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The Political Economy of 'Specialism' in Tanzania: How to make Export Processing Zones work via conditional special licensing

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Executive summary

Industrial policies increasingly rely on the use of special regimes which provide fiscal, regulatory and other advantages to firms that invest in a particular geographic area. Such special investment regimes, particularly Special Economic Zones (SEZs) and free zones, were adopted widely in Africa from the 1990s, coinciding with the liberalisation of trade and investment regimes following the end of the Cold War. In 2019 there were 237 SEZs in Africa. The main reason for establishing SEZs in Africa is to promote investment in strategic sectors such as manufacturing, to boost employment and exports, and generally to accelerate the process of economic development.

In this paper we focus on Tanzania's experience since 2002 with Export Processing Zones (EPZs) – a sub-category of SEZ focused on export-oriented manufacturing. Between 2008 and 2019, the Export Processing Zones Authority (EPZA) issued licences for 148 foreign and domestic firms – some of them located in designated zones but a large number located across the country as stand-alone companies. In particular, we analyse the challenges and vulnerabilities in the governance of the tax incentives of mainland Tanzania's special EPZ regime in the context of regional integration and the customs union of the East African Community (EAC). Our analysis is based on a newly developed firm-level dataset for 148 companies, reviews of existing documents and analyses, available secondary data of varying quality, and more than 30 interviews over a two-year research endeavour.

Our work suggests that the performance of Tanzania's EPZ regime has generally failed to lead to meaningful industrialisation despite some successful results at firm level. Research on other African countries suggests that several of them have had similar experiences. The special regimes have often fallen short in terms of export dynamism, employment creation and linkage creation. More specifically we have identified 10 sources of vulnerabilities to corruption and related rent misallocation and rent-seeking processes. In addition, we have shown how these processes cut across the many institutions in charge of running the EPZ scheme as well as the firms that are operating under this special regime. We have also highlighted how these corruption vulnerabilities are interdependent and reinforce each other in a complex bundle of processes, interests and trade-offs.

In short, regulatory inconsistencies and ineffective tax incentive governance, alongside EPZA's willingness to receive more investments based on loose licensing criteria, can attract companies with the wrong mix of capabilities and incentives (adverse selection). This has made the enforcement of Tanzania's EPZ special regime more challenging and reduced its outcomes. A feasible anti-corruption strategy therefore requires more than conventional analyses may suggest; it is not sufficient to seek to improve the policing of firms, or to attempt to fill the administrative holes in the system, or to increase capacity building (although some such measures may be relevant).

Rather, a feasible anti-corruption strategy should start from reducing the interests of the firms themselves in misusing the EPZ licensing scheme. For a capable firm with appropriate initial investments and technological and organisational capacities, which is interested in the

real benefits offered by the scheme and that has routes to export markets, it would be against the firm's own interest to concentrate on rent seeking. Such enterprises have a different option: to make profits by conducting legal activities within the scheme, whether they are stand-alone firms or are located in industrial parks.

We therefore propose to introduce a simple criterion, which we call conditional special licensing. An EPZ licence is granted on the condition that the firm has secured contracts from international buyers ex ante. This ex-ante conditionality reduces the burden of enforceability at all levels of the system and throughout the processes described above. Moreover, we propose that distressed EPZ firms that are struggling to meet the 80% export condition (which is a central EPZ condition) be given an exit option or a parallel pathway whereby they are supported while they re-focus their activities towards the growing 'domestic' markets of the EAC. Finally, the tax and non-tax incentives for the presently non-operational SEZ scheme should be revised and should target companies with limited export capability, which are more interested in domestic and regional markets – if harmonisation and agreement can be reached under the EAC Common Market.

1. Introduction

Building on the East Asian model, Export Processing Zones (EPZs) and Special Economic Zones (SEZs) have been widely replicated across Africa. While the literature on these schemes has been growing significantly, there is a lot that remains unknown about how they have been implemented and enforced on the ground. Some of the existing literature is reviewed below, in section 2. Drawing on approaches rooted in critical political economy and institutional economics, we depart from this literature to propose a 'political economy of specialism' perspective on EPZ/SEZs. From this perspective we view these schemes as mechanisms to deliver learning rents to promising firms, often conditional upon achieving success in export markets. In this framing, the lack of success observed in African SEZs in terms of export dynamism, employment generation and linkage creation points towards the need to understand and address several types of governance and firm-specific vulnerabilities to corruption, rather than adopting the orthodox response of trying to 'get the institutions right'.

In this paper we analyse why the governance of tax incentives is challenging in Tanzania, in the context of the East Africa Community (EAC) customs union. Section 3 focuses on Tanzania, synthesising the key institutional design features of the country's special regimes in the form of SEZs, EPZs and other related incentives. We chart the evolution of these overlapping regimes within Tanzania but also how they interact with processes of regional integration, as important areas of trade and industrial policy sovereignty shift to the EAC. We review existing evidence on the performance of Tanzania's special regimes, which generally suggests that they have failed to contribute to meaningful industrialisation despite some successful outcomes at firm level.

Building on a two-year research project and more than 30 interviews, we present new firm-level evidence on EPZ/SEZ licensed firms in Tanzania. Between 2008 and 2019, the Export Processing Zones Authority (EPZA) licensed 148 firms which started operating and reported production for export in at least one year. There are almost 40 additional firms which have expressed interest in the scheme and are mentioned in several internal EPZA documents. However, there is little evidence that many of these firms ever moved from an expression of interest to getting a licence, or, for those that were licensed, that they had at least one operational year of production for export. Section 4 analyses these data both longitudinally – to assess the evolution of the scheme – and comparatively, comparing different types of firms for the last year for which data have been collected (2019). Our analysis points to a number of stylised differences between firms that are still in operation and those which have exited the scheme, with evidence pointing to different capabilities in terms of initial investments and export performances.

Based on this new evidence, in section 4 we frame the political economy of specialism within 10 types of vulnerabilities to corruption which cut across the governance of the scheme and the firms involved. We claim that rather than attempting to address all these governance challenges and going after rent-seeking firms, a feasible anti-corruption strategy should start from ensuring that misuse of the EPZ/SEZ licensing scheme is not in the firms' interests. We discuss how, by reviewing processes, conditionalities and criteria for investment licensing,

the EPZA can select more productive companies, which are genuinely interested in benefiting from the incentives to achieve export success, rather than in rent-seeking opportunities emerging from the schemes. We propose to introduce a simple criterion, that is, making the granting of an EPZ licence conditional on the firm having secured contracts with international buyers ex ante. This ex-ante conditionality, which we call *conditional special licensing*, would reduce the burden of enforceability at all levels of the system. We also claim that for distressed firms struggling to meet the current 80% export condition, an exit option or a parallel pathway should be put in place whereby firms are supported while they re-focus their activities towards the growing 'domestic' markets of the EAC. From this perspective, a revision and administrative implementation of the tax and non-tax incentives associated with the SEZ scheme for companies with limited export capability and better suited to domestic and regional markets could be a starting point, provided that harmonisation and agreement is reached within the EAC Common Market.

2. What we think we know about EPZs and SEZs in Africa: A literature review

In this section we first review the existing academic literature related to the political economy of special regimes for investment in zones. Two main strands are identified, one rooted in critical global political economy and the other in institutional economics. Building on but departing from these, we propose a 'political economy of industrialisation' perspective which guides the rest of our analysis. Research on special regimes in Africa is then reviewed, which we argue largely fails to ask the right questions by focusing on the 'design features' of SEZ/EPZs rather than the broader political economy of industrial policy.

2.1. Political economy of specialism for industrialisation

Industrial policies increasingly rely on the use of special regimes which provide fiscal, regulatory and other advantages to firms that invest in a particular geographic area. The use of Special Economic Zones has proliferated in recent decades from less than 100 existing worldwide in 1975 to around 5,400 in 2018 (UNCTAD, 2019). While the design and effectiveness of special investment regimes have been extensively studied in the literature, there is a tendency to focus on their economic aspects such as the positive externalities of clustering identified by Alfred Marshall (see Andreoni and Lazonick, 2020), especially in manufacturing, due to the presence of increasing returns (Young, 1928; Hirschman, 1958), and with an emphasis on production for export to earn foreign exchange and ensure competitiveness. Much less has been written about the political economy of these special regimes – how power and politics underpin their design, implementation and effectiveness as industrial policy tools for structural transformation of the economy (Chang and Andreoni, 2020).

In reviewing studies of special investment regimes which employ a political economy perspective, two main approaches stand out in the literature. The first is based on critical global political economy and views special investment regimes as a key tool used by transnational corporations and neo-imperial Western states to promote export-oriented neoliberal capitalism (Neveling, 2020). The increased use of SEZs is part of a 'race to the bottom' driven by the structural weakness of contemporary latecomer states in the face of 'footloose' international capital, which results in forgone revenues and lower labour and environmental standards in return for foreign investment in 'enclave economies', with negligible developmental spillovers or local linkages (Gallagher and Zarsky, 2007; Andreoni, 2019). This literature has less to say about the domestic political economy underlying many countries' adoption of special investment regimes, for instance how employment creation in SEZs contributes to the stability of political settlements.

The second strand of literature identified here is only nominally focused on political economy issues, since its emphasis is on the incentive structures and institutions underpinning outcomes in SEZs, with little actual analysis of political factors (Farole and Moberg, 2014; Moberg, 2015). In this perspective SEZs are seen as ways to overcome broader failures in institutional settings that limit investment by focusing efforts on defined geographic areas. Successful SEZs are characterised by a 'coherent' regulatory/governance framework 'shielded' from political pressures, while failure is explained by the 'distorted' incentives of 'self-interested' officials, coordination failures across ministries and inadequate knowledge of policymakers. This literature makes important contributions on institutional design but is limited by its roots in neoclassical economics and public choice theory, with assumptions of self-interested utility maximisation taking precedence over contextual analysis of political economy dynamics, such that an illusory 'absence of politics' is seen as a precursor for success.

Finding shortcomings in previous political economy analyses of special investment regimes, we propose a 'political economy of industrialisation' approach. This situates SEZs as a tool for infant industry development in latecomer countries, providing targeted rents through fiscal and non-fiscal incentives to compensate producers for operating in costly settings with weak infrastructure (Hamilton, 1827[1791]; List, 1909[1841]; Andreoni and Chang, 2019). The conditions attached to these rents, such as export requirements, aim to ensure that 'learning for productivity' occurs and that global competitiveness is achieved (Whitfield et al., 2015). Effective monitoring and enforcement of these conditions, particularly the withdrawal of rents from non-performing firms, depends crucially on the political settlement, i.e. the relative power of public and private organisations (Khan, 2018). Ineffective enforcement or non-compliance with rent conditions may generate informal (non-productive) rents, with heterogeneous firms responding to incentives differently by choosing to pursue 'learning for productivity', unproductive rent seeking or some combination of both. This paper employs the proposed framework, based on the political economy dynamics underlying the (non-) enforcement of conditions attached to learning rents, to explain the performance of special investment regimes in the case of Tanzania.

2.2. Pretty… vacant? EPZs and SEZs in Africa

Special investment regimes, particularly SEZs and free zones, started to be adopted widely in Africa from the 1990s, coinciding with the liberalisation of trade and investment regimes following the end of the Cold War. In 2019 there were 237 SEZs established in Africa of which 51 were under development, with a further 53 planned (UNCTAD, 2019). In addition, there were more than 200 single-enterprise zones. SEZs were present in 38 of 54 African countries, led by Kenya with 61 SEZs, Nigeria with 38 and Ethiopia with 18.

The headline reasons given for establishing SEZs in Africa are to promote investment in strategic sectors such as manufacturing, to boost employment and exports, and generally to accelerate the process of economic development (Whittaker et al., 2020). In particular, industrial policymakers have sought to emulate the extraordinary success of late developers in Asia, with China's rapid industrialisation seen as linked to its prolific use of SEZs – China hosts half of all SEZs in the world (UNCTAD, 2019). Another motivation for SEZ use is the

rising importance of global value chains (GVCs) in the world economy. These are seen as requiring a new kind of industrial strategy – vertically specialised industrialisation – with EPZs being a key policy tool for insertion into international production networks (Milberg and Winkler, 2013). Among African countries with structurally 'weak' infrastructure and institutions, SEZs and EPZs are seen as attractive since resources can be focused in a delimited area, with donors often ready to finance zone development and capacity building (UNCTAD, 2019). Furthermore, preferential trade arrangements offered by high- and middle-income to low-income countries (LICs) are a major driver of investment in SEZs, providing rents to lead firms and first-tier suppliers sufficient to justify relocating their production to LICs, for example in the clothing industry (Pickles et al., 2015).

SEZs are generally seen as underperforming globally, with 22% considered 'largely vacant' and a further 25% 'somewhat vacant' according to national investment promotion agencies (UNCTAD, 2019). A recent influential study of SEZ performance for 22 emerging economies, including five African countries, found that even where zone growth was dynamic – such as in Kenya and Ghana – the overall growth rate of SEZs does not exceed that of the countries where they are located. However, the use of experimental nightlight data to measure growth may be a reason to treat the interpretation of these results with caution (Frick et al., 2018).

Although comprehensive comparative data are limited, conventional assessments of African SEZ performance generally find it underwhelming, with below-expected results in terms of 'static' outcomes such as investment, employment and exports (Farole, 2011; Farole and Moberg, 2014; Kweka and te Velde, 2020). Crucially, the presence of SEZs is not the most important factor in explaining outcomes, with some countries achieving high levels of GVC integration without SEZs (e.g. Namibia) while other countries with SEZs see no growth in trade (UNCTAD, 2019).

African SEZs are also seen as underperforming when it comes to 'dynamic' outcomes, i.e. their contribution to industrialisation, but this is in the context of a general lack of sustained structural economic transformation on the continent (Farole, 2011). Even where SEZs have seen high levels of investment and rapid employment and export growth – e.g. in the garment sectors of Lesotho and Kenya – linkages to the broader economy have been weak and technological spillovers minimal (Phelps et al., 2009; Morris and Staritz, 2017; Whitfield and Staritz, 2020). The creation of backward linkages within SEZs and to firms outside them is a challenge across geographies, with Frick and Rodríguez-Pose (2022) finding that SEZ firms in Africa, Asia and Latin America are often only able to source packaging materials locally, and must import most of their key inputs from abroad.

Conventional accounts explain the weak performance of African SEZs by reference to institutional failures such as poor strategic planning and coordination, misaligned incentives, a weak 'business environment' and simply a 'lack of knowledge' (Farole and Moberg, 2014; Kweka and te Velde, 2020). Despite Frick et al. (2018) finding that incentive structures are not correlated to SEZ performance, these accounts assume that if countries can 'get the institutions right', by correctly transposing the best-practice blueprint of successful SEZ programmes (e.g. those in East Asia), then strong economic performance will follow (Farole,

2011; Farole and Kweka, 2011). Yet this approach confounds form and function: comparative studies of historical development processes find that institutional approaches of latecomers varied across countries, and attempts to merely replicate institutional formulae are unlikely to succeed (Gerschenkron, 1962). While some institutional emulation is inevitable, a policy focus on the function of SEZs – providing learning rents to enable productivity growth – rather than their form, is to be encouraged.

Studies of African SEZs rarely take a political economy of industrialisation approach, i.e. with a focus on how domestic political developments affect the enforcement of conditions attached to learning rents. An exception is Kohli (2004) who links the failure of industrial policy in Nigeria to its colonial political-institutional legacy, while explanations of recent successes in Ethiopia – including the development of SEZs – sometimes refer to its unique political history (Cheru et al., 2019). Gray (2018) applies a political settlements analytical framework to industrial policy in Tanzania, finding that the contested legitimacy of the dominant Tanzanian-Asian industrialists resulted in difficulties organising sufficient formal rents. Whitfield et al. (2015) – who include a case study of SEZs in Tanzania in their volume – posit three conditions for successful industrial policy in Africa: mutual interests between firms and ruling elites, pockets of efficiency in bureaucracies, and learning for productivity by firms. They find that, due to a lack of mutual interests between firms and elites, a bureaucratic pocket of efficiency did not emerge, so rent conditions – particularly export requirements – were not properly enforced, and learning for productivity did not occur. By contrast, Tyce (2019) argues that the EPZ authority in Kenya was relatively 'insulated from political pressures' and had sufficient coordination capabilities to be classed as a pocket of efficiency; this contributed to strong growth in the Kenyan garment sector, although there is also evidence of weak rule enforcement with EPZ companies able to roll over tax holidays (Boys, 2022).

The rest of this paper builds on these political economy analyses of African special investment regimes, through a study of the Tanzanian case. We pay particular attention to the implications for rent enforcement of single-enterprise zones, which remain under-explored in the literature. Furthermore, the importance of tensions between national SEZ frameworks and regional integration initiatives, highlighted by Koyama (2011), is increasingly relevant given the push towards an African Continental Free Trade Area (AfCFTA), and is addressed here.

3. Special regimes for export-led industrialisation in Tanzania: Legal framework, incentives and contradictory evidence

3.1. The EPZ/SEZ legal framework in Tanzania within the East African Community

The special regime for investment in Tanzania is largely defined by three overlapping frameworks, relating to EPZs, SEZs and investments covered by the Tanzania Investment Centre (TIC). They share a common objective of promoting and facilitating investment through fiscal and non-fiscal incentives, but differ with respect to the economic activities covered, export requirements and the nature of incentives offered.

Tanzania's approach to industrial policy has shifted from state-led import substitution industrialisation in the post-independence era to export-oriented industrialisation (EOI) alongside liberalisation and privatisation from the 1990s (Msami and Wangwe, 2016). The Sustainable Industries Development Policy covering the 1996–2020 period (MIT, 1996) paved the way for the introduction of the Export Processing Zones Act in 2002 as a cornerstone of the shift to EOI, aimed at 'the creation of international competitiveness for export-led growth' (URT, 2002: 3). The EPZ regime offers a range of fiscal incentives including exemptions from corporate tax (for 10 years), exemptions from customs duty and VAT on raw materials and equipment, withholding tax on dividends, as well as non-fiscal incentives, e.g. facilitation of procedures such as customs inspections. In order to benefit, a new investment must be made in manufacturing or processing activities, to a value of at least US$5 million for foreign or US$1 million for domestic investors, and 80% of annual sales must be exported outside the customs territory, i.e. the EAC (URT, 2002, 2006, 2012; EAC, 2004). EPZs may be located in a particular geographic zone or EPZ status may be conferred on a designated factory or group of factory units (URT, 2002).

Although legislation providing for the creation of EPZs pre-dated it, the Special Economic Zone Act of 2006 clarified that EPZs are a sub-category of SEZs focused on export-oriented manufacturing (URT, 2006). Other types of SEZs have no export requirement and can cover a much broader range of activities, from agriculture to industry and services such as commerce, tourism and finance, although priority is given to those most likely to boost domestic production, exports and employment. SEZs are to be established in specified zones with no explicit provision for single-factory licences, with a view to promoting clusters of firms and associated spillover effects (URT, 2006; Gray, 2018). The SEZ scheme was drawn up as part of the 'mini-tiger plan' for Tanzania, in partnership with the World Bank and the Japanese Development Institute, but its regulatory framework is not yet operational;

proposed SEZs remain under development except for those which are occupied exclusively by EPZ firms (Whitfield et al., 2015; Kweka and te Velde, 2020). The minimum investment requirements and fiscal and non-fiscal incentives offered to domestically oriented SEZs are largely the same as for EPZs, except that the former are not eligible for the 10-year corporate tax holiday offered to EPZs.

A further notable element of Tanzania's special investment regime is the range of benefits offered by the Tanzania Investment Centre, established by the Investment Act of 1997 (URT, 1997). The TIC is a 'one-stop shop' mandated to coordinate across government to identify, promote and facilitate investment opportunities in all sectors regardless of export-orientation. For investments over US$300,000 for foreigners and US$100,000 for Tanzanians, the TIC provides certificates of incentives available under other legislation, such as import duty and VAT exemptions on capital goods and import duty drawback on inputs used to produce for export. Eligible investments also benefit from facilitated establishment procedures, various investment guarantees (e.g. against expropriation) and an automatic immigration quota of up to five people. **Table 1** summarises the main elements of Tanzania's special investment regimes.

Table 1: Main elements of special investment regimes in Tanzania

	SEZ investors		TIC
	For export: EPZ	Other SEZs	
Year of introduction of legislation	2002	2006	1997
Framework operational?	Y	N	Y
Responsible authority & 'one-stop' service provider	EPZA	EPZA	TIC
Minimum export requirement (outside EAC)	80%	None	None
Target sectors	Manufacturing	All	All
Minimum investment – foreigners	US$5 million	US$5 million	US$300,000
Minimum investment – Tanzanians	US$1 million	US$1 million	US$100,000
Available for single factories?	Y	N	Y
Access to competitive zone services/infrastructure	Y	Y	N
Exemption from corporate tax (10 years)	Y	N	N
Exemption from local government taxes (10 years)	Y	N	N
Exemption from VAT on utility charges and wharfage	Y	N	N
Exemption from withholding tax*	Y (10 years)	Y (partial)	N
Exemption from VAT on raw materials	Y	Y	N
Exemption from import duties on raw materials	Y	Y	Y (for export)
Exemption from VAT on capital goods	Y	Y	N
Exemption from import duty on capital goods	Y	Y	Y
Automatic five-person immigration quota entitlement	Y	Y	Y
Guaranteed lack of foreign exchange controls	Y	Y	Y
Access to export credit guarantee scheme	Y	N	N
Facilitated/reduced customs inspection requirements	Y	Y	N

Source: authors' own based on URT (1997, 2002, 2006, 2012), TIC (n.d.).
Notes: incentives for SEZ developers not included in the Table. *EPZs are exempt from withholding tax on rent, dividends and interests for the first 10 years, while SEZs are exempt from withholding tax on interest on foreign-sourced loans.

As shown in Table 1, there are large areas of overlap between the packages of incentives offered by the EPZ, SEZ and TIC regimes. This increases the potential for confusion and ambiguity around eligibility and the conditions attached to each. For instance, the 1997 Investment Act (URT, 1997) states a minimum threshold of US$300,000 for foreigners to be eligible for TIC support, but the TIC's own informational materials state a threshold of $500,000 (TIC, n.d.). Despite the existence of SEZ regulations dating from 2012 (URT, 2012) the literature is clear that SEZ regulations are yet to be approved (Kweka and te Velde, 2020) and that the SEZ regime remains non-operational. Our own research heard reports that at least one firm is operating under an SEZ licence. The possibility of single-factory EPZs located outside of delimited zones raises questions about the enforceability of special fiscal regimes and creates opportunities for unproductive rent-seeking activities, such as the import of 'inputs' – without payment of import duties – that are in fact sold on rather than being used for manufacturing.

Domestic political economy factors suggest an unfavourable climate for the implementation of SEZs and enforcement of their rules. The impetus for launching EPZ and SEZ frameworks largely came from outsider agencies such as donors, with no strong domestic coalition behind them (Whitfield et al., 2015). Several important constituents were actively opposed to their introduction: the finance ministry and revenue authority because of revenue losses through tax holidays, private sector organisations due to fears of unfair competition (e.g. EPZ firms offloading in the domestic market), and labour unions and civil society because of concerns around employment practices in SEZs. Some of this opposition is connected to economic nationalism and colonial history, with the emphasis on attracting foreign investment in SEZs/EPZs not always welcome in the Tanzanian context, where advancing the interests of black indigenous entrepreneurs is a political priority (Whitfield et al., 2015).

Another complicating aspect of special regimes in Tanzania is how they interact with processes of regional integration in the EAC. When the EPZ regime was introduced in 2002, it was clear that the 'domestic market' in which EPZ firms could sell a maximum of 20% of their output referred to Tanzania (in particular, to mainland Tanzania since Zanzibar already had its own EPZ regime). A number of firms were established in EPZs to serve the regional market, including neighbouring Kenya with its higher income market segments. However, from 2010 the East African Community Customs Union protocol was implemented, meaning that the EAC single customs territory (including Kenya, Uganda, Rwanda and Burundi) was newly designated as the 'domestic market', a problem noted in other instances of regional integration (Koyama, 2011). Tanzanian EPZ firms formerly complying with the 80% export requirement by selling to other EAC countries had to find new export markets outside the EAC, but this was not initially enforced. From 2015, an increased policy focus on tax collection and unfair competition resulted in stricter enforcement of the requirement to export 80% of goods outside the EAC, and in severe difficulties for less competitive firms which struggled to comply.

3.2. Contradictory evidence on the impact of EPZs/SEZs in Tanzania

Evidence generally suggests that the contribution of EPZ/SEZs to industrialisation in Tanzania has been small. Recent studies find poor results in terms of the number of operational firms in SEZs, levels of investment, employment generation, exports and linkages to the broader economy. There are also major difficulties in gaining access to reliable data about the number and performance of firms in EPZs, which has been an obstacle to multiple studies including this one.

Conflicting reports reflect a high level of uncertainty around the number of firms in SEZs, with different sources giving wildly different figures. Kinyondo et al. (2016) aimed to survey 50 of the 147 firms which were listed by the authorities as having SEZ/EPZ licences, but ultimately only 18 could be surveyed because most of the firms approached were not yet operational or had already ceased operating. The latest publicly available data from the authorities (EPZA, 2019) report the number of registered companies as 169 in 2019, but a local news report from the previous year stated that of the 160 companies licensed since the launch of the EPZ regime only 120 were operational (The Citizen, 2018). Kweka and te Velde (2020) point to Tanzania's Annual Survey of Industrial Production which found that in 2015, 18% of the 2,389 firms surveyed – a total of 430 firms – identified themselves as being in SEZs, far higher than the number recognised by authorities.

The performance of SEZ/EPZs in terms of investment, exports and job creation is hard to ascertain from published materials due to a lack of transparent data. The EPZA appears to report investment in cumulative terms such that there is never a decline in investment from one year to the next and capital depreciation and firm exit are unaccounted for. The EPZA's 2019 strategic plan reports the stock of capital invested in EPZs at US$2.242 billion in 2019, up from US$1.292 billion in 2014 (EPZA, 2019: 4, Table 1), but a speech on the EPZA website states total capital invested as US$2.6 billion by early 2019 (EPZA, 2021). Exports also appear to be reported on a cumulative basis, with the 'stock' of export earnings increasing from US$0.794 billion in 2014 to US$2.219 billion in 2019 (EPZA, 2019: 4, Table 1), which equates to average annual exports of around US$285 million. This corresponds approximately with Kweka and te Velde's (2020) report of annual exports of around US$200 million in 2016 and Boys and Andreoni's (2020) report of US$30 million in textiles and apparel EPZ exports in 2017. In the same Table in EPZA's strategic plan, the number of jobs generated is reported as having increased from 21,493 in 2014 to 56,312 in 2019 (EPZA, 2019: 4, Table 1). It appears likely that this is also a cumulative figure of jobs created, without counting the number of jobs that have been removed by SEZ firms ceasing operations. It is known that in 2019, the total number of jobs in the EPZ-based textiles and apparel sector – mainly garment factories – was only around 5,000 (Boys and Andreoni, 2020), despite this being a priority sector for the EPZA (EPZA, 2019).

Tanzanian SEZ firms appear to have weak linkages among themselves and to the broader economy, and are largely owned by foreign investors. Kinyondo et al. (2016) found only one firm of those surveyed that was selling to others in SEZs, suggesting a failure of zones to

materialise possible benefits from clustering. The same study found that nearly half of inputs were imported directly by SEZ firms; the remainder were purchased locally but might in fact include a large share of products ultimately imported from outside Tanzania. Boys and Andreoni (2020) find negligible local content in the two EPZ-based garment manufacturers surveyed, but a high level of local cotton use by the EPZ firm spinning yarn for export. The number of SEZ companies owned by locals and foreigners appears fairly balanced, with 44% locally owned, 42% foreign owned and 14% being joint ventures (Kweka and te Velde, 2020). This does not hold for the value of investments, however, which is likely to be weighted towards foreigners – as it is for textiles and apparel where all three EPZ firms are foreign owned (Boys and Andreoni, 2020).

4. Political economy of specialism in EPZ/SEZ schemes: New firm-level evidence and corruption vulnerabilities

4.1. Firm-level evidence on 'special' firms in Tanzania

As discussed in section 3.2, evidence on the functioning of the EPZ/SEZ scheme and its developmental impact is contradictory. Moreover, information is not sufficiently granular, making it difficult to identify either good or bad performance at firm level, as well as obscuring the strengths and vulnerabilities of scheme governance. As part of this project, including a two-year effort in data collection at EPZA, we came to discover that firm-level evidence on companies licensed under the EPZ/SEZ scheme is extremely difficult to gather. There are several reasons for this. First, EPZA does not seem to have a data system and firms have not been consistently reporting information over time. Second, firms report to different authorities – the Tanzanian Revenue Authority (TRA) as well as EPZA – hence EPZA does not have a consolidated view of the data. Third, there is significant opacity on the status of operation of the firms, both at the initial stages – when firms have received a licence but are still under construction/development – and later, as to whether firms are actively producing or are dormant. Fourth, given that the majority of firms hold a 'stand-alone' licence – i.e. they are located outside dedicated zone infrastructure (whether public or private) – the EPZA lacks sufficient capacity to oversee their operation and collect data, let alone enforce conditionalities attached to the scheme (as discussed in section 4.2 below). Fifth, firms are reluctant to provide complete data even when this is officially compulsory. They are reticent for different reasons. For firms involved in unproductive rent-seeking behaviour, data may be 'massaged', while firms conducting activities according to regulations might find reporting difficult due to cumbersome regulatory requirements and fears of being challenged by EPZA or TRA if mistakes or inconsistencies in reporting become evident.

Despite these major difficulties, in what follows we present our best attempt at collating and analysing anonymised firm-level information on companies operating in Tanzania under the EPZ/SEZ licensing scheme. This is to our knowledge the only attempt that has been made so far to collect data on all companies participating in the scheme from its inception until 2019 (with an update to 2021).

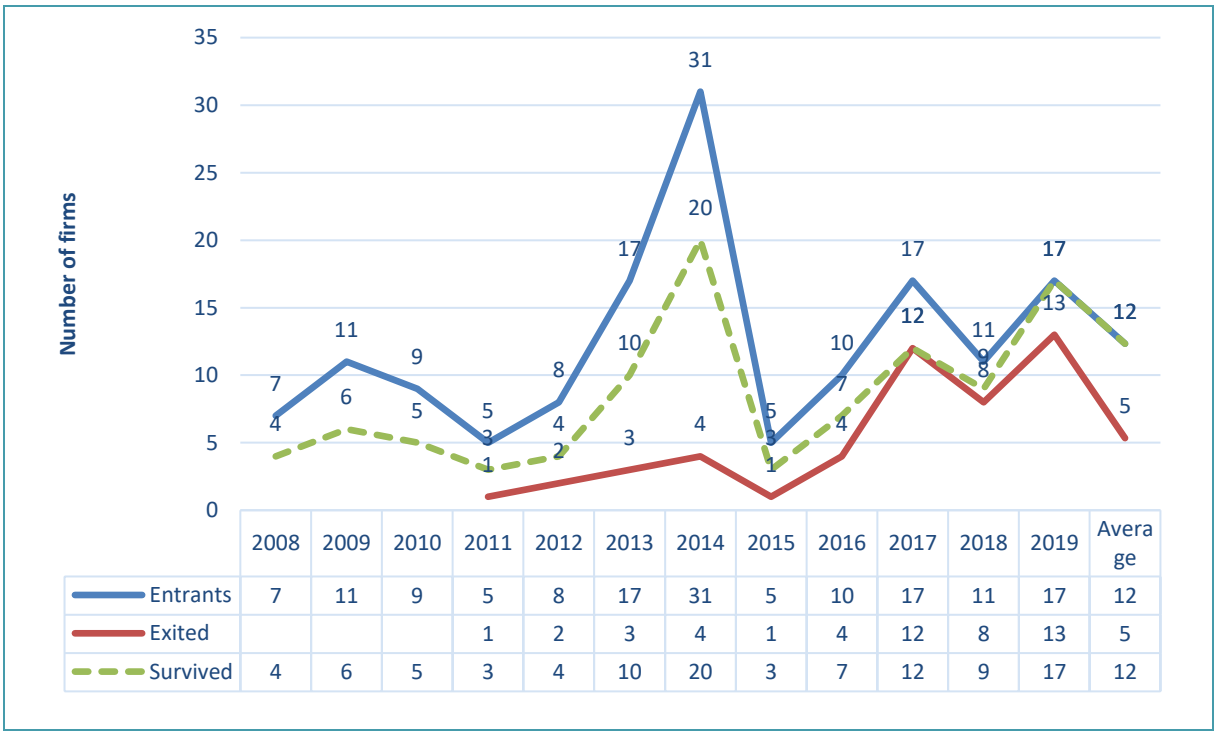
From 2008 until 2019 the EPZA licensed 148 firms which have started operations and reported production for export in at least one year. In addition to these, there are almost 40 firms which have expressed interest in the scheme and are mentioned in several internal EPZA documents. However, there is no evidence that these firms ever moved from an

expression of interest towards actually getting a licence, or if they did get a licence, that they had at least one operational year with production for export.

Figure 1 shows the firms that were licensed since the start of the EPZ/SEZ scheme in 2008 by year; we called them 'Entrants'. It also shows the number of firms that left the scheme; we called them 'Exited'. In some cases, these firms stopped producing and became dormant, in other cases EPZA has withdrawn their licences. Finally, we plot a line showing the effective entrants, or so called 'Survived'. This line shows the firms that effectively entered the scheme and were still active in 2019. The data show a significant peak in the number of 'Entrants' in 2013 and 2014. However, of the 48 new Entrants in these two years, only 30 were still in operation in 2019.

Figure 2 further reveals that 46% of the firms that Exited were licensed between 2012 and 2014. In fact, the dramatic expansion in the scheme in this period was offset by two peaks of exiting in 2017 and 2019.

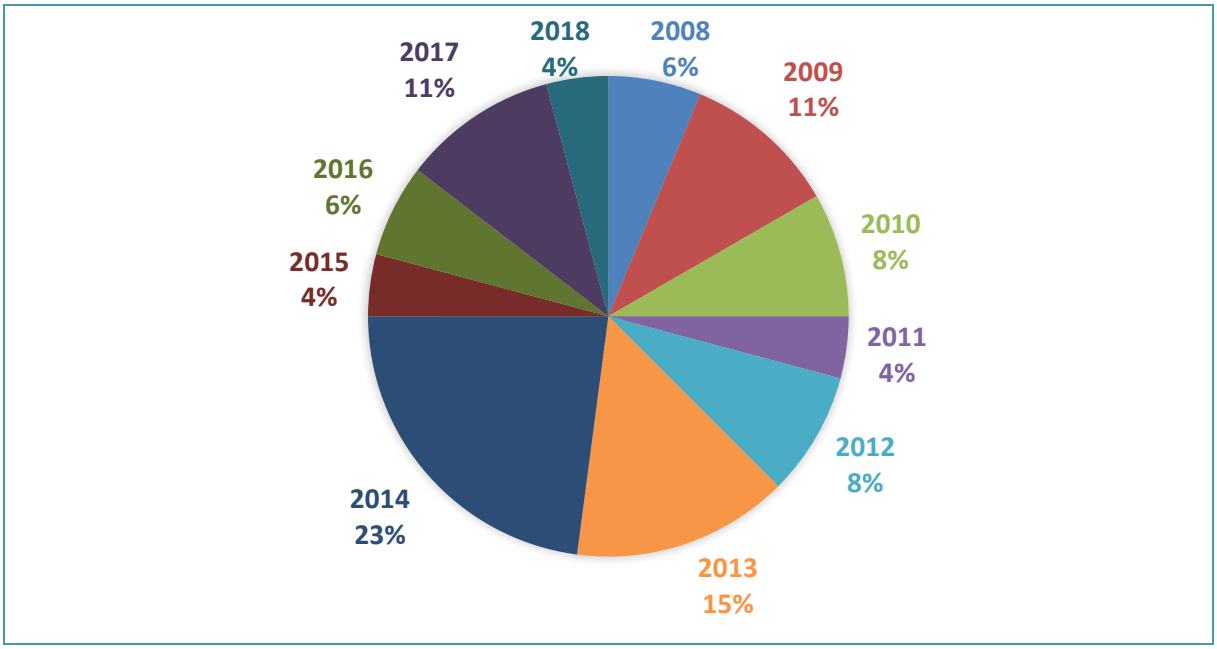
Figure 1: Tanzania's EPZ/SEZ Scheme, 2008–2019: Entrants licensed, exited and survived



	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Average
Entrants	7	11	9	5	8	17	31	5	10	17	11	17	12
Exited				1	2	3	4	1	4	12	8	13	5
Survived	4	6	5	3	4	10	20	3	7	12	9	17	12

Source: authors based on EPZA firm-level data

Figure 2: Tanzania's EPZ/SEZ Scheme, 2008–2018: Exit rate by year of licensing



Source: authors based on EPZA firm-level data

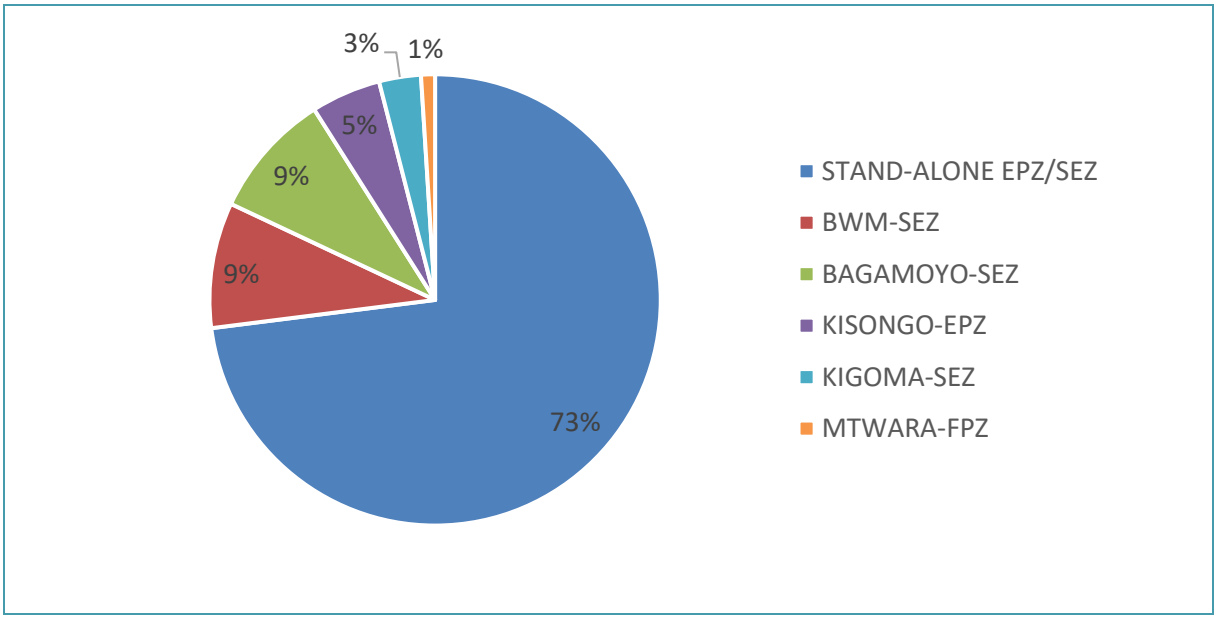
By 2019, we found evidence of 100 companies registered and in operation under the EPZ/SEZ licensing scheme in Tanzania. Of these, 90% have a licence to operate manufacturing and industrial activities, while the others are in services and commerce. We also found that over the period 2008–2018 a total of 48 firms exited the scheme, with the number of exiting firms increasing from 2017 (Figure 1). However, in March 2022, the EPZA reported that in the year since President Samia Suluhu Hassan took office in March 2021, 23 new firms had entered the scheme, creating 6,860 new jobs, investing capital worth US$98 million, and with an export turnover of US$103 million.[1] This suggests the scheme witnessed a surge after the global Covid pandemic, but we do not have evidence on the number of firms facing production or export challenges that became dormant or exited the scheme in 2020 and 2021, during the pandemic.

Figure 3 turns to the types of EPZ/SEZ licence under which the firms that were active and exporting in 2019 have been operating. Over 70% of the firms which were in operation in 2019 were issued a stand-alone licence, that is, they were operating as single-factory units outside any of the public or private zone infrastructures. Most of the other firms were located in the industrial hub between Dar es Salaam (Benjamin William Mkapa, known as BWM SEZ, where the EPZA headquarters is located) and the growing Bagamoyo area, where a new SEZ is expected to be developed, with the necessary infrastructure, alongside the new deep-sea port facility. This will entail a US$10 billion investment from Oman (the National Reserve Fund of Oman) and China (China Merchants International). The plan to develop an SEZ in Bagamoyo dates back to former president Kikwete, was supported strongly under the previous president, Magufuli, and now continues under the new president, although

[1] https://www.epza.go.tz/news/epza-under-the-president-h-e-samia-suluhu-hassan

negotiations have stalled and restarted several times.[2] As discussed in section 4.2 below, the distinction between stand-alone licences and firms in actual zones matters greatly. With a shortage of zone infrastructure and delays in investment, stand-alone licences have been used to grow the EPZ/SEZ scheme, but this has made monitoring and enforcement of incentive conditions increasingly difficult and the whole scheme more vulnerable to corruption.

Figure 3: Stand-alone EPZ/SEZ licensed firms and firms located in specific EPZ/SEZs, 2019

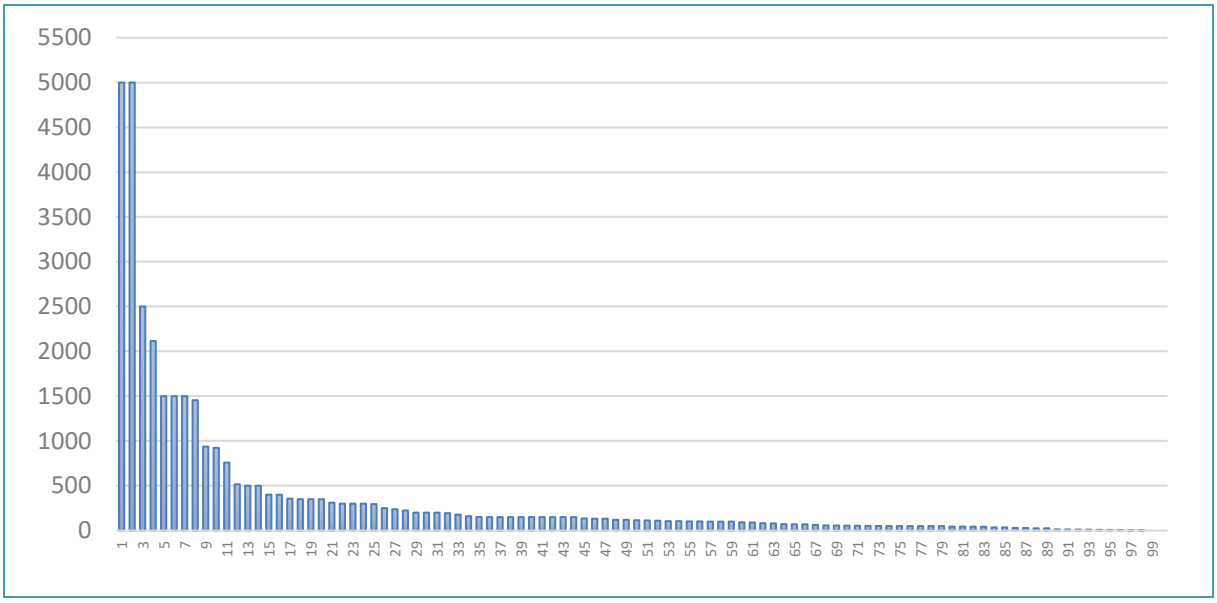


Source: authors based on EPZA firm-level data

Firms differ in terms of their licence type and geographic location, but also in terms of their size and export performances. **Figure 4** shows that there are fewer than 15 very large firms, employing more than 500 workers, with companies often operating in labour-intensive export-oriented sectors such as textile and garments. There are around 45 large firms with between 100 and 499 employees, and then a long tail of medium and small firms. This confirms a strongly dualistic industrial structure, albeit less acute than the overall Tanzanian economy (see also Andreoni, 2017).

[2] https://www.thecitizen.co.tz/tanzania/news/bagamoyo-sez-negotiations-all-set-to-commence-afresh-3607784 ; for the most recent update, see: https://www.seetao.com/details/124724.html

Figure 4: Tanzania's EPZ/SEZ Scheme: Firm distribution by employment, 2019

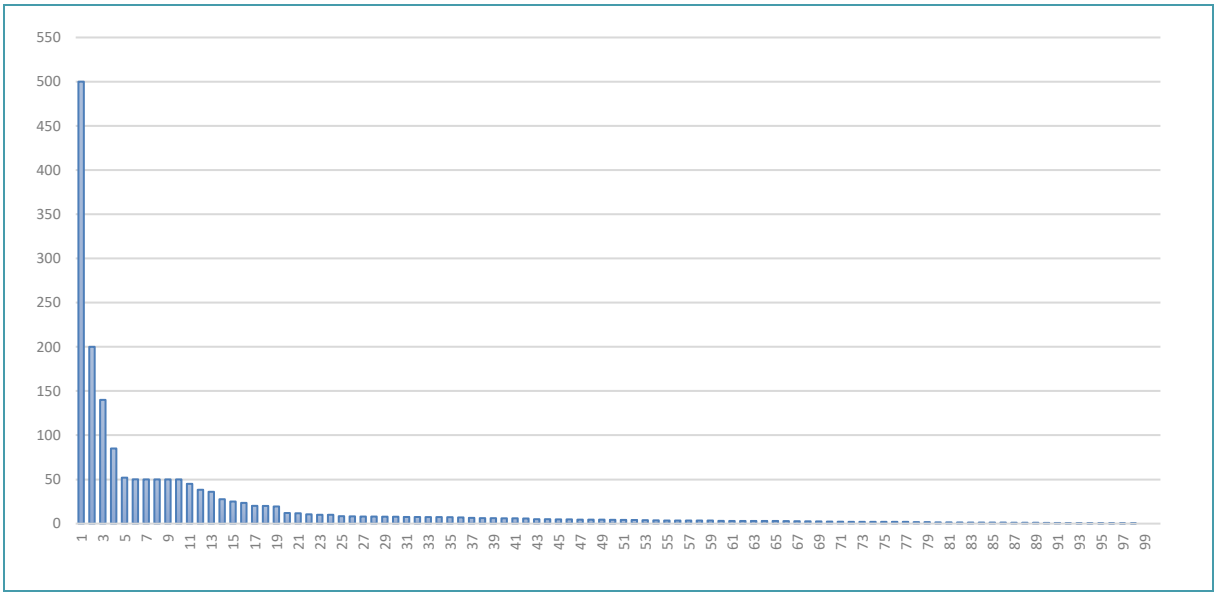


Source: authors based on EPZA firm-level data

Figure 5 presents the distribution of EPZ/SEZ firms by export value. Ten firms reported exports above US$50 million in 2019, while the majority of the firms – around 75% – report exports of less than US$10 million. In fact, half of all the firms operating under an EPZ/SEZ licence exported less than US$5 million in 2019. The extent to which exports reach beyond the so-called 'domestic market' of Tanzania and the EAC is not known consistently for all firms. As discussed above (section 3.2), by law these firms can continue benefiting from tax and import duty incentives only on the condition that 80% of their export is destined for countries outside the domestic market. While for some firms this might be plausible – for example those operating under the AGOA agreement for garments and apparel – for others it is difficult to know whether it is happening. As discussed below (section 4.2), this lack of information is partially due to government vulnerabilities in managing the overall scheme, as well as strong incentives for firms to engage in unproductive rent seeking.

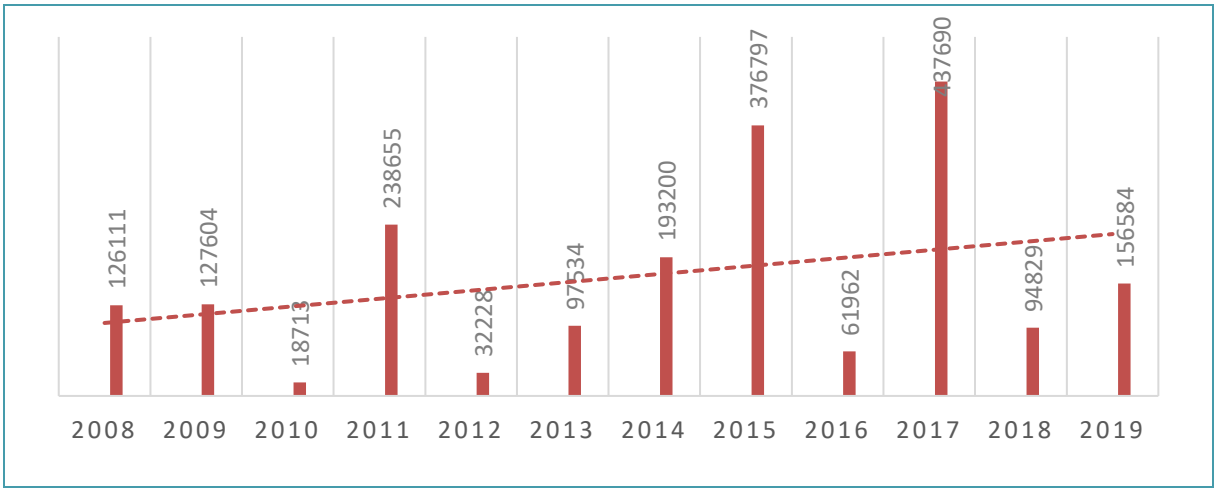
Figure 6 focuses on the initial capital investments made by the sub-set of firms that were still operational in 2019, and shows an erratic pattern. While there has been a positive trend overall in terms of increasing total investment, there are also lots of discontinuities. Of these investments more than 60% are from foreign investors, while the remainder come either from Tanzanian investors alone or from investment groups involving Tanzanian and foreign investors. For stand-alone companies, in particular, total initial investments include investments in production facilities but also basic infrastructural investments such as access to main roads, electricity backup facilities, connections to utilities, etc.

Figure 5: Tanzania's EPZ/SEZ Scheme: Firm distribution by export in millions of US$, 2019



Source: authors based on EPZA firm-level data

Figure 6: Tanzania's EPZ/SEZ Scheme: Investments in millions of Tanzanian shillings, 2008–2019

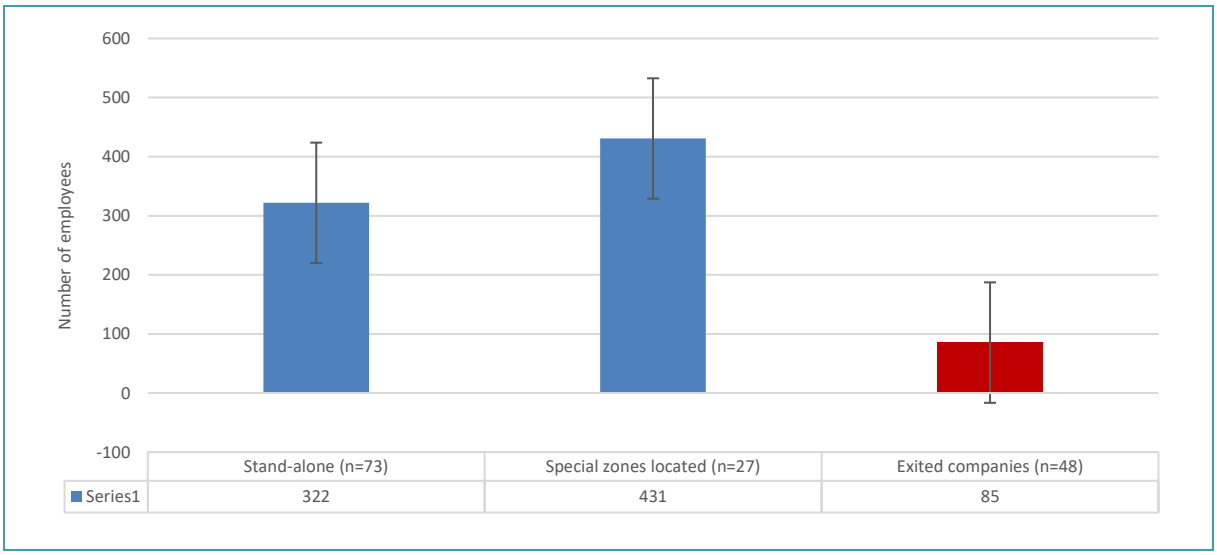


Source: authors based on EPZA firm-level data

Note: missing data: 1 firm for 2013; 1 firm for 2014; 1 firm for 2017; 2 firms for 2018; 5 firms for 2019. Data are not deflated and do not present cumulated investment and depreciation.

Based on the distributions shown in Figures 4 and 5, we can compare two key parameters – total employment and export performance – for different types of firms, including those which have exited the EPZ/SEZ scheme. Among the many groupings possible, **Figure 7** compares the average employment for three types of firms, that is, EPZ/SEZ licensed firms operating as stand-alone units, EPZ/SEZ licensed firms located within a special zone, and companies which exited the scheme over the period 2008–2019. What we notice is that stand-alone firms are smaller on average when all licensed firms are considered, although their size is comparable to firms located in special zones. By contrast firms that exited had significantly lower employment levels.

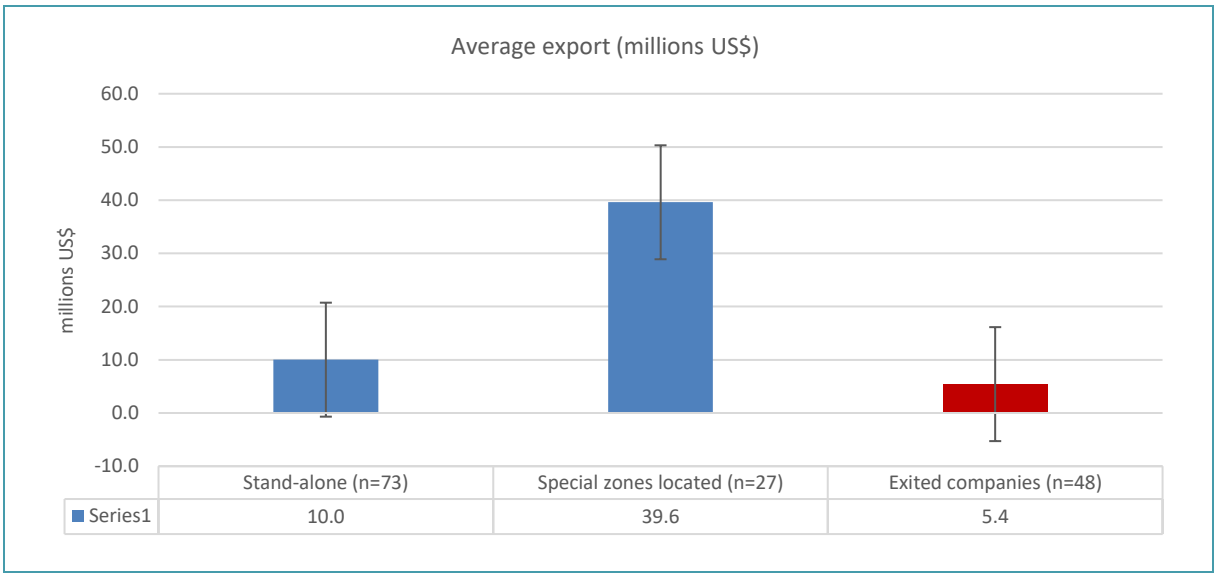
Figure 7: Tanzania's EPZ/SEZ Scheme: Average employment for different types of firms in operation in 2019 and firms that have exited since 2008



Source: authors based on EPZA firm-level data

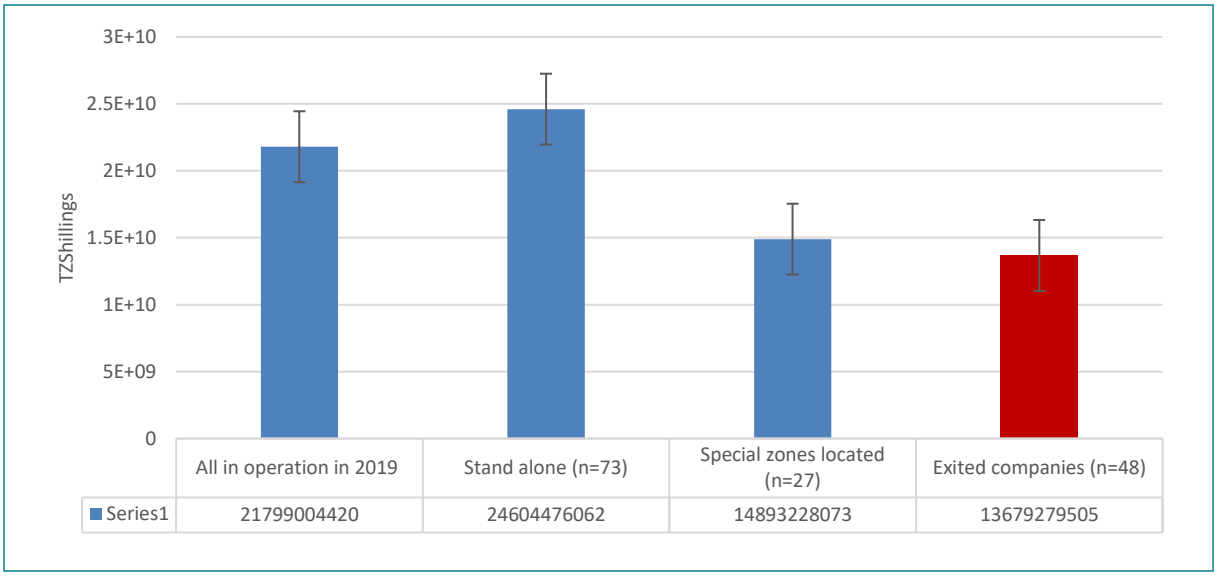
Figure 8 compares the same three types of firms in terms of export performance, showing that stand-alone firms contribute significantly less on average than firms located within special zones. This is due to their smaller size and limited access to supporting infrastructure, but also potentially because they can more easily 'offload', i.e. sell output locally, than companies in designated zones (discussed further in section 4.2). What is striking, however, is that companies that exited had significantly lower export turnover. Given that many of these companies exited within a few years of starting operations, this evidence suggests that these businesses struggled to export from the beginning. Firms that exited therefore appear significantly different from the other two groups in terms of their production, technological and organisational capabilities, as well as access to markets. **Figure 9** further reinforces this finding, showing that firms which exited had lower total investment on average than firms which remained in operation until 2019. Larger investments are normally associated with companies having significant volumes and routes to export markets via direct access or mediated access (via integration into value chains).

Figure 8: Tanzania's EPZ/SEZ Scheme: Average export performance for different types of firms in operation in 2019 and firms that have exited since 2008



Source: authors based on EPZA firm-level data

Figure 9: Tanzania's EPZ/SEZ Scheme: Average initial capital investments for all firms, and for different types of firms in operation in 2019 and firms that have exited since 2008



Source: authors based on EPZA firm-level data

Note: missing data for investments: 1 firm for 2013; 1 firm for 2014; 1 firm for 2017; 2 firms for 2018; 5 firms for 2019. Data are not deflated and do not present cumulated investment and depreciation. For stand-alone firms, total investments figures were available for 64 firms out of 73, for special zone located firms 26 out of 27, for exited firms 43 out of 48.

Table 2 summarises the main results for key parameters – employment, investment and export performances – by different types of firms and groupings, and includes the most updated information on new entrants in 2021.

Table 2: Summary of employment, investment and export performance for different types of firms in operation in 2019 and for the new entrants in 2021

	Total employment	Total export (million US$)	Total investment (TZShillings millions)	Average employment	Average export (million US$)	Average investment (TZShillings millions)
All in operation in 2019	35120	1800.9	1961910	351	18.0	21799
Stand-alone (n=73)	23492	731.6	1574686	322	10.0	24604
Special zones located (n=27)	11628	1069.3	387223	431	39.6	14893
Exited companies (n=48)	3753	227.8	588209	85	5.4	13679
	Total employment	**Total export**	**Total investment (million US$)**	**Average employment**	**Average export (million US$)**	**Average investment (million US$)**
New entrants in 2021 (n=23)	6860	103	98	298	4.5	4.3

Source: authors based on EPZA firm-level data and media release from EPZA for 2021

Note: missing data for investments: 1 firm for 2013; 1 firm for 2014; 1 firm for 2017; 2 firms for 2018; 5 firms for 2019. Data are not deflated and do not present cumulated investment and depreciation. For stand-alone firms, total investments figures were available for 64 firms out of 73, for special zone located firms 26 out of 27, for exited firms 43 out of 48. Unchecked data on new entrants were reported on the EPZA website: https://www.epza.go.tz/news/epza-under-the-president-h-e-samia-suluhu-hassan.

4.2. Corruption vulnerabilities: Rent misallocation and rent seeking

The legal, regulatory and governance framework managing the EPZ/SEZ incentive scheme was described and discussed in section 3.1 above. There are, however, significant differences between the formal institutional arrangements *under the law* governed by the EPZA, and informal institutional arrangements and functioning *on the ground*. Indeed, the discrepancies between the formal institutional process of rent allocation of the EPZ/SEZ scheme and its de facto implementation and enforcement can explain some of the contradictory evidence and data highlighted above (sections 3.2 and 4.1). Specifically, there are several governance-related vulnerabilities to corruption resulting in processes of rent misallocation and lack of data transparency, particularly around exports, end-market destinations and employment generation.

However, governance-related vulnerabilities to corruption – leading to cases of rent misallocation or capture – are only one side of the coin, the other being opportunities for rent seeking by firms. Firm-related vulnerabilities to corruption arise from the fact that firms which receive an EPZ/SEZ licence are operating within a special regime whose enforceability is highly problematic. This is not unique to the SEZ/EPZ scheme – Andreoni and Sial (2020) show that many large firms in Tanzania rely on rent-seeking opportunities under different regimes of accumulation. The issue here is that the special status accorded to EPZ/SEZ licensed firms creates a number of specific opportunities which weaken the overall effectiveness of the EPZ/SEZ scheme in fostering industrialisation.

Governance and firm-related vulnerabilities to corruption might follow different routes and benefit different actors; however, they are ultimately interrelated and reinforce each other. In what follows we identify 10 governance and firm-related vulnerabilities to corruption resulting in potential rent misallocation and rent seeking. It is not our intention to point to any specific case: we have neither the evidence nor interest for that. Rather, we are concerned about unpacking the nature of corruption as a process (Khan, 2018) and identifying ways in which rent misallocation and rent seeking can feasibly be addressed (Khan et al., 2019). We will turn to this second task in section 5, where we will put forward a proposal around a potentially plausible governance reform which should reduce the existing vulnerabilities of the EPZ/SEZ scheme in Tanzania. The list of vulnerabilities is based on information extracted from more than 30 interviews and conversations with informants in the public and private sector, including firms which have exited the scheme.

4.2.1. Governance-related vulnerabilities and rent misallocation

Governance vulnerability 1: Adverse incentive – EPZ expansion rather than company capability prioritised in licensing

In general, to legitimise the EPZ/SEZ scheme, EPZA has always had a strong incentive to increase the number of licensed firms rather than to carefully select firms based on their capabilities and export potential. That EPZA has prioritised this expansion in the number of firms from the very beginning (in 2004), is clear from the analyses in section 4.1. Expansion was a defining feature under the leadership of Dr Adelheim Meru, as illustrated in his promotional material (Meru, 2010a, 2010b), and continued when he was replaced by Joseph Simbakalia in 2014 (see, for example, EPZA, 2019). This expansion strategy has resulted in weak enforcement of EPZ export requirements and a willingness to receive investments based on loose licensing criteria.

More recently, EPZA has run deficits for the four years from 2016 to 2019, which weakens its dual role as a regulator and developer. According to the Controller and Auditor General (2020: 15), the deficits 'mainly resulted from insufficient revenue generated from land lease and office rent as well as operator and developer licenses for established economic zone'. Furthermore, 'only three industrial parks were operational while others were under various stages of development. Without Government support for the completion of the economic zones, EPZA will continue making losses' (ibid.). On top of that, 'delays in payment of compensation of land for economic zones' development have resulted in substantial increase in the liability' from 2016 to 2019 (ibid.: 21). In the absence of adequate funding, one way to address deficits and lack of funds is to expand licensing through stand-alone firms as explained in section 4.2.2 below.

This adverse incentive interacts with further vulnerabilities. For example, the existence of several regulatory inconsistencies and ineffective incentive governance might have attracted companies with an inappropriate mix of capabilities and incentives, thus making the enforcement of the EPZ/SEZ scheme more challenging.

Governance vulnerability 2: Contradictory data and regulations – Governance hampered by lack of data for monitoring

Consistent enforcement of EAC and EPZ rules are difficult without up-to-date reliable data on the operating EPZ firms. As discussed above (sections 3.2 and 4.1), the available EPZA data on EPZ firms (operational status, employment, exports, etc.) are contradictory, patchy and unreliable. This indicates that EPZA's monitoring systems for tracking firms are inadequate and dysfunctional – a problem which has existed since the start of the programme.

EPZA's lack of a reliable monitoring system also affects the ability of other ministries to track the EPZ programme. According to Ministry of Finance (MOF) records,[3] for example, 31 companies received EPZ exemptions during the April–June 2015 quarter, but only 17 of these companies were on the EPZA list.[4] All the exemptions refer to the East African Customs Management Act of 2004. Data from other periods are not available on the MOF website.

The inadequate monitoring systems also limit accountability and hamper the possibilities for the public, interested politicians and civil society to scrutinise the EPZ/SEZ programmes and their progress.[5]

Governance vulnerability 3: Fragmented control of incentives – Enforceability limited by governance fragmentation and conflict of interests

The EPZ programme involves several departments, government ministries and agencies. Vulnerability to rent seeking increases to the extent that these do not cooperate, do not share information, or have conflicts of interest. First, TRA does not recognise legislation that is inconsistent with TRA-specific legislation. Consequently, in cases where EPZ-related legislation provides for certain fiscal incentives, but the TRA-related legislation does not, then TRA does not recognise those incentives. This creates bureaucratic hurdles for firms and may incentivise them to evade rules.

Second, while EPZA issues EPZ licences to firms, TRA enforces firms' compliance with the fiscal incentives provided by the EPZ programme. Conflicts of interest can therefore arise between TRA (which in principle seeks to maximise revenue collection) and EPZA (which has strong incentives to attract investors with tax breaks). Moreover, in its ambition for expansion, EPZA may license firms that do not have the capacity, skills and business models to meet the eligibility criteria. In the absence of cooperation and information sharing in the licensing process, it may take some time before TRA clamps down on such firms.

[3] http://www.mof.go.tz/mofdocs/exemptions/Mainland_Custom%20and%20Excise_Exemptions_April-June15.pdf.

[4] Among the companies on the MOF list that received EPZ exemptions are several mining companies plus, for example, Dangote Industries and Mokka City Cafe & Lounge.

[5] The website of Kenya's EPZA, for example, is more informative.

Third, although conflicts of interest between EPZA and TRA are an important feature of their relationship, situations may arise when they have mutual interests. According to an EPZA staff member interviewed, some TRA staff – in order to meet their revenue collection targets – may actually be interested in maximising domestic offloading of the firms that they deal with, because profits from domestic sales are taxable and subject to VAT payment. Import duties can also be charged on offloaded products. In such situations, front-line TRA and EPZA staff may have a shared interest in *not* enforcing the EPZ export requirement.

Governance vulnerability 4: Conflicting or incomplete domestic legislation – Governance hampered by confusion between EPZ and SEZ licensing schemes

Tanzania has legislated for two economic zone initiatives: EPZs in 2002 and SEZs in 2006 (as discussed in section 3.1). However, conditions and requirements overlap and the actual status of the SEZ programme is unclear. Nevertheless, EPZA continues to advocate for the SEZ, and this creates confusion and ambiguity. Although the SEZ legislation is more than 15 years old, the regulations needed to make the law operational have not been implemented and the scheme has therefore not taken off. [6] Dube et al. (2020: 14) note that most firms operating in SEZs only have EPZ licences, and the SEZ programme mainly exists on paper.[7] Nevertheless, EPZA's advocacy for the SEZ continues (see, for example, Meru 2010a, 2010b; EPZA, 2019; and the EPZA website[8]).

It adds to the confusion that EPZs are, strictly speaking (and in much of the relevant international literature), regarded as a sub-set of SEZs. But despite overlaps (as shown in section 3.1, Table 1), the Tanzanian legislation on SEZs and EPZs differs with respect to incentives, eligibility, conditionality and provision regimes. One central difference, already noted, is that the SEZ has no export requirements whereas EPZ firms must export 80% outside the EAC. This difference might partly explain why the SEZ programme has not been operationalised: it would cause unfair competition for firms outside SEZs and therefore is resisted by the private sector. It is also possible that the absence of export requirements, combined with tax incentives, can be used to lure firms to apply for SEZ status, only to end up with an EPZ licence.

Governance vulnerability 5: Conflicting interests and contradictory implementation in the EAC 'domestic' market – Conflicts among EAC member states in the interpretation and regulation of EPZ export requirements

Regional-level conflicts have contributed to mixed enforcement of the offload rule as stated in the EAC Customs Management Act (EAC-CMA) of 2004. It specifies that in order to qualify for EPZ incentives, firms should export 80% of their annual production to countries outside the EAC – but crucially this is subject to approval by relevant national (not EAC) authorities.

[6] Moreover, the SEZ legislative framework is not properly aligned to the East African Community Customs Area Act of 2004 (Kweka, 2018).

[7] According to one interview for this research in 2018, just one firm was registered under the SEZ scheme.

[8] EPZA | Eligibility Criteria and Licensing Procedures

Consequently, the various guidelines on EPZ issued by the EAC secretariat (for example, EAC Secretariat, 2010) are not binding for the member states. These conflicts and the resulting compliance problems have several roots.

Kenya started its EPZ programmes back in the 1950s,[9] before any of the other members of the current EAC. Until the mid-2000s, EPZ firms in Kenya were allowed to export 100% of their production into neighbouring countries. In principle, this changed with the introduction of the EAC-CMA. From that point on, exports should be to countries outside the EAC, with no transition period provided for. However, Kenya objected to the changed exporting rules.

With the EAC Customs Union Protocol of 2010, the 20% offload criterion gained new momentum, but conflicts continued. Kenya argued that enforcement would force the closure of many of its EPZ firms and that the threshold should be lifted significantly to compensate for 'lost markets'. Other member states objected to this and reiterated their official support for the 20% offload requirement.[10] Another contentious question is whether to allow EPZ firms to offload more than 20% – Kenya has proposed up to 100% – if companies are willing to pay all relevant duties (a rule that applies for EPZ programmes in other countries).[11] That proposal was rejected.

These conflicts also occur because the investment promotion agencies in the member countries compete with each other to attract investments. Such competition could lead national authorities to offer incentives to firms based on the individual authorities' own decisions or by tweaking domestic rules that are not subject to formal EAC-level restrictions.

At the EAC Secretariat these problems are well known, but it cannot deal with the technical aspects of them without political endorsement from the member states. So far this has not been forthcoming. In the meantime the Secretariat continues to pay only limited attention to the need for harmonisation of EPZ regulations within the EAC as illustrated, for example, by the flagship EAC Trade and Investment Report (EAC, 2019).

4.2.2. Firm-related vulnerabilities and rent seeking

Firm vulnerability 1: Stand-alone status – Being located outside designated EPZ zones can make firms especially susceptible to rent seeking

As noted earlier, EPZA has promoted stand-alone licences from the very start. These firms do not require infrastructure investments by the agency (which is short of funds for such purposes) and they do contribute to agency incomes (which helps to reduce its deficit). But these agency advantages come at a cost to the EPZ programme: some companies may bribe officials in exchange for free-zone status because the control and enforcement of customs

[9] Interview, East African Business Council, Arusha, January 2019.

[10] Restrictions on Kenya EPZ exports to remain - The East African (accessed 20-9-2019) plus interviews with staff in the EAC Secretariat in January 2019.

[11] Minutes of the EAC Sectoral Council on Trade, Industry, Finance and Investment, November 2017, and https://www.trademarkea.com/news/new-push-to-have-more-epz-products-sold-in-east-africa/

rules and of social and environmental legislation is more complicated in stand-alone companies and hence the potential for rent seeking is higher.

Indeed, the most critical and difficult aspect of enforcement is customs compliance and monitoring because of the high costs of physical control measures, involving stationing customs officers at licensed premises. Consequently, vulnerabilities to corruption are likely to be more pronounced for stand-alone firms – especially for smaller firms – because enforcement costs are comparatively higher. This makes it more difficult to ascertain whether stand-alone firms are complying with the 80% export requirement that entitles them to special tax incentives. They may, instead, offload a larger share of their production on the domestic markets without paying the relevant duties and taxes.

From a total of 43 EPZ firms in 2010, some 20% operated outside the designated EPZ zones, according to EPZA data in Gray (2013: 195–196). These licences 'were overwhelmingly given to domestic manufacturers rather than international firms', and mostly to existing local firms that switched to the EPZ programme to get fiscal incentives.[12] By mid-2015 around 50% of registered firms were stand-alone, according to Kweka and te Velde (2020). The data from our research, presented in section 4.1, show that by 2019 over 70% of the companies with an EPZ/SEZ licence were operating as stand-alone units.

Firm vulnerability 2: Production formula manipulation – Complex formulae are prone to rent seeking and result in rent shifting rather than rent capture reduction

Vulnerability to rent seeking arises from the lack of clarity and certainty around tax incentives and procedural criteria (the so called 'production formula'). This also affects companies' investment planning and the extent to which they can or cannot effectively benefit from incentives. The 'production formula' was introduced by TRA in 2015 to check that all duty-free imported raw, semi-processed and capital goods are used according to the law and that companies are not accumulating goods for reselling in the market. A Unit for Suspense Producers within the TRA was established to do this. The Unit also deals with supervising customs bonded warehouses, bonded manufacturing and duty-free shops. EPZ-related matters make up a major part of the Unit's work partly because a clean-up of past cases was required.[13]

Although this set-up has probably improved compliance with the offload requirements, TRA's efforts to strengthen such compliance by using the production formula can be – and likely is – counteracted by individual rent-seeking firms. A main reason is a lack of specificity in the formula: as one interviewee explained, it makes a difference whether production offloads are measured in units, value, or weight, and individual firms can utilise this to their advantage. The production formula ideally should be specific to the sector or even the firm in question to make the control effective. The lack of specificity in TRA's formula presents firms with rent-seeking opportunities.

[12] Only new investments are eligible for EPZ incentives.

[13] Interview with officials at TRA, 2018.

There is a limit to the extent to which vulnerability to rent seeking can be reduced by TRA's approach. As discussed in Andreoni et al. (2020), the application of a similar approach to regulate sugar import licences for industrial use created several implementation and enforcement problems. While the application of these formulae might be well intentioned – that is, to reduce import duty evasion and other tax avoidance opportunities – they tend to shift rent opportunities to other parts of the tax system, rather than eliminating them completely.

Firm vulnerability 3: Re-exporting – Opportunities for rent seeking created by special import duty regime and loose administration

Re-exports are defined as foreign-made goods which are exported – for example from an EPZ – in the same state as they were previously imported. If the 80% EPZ export conditionality is not enforced, or the administration of the duty drawback system is loose, rent-seeking opportunities arise from these re-exports. This vulnerability is, of course, larger for stand-alone firms which are more difficult to control. The problem in monitoring trade inflows has been well documented in several companion contributions in which we have shown, through product-level mirror statistics, that Tanzania has experienced major problems in trade mis-invoicing (see Andreoni and Tasciotti, 2019; for an analysis of sugar, see Andreoni et al., 2020; for an analysis of rice, see Andreoni et al., 2021).

This vulnerability may help to explain why Tanzania's re-exports are significant, accounting for about 16% of 2016 exports, rising from 3% of 2012 exports. 'According to the authorities, this increase can be attributed to a large increase in the use of Export Processing Zones (EPZs) and Special Economic Zones (SEZs)' (World Trade Organization, 2019: 247).

Firm vulnerability 4: Offloading – Opportunities for rent seeking created by special import duty regime and loose administration

Similar to vulnerability 3, companies can decide to offload their production domestically even without significant manipulation of the production formula (which deals with the imported inputs). They can do so directly by selling more than 20% of the allowed production quota in Tanzania and/or in the EAC market. For several commodities, there are significant price differentials in the region; companies can speculate on these differences in the process of offloading (and in some cases create them, if they are part of larger groups controlling significant volume of imports).

They can also decide to offload imported inputs. In both cases, they benefit from the fact that import duties have not been paid, so the price at which they can sell these products locally is very competitive. Given that capital goods are already exempt from import duties, companies can speculate on intermediate goods and other final goods that they are allowed to import at zero duty as part of their EPZ/SEZ licence.

Firm vulnerability 5: Corporate tax avoidance – Opportunities for rent seeking created by special corporate tax and VAT regime

Under the EPZ/SEZ incentive scheme, firms are granted generous corporate tax incentives. While these incentives matter, firms can also find other ways to avoid taxes. For greenfield investments, profits do not normally occur in the early years. In many cases, even when they do occur and are reported, they can be largely shifted away in time given the initial fixed costs of the investment. This is particularly possible in a fragile and patchy regulatory regime with several holes in the reporting system. Once a firm reaches the end of the 10-year exemption period, changes in ownership of the company can be used to 'reset the clock', and allow for a further period of tax exemptions.

The vulnerability discussed here creates unfair competition against domestic producers which are not granted the EPZ/SEZ licence. This becomes particularly acute when companies use their EPZ/SEZ licence to offload more than the permitted 20% and engage in re-exporting, thereby competing directly with other domestic firms in Tanzania and the broader EAC.

5. Towards a feasible anti-corruption strategy: Re-aligning governance and firm incentives via conditional special licensing

Based on our rent-seeking analysis of the EPZ/SEZ scheme in Tanzania and more than 30 interviews over a two-year research endeavour, we have identified 10 potential sources of vulnerabilities to corruption and related rent misallocation and rent seeking. We have shown how these processes cut across the many institutions in charge of running the EPZ/SEZ scheme as well as the firms that are operating under this special regime. We have also highlighted how these corruption vulnerabilities are interdependent and reinforce each other in a complex bundle of processes, interests and trade-offs.

A number of these corruption vulnerabilities have already been identified in other studies, as discussed in section 2; however, their assessment has often remained non-specific and limited to a generic corruption narrative. Given the lack of evidence pertaining to these processes and the reality on the ground of the different types of firms involved in the EPZ/SEZ scheme, policy recommendations have mainly advocated for standard good governance reforms. For example, the development of 'one-stop shop' authorities has been seen as a way of streamlining processes and reducing fragmentation in governance. In other cases, studies and reports have emphasised the importance of strengthening the vertical enforcement of rules via increased policing and use of technologies. The latter can be deployed more extensively to track imported goods and operations within bonded warehouses, as well as the movement of goods between bonded warehouses and production facilities in special zones. The importance of streamlining national regulations within the EAC regulatory framework to reduce unproductive flexibility and opportunities for rent seeking, including ambiguities associated with the EPZ and SEZ, have also been discussed.

While each of these instruments and proposed reforms can play a role in reducing corruption vulnerabilities, they can also be very difficult to enforce. They start from the assumption that the system can be 'waterproofed', so to speak, and that each of these corruption vulnerabilities can be addressed by adding an extra layer of policing. The production formula discussed above also starts from this assumption. In that case, as in many others, however, such interventions tend to reduce some opportunities in some parts of the system, only to create new ones in others. Moreover, they assume that the state has the capacity to implement such measures, and that there is enough political interest and organisational power backing the enforcement of the measures.

Based on our political economy analysis, and taking account of the differences between firms highlighted in section 4.1, we argue that an anti-corruption strategy that starts from

the above premises is doomed to fail. We propose to start from a different point, i.e. the fact that regulatory inconsistencies and ineffective incentive governance, alongside willingness to receive more investments based on loose licensing criteria, might have attracted companies with the wrong mix of capabilities and incentives (adverse selection), thus making the enforcement of the EPZ/SEZ scheme more challenging. If companies attracted into the scheme have limited capabilities, their default option when in trouble is to exploit the vulnerabilities discussed above. For example, the sudden change in the enforcement of the 80/20 export/domestic market quota is likely to have triggered the exit of multiple firms. We can also expect that some of the less capable firms might have responded to the new regime by exploiting vulnerabilities.

Instead of chasing firms and attempting to fill all the holes in the system, a feasible anti-corruption strategy should begin by reducing the interests of the firms themselves in misusing the EPZ/SEZ licensing scheme. A capable firm with appropriate initial investment and technological and organisational capabilities, which is interested in the real benefits offered by the scheme and that has routes to markets, would be going against its own interests if it were to concentrate on rent seeking. Such capable firms have a different option, that is, making profits by conducting legal activities within the scheme, independently of their stand-alone or zone status. Interestingly, while not conclusive, the evidence presented in section 4.1 points to the fact that those firms that exited the scheme were also those which were performing worst in export and had a lower initial capital investment.

We therefore suggest that EPZ/SEZ licensing processes should be reviewed to attract more capable firms that have a relatively lower incentive for gaming the system. Processes, conditionalities and criteria for investment licensing should be reviewed with the aim of selecting productive companies that are more interested in benefiting from the incentives on offer, than in rent-seeking opportunities. A simple and transparent criterion which could be easily implemented is to make the granting of an EPZ licence conditional on the investor having secured contracts with international buyers ex ante. This ex-ante conditionality, which we call *conditional special licensing*, reduces the burden of enforceability at all levels of the system. This criterion would work well for companies operating along value chains as first, second and third tier suppliers exporting to markets in the US, Europe, China and Japan. The experience of other countries such as Ethiopia, in garments, seems to point in the same direction (Oqubay and Lin, 2020). Firms investing in EPZs/SEZs across Africa are often operating within buyer-driven value chains. Buyers' commitments to buy their produce is often their unique route to global markets, although some firms might diversify and start exploring regional markets on the side (see Boys and Andreoni, 2020).

While the introduction of this criterion might negatively impact the number of firms entering the EPZ/SEZ scheme, it would make the entire scheme more enforceable and potentially more impactful in the medium to long term, with a reduction in early exiting companies. As shown in section 4.1, one in three companies which entered the scheme since 2008 subsequently exited, and when there was a push to recruit new entrants, an increase in exiting was reported in the years thereafter.

The introduction of this *conditional special licensing* criterion would not solve the potential problems that Tanzania will face as more of the less-capable firms exit the scheme in the coming years. Interviewees pointed out that even if the number of firms in operation in 2019 appears healthy, many of the firms were experiencing several challenges, including production reduction, less-than-efficient production capacity utilisation and increased competition. Since 2020, the Covid pandemic has put some of these companies under further pressure. An exit option or a parallel pathway is needed, whereby firms which were granted an EPZ/SEZ licence are offered the chance to leave the scheme and are supported while they re-focus on the growing 'domestic' markets of the EAC. This could be based on administrative implementation and revision of the tax and non-tax incentives associated with the SEZ scheme for companies with limited export capability, which are more interested in domestic and regional markets – provided that harmonisation and agreement is reached within the EAC Common Market.

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