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HARNESSING SPECIAL ECONOMIC ZONES TO SUPPORT IMPLEMENTATION OF TANZANIA'S FIVE-YEAR DEVELOPMENT PLAN 2016/17–2020/21

Josaphat Kweka

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KEY MESSAGES

Tanzania has prioritised the development of special economic zones (SEZs) as a critical lever to support industrialisation and economic transformation.

Realising these plans will require significantly more effort and targeted implementation, including looking out for viable financing options and starting gradually by focusing investment on one or two zones at a time to spur momentum.

For Tanzania to harness the full potential of SEZs to drive industrialisation and contribute to economic transformation, the Government of Tanzania (GoT) will need to (i) address the lack of a functioning fiscal regime for SEZs; (ii) make hard choices and trade-offs to commit government financing to SEZ development and leverage other funding sources such as concessional loans, social security funds, public–private partnerships (PPPs) and development finance institutions; and (iii) elevate the autonomy of the agency leading SEZ development and improve accountability and coordination across various ministries, departments and agencies (MDAs).

On this basis, GoT should look to:

- **make the SEZ law operational** by pushing other East African Community (EAC) Partner States to make necessary amendments in the EAC Customs Management Act. In the meantime, the Minister of Finance and Planning could issue an executive order to amend domestic taxes (VAT and income tax) to provide fiscal incentives to SEZ firms and operators

- **accelerate PPPs or harness the leveraging role of TIB Development Bank** to address funding constraints, especially financing of preliminary investments for zone development

- **select zones for priority investment to induce implementation**. GoT should select low-hanging fruit zones as quick wins to accelerate progress, thus creating momentum for developing other zones and providing a demonstration effect

- **strengthen the autonomy, authority and management of SEZ development** by elevating the Export Processing Zones Authority to the President's or Prime Minister's Office so as to empower it to coordinate the SEZ programme across various MDAs, to solicit its own funding and to step up its staffing levels and operational capacity

- **make SEZs *special*** by providing supplementary incentives to enhance the competitiveness of developers or firms operating in the zones (e.g. by lowering the cost of electricity and providing more flexible labour regulations). Incentives for results (performance contracts) can be agreed with GoT.

1 INTRODUCTION

Special economic zones (SEZs) can help stimulate industrialisation and structural transformation (Abdusharipovich, 2018).[1] In particular, they play an important role in manufacturing development and employment creation in sub-Saharan Africa (Kingombe and te Velde, 2015). As a result, more countries have adopted and started to implement this instrument as a way of attracting foreign direct investment (FDI) in the manufacturing sector. However, Farole (2011) shows that success in African zones is limited mostly to a few countries (Kenya, Madagascar and Mauritius), and many zones on the continent are still in the early stages of establishment. In Tanzania, the Government of Tanzania (GoT) is pursuing SEZs as a critical mechanism for facilitating private sector investment in the manufacturing sector to support industrialisation.

A review of experience shows GoT has made notable progress in putting in place a conducive policy, regulatory and institutional framework for supporting SEZs. However, actual progress in terms of number of zones developed and investment made in existing zones has been rather limited. Nonetheless, the current industrialisation drive offers momentum to leverage SEZs as an effective implementation mechanism. This paper aims to take stock of progress made and identify actions needed to harness SEZs to support Tanzania's industrialisation agenda.

The briefing has been prepared as part of the Overseas Development Institute (ODI) Supporting Economic Transformation (SET) programme, which provided analytical support for the preparation of Tanzania's National Five-Year Development Plan 2016/17–2020/21 (FYDP II), has helped guide the preparation of an Implementation Strategy for the Plan and is currently reviewing progress to hasten implementation. The briefing is informed by a review of existing government policies, plans and priorities relevant to SEZs as well as consultations with representatives of the public sector, including the Ministry of Industry, Trade and Investment (MITI), the Export Processing Zones Authority (EPZA), the Tanzania Investment Centre (TIC), the National Development Corporation (NDC), the Textile Development Unit (TDU); and representatives of the private sector, particularly the Tanzania Private Sector Foundation (TPSF), the Confederation of Tanzania Industries (CTI) and local think tanks (Research on Poverty Alleviation, REPOA, and the Economic and Social Research Foundation, ESRF).

This paper is structured as follows. Section 2 examines the potential role for SEZs in supporting industrialisation by reviewing how SEZs are positioned in GoT's policy frameworks and plans, and providing illustrative examples of actual industrial developments in particular SEZs. Section 3 takes stock of regulatory and institutional reforms made, or to be made, to enhance the development and operational effectiveness of SEZs. Section 4 outlines the current status of each priority zone, and pending progress in their respective development. Section 5 discusses key issues affecting the participation of domestic firms in boosting investment in SEZs. Section 6 concludes and proposes policy recommendations.

[1] SEZs are spatially delimited areas that offer a combination of high-quality infrastructure, expedited customs and administrative procedures and a range of fiscal and non-fiscal incentives to overcome barriers that hinder investment in the wider economy.

2 THE POTENTIAL ROLE FOR SEZS IN TANZANIA'S INDUSTRIALISATION

2.1 Policy framework and objectives

The strategic role of SEZs in supporting Tanzania's industrialisation is well defined in GoT's key policy frameworks, including the Tanzania Development Vision (TDV) 2025, FYDP II and the Sustainable Industrial Development Policy (SIDP). Both TDV 2025 and FYDP II note that SEZs will be established to spearhead growth and development with the overall objective of achieving socioeconomic transformation and making a structural shift to enable Tanzania to become a middle-income, semi-industrialised country. Furthermore, SIDP (1996–2020) establishes export processing zones (EPZs) as one of the strategic policy instruments for achieving export growth and diversification through trade in manufactured goods. In this regard, EPZs were first established in Tanzania in 2002 for the purposes of promoting and facilitating export-led industrial development. GoT established Benjamin William Mkapa (BWM) SEZ in the wake of enacting the Special Economic Zones Act 2006. Although the BWM zone is a designated SEZ, the firms operating in it are EPZ firms (exporting 80% of output at a minimum as per the legal requirement), since the regulatory framework for SEZs is not (yet) functional.

FYDP II identifies SEZs among a series of flagship projects. Specific SEZs listed in the Plan include Bagamoyo SEZ, Mtwara SEZ, Kigoma SEZ, Ruvuma SEZ, Kurasini Trade and Logistics Centre and Dodoma Trade and Logistics Centre (associated with the development of the Central Transport Corridor with Standard Gauge Railway line).

While the policy objectives for promoting SEZs are well framed and legitimate, the key issue is implementation effectiveness. This is important because of the role SEZs have in driving industrialisation. MITI has prepared official reports for informing the GoT strategy on industrialisation. These include the strategy for fast-tracking industrialisation (2016–2020) developed in March 2017, and the joint Programme for Implementation of the Industrialisation Drive (July 2018). In both reports, the role of SEZs in achieving the industrialisation drive is clearly demonstrated. The fast-tracking report provides a list of industrial projects alongside a proposed implementable timeframe, which varies depending on the nature, viability and readiness. In that respect, the list categorises the projects into short-, medium- and long-term projects (see Annex 2). The short-term projects (22 in number) are further sub-divided into three categories, one of which is the SEZ cluster. This comprises expansion of existing industries, development of SEZs/clusters, establishment of new industries and, finally, reviving non-functioning industries (privatised and state-owned). Most of the planned SEZs are considered medium-term projects, while the short-term initiatives include those identified (by EPZA) for expansion. Three out of ten projects listed as long-term initiatives are related to SEZs.

Broadly, the development of SEZs is considered a priority for implementing Tanzania's industrialisation agenda. Indeed, SEZs form one of the clusters in the list of projects identified in MITI's strategy for accelerating industrialisation. The priority projects are outlined in FYDP II (the action plan) and SIDP, including the flagship projects, and are consistent with EPZA plans. However, a key question is how these priorities are determined.

Recent reports indicate that Tanzania is among the top five countries by manufacturing growth in Africa, driven mainly by improved infrastructure, growth of regional markets and promotion of FDI through EPZ schemes. The manufacturing sector in Tanzania consists mainly of food processing (24%), textiles and clothing (10%), chemicals (8.5%) and others, including beverages, leather and leather products, paper and paper products, publishing and printing, and plastics. Exports of Tanzanian manufactured goods include cotton yarn, processed coffee and tobacco, sisal products (yarn and twine), wheat flour, plastic items, textile apparel and cement.

Figure 1: Star City SEZ, launched in 2016 in Morogoro

Source: Tanzania Investment Monitor

A number of SEZ projects have been established in Tanzania, demonstrating the potential for SEZ development to support industrialisation. Over the past two years, MITI has launched the Star City integrated township project in Morogoro located in the newly established Tungi SEZ, which will be the largest SEZ project in Tanzania, with a total site of 10,620 acres.[2] The project has already received the developer licence from the EPZA, and completion of the start-up phase with an initial capital of TZS140 billion ($62 million) is planned by 2025, and that of the rest of the phases by 2050. The major part of the project focuses on the industrial manufacturing sector as well as other commercial, housing recreational venues and public amenities.

Some of the factories operating in existing zones have grown fast and are looking to expand. For instance, it appears that some factories in the BWM SEZ have no space for expansion (e.g. Tooku). This shows further evidence that the SEZ has been effectively harnessed to support industrialisation.

2.2 Challenges limiting the impact of SEZs on industrialization in Tanzania

Insights from industry actors (CTI) indicate that the challenge of inadequate electricity has reduced, mainly by addressing losses and inefficiencies in power generation, distribution and transmission and through additional capacity to the national grid from Kinyerezi II (167.82 MW) as of April 2018. More generally, there is limited availability of serviced premises for industrial factories in Tanzania, which implies that the demand for SEZ spaces is potentially high. Given competing schemes for attracting investment (TIC, EPZA and NDC), it will be critical that GoT streamlines the procedural, regulatory and institutional framework for guiding investment promotion. Specifically, this could include:

1. review and consolidation of key legislation and policies governing FDI and clarifying of specific criteria for strategic and super-strategic investors
2. review and streamlining of legislation relating to establishment of EPZs and SEZs
3. creation of a single contact point for prospective investors to obtain guidance on the process and requirements (coordinating collaboration)

[2] https://www.tanzaniainvest.com/industry/manufacturing-growth

4. definition of roles and responsibilities of key institutions and agencies (in central and local government) in attracting and facilitating FDI.

Kinyondo et al. (2016) assess the role and effectiveness of EPZs and SEZs in Tanzania, highlighting that Tanzania has not effectively tapped the benefits of operating in these zones. The study finds that, although the agglomeration economies resulting from technology transfers represent one of the arguments to support SEZs, the experience of SEZs in Tanzania shows that firms are benefiting from technological transfers through the supply chain and from export markets but not from each other. More generally, interactions between firms within zones and with the local community were found to be dismal, implying few benefits of zone firms over the non-zone firms (including small and medium enterprises, SMEs). This raises a question as to how to effectively promote linkages among firms within and outside the zone to tap technological spillovers.

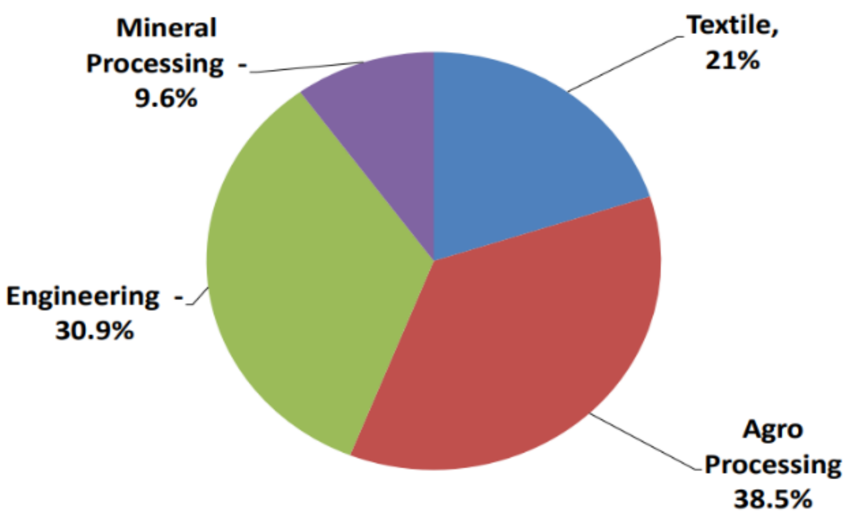
GoT acknowledges the conclusion about SEZs being less effective than expected in Tanzania. Indeed, MITI's fast-tracking report notes that the actual performance of EPZs has been moderate compared with their potential. Up to December 2016, EPZA had issued licences for the establishment of 140 industrial companies, 79 of which (56%) are single factory units (standalone) and 61 (44%) industrial parks.

2.3 Investments in SEZs/EPZs in Tanzania: progress so far

Since its establishment in 2006, EPZA has gazetted eight SEZs in the form of industrial and commercial parks (most of which have supporting infrastructure) and licensed 160 firms, out of which 20 are operational (Malanga, 2018). These zones accommodate 47% of EPZ registered investments. The remaining EPZ projects are located outside the industrial parks as standalone factories. Half of the industrial parks are privately owned and GoT owns the remaining 50%. Only the BWM SEZ is fully operational, with 19 factories out of which 6 have started production with 24,413 employees. The rest are in different stages of construction. The BWM SEZ is served with supporting infrastructure, including onsite roads, water and electricity.

A disaggregation of ownership patterns across SEZ/EPZ investments in Tanzania shows that 59 companies (equivalent to 42%) are foreign, 19 (14%) are joint ventures (JVs) and 62 (47%) are Tanzanian-owned. Based on data from EPZA, Malanga (2018) reports that total investment capital in these zones by July 2017 was TZS1.73 billion, which represents an 18.4% increase from TZS1.45 billion in 2016.

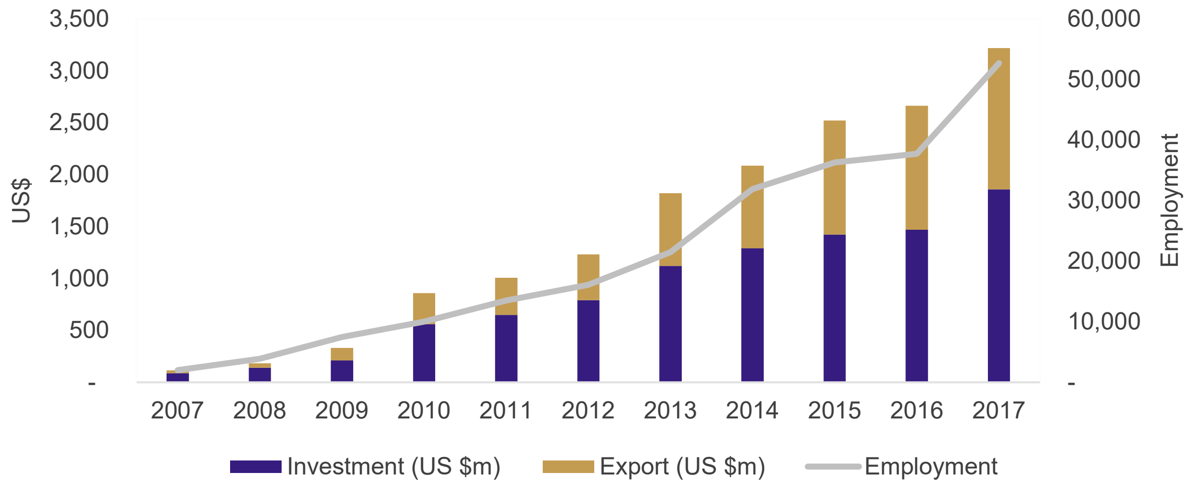
Figure 2: SEZ/EPZ investments by sector, 2016 (%)



Source: EPZA data (2016)

Overall, what has been the outcome of the SEZ/EPZ programme? Figure 3 summarises trends in investment, exports and employment in the EPZs. According to information from EPZA, foreign exchange earnings from EPZ operations have increased markedly, from $22 million per annum in 2008 to about $200 million in 2016. During the same period, the processing and manufacturing capacity generated 36,000 jobs for Tanzanians and exports worth cumulatively over $1 billion. Malanga (2018) reports that earnings from EPZs increased by 12.6%, from $1.19 billion in 2016 to $1.34 billion in 2017. Furthermore, employment more than doubled, from 21,493 in 2013 to 52,395 in 2017 (an increase of 143%). Between 2016 and 2017, employment increased by 38.9% from 37,730 in 2016 to 52,395 in 2017.

Figure 3: Key trends in SEZ development, 2007–2017



Source: Calculated based on data from EPZA

The SEZ/EPZ programmes have also encouraged some innovative collaboration from non-traditional stakeholders to support industrialisation. Two areas stand out. The first involved provision of a training fund by the Prime Minister's Office as part of the Skills Development Levy for industrial skills development to meet the demands of one garment manufacturing firm, M/S TOOKU Garments Ltd. The same fund was utilised to facilitate leather goods design skills training to youths at the Dar es Salaam Institute of Technology Mwanza Campus (formerly known as the Tanzania Institute of Leather Technology). This kind of collaboration provides very important facilitation to investors in terms of reducing transaction costs while at the same time enhancing the development and availability of required industrial skills. The second centred on involvement of social security funds in the development of the manufacturing sector. According to MITI's fast-tracking report, this programme has supported 26 manufacturing projects.

3 THE INSTITUTIONAL, REGULATORY AND OPERATIONAL REFORMS NEEDED TO LEVERAGE THE BENEFITS FROM SEZS

3.1 Regulatory and institutional reforms

GoT has made progress on the institutional environment for SEZs by amending the EPZ Act and the SEZ Act in 2011 so that one regulatory authority – EPZA – will administer both. The amendments were intended to rationalise the roles and functions of the EPZA and to effectively place the two parallel regimes (SEZs and EPZs) under one regulatory body, thereby eliminating the overlap between them. Those amendments have also allowed EPZA to issue derivative rights to investors, similar to the function of TIC.[3] This enhances EPZA's capacity to better regulate zones through performance contracts with investors. This action was accomplished by Parliament through amendment and adoption of the Economic Zone Laws (Miscellaneous Amendments) Act of 2011, in June 2011.

In order to operationalise the legal framework for SEZs, new regulations were adopted to distinguish the roles of developer and regulator of zones. The regulations also set forth selection criteria for developing SEZs, with an emphasis on economic and social impacts while providing guidance on the process of issuing and regulating licences for developing and operating SEZs. Furthermore, the regulations encouraged private sector participation in the development, operation, maintenance and promotion of SEZs through public–private partnerships (PPPs).

Another important reform relates to the implementation of a one-stop service centre for SEZ investors, which GoT has successfully established in the BWM SEZ. This initiative has significantly streamlined the administrative procedures in zones, especially in the areas of licences, taxes, customs, work permits, visas, residence permits and land matters. The average time taken for operators to get a licence within the BWM SEZ has reduced considerably, from two to three months in 2011 to just three days in 2015 after the investor has complied with all licensing requirements.

To ensure realisation of the role of SEZs in supporting industrialisation, economic transformation and job creation, Tanzania would need to step up efforts to attract investment in the SEZs by improving the business environment and aggressively engaging in investment promotion. However, such efforts will be successful only if GoT makes initial investments in the zones. GoT should embrace international good practice (see Box 1), based on lessons from proven international experience – which may imply a need for further reforms. For instance, instead of the SEZ programme running under a line ministry, it could be elevated to the Prime Minister's or President's Office, to raise its prominence and, at the same time, improve its independence.

[3] Derivative rights refer to rights of occupancy of land given to an investor for the purpose of investment through an investment promotion agency. Foreign investors may occupy land for investment purposes through a government-granted right of occupancy (derivative rights), or through sub-leases through a granted right of occupancy.

Box 1: Abridged summary lessons from international experiences in developing a successful SEZ programme

A number of key lessons from international experience have been widely documented (CDE, 2012; Zeng, 2015). These include, among others, the need to make SEZs special by offering investors something significantly different from what is available in the rest of the economy to ensure they are globally competitive. A critical element of competitiveness is ensuring costs are down and SEZs offer tailored solutions to problems faced by local firms. For instance, the Centre for Development and Enterprise (CDE) (2012) shows that costs and flexibility of employment matter in the sense that employers who are unable to hire and lay off temporary staff and structure shift systems in line with demand struggle to compete internationally. Furthermore, SEZs require political commitment from the highest levels of government, and the most successful SEZs are PPPs. Countries with successful SEZ programmes have adopted a gradual approach by investing in a few zones and building momentum. For instance, China started with only four zones in very strategic locations (Zeng, 2015); South Africa started with two (CDE, 2012). The quality of the institutional and regulatory framework also matters in determining successful zone programmes (Farole and Kweka, 2011).

3.2 The key institutional actors

An SEZ Act was passed in 2006, but implementing regulations have not yet been approved. Development of the zones programme was slow in the initial years in part as a result of the poorly defined institutional framework and the overlapping mandates for the EPZ and SEZ programmes, but has picked up since the reforms were carried out in 2011. In addition to EPZA, other relevant actors on the SEZ programme include TIC and NDC – both of which are also managed under MITI. TIC is generally responsible for coordinating, encouraging, promoting and facilitating investment in Tanzania and advising GoT on investment policy and related matters. NDC is mandated to promote a resource-based industrialisation model, which encompasses synchronisation of agro-processing (to promote feedstock to manufacturing industries, hence value addition), basic industries (industrial parks) and infrastructure development (economic corridors). The Small Industries Development Organisation has a mandate to promote small-scale industries. EPZA is mandated to promote, register and facilitate investments in SEZs in mainland Tanzania. EPZA's functions include the development of EPZ and SEZ infrastructure, provision of business services to EPZ and SEZ investors and issuing of EPZ and SEZ licences. However, in addition to streamlining the functions of EPZA, there is a need to elevate the Authority beyond the line ministry to the Prime Minister's or President's Office, so as to give it visibility, independency and autonomy. This was one of the suggestions made by Justin Lin (then-World Bank Chief Economist) during a visit to Tanzania.

In the private sector, promoters of SEZs include mainly the recently established SEZ developers, but there is no umbrella organisation or company that specifically promotes SEZs across the board.[4] Each private SEZ developer promotes its respective zone. Currently, there are three main private developers (excluding the standalone factories):

1. Star City SEZ located in Morogoro region (170 km west of the commercial hub, Dar es Salaam). The Star City SEZ project (spanning an area of approximately 10,661 acres) is a JV between Dominion Plantation Ltd from Tanzania and Hyflux Limited from Singapore. The project plan includes an allocation of industry, trade, technology, tourist parks, residential buildings, transportation services, financial institutions and dry ports.

[4] In the past, Ubungo Milenium Business Park was designed to be a private developer for promoting SEZs but this fell out with the EPZA regarding licensing conditions and financing, and hence opted to be a general business park.

2. Vigor SEZ Project in Kisarawe Coast region is to be established within the envisaged Vigor City, totalling 1,100 acres. The investor (Turky Group of Companies) has already acquired the entire land of Vigor City, for which 509 acres will be used for Vigor SEZ.
3. China Merchants Ports Holding Company of China and the State General Reserve Fund (SGRF) of Oman have invested within Bagamoyo SEZ. Development of Bagamoyo SEZ entails the construction of a world class sea port as a transport logistics hub and gateway for international trade, with a linked industrial platform for value addition and manufacturing processes.

3.3 Administration of SEZ incentives

The main issue affecting the effectiveness of the SEZ programme in Tanzania is the fiscal regime that regulates the provision of incentive packages. Although EPZA is recognised as a Competent Authority for issuing SEZ licences, the East African Community (EAC) Customs Management Act (CMA) of 2004 does not recognise the scheme. Hence, no actual SEZ project has been established in Tanzania, as the law at the EAC level does not support the dispensation of incentives under the scheme. Stakeholders interviewed advised the Ministry of Finance and Planning (MoFP) to ensure the directive of the EAC Sectoral Council of Trade, Industry, Finance and Investment to prepare SEZ policy and regulation is implemented in full to facilitate utilisation of the scheme. In addition, under the EAC CMA, the Minister of Finance and Planning can give a directive through an executive order to amend domestic tax laws (VAT and income taxes) for the Tanzania Revenue Authority to provide incentives as per the SEZ Act. One clear recommendation is for the industry actors (TPSF, CTI) to follow up by engaging with MoFP.

4 PROGRESS WITH THE DEVELOPMENT OF SPECIFIC ZONES

With only a few zones operational, it is useful to provide an overview of the current status of the planned ones to illustrate progress and prospects for SEZs to contribute to industrial development and further implementation of FYDP II. Detailed information on the status of implementation is shown in Annex 1. Below is a brief profile on the progress for each zone.

Bagamoyo SEZ. The strategic objective of Bagamoyo Special Economic Zone (BSEZ) is the construction of a world class port as a transport logistics hub and gateway for international trade, with a linked industrial platform for value addition and manufacturing processes. BSEZ includes 800 acres for a port at Mbegani and 2,200 acres for a port-side industrial city to include logistic and residential components. It involves two private developers: China Merchants Port and SGRF of Oman. The role of GoT will be to provide basic supportive infrastructure (worth over $1.5 billion) and fiscal incentives. The plan for BSEZ development was approved in October 2017 but progress has been slowed by protracted negotiations. Nevertheless, recent progress includes the issuance of new directives for investors to pay the pending compensation as part of the advance payments to GoT or investment to be recouped in future. GoT financing will be provided in phases and synchronised with the progress made by the developer. Furthermore, to spur implementation, the various government agencies involved in zone development (utilities, infrastructure, etc.) have been instructed to budget for their respective aspects of the financing.

Mtwara SEZ. The strategic objective of Mtwara SEZ is the construction of a world class Mtwara Free Port Zone that will be the logistics and supply services hub for the oil and gas industry in East and Southern African. The total land area reserved for Mtwara SEZ development covers an area of about 2,600 hectares and it is owned by Tanzania Ports Authority. The zone is also planned to spearhead an agricultural revolution through the production of ammonia/urea fertiliser, as well as a petrochemical complex as part of the Gas-to-Industry (G2I) strategy of the Mtwara Development Corridor initiative. Currently, there are three investors. GoT is pending deployment of basic supportive infrastructure worth about TZS9 billion ($3.9 million).

Kibaha SEZ. The GoT has allocated 95 acres of the 200 acre TAMCO Industrial Estate for a dedicated textiles and apparel SEZ. The land is owned by NDC who are leading the development of the site with the support of TDU, a project unit within MITI that is funded by Gatsby Africa. The project preparations, including feasibility study, financial model, masterplan and environmental and social impact assessment are complete and the project is now focusing on fundraising. The GoT has committed TZS11 billion in the 2018/19 budget to develop the core utilities required, and additional public and private funds are being sourced to complete the development with the site likely to be operational in 2020.

Kigoma SEZ. Kigoma SEZ (KiSEZ) is an initiative developed by Kigoma region as a strategy to accelerate development. The region's strategy aims to make Kigoma an investment destination and international trade gateway of various businesses in the riparian area of Lake Tanganyika, including Burundi, Democratic Republic of Congo, Rwanda, Tanzania and Zambia. GoT has already compensated (and, hence, effectively acquired) 700 hectares out of the total area of 3,000 hectares earmarked for SEZ development. The 700 hectares are ready for private investors. Obtaining the title deed has secured the area and is expected to appeal to the private investor.

Kurasini Logistics Centre SEZ. EPZA considers Kurasini the most attractive zone, hence low-hanging fruit in SEZ development, because it is near the port (thus suitable for export-oriented manufacturing) but also because it requires much smaller investment (TZS58 billion or $25.3 million) compared with other zones. So far, GoT has invested over TZS100 billion ($436 million) and completed 98% compensation. The area is available for over 20 (especially export-oriented) manufacturing factories, and is estimated to generate 10,000 jobs, increase FDI and boost exports. Much of the demand is expected to come from the firms operating in the BWM SEZ that need to expand into a nearby location. The project will deliver key infrastructure for trading, warehousing, packaging, light manufacturing, financial services and logistics services.

Tanga SEZ. About 1,363 hectares of land have been earmarked for an SEZ in Tanga City comprising a multi-industry development cluster and point of entry for various core infrastructure projects around the eastern gateway for the northern regions. This city has been identified to operate as the international gateway to the region through Tanga–Dodoma super corridor and as a hub for international trade and commerce. The zone is part of Tanga Economic Corridor Ltd, an independent part developer and JV between Tanga City Council and Good PM Group.

5 ISSUES AFFECTING THE DEVELOPMENT AND OPERATIONALISATION OF SEZS

5.1 Overview

The assessment of constraints facing the development and operation of SEZs presented in this section focuses on institutional and financial issues, rather than operational challenges facing firms, such as lack of power or the high cost of raw materials. Such constraints fall under the business environment agenda applying to all firms and not specifically to those located in, or planning to locate in, zones. Previous studies have highlighted some of these constraints. For instance, Kinyondo et al. (2016) show that difficulties accessing cheap labour and high energy costs are the key constraints affecting firms' competitiveness, and argue that policies promoting labour mobility may help firms better access the labour resources they need.

As shown in MITI's fast-tracking report, GoT is aware of the major constraints affecting implementation of EPZ and SEZ schemes, so the discussion should focus on identifying viable solutions. The report identifies four main challenges: (i) non-availability of serviced land, (ii) funds to meet compensation requirements once the land has been identified, (iii) supporting infrastructure such as roads, railway lines, power, gas and data connectivity and (iv) failure to provide SEZ incentives as given in the SEZ Act 2006 owing to non-recognition of the SEZ scheme by the EAC CMA 2004.

Generally, these challenges are not mutually exclusive. For instance, because of the unavailability of funds, EPZA cannot implement compensation, and so cannot provide serviced land ready for investor uptake or offer basic infrastructure. Therefore, the major challenge the policy actors need to confront is the financing issue; without doing so, most of the other impediments cannot be addressed. Another key challenge is coordination efficiency among various actors in the development of SEZs. These challenges are discussed below.

5.2 Financing challenges and proposed solutions

Interviews with several GoT officials indicated that the financing challenge affects effective implementation of the SEZ programme (especially in paying compensation). Apparently, this is because the GoT budget is not adequate to finance potential projects. In response to this challenge, both the public and the private sector are advocating PPPs as a financing option. In 2017, at its 17th Annual General Meeting, focused on 'The role of PPP's in the development of modern special economic zones', TPSF urged GoT to fast-track industrialisation through leveraging PPP financing mechanisms in the development of modern SEZs.[5] Furthermore, TPSF has continuously advocated for the establishment of an industrial development bank to extend credit to investors and entrepreneurs keen on setting up factories. The policy and regulations on SEZs are supportive of private sector participation in the development and operation of SEZs. Development financing for SEZs can take any of the three investment models as briefly outlined below.

1. **Public sector investments (PSI)** – with land ownership retained by GoT directly or acting through a public sector entity as the title-holder. GoT also assumes responsibility to supply the facilitative economic services infrastructure, such as roads, water, electric power, communication and railway lines. GoT acting through EPZA has implemented the BWM SEZ as a PSI initiative. The private sector participates as engineering, procurement and construction contractors or investors in industries and services within the SEZs. Other SEZs under PSI initiatives are at the land acquisition stage, including flagship projects like

[5] https://entrepreneurs.or.tz/fast-track-industrialization-through-ppps-in-the-development-of-modern-special-economic-zones/

Kurasini, Kigoma, Tanga and Mtwara. GoT is dedicating resources to complete the payment of outstanding compensation claims. The main challenge with PSI is insufficient budget allocated to EPZA compared with requirements in both land acquisition and infrastructure development.

2. **Private finance initiatives (PFI)** – with the cost of land acquisition and of supplying on-site economic services infrastructure being borne 100% by the private sector.[6] The role of GoT is to provide off-site infrastructure to link the zone with markets as well as supply chains. The operators within the SEZ are also private sector players. So far there are two PFIs in Tanzania: Star City SEZ in Morogoro (10,661 acres) and Vigor SEZ in Kisarawe Coast region (1,100 acres) by a Turkish developer. Both of these SEZs are operational and available to potential investors. The main challenge with PFI is that the zones are operated on purely commercial terms and, therefore, the rates charged for land lease are relatively higher compared with for government-owned zones, which, to some extent, makes them less attractive. For example, the land lease rate has reached up to \$70 per m^2 for some zones, while currently GoT charges \$0.6 per m^2 per annum.

3. **PPPs** – which aim to leverage private sector resources to fund development projects. BSEZ will be implemented as a PPP. GoT approved the investors' comprehensive proposal in October 2017 as a basis for negotiations ahead of the signing of the definitive agreements. Negotiations are currently underway with the expectation that the key terms agreement will be concluded in 2018 and development will commence from 2019. KiSEZ could also be implemented as a PPP should a suitable investor be found. The main challenge with the PPP route is the lengthy negotiation process necessary before actual implementation, given the nature of investments and other considerations. The aim is to ensure a win-win situation for all parties involved.

Tyson (2018) discusses different models of public and private financing for SEZs, with case studies of how they have been applied to different countries. The sources of public SEZ financing include (i) multinational development banks, such as the World Bank and African Development Bank, and development finance institutions (DFIs) providing both financial and technical assistance; (ii) Chinese-led partnerships as global leaders in SEZs, where financing comes from Chinese state-owned banks and Chinese firms establishing operations in the SEZ through specially created companies (as is the case, for example, in some Ethiopian SEZs); and (iii) PPPs – which have been the most common form of private financing of SEZs especially for infrastructure development, through Build-Operate-Transfer schemes. Private financing for SEZs involves the private sector taking the risk and returns without any liability to the government. Private investors source financing from commercial banks and other financial institutions.

5.3 The role of national development finance institutions

DFIs can play an important role in SEZ development, including financing some infrastructure projects (e.g. ports). However, in Tanzania, GoT appears not to have harnessed the role of DFIs for development financing. According to a TIB Development Bank official, GoT's traditional approach of financing projects from the national budget is not the optimal approach. TIB Development Bank advises that projects that can generate cash flows not be financed from the national budget. There is a need to boost the capacity and level of capitalisation of national DFIs in the provision of finance for projects as well as for syndication and leveraging.

In most cases, TIB Development Bank is not co-opted as a reliable partner for leveraging and syndicating financing, a factor that may be attributed to a lack of trust. Furthermore, TIB Development Bank appears to be undercapitalised and, as a result, has resorted to seeking short-

[6] Kamal SEZ invested very little in its zone and ended up pricing its land far too high (\$79.1 per m^2).

term loans that attract relatively higher interest rates. Consequently, TIB Development Bank charges comparatively higher interest rates for project financing (10–12%) relative to international or global DFIs (including the World Bank), making it less competitive. Furthermore, TIB Development Bank requires significant capacity-building of its staff. However, TIB Development Bank is keen to take more active participation in advising and financing some of the priority development projects identified for PPP financing (see Balchin, 2018). One of the recommended solutions is to seek to recapitalise TIB Development Bank from international DFIs.

Finally, to contribute to addressing the financing challenge, EPZA is considering reviewing its rental fees such that the rate charged will be determined by realistic market rates. The current rate is \$0.6 per m^2 per annum, while private SEZ charges are as high as \$70 per m^2 per annum. EPZA is also advocating the asset-backed financing approach by leveraging acquired land to raise finance for infrastructure development. Furthermore, EPZA is in the process of reviewing its organisational structure in order to be more efficient and match the demand arising from implementation of its mega projects like BSEZ.

5.4 Coordination and prioritisation

SEZs can play a key role in kick-starting industrialisation, but developing effective SEZs requires significant coordination, particularly for investments in infrastructure, licensing and land acquisition and ownership (Adeyeye, 2016). Interviews with MITI officials affirmed that the major challenge to implementing Tanzania's industrialisation agenda was coordination among the involved government agencies. With the current 5th Phase Government, there has been improved understanding that the industrialisation agenda is not the sole responsibility of MITI, but rather a cross-cutting priority of all agencies through their annual budgeting. One example of the coordination challenge is the need to consider provision of a reliable power supply around the identified SEZ locations or other mega projects. Indeed, Tanzania Rural Roads Agency is mentioned as a good example of allocating a budget in its annual plans to implement necessary road access to the demarcated industrial locations. A recent workshop organised by GoT in collaboration with SET (see Balchin, 2018) suggested that one way of addressing the coordination challenge would be for GoT to establish working groups for SEZs in Bagamoyo, Kurasini, Mtwara and Kigoma.

5.5 Participation of domestic firms in boosting investment into SEZs

As a measure to attract more domestic investors into zones, EPZA provides more favourable conditions for local compared with foreigner investors in terms of minimum investment capital and annual export requirements.[7] However, the number of local investors looking to invest in SEZs is not encouraging. Unfortunately, the most recent figures available from EPZA on the number of firms operating in the zones by nationality date back to 2015. The figures show that, out of a total of 140 EPZ companies licensed by EPZA in September 2015, 44% are owned by local investors and 14% are operated as a JV between foreigners and domestic investors, while 42% are foreign-owned (mainly China, Turkey and India). EPZA officials believe local investors have not adequately taken the opportunity to invest in the zones. Furthermore, in recent years, there seems to have been a proliferation of standalone SEZ factories, especially in Dar es Salaam, which, to some extent, defeats the purpose of the SEZ concept.

Owing to the requirement to export 80% of output under the EPZ licence, local firms may be unable to compete in the export market. While EPZA does issue developer or operator licences, an SEZ scheme that would have encouraged local firms to participate in the zones is not yet effective because the anticipated tax incentive has not (yet) been recognised by the EAC CMA.

[7] The minimum capital requirement for local firms is \$100,000 and that for foreign firms is \$500,000. However, local firms consider the working capital required to stay in the zones too high for them to afford (Kinyondo et al., 2016).

Indeed, as Table 1 shows, the most important factor cited by respondents in moving to zones is tax benefits. So far, it is not clear whether local firms are hindered most by this or by other factors. The decision regarding whether to operate in or out of a zone is influenced by various factors, including flexibility to locate near the raw materials and availability of cheap and suitably skilled labour.

Table 1: Importance of factors influencing the decision to establish in an SEZ

	Mean	n
Access to grant/subsidy	1.68	19
Tax benefits	3.52	23
Access to transportation infrastructure	2.43	21
Access to inputs	2.77	22
Access to customers	2.32	22
Access to skilled labour	1.81	21
Access to unskilled labour	1.48	21
Interactions with other firms in SEZ	1.81	21
Marketing	2.00	21
Access to electricity	2.34	21
Access to water system	2.34	21

Source: Table 5 in Kinyondo et al. (2016)

Although there is no study that has comprehensively analysed the net benefit of operating in or out of zones in Tanzania, some general insights can be drawn from a case study of NIDA textile mills reported in Kinyondo et al. (2016). NIDA had to leave the SEZ scheme to operate in the domestic market after realising it could not compete in export markets with Asian firms in terms of technology, labour costs, productivity and utility costs.

Kinyondo et al. (2016) report that NIDA subsequently increased its profits significantly and become more competitive in the domestic market and started exporting to Mozambique and Zambia. The main reasons for failing to be competitive in the zone were cited as high electricity prices, lack of cheap labour and the high cost of raw materials (owing to high transport costs). Outside the zone, the firm reported that it could choose who to employ and where to locate its plants, and work free from the requirements of EPZA. In addition, it benefited from protection as a result of the import tariff paid by importing competitors.

Interviews with CTI (an umbrella organisation for industrialists) confirmed that most domestic companies are less attuned to operate in SEZs. However, it was not clear why this was the case, putting further scrutiny on the efficacy and effectiveness of the SEZ regime. However, anecdotal information shows that CTI members are satisfied with domestic and regional markets, implying less need for taping (a more competitive) export market. Nonetheless, a few companies, such as Azam Bhakhresa, have invested in the BWM SEZ (packaging materials). Furthermore, it appears that CTI is not keenly engaged in SEZs, nor does it see SEZs as an opportunity for increased investment – perhaps because its mandate is specifically to advocate for improving the business environment, which is ostensibly not a major issue within SEZs.

As noted earlier, most domestic firms are not export-oriented (for lack of capabilities or interest). It may also be true that domestic investors are not aware of the SEZ regime or others do not see the need for it. Indeed, some incorrectly believe the EPZ/SEZ schemes are for foreigners only. More importantly, the regulatory regime for SEZs, which is currently limited to EPZ licences, is a major constraint in leveraging benefits from these zones. For the SEZ licensing regime to be operational, it will be necessary for EAC Partner States to endorse amendment of the EAC CMA (as discussed above), thereby supporting both EPZ and SEZ licences. This is one agenda that TPSF is willing to push for GoT to take to the regional block.

6 CONCLUSIONS AND RECOMMENDATIONS

SEZs are recognised worldwide as an effective tool for achieving industrialisation and economic transformation (Farole, 2011). However, country experiences vary notably, depending on the nature and quality of policies pursued and political will (prioritisation and commitment) accorded to SEZ development, thereby resulting in different levels of success. In Tanzania, SEZs are being mainstreamed in GoT's policy frameworks as key to realising the objectives of FYDP II, particularly in implementing the industrialisation drive. While the performance of existing SEZs (EPZs in practice) has been moderate at best, significant progress has been made in recent years by GoT in supporting plans for SEZ development and improving the institutional framework. However, realising these plans will require significantly more effort and targeted implementation. This briefing has aimed to take stock of progress made and propose actions that will spur implementation of the SEZ programme and harness the role of SEZs in realising the objectives of FYDP II.

Based on this discussion, the briefing recommends actions aimed at addressing three main constraints. First, the lack of a functioning fiscal regime for SEZs makes it difficult to promote a zone agenda, and, unless actions are taken to address this, it will be impossible for firms to be attracted to SEZs in Tanzania. Given the tough requirements of the EPZ scheme, investors attracted by the domestic market (especially local firms) will be shut out of the zones programme. Second, GoT financing for SEZ development will be necessary to make the zones ready and attractive for private investors. Hard choices and trade-offs are needed to commit funding, including to leverage concessional loans, social security funds and PPPs. However, because these public investments are needed to harness private investments, GoT could strengthen TIB Development Bank as the national DFI to pursue SEZ financing. In any case, a number of selected zones need to be reprioritised, and effort needs to be made to devise an overall business/action plan outlining which actions, funds or agency will be deployed at which time and for which zone, such that implementation of all priority zones will be completed after a particular period of time (say 10 years). The final constraint is inadequate leadership and management of the SEZ programme, partly because of insufficient commitment (political will) and power to enforce accountability and coordination across various ministries, departments and agencies (MDAs).

On this basis, GoT should:

1. **Make the SEZ law operational**. For the SEZ scheme to be functional, it will be necessary for EAC Partner States to make amendments to the EAC CMA to allow for it to recognise SEZ incentives, thereby supporting both EPZ and SEZ licences. Since the motivation to pursue the amendments may vary among the EAC Partner States (owing to the prevailing political economy around industrial policy), Tanzania should push for progress on this. Indeed, TPSF is willing to work with GoT to take this agenda to the regional bloc. In the meantime, the Minister of Finance and Planning could issue an executive order to amend domestic taxes (VAT and income tax) to provide fiscal incentives to SEZ firms and operators.

2. **Step up government financing of preliminary investments for zone development**. To make potential zones viable and attractive for private developers or operators, GoT should shoulder the responsibility of funding the preliminary investments (e.g. compensations to secure the land, basic supportive infrastructure) that can be recouped from future charges. Clearly, it is difficult to attract private financing for such types of investment and, in most cases, this may involve protracted negotiations with private developers and outcomes may be unpredictable or unfavourable. To address this challenge and ensure desired progress, GoT should look for commercial financing for greenfield investments, including to make the necessary upfront investments (compensation and infrastructure) that would make the potential zones attractive to private investors. This is possible if hard choices are made that will necessitate trade-offs between government priorities.

3. **Other than the initial (preliminary) investment to kick-start zone development, consider and be ready to assess all viable options for soliciting funding**. Options include (i) strengthening the environment for attracting foreign investment, including relaxing foreign capital restrictions to allow greater inflow of finance and investment; (ii) leveraging natural resources by seeking sovereign wealth funds, or issuance of a domestic bond; (iii) harnessing PPP financing by aggressively marketing specific zones based on government-funded pre-feasibility studies; and (iv) recapitalising, capacitating and empowering TIB Development Bank to effectively play its role as a reliable national DFI for mobilising other sources of funding through leveraging and syndication. Government direct investment through budgetary allocation is not optimal because such funds have no leverage effect. TIB Development Bank could also explore refinancing options for funds already committed or spent on the mega projects (e.g. money paid to compensate land for SEZ development, etc.) to achieve the leveraging effects.

4. **Select zones for priority investment to induce implementation**. Rather than spreading too thinly, GoT should select low-hanging fruit zones as quick wins to accelerate progress, thus creating momentum for developing other zones and providing a demonstration effect. Apparently, although progress has been made in each the five priority zones, GoT cannot develop all of them at once. Calculated decisions needs to be taken about which zone should be developed first, given the available funds, and decisions on which action and agency need to be deployed at which time should be made based on objective criteria. For instance, while both Mtwara and Bagamoyo zones have existing investors, Mtwara needs a much smaller investment (less than TZS10 billion or $4 million), compared with the $1.5 billion required for Bagamoyo. Although compensation for KiSEZ is completed, it does not boast the same level of immediate demand (ready market) as the Kurasini logistics zone (i.e. given the number of firms currently operating in BWM SEZ and seeking to expand, and the lack of additional spaces at the BWM SEZ). The Kibaha zone represents an exciting opportunity to kick-start the industrialisation of the textiles and apparel sector. The sector offers unparalleled opportunities for job creation and value added but given the tight margins in the sector some level of public funding is required to make SEZ rental payments commercially viable for manufacturers and investors alike. By funding the base infrastructure and leasing this serviced land to private developers the GoT can leverage private funds for the majority of the cost of the development, and then use the revenue from lease payments to invest in subsequent zones.

5. **Strengthen leadership and management of SEZ development**. Strong leadership for SEZ development is essential to ensure EPZA is empowered to coordinate the SEZ programme across various MDAs, as well as to step up its staffing levels and competencies to increase operational capacity. Some suggestions include empowering the Board to report directly to the President or the Prime Minister rather than the current practice of reporting to the Line Minister. It is also critical for EPZA to promote learning from successful experiences, hire world class specialists to provide expert advice and benchmark with other successful countries. Good candidates for learning within Africa include Côte d'Ivoire, Ethiopia and Mozambique.

6. **Provide supplementary incentives for investing in zones**. GoT has made notable progress in improving the business environment through the Blueprint for Regulatory Reforms initiative. However, firms located in the zones require additional support to be competitive. GoT could consider providing supplementary incentives beyond those outlined in the SEZ Act, at least in the initial phase of SEZ development, to entice firms to move to the zones. Two potential candidates for supplementary incentives include measures to enhance access to cheap labour and policies that promote labour mobility and reduce energy costs. Other measures to promote better linkages between firms within zones, and with other domestic firms, may be worth pursuing at later stages.

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ANNEX 1: IMPLEMENTATION STATUS OF VARIOUS SEZ PROJECTS

Zone	Status	Next steps
Bagamoyo SEZ	• Compensation completed by 25%. • Masterplan and feasibility study in place • Strategic investor secured and negotiations currently ongoing. China Merchant Holding International and SGRF of Oman to develop a 3000 ha zone • EPZA has entered into an agreement with Tanzania Commission for Science and Technology to develop a 175 ha Bagamoyo Tech Park within BSEZ	• Complete payment of outstanding compensation claim • Signing of the Key Terms Agreement by parties (GoT and investors) • Signing of Definitive Agreements for project development • Commence development of 3,000 ha zone
Kurasini Trade and Logistics Centre–Special Economic Zone	• Compensation complete save for three residents demanding TZS 477,360,000. The amount has been budgeted for in the 2018/19 EPZA budget • A pre-feasibility study has been completed	• Resolve pending compensation case and complete payment of outstanding claims • Obtain title deed in name of EPZA • Conduct environmental impact studies, full feasibility study and masterplan, develop a detailed development scheme • Construction of infrastructure and industrial sheds
Kibaha SEZ	• 95 acres of land allocated for a dedicated zone • Feasibility study, financial model, masterplan and environmental and social impact assessments complete • GoT has commited TZS11 billion in the 2018/19 budget to develop core utilities	• Fundraising • Sourcing additional public and private funds to complete the development • Site expected to be operational in 2020
Kigoma SEZ	• Compensation 100% complete for 691 ha and title deed secured • Masterplan and pre-feasibilty study has been completed	• To secure a suitable investor to develop Kigoma SEZ through PPP (Build–Operate–Transfer)
Mtwara SEZ	• Compensation complete for 110 ha and title deed obtained. Phase 1 development of onsite infrastructure on 10 ha is underway. • 33KV power line installed • Three investors have already established operations in the area	• Preparation of SEZ master plan and social and environmental assessment for whole 110 ha • Construction of onsite infrastructure on 10 ha and Phase 1 area for Mtwara Freeport Zone
Tanga SEZ	• Compensation 50% complete • Project still at land acquisition stage	• Complete payment of outstanding compensation claim • Conduct feasibility study and develop masterplan • Financing and development of project infrastructure

Source: EPZA

ANNEX 2: SUMMARY OF PROJECTS BY IMPLEMENTATION TIMEFRAME

A: Short-term (quick win) projects (12 months)	
Category 1: Expansion of existing industries	
1	Expansion of TOOKU Garment at BWM SEZ, Mabibo – DSM
2	Expansion of Mazava Fabrics and Production Ltd
3	Expansion of Mbeya Cement Factory
4	Revival of Bora Shoe Factory
5	Expansion of Tanga Cement Factory
6	Expansion of juice processing at Mwandege in Mkuranga, Coast region, by Bakhresa Food Products Ltd
Category 2: Development of SEZ/clusters	
1	Star City SEZ – Morogoro
2	Construction of leather industrial clusters at Zuzu – Dodoma
3	Development of Chamwino sunflower processing cluster
4	TAMCO Industrial Estate, Kibaha, Coast region
Category 3: Establishment of new industries	
1	Ferrostaal Fertilizer Plant in Lindi
2	Biolarvicides Project – TAMCO Kibaha
3	Global Packaging Project – TAMCO Kibaha
4	MOVE MAX Refinery Plant – Kamal Industrial Estate – Zinga Bagamoyo
5	Goodwill Ceramic Ltd, at Mkiu – Mkuranga
6	Hengya Cement Factory – Tanga
7	Steel Factory in Mlandizi, Coast region by Kilua Steel Co. Ltd
8	FSJ African Starch Development Co. Ltd at Bungu A Kibiti, production of starch from cassava
Category 4: Reviving non-functioning industries (privatised and state-owned)	
1	Arusha Tyre Manufacturing Factory
2	Revival of Mponde Tea Estate in Lushoto
3	Rubber plantations and industry
4	KMTC Manufacturing Factory
B: Medium-term projects (30 months)	
1	Kigoma Agro Forest Plantations Ltd
2	Kigoma SEZ
3	Bagamoyo SEZ
4	Bagamoyo SEZ Phase 1 and 2B
5	Bunda and Manyara SEZ
6	Kange Industrial Park in Tanga City
7	Liganga Iron Ore Project
8	Mchuchuma Coal to Electricity Project (4 x 150 MW)
9	Establishment of handloom cluster in Tabora and Mwanza
10	Establishment of Fertilizer Blending Plant (NPK fertiliser) in DSM
11	Furniture cluster
12	Rice cluster and related value chain processing for local and export
13	Extraction of fibres from banana pseudo-stem and conversion to useful products
14	Cassava processing factory for tapioca starch; products use
15	Development of sunflower processing Clusters at Kizota-Dodoma, Singida and Manyara
16	Development of industrial parks (Mtwara, Lindi, Songea, Sumbawanga, Dodoma, Singida, Shinyanga, Kagera, Mara, Manyara, Njombe, Katavi, Geita, Simiyu and Morogoro)
17	KMTC Industrial Estate

C: Long-term projects (54 months)	
1	Soda ash at Engaruka
2	Mkulazi Agriculture City/SEZ for cereals production
3	Oil palm project at Kimala Misale
4	Meat processing and allied products
5	Development of land for sesame farms and oil production plant at Kilwa
6	Ruvuma and Manyoni SEZ
7	Mtwara Petro Chemical Industries Complex
8	Packaging industry glass, plastic, metal, cardboard, paper, aluminium, brick carton
9	Development of Morogoro and Kilimanjaro metal clusters
10	Polyethylene Foam Plant