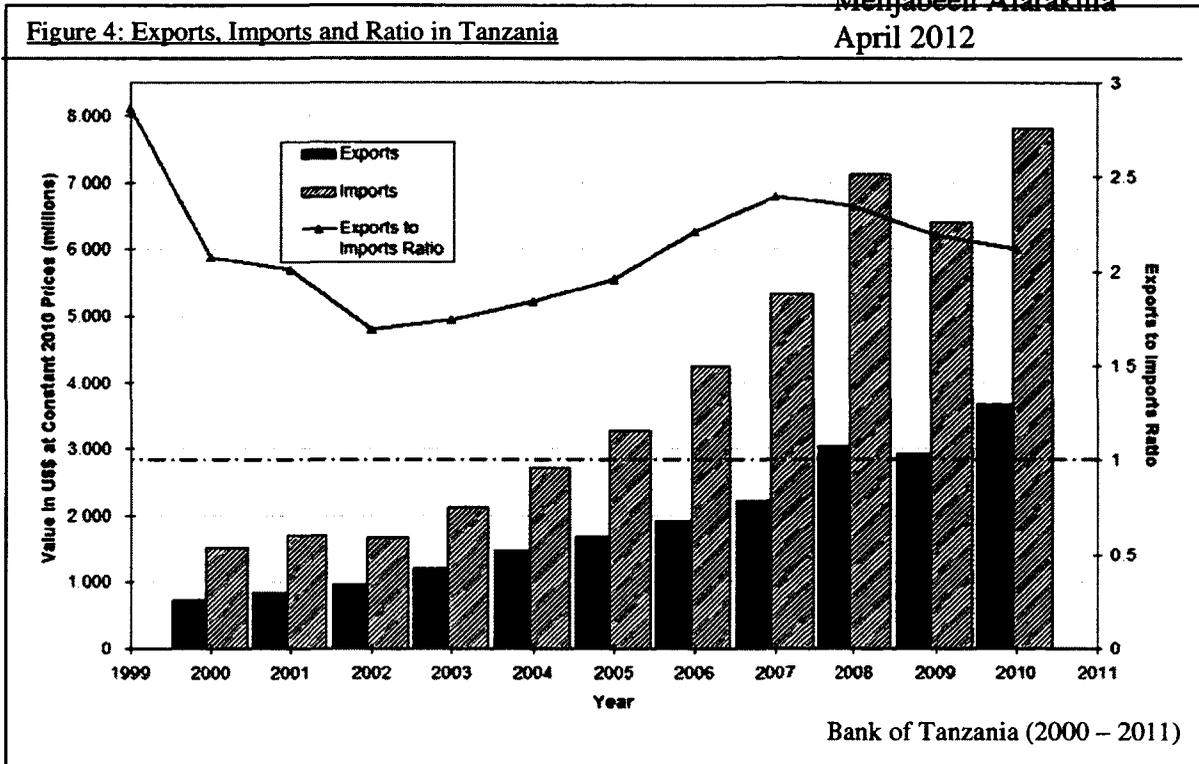
investors are encouraged to invest – evident through the lower threshold for eligibility of incentives under both the SEZ and the TIA investment schemes. It is proposed that the zones would provide two main sources of foreign exchange earnings: firstly, directly through the increase of earnings from exports from both foreign and local firms; and secondly, where the firm is a foreign firm, foreign exchange could be earned indirectly through the conversion of earnings into local currency to buy local goods (for consumption), for paying taxes and salaries.

Tanzania however, provides a 10 year exemption to all investors on all taxes, on imports and exports. This implies that for the initial 10 year period all tax earnings would be zero. In the case of local firms, foreign exchange earnings would therefore be the profits earned through exports that remain within the country. This would not be the case with foreign firms as the SEZ and EPZ Acts allow foreign companies the right to repatriate 100% of the profits made back to the ‘home’ country and therefore these would not remain within Tanzania. Thus the policy framework for Tanzania allows the country to earn foreign exchange from foreign firms only through what they convert to pay local staff salaries, and for consumption. Meanwhile the country’s earnings from local firms is from the export earnings. As EPZ/SEZ firms are to export a minimum of 80% of their products, it can be assumed that the largest part of the foreign exchange earning would be from the export earnings. As export earnings of foreign firms (minimum investment US\$5,000,000) that are usually larger than local firms (minimum investment US\$1,000,000) this is repatriated to the foreign economy leaving Tanzania with no

significant earnings from the exports. Thus, in order for Tanzania to achieve its objective of increasing exports to increase foreign exchange earnings, it is more logical for Tanzania to encourage local investors in EPZ/SEZ investment as the policy framework implies that the foreign exchange earnings from the exports will remain within the country.

### Export Performance

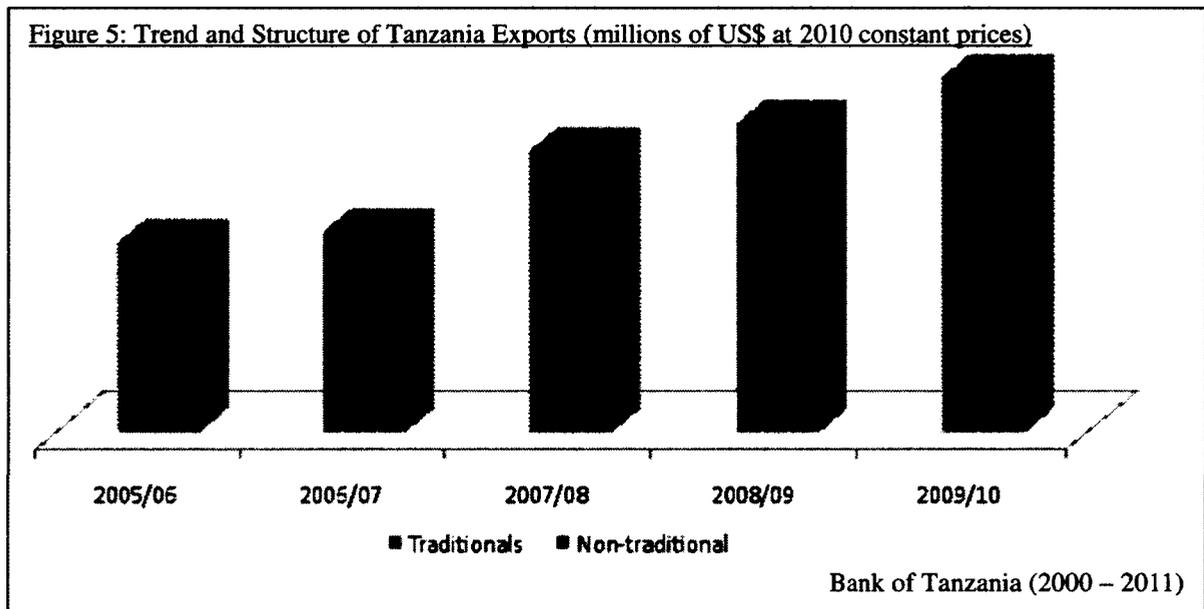
Exports in Tanzania have increased over the years and this is particularly true for the period starting from 2007. Beginning from the early 2000's imports began to grow exponentially, and the deficit in the trade balance was getting larger. The trend line in Figure 4 illustrates the ratio between exports and imports. For the balance of trade to be even the value of this ratio must be below 1 or below. In Tanzania, the trade balance has not been even since the early 1970s. Tanzania started to export gold in 1999, at which point the Bank of Tanzania began to disaggregate data illustrating the value of gold in net exports. Beginning in 2002, the difference between the value of imports and exports began to grow illustrated by the increase in the ratio starting in 2002 as there was an increase in imports. The gap between exports and imports grew wider until 2007, at which point there is a clear decline in the ratio. This is attributed mainly to the increase in gold exports as the country has recently become the third largest exporter of gold in Africa. Gold and other precious metal exports constituted almost 45% of the total value of exports in 2009. The global increase in gold prices has led to a further valuation of



Tanzania's exports but this should not be mistaken with increased exports of manufactured goods.

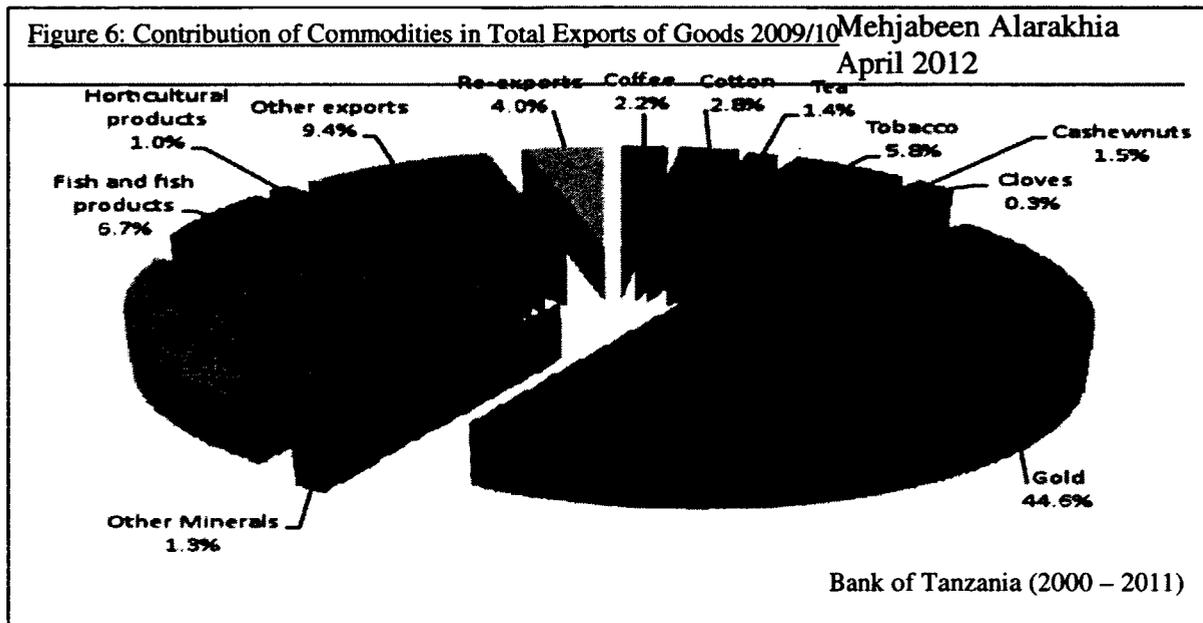
Imports have continued to rise at an exponential level. Tanzania's primary import commodities are fuel oil, transportation vehicles and grain. Tanzania's electricity consumption has grown over the last two decades and as a result Tanzania's hydropower dams are unable to meet the increased demand. As a result, Tanzania has to rely on imported diesel fuel to create electricity as well as for transport which have been increasing over the past decade. In 2010, oil was 25% of all imports and was the largest single import of the country. This results in an increasing dependency on imports to run the economy and thus the need for foreign exchange.

The following charts are from the Bank of Tanzania's annual report for 2010 which was released in mid 2011. Figure 5 (BOT, 2011:29) illustrates the changes in the trend and structure of Tanzanian exports from 2005 to 2010 showing that non-traditional



exports have increased significantly during this time while traditional exports have grown little.

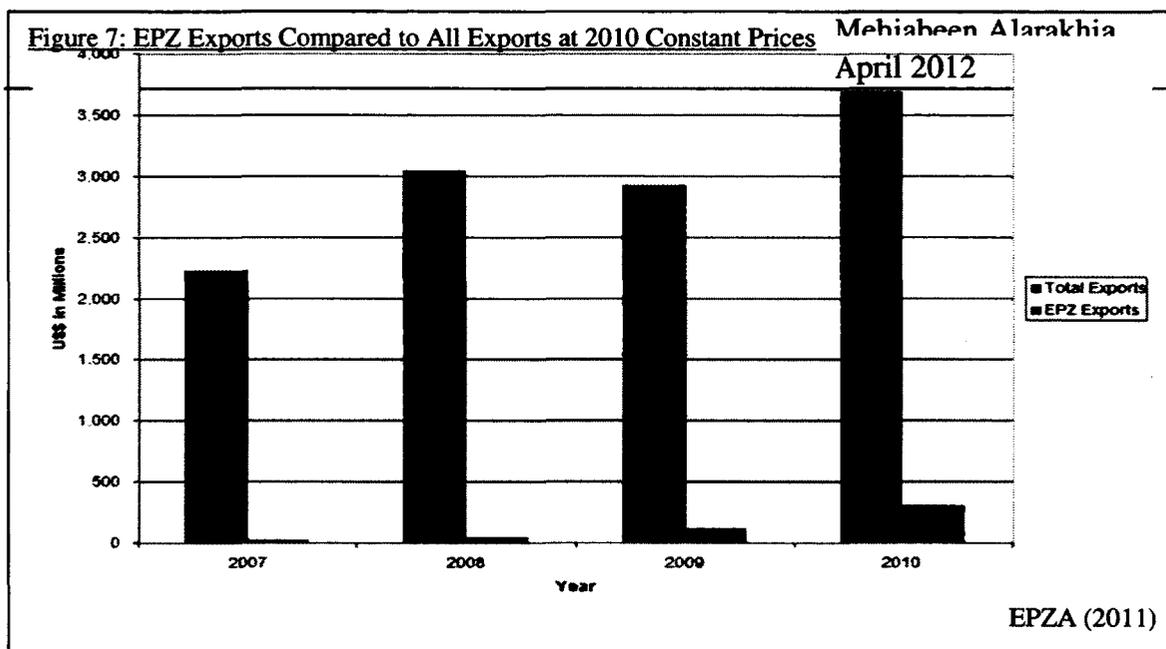
Figure 6 (BOT, 2011:29) shows the make up of exports in the fiscal year from July 2009 to June 2010 which illustrates that gold made up over 44% of the total exports an increase from 39.9% in fiscal year 2007/8. In the fiscal year July 2007 to June 2008, manufacturing made up 18.1% of total exports. By fiscal year 2009/10 this had only gone up to 19% illustrating that the sector grew much slower than gold exports. Similarly, in the fiscal year 2007/08 manufacturing sector contributed 9.2% to GDP earnings, while in 2009/10 this contribution had only increased to 9.5%.



The manufacturing sector has not significantly grown between 1998 and 2008 despite the efforts to increase manufacturing in EPZs and SEZs. There has only been a 1% change in the sectors' contribution to the GDP, rising from 8.4% to 9.4% between 1998 and 2008 (URT, 2009). Exports are still a small share of the GDP and of these only 40% were manufactured exports in 2008 (BoT, 2008).

Exports from EPZs have grown in value to about 10% of total exports. Figure 7 below illustrates the increase in EPZ exports from 2007 to 2010. However, the EPZA was unwilling to share detailed data and merely provided aggregated data from financial audits. Thus it is impossible to tell from this data if the exports were from foreign or local companies and as a result, it is impossible to estimate the amount of this activity is contributing to the country's foreign exchange earnings. However, it is possible to conclude that the value of exports in the EPZs has been increasing over the past 4 years.

Tanzania's exports have been increasing over the past five years albeit because of the increased value of gold. Similarly, Tanzania's imports have been increasing due to



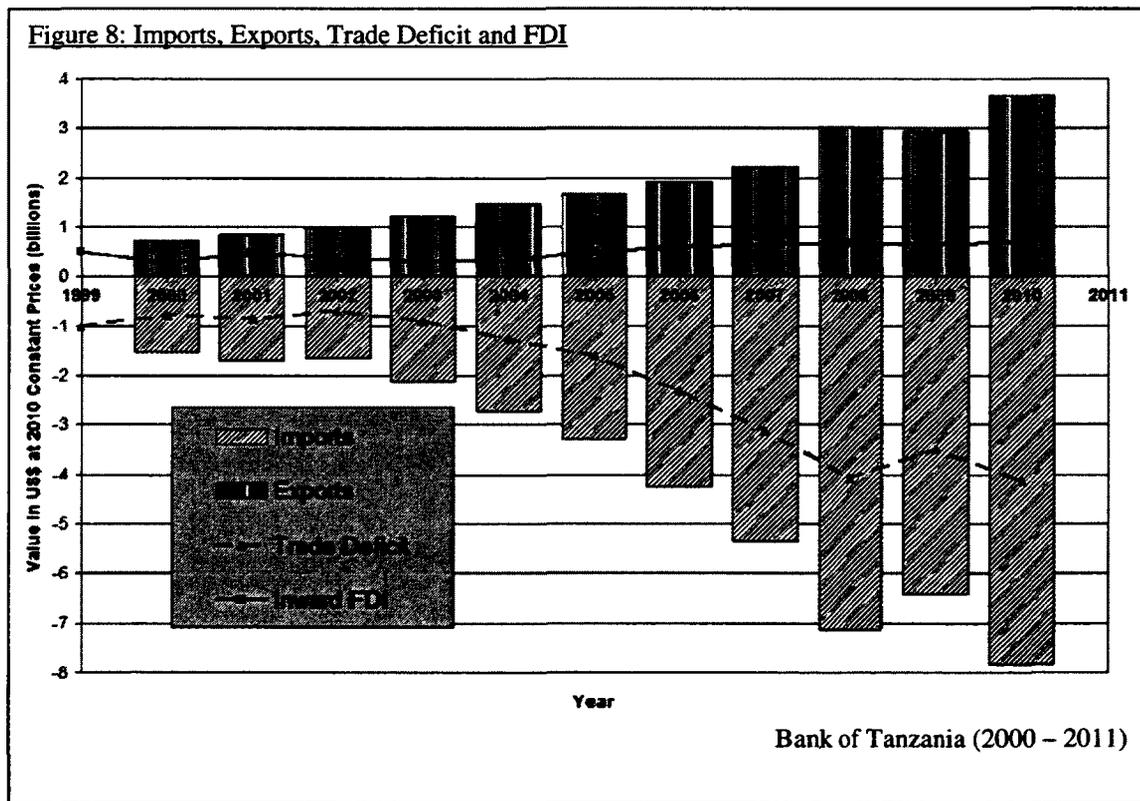
the increased oil-fuel consumption. However, the data also show that the value of Tanzania's EPZs exports has increased. Unfortunately because of the reluctance of the EPZA to provide disaggregate data it is impossible to estimate the amount of foreign exchange earnings that have remained in the country as a result of EPZ exports.

In summary, exports since the year 2000 have increased in value however, this increase has mainly been due to the increase export of gold from the country. Manufactured goods make up under 20% of the total exports of the country. By 2010, EPZs contributed only about 50% of manufactured exports and therefore about 10% of the countries total exports.

### Foreign Direct Investment

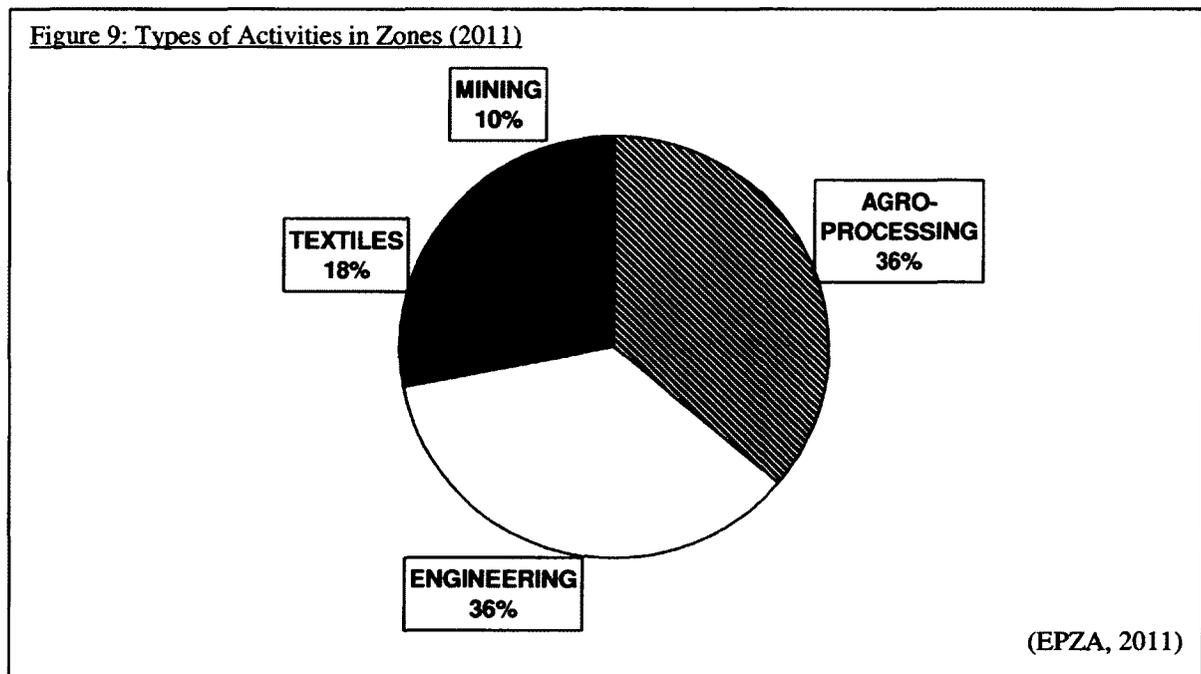
Both the Tanzania Mini Tiger Plan and the National Trade Policy stressed the importance of attracting foreign direct investment (FDI) via the EPZ strategy as this would contribute to the development of the Tanzania's domestic industrial sector. There have been the extensive discussions in Tanzania (see Wangwe, in Szirmai and Lapperre,

2001; and Daima Associates, 2007), as well as the extensive control and direction of FDI in the Asian Tiger and Tiger Cub countries as well as in some Latin American countries. Although there were many differences between these countries policies, they were similar in that they were very sceptical of foreign investors and significant measures were taken to control the power of FDI (discussed in chapter 1). However, in line with the neoliberal economic position, there has been no discussion of the control or the limits of FDI in the policy documents that have been reviewed. FDI has been treated as a homogenous entity and there has been no analysis presented of it. All that is discussed is that FDI is required for the development of industries and merely building EPZs and SEZs will draw the FDI to Tanzania.



Despite the high dependence on FDI in Tanzania's EPZ and SEZ programmes, the FDI inflow in the country has not increased significantly in the last 10 years since the launch these programmes. As discussed above, during this period both exports and imports have increased. Figure 9 below presents the overall FDI in Tanzania which has remained under US\$1 billion per year. The EPZA was unwilling to provide disaggregate data on the level of foreign direct investment within the EPZs. However there has been little change at the national level in FDI flows into the country (UNCTAD, 2011).

Tanzania's EPZ programme has from its onset seen foreign direct investment as the key driver for development within these zones. In 2006, the EPZ Act amendment allowed the EZPA to enter into joint ventures to develop new zones. This shift has further deepened the reliance on foreign investment in the EPZ programme as even the



development of the zones is now dependant on investors with tax exemptions.

As of May 2011, there are 25 Gazetted zones in Tanzania; 6 of these are industrial parks while 19 are standalone factories. In total, there are 44 companies licensed with the EPZ or SEZ status. However, many of the licensed companies are not yet operational. The table below is a presentation of some of the companies registered. Forty one percent of these are purely foreign investment and 44% are local investment. The 15% presented as joint ventures are EPZA partnerships with private sector companies to develop new or existing zones. Agro-processing and engineering are the major sectors of investment (36% each) with the textile sector having 18% of the investment and mineral processing standing at 10% of total investments.

Although FDI has not increased in Tanzania over the past 10 years, exports have increased. This implies that despite the heavy focus on FDI in the EPZ strategy, Tanzania has not been able to attract significant FDI. One explanation could be that as many of the other countries in the region are also implementing EPZ strategies and are attracting FDI, Tanzania is unable to attract FDI because of its insufficiently developed policy environment with the EPZs. However, the unintended benefit of this is that domestic capital is benefiting from the EPZ strategy and local know-how is being built in the absence of foreign investors.

### **Diversification of Domestic Industry Base**

Both the EPZ and the SEZ Acts refer to the development of local industry through both forward and backward linkages within industries in the zones. The National Trade

Policy and the Tanzania Mini Tiger Plan specifically mention linkages as being an important component of diversification of the industry base. From a policy perspective, countries have commonly utilized a quota system, requiring investors to source a minimum level of inputs from the local market. The Tanzanian EPZ/SEZ laws and policies, contain no such requirement. Following the principles of the neoliberal economics, companies may source their raw materials for anywhere in the world. When goods enter into the country bound for EPZs or SEZs, these goods are given transit status and are not charged any type of duty for being imported into the territory. On the contrary, goods that are bought locally for use as inputs into EPZ or SEZ would incur an export duty that would be charged to the local company selling to the EPZ/SEZ company which in effect discourages local firms to sell to EPZ/SEZ firms. As discussed in Chapter 2, the Government of Tanzania was utilizing schemes that required manufacturers of export goods to utilize a minimum amount of local products in production in the 1970s. However, these measures were removed during the Economic Recovery Period and the Structural Adjustment Programmes and have not been able to be introduced again.

With respect to technology transfer, with the lack of linkages being forced there is little incentive for advanced manufacturers to develop the skill and technology base in the local market. There has not been a framework to establish any strategic partnerships between research organizations (both universities and technical organizations) and manufacturers in the EPZs or SEZs. In the Asian countries these partnerships were deliberately developed as a means of developing a technical knowledge base within the

country in a particular industry. This skill base can then be developed to innovate and create new methods of production.

Unfortunately, at present due to the infancy of the EPZ and SEZ programmes in Tanzania, there is little data available about the level of local materials being utilized in goods produced for export. In the 2011 annual report to the Treasury Department, the EPZA reported that 85% of investors utilize some local material in their production for export. However, the value of this material was not presented (EPZA, 2011).

This section illustrates that there has been little done from the policy side to ensure that linkages happen. The global experiences have demonstrated that linkages, technology transfer and industrial know-how do not happen by default as prescribed by the neoliberal economists. Instead, most countries have had to establish direct quota or other mechanisms in the policy framework to ensure these benefits of EPZs and SEZs materialize, however, none of these are present in the Tanzanian policy framework.

### **Decent Employment**

The policies clearly state employment creation as a key objective of pursuing the EPZ and SEZ strategies. Although there has been a high level of neoliberal influence in Tanzania's EPZ/SEZ programme, and the increased focus on FDI has required the government to provide many investment incentives, the current EPZ regulations do not provide EPZ workplaces exemptions from the country's labour laws. The EPZA Board is allowed to grant additional incentives as seen appropriate to any investor, therefore it is

possible that exemptions could be made, however, to date, no such exemption has been reported. In addition to this, Tanzania has very progressive labour laws which are applied uniformly inside and outside the EPZs, requiring employers to grant paid maternity leave, annual leave, and compassionate leave. In addition, the law stipulates maximum working hours for various sectors, as well requires all employers with 5 or more employees to contribute to the National Social Security Fund at 10% of the salary of the employee (in addition to the salary paid to the employee). The Labour Act however does not require employers to provide mechanisms for upgrading of skills neither outside nor inside the EPZs.

Tanzania's population is approximately 45 million and grows by about 1 million people each year. The latest unemployment rate available was for 2006 which pegged unemployment at almost 12% with 630,000 new candidates entering the labour market each year (NBS, 2006). The national unemployment rate for men is 10.7% and the ILO estimates that 90% of jobs are in the informal or agricultural sector. For women the unemployment rate is 12.6% with over 96% of jobs being in the informal or agricultural sector (ILO, 2010). Thus over 90% of employment in Tanzania is in the informal or agricultural sectors where incomes are unreliable and vulnerable. Women and those living in urban areas are disproportionately unemployed with unemployment figures being 12.6% for women and 22.6% for urban populations (NBS, 2006).

Over all the employment of the manufacturing sector was reported as 1.4% of those employed in the formal sector according to the 2008 Household Budget Survey. It

is estimated that by the end of 2008, employment in zones was only 2.5% of total industrial employment in Tanzania (Farole, 2011) thus being 2.5% of 1.4%. However, according to the audit reports of the EPZA the employment figures in EPZs have consistent increased of the past several years. For the year from July 2010 to June 2011, it is estimated that EPZs provided direct employment to 13,500 individuals and indirect employment to 60,000.

Figure 10: Employment in EPZs

<b>YEAR ENDING</b>	<b>DIRECT EMPLOYMENT</b>	<b>INDIRECT EMPLOYMENT</b>
30-Jun-11	13500	60000
30-Jun-10	10000	32300
30-Jun-09	7500	21300
30-Jun-08	3900	13700
30-Jun-07	2010	8600

Controller and Auditor General Audit Report (2007, 2008, 2009, 2010, 2011)

Almost 8,000 of these jobs are in A to Z Textiles, a locally owned textile and mosquito net manufacturing EPZA factory. This one factory located in Arusha employs more than 50% of EPZ workers in Tanzania. While this company is locally owned, several of the senior management staff are expatriate textile management professions. A recent study conducted by the University of London, School of Oriental and African Studies, found that the employment conditions within this factory allowed employees to develop skills and have sustainable livelihoods, respected the rights of workers, provided safe places to work, giving employees sufficient time away from work and enabling access to health and other welfare services.

Minimum wages in Tanzania vary across the different employment sectors. They range from 65,000/- (Tanzanian shillings) in the hotel, tourism and domestic service sector to 350,000/- in the mining and aviation sectors. The minimum wage in the manufacturing sector is 80,000/- per month (ATE, 2010). The average salary of employees in A to Z Textiles is 140,000/- which is 50% more per month than the national minimum wage. There are opportunities for employees to make an additional 40,000/- per month in overtime. Employees of A to Z Textiles claim to be able to support not just their immediate families but also relatives with school fees and access to health services. It is estimated that through these jobs about 25,000 dependents are supported (Jennings, 2011).

According to Jennings (2011), A to Z Textiles pays better than other manufacturing jobs in the geographic area thus resulting in the company being perceived as a good employer and as contributing to the local economy through the provision of local income streams. The company gives employees 28 days of paid leave per year, 4 days of emergency leave, 3 months maternity leave and the ability to negotiate longer unpaid leave if required. The company also provides consistent training and upgrades skills of workers and on the job training upon initial recruitment. Trade Unions are free to organize in the factory and the Tanzania Union of Industrial and Commercial Workers (TUICO) provides several trainings on workers rights and entitlements several times a month, in addition, the management and workers have a weekly meeting. Workers in this company are entitled to social security payments and health care is provided through a

health centre and a hospital at the factory site. Workers are also provided with voluntary individual and family housing with electricity and water on the site of the factories (Jennings, 2011).

Although, A to Z textiles is only one EPZ site, it represents more than 50% of the jobs available in EPZs in Tanzania. The evidence shows that these jobs are not only better than other jobs available in the area; they are also generally meet the ILO criteria for decent work. It is possible that this employer will establish a precedent and a minimum standard to the jobs available in Tanzania EPZs. It must be noted that this is local investor and most of the employment standards violations occur when foreign investors are involved and when the 'race to the bottom' gets more intense. In addition, it should not be assumed that the conditions in one firm would be the same in other firms even if this firm represents the majority of jobs.

The data shows that the majority of jobs in the Tanzanian EPZs do meet many of the criteria of the ILO Decent Work agenda despite these jobs being in EPZs. The major employer in the EPZs is a domestic investor who provides health benefits, housing, paid leave, the right to unionize, on the job training, decent working hours, 50% higher wages than the national minimum wage for these positions, social security and the free movement of people.

**Conclusion**

This chapter has presented the policy environment of the EPZ and SEZ programmes in Tanzania. The lack of focus and coordination in developing the programmes resulted in two parallel and almost identical programmes being developed in the country in a process that long and protracted. Despite this, the policy regime that evolved was similar to what already existing in the Tanzania Investment Act of 1997.

While the initial impetus had been to replicate the successes of the Asian Tiger countries through the development of the Tanzania Mini Tiger Plan, there seems to have been little analysis or inclusion of the actual policy approaches utilized by the Asian countries to develop local industries. Unlike the Asian model where the state played a strong role in coordinating and managing the foreign direct investment as well as in developing and nurturing the infant industries, the Tanzanian model has emerged as the standard neo-liberal model implementing the neoliberal policies.

In all three aspects analysed, the increase of exports, the diversification of the domestic industry base, and the creation of decent employment opportunities, the Tanzanian policies have declared aspirations towards achieving ambitious targets. Despite global experience where these targets have not been met unless the foreign investors are required to contribute to them through policies, the Tanzanian policies do not in any way require the investors to meet these targets.

Although the discussions about EPZs began as early as 1996, and the EPZ Act first being passed in 2002, activities to develop EPZs only began after the EPZ Act

amendment in 2006, thus the EPZs have only been operational for 5 years after the establishment of the Export Processing Zones Authority (EPZA). Perhaps because of the infancy of the EPZ and SEZ programmes in Tanzania, little empirical data is available on any of the major indicators being aspired towards in the programme.

Empirical data on exports generally shows that EPZ investors are exporting more products. In 2010, EPZ exports currently only make up approximately 8% of total exports of Tanzania. On the other hand, national data shows that FDI flows into the country have remained unchanged in the past 10 years implying that even if the EPZs are attracting foreign investors, they are not making a difference in the national FDI stock. The EPZ authority reports that approximately 40% of the companies operating in EPZs are foreign implying that 60% of the investors are domestic or are in joint-ventures. This then implies that the the EPZ strategy to attract and depend on FDI is failing, and that the government of Tanzania should be looking more at incentivizing investment for domestic capital.

Fortunately, empirical data was available for employment in EPZs. Putting together data from the CAG reports as well from academic publications, it can be concluded that although EPZ jobs are small in number in the country, they are currently good jobs that adhere to the principles of decent work. The incentives being provided to EPZ investors have remained financial and exemptions on labour standards have not been included.

Over all this chapter has illustrated that although the initial formalization and implementation of the EPZ and SEZ programmes was extremely slow, over the past few years there has been some progress in the zones but in terms of exports as well as in terms of employment creation. The policy framework for incentives has been heavily influenced by neoliberal economics despite aspirations to replicate the successes of the Asian countries.

## **CONCLUSION**

The purpose of the thesis was to determine if Tanzania's Export Processing Zone (EPZ) Programme will contribute to development. Given that Tanzania is a latecomer in the implementation of EPZs, it was a great opportunity for Tanzania to develop an EPZ model that would take into consideration lessons learned from other country's experiences in order to ensure success.

Based on a review of the EPZ and industrialization literature, the thesis statement argued that Tanzanian EPZ programme will not achieve the objectives of increasing exports, diversification of Tanzanian domestic industry, and increase decent employment opportunities because it was based on a neoliberal approach.

The literature review demonstrated that EPZ programmes failed to achieve the desired outcomes because they were implemented using a neoliberal approach thus assuming that industrial policy should be the same for any country. However, in countries where EPZs have lead to development outcomes, the state has had to play a very active role in tweaking and customizing the EPZ programme to protect and nurture infant domestic industries and to ensure that the benefits of having foreign direct investment (FDI) manifest.

The discussion in the literature review illustrated that the neoliberal approach prescribed that the benefits of EPZ would manifest through the 'magic of the market'. However, it also showed that in countries that utilized a purely neoliberal approach, these benefits did not materialize and only did when states veered away from the neoliberal

approach and adopted interventionist practices that allowed them to adapt the EPZ model that benefits manifest.

The discussion of Tanzania's industrial policy showed that Tanzania had great success during its implementation of the ISI strategies. However, the external shocks occurred in the 1970s sent the country spiralling into debt which eventually led to an economic crash. Thus Tanzania was forced to abandon many of its ISI strategies and adopt ELI approaches to industrialization. In an effort to recover from the economic crash of the early 1980s, Tanzania has liberalized its economy and deregulated its markets at a rapid pace. However, the industrial sector has failed to grow despite implementing all the neo-liberal prescriptions. Exports have remained low and undiversified and the problem of balance remains as it did during the ISI period.

The EPZ case study showed that Tanzania continues to follow neoliberal policy prescriptions despite the experiences of countries around the world. The standard model of EPZs has failed to increase exports, diversify the domestic industry base, and increase decent employment opportunities. Despite this, Tanzania has embarked upon a path that is no different. Thus the EPZs in Tanzania will not achieve their development goals because the policies that have been put into place do not allow the state an active role in controlling and guiding the investments nor developing the domestic industrial sector.

The data from the policy analysis shows that Tanzania has not introduced any of the learning from global experiences such as those of the Asian Tiger, Tiger Cubs or

Latin American countries, even though the vision that led to the introduction of the EPZ/SEZ strategy was to replicate the successes of the Asian countries.

The heavy dependence on FDI in Tanzania to finance industrialization means that local industries are not nurtured or protected while the foreign firms get indirect subsidies through attractive incentive packages. This is happening despite there being a higher number of domestic investors in the EPZs. The increasingly attractive incentive packages developed in a neoliberal context continues to imply revenues of host countries, like Tanzania, are lost while profits of foreign firms are repatriated away.

Tanzania, like many other developing countries is under immense pressure to liberalize economies and markets, and the costs of failing to adhere to these requirements are grave. Policy makers must reconsider the impacts of implementing policies that have proven to be unsuccessful in almost every other country as in the case of EPZs but also in the case of the country itself. Countries like Tanzania have been implementing market-led strategies for almost 3 decades without having much in terms of economic or industrial development to show for it, while when state-led strategies were being implemented there were significant results to show within a period of 10 years. Countries must consider their development strategy with their outcomes in mind, and then develop policies that will bring about the desired outcomes, especially when viable examples of innovative approaches are available. Instead, countries are forced to work within a small range of policy options that primarily give the state very limited power to influence development in the country, and then are promised to immense outcomes.

With the implementation of Tanzania's EPZ/SEZ programme within the neoliberal orientation, another opportunity to develop the industrial sector has been lost. The overall beneficiaries of this programme will not be the host countries of the EPZs, but rather the share holders of foreign companies. Meanwhile the cost of providing the subsidy will be borne by the Tanzanian state and the infant industries with Tanzania, as they struggle to survive.

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