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New Institutional Economics And Exit Procedures In the Context of Economic Transformation

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New Institutional Economics And Exit Procedures In the Context of Economic Transformation

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ABBREVIATIONS

BOT	Bank of Tanzania
ESRF	Economic and Social Research Foundation
GDP	Gross Domestic Product
IDM	Institute of Development Management, Mzumbe
LART	Loans and Advances Realization Trust
MBO	Management - Buy Out
MEBO	Management-and-Employees-Buy-Out
NBC	National Bank of Commerce
NPA	Non-Performing Asset
OECD	Organization for Economic Cooperation and Development
PSRC	Parastatal Sector Reform Commission
THB	Tanzania Housing Bank
TPL	Tanganyika Packers Limited
TRA	Tanzania Revenue Authority
UNDP	United Nations Development Programme
USAID	United States Agency for International Development

PREFACE

This report is a synopsis of a Workshop organised by the Economic and Social Research Foundation (**ESRF**) and funded by the United States Agency for International Development (**USAID**). The Workshop was organised within the framework of the ESRF's Police Dialogue Programme which seeks to promote policy dialogue between various actors in the domain of economic and social policy.

In the Workshop Two study papers were presented. The first paper focused on **"The Role of Institutions in Economic Growth"** which was co-authored by Dr.Estomih Nkya and Professor Joseph Kuzilwa of the Institute of Development management, Mzumbe (**IDM**). The second paper entitled **"Exit Procedures and Economic transformation: The Case of Tanzania"** was co-authored by Professor Samuel Wangwe, Dr. Haji Semboja of the ESRF and Dr. Henri Lecomte.

The proceedings of the Workshop were conducted under the chairmanship of Professor Joseph Semboja, former Director of the Economic Research Bureau (**ERB**) and the current Executive Director of the Research on Poverty Alleviation (**REPOA**). The main discussant was Dr. Frederick Ringo, the Director of Studies of the Tanzania Institute of Bankers. The Workshop was attended by a number of participants: members of the business community; academicians, researchers and Government officials.

1.0 Introduction

The objective of the paper on the **Role of Institutional in Economic Growth** was to explore and describe the relationship between institutions and economic growth. The study report postulated that institutional arrangements are critical factors for economic growth as they have a key role in creating a conducive and enabling environment for improving the allocation of productive resources. Further, institutional arrangements are "signaling mechanisms" for allocation and utilisation of resources. These mechanisms induce the self-interested atomistic economic agents to act in the interest of economic development and of the general welfare of society. Indeed, the absence of understanding the role of institutions, especially during a period when socio-economic reforms are in play, lies in identifying and addressing the specific institutional factors which adversely impact reforms.

2.0 The Concept of Institutional Economics

The definition of the term "institutions" has both a narrow and broad meaning. Whereas the narrow meaning refers to the organisational characteristics, the broader meaning incorporates rules of the game which impinge on the functioning of an economy. Broadly speaking, institutions constitute the organisation of economic units through which units cooperate or compete. They also embody a set of constraints on behaviour in the form of rules, regulations and procedures. At the same, time, they are a set of moral, ethical and behavioural norms which define the contours that constrain the way rules and regulations are specified and how enforcement of compliance is carried out.

Institutions can be grouped under the following frameworks: constitutional order, institutional arrangements and normative behavioural codes. Whereas the constitutional order characterizes the rule-making process which includes the making of the national constitution and the related governance framework, the institutional code is characterised by by-laws, regulations, associations, contracts and conventions that are created within and by the constitutional order. Institutional arrangements, in this regard, define the "domain of choice" of the economic agents. The normative behavioural code, on the other hand, relates to cultural values, customs and norms which legitimize the institutional arrangements and constrains the behaviour of individuals and groups in society.

The fundamental economic concern about institutional arrangements is transaction costs. These costs embrace the cost of obtaining information about market opportunities, the cost of negotiating contracts and bargaining, and the cost of enforcing contracts.

2.1 Institutional and Economic Growth: The Issues

In creating an enabling environment for economic development, various institutional arrangements are necessary. These include rules on private property rights; rules and conventions on the relationships of different participants in the economy and those which restrict such participation; rules which define the economic role and norms of hierarchy of social institutions. All these arrangements are critical in determining both the response of economic agents to economic opportunities and the changes in opportunities themselves. In this context, the continued use of the various legislations and policies which are not only outdated but also incompatible with the current thrust of the free market-based economic development paradigm, needs to be addressed.

In this context, the Land policy of 1961 and the Land laws enacted to prohibit freehold ownership of land as well as a whole range of labour laws which are incompatible with the on going socio-economic reforms and the efficient operation of a market economy need to be realigned. Apart from the incompatibility problem, there are also problems of duplication and the existence of a plethora of rules and laws which constrain the smooth operation of business activities. For example, a **USAID** study conducted in Dar es Salaam revealed that business activities are governed by 6 statutes, 12 by-laws, 15 regulations, 11 ordinances, 7 government notices and 1 rule. This structure of over regulation is made more burdensome by the fact that the capacity to make legal and institutional reforms to support macroeconomic reforms is not readily available there by impacting negatively on reforms. It is underscored that, unless economic reforms are accompanied by institutional reforms, the objectives of reform are either rendered ineffective or they become difficult to achieve at the optimum pace equally, unreasonably high transaction costs arise on the part of the economic agents.

To the extent that institutional inadequacies inhibit the credibility of reforms, the enforcement of laws gets undermined and the opportunities for abuse of administrative power also increase. Efforts to strengthen institutional capabilities with a view to fighting corruption and to lowering transaction costs are thus an imperative.

2.2 Effects of Institutions on Factor Growth

2.2.1 Factor inputs, efficiency and Institutions

The growth of factor inputs and the rise in efficiency are dependent on institutions. In the same vein, just like the growth of capital stock is dependent, inter alia, on investment and the levels of investment, investment is equally a critical factor for bolstering domestic and foreign savings and economic and political stability. In reference to institutions, the basic question that arises is how does a country create requisite institutional arrangements. In other words, the legal and regulatory framework which facilitates the growth of input factors? For instance, whereas foreign investment could augment the capital stock and hence enhance economic growth, the institutional arrangements for attracting foreign investment are a pre-requisite for the investment to flow in. Likewise, just like technical efficiency is a function of innovation and invention, the latter cannot take place without for instance, appropriate institutional arrangements for protecting intellectual property rights.

2.2.2 Essence of Appropriate Legal Framework

An appropriate legal framework, effective property rights and the removal of barriers which inhibit inflow of foreign investment are critical institutional factors for attracting new investments and for enhancing the productivity of the capital stock.

2.2.3 Public Policy, Institutions and Growth

Despite the fact that there are various schools of thought on the role of public policy and of institutional arrangements in economic growth, the paper underscores that institutional arrangements are a product of public policy and that the two factors have to exist in tandem if sustainable and high economic growth is to result.

3.0 Areas for Further Research

- Seven major areas are identified for further research work. These are as follows:

- How are the institutional arrangements influencing the promotion and response of entrepreneurship in the context of economic reforms?

- To what extent are financial laws and regulations compatible with the liberalized financial market?

- Whether the divestiture strategies are compatible with the existing laws and regulations and conventions;

- To what extent do the existing institutional arrangements in land ownership inhibit long term investment in agriculture?

- How can policy makers and researchers integrate the expertise of various economic policy professionals and public administrators in designing effective and efficient institutional arrangements for economic growth and development?

- To what extent do particular institutional arrangements impede or facilitate stabilization programmes?

- Carry-our inter-country studies in particular sectors or economic activities to investigate variations in performance arising from the role of institutional arrangements.

Exit Procedures and Economic Transformation: The case of Tanzania

By
Samuel M. Wangwe, Haji H. Semboja
and Henri B. Lecomte

4.0 Introduction

The manufacturing factor has since 1986 been subjected to several trade, industrial and macroeconomic policy measures, such as structural adjustment, trade liberalization and financial sector reforms. Tanzania has made major progress towards putting in place a policy environment that is more favourable to private sector expansion and growth.

Despite these reforms, however, the performance of the manufacturing sector has not been impressive. Many small and medium sized industries have had a limited capacity to invest in production technology and modernization of their aging plants and machinery partly due to their weakened financial positions.

On the other hand, the institutional framework in which dynamic market forces are mediated through the permanent process of entry and exit have not been flexible enough. Entry barriers attenuate the contesting ability of existing productive structures. Exit impediments allow inefficient firms to be bailed out and permit the continued misallocation of resources. Thus, the stimulation of dynamic and efficient resource allocation is hampered by the lack of efficient exit and bankruptcy procedures. More specifically, inefficient firms are being bailed out and thereby accentuating the misallocation of resources.

The study aims at analyzing the evolution of industrial structures underlying the importance of institutional framework for facilitating exit procedures in the allocation of productive resources. The focal point is the question of setting up and implementing processes which facilitate the re-allocation of resources from non-performing uses to better performing ones.

5.0 Manufacturing Performance, Structure and Dynamics

5.1 Manufacturing Performance

The post-independence industrialization process took off from the initial stages of import substitution, accompanied by a rapid growth of the economy. The manufacturing sector's contribution to the Gross Domestic Product (**GDP**) rose to about 12% in 1977. This was followed by a period of de-industrialization between 1980-84. A significant growth was again recorded between 1985-89.

From 1986, when the Economic Reform Programme commenced, the manufacturing sector was subjected to several trade, industrial and macroeconomic policy measures which were intended to unshackle the whole economy from the doldrums it was in.

However, in spite of the reforms, the performance of the sector has not been very impressive for a number of reasons. These include high interest rates, accelerated inflation lack of adequate physical infrastructure (such as reliable electricity and water supply) poor back-up and maintenance facilities, and weak business support. Many small and medium-scale industries have been particularly affected by these reform measures as the cost of capital became too high for them and thus constraining them from upgrading their technologies at a time when trade liberalisation demanded heightened competitiveness as a central factor for survival.

5.2 The Current Manufacturing Structure

Since the 1970s, the sector has increasingly shifted from basic primary export processing to a supply-oriented domestic market, providing basic consumer goods and construction materials, whilst remaining with a small but growing intermediate and capital goods industry based on metal working and light engineering. The situation has remained unchanged between the 1970s and the 1990s with the food, beverage and tobacco sub-sectors in dominance. Only a few industries expanded and operated successfully while many others continued to limp owing to various production constraints. In consequence, many manufacturing firms perform below their installed capacities.

6.0 Market structure

6.1 Domestic Competition

The Tanzania manufacturing structure is still inward-oriented with the source of competition for firms coming from domestic rivals. The domestic market structure varies greatly depending upon the organizational structure, the mode of ownership, the size of the firm, and the nature of the product. In a way, the competitiveness of the domestic market appears to be inversely proportional to the size of the firm.

6.2 Competition from Imports

Imports affect the informal sector only marginally but constitute a major concern for about 40% of the firms in the formal sector. The intensity of import competition, when measured by the reported number of import competitors, varies significantly between private firms and parastatals. Being protected through a regulatory bias, parastatals are sheltered from the entry of new domestic or foreign competitors. Thus, when exposed to competition from imports, private firms face a greater number of competitors than parastatals and are mostly confined to the segments of consumer goods where a more competitive domestic market structure exists.

With the reforms in place, the proportion of formal firms subjected to competition from imports has increased. This is because access to foreign exchange has boosted the imports trade.

Competition from imports also varies along industrial and geographical dimensions; domestic competition is more localized and firms operating outside major towns or remote regions face less competition.

6.3 Industrial Dynamics

The number of establishments has been increasing steadily over time with food, beverage and tobacco being the dominant sub-sectors. A rapid increase in the number of establishments from 560 in 1977 to 848 in 1978 can be partly attributed to a sudden increase in the number of establishments in food, footwear, wood and paper manufacturing activities. Evidence shows that the wood, furniture, transport, equipment and food sub-sectors were the most turbulent manufacturing activities.

Evidence further indicates that entries and exits appear to occur essentially among the smaller size categories; the smaller the firm the higher the competitive pressure it faces, both in the sellers' and buyers' markets and, notably, for the food and metal industries. However, competitive pressure is to some extent low and unevenly felt among firms. In many cases, pricing is done on the basis of mark -up over costs (or cost plus). The smaller firms are the weaker ones and are often subjected to local competitive pressure with some larger firms portraying monopolistic tendencies in their respective markets.

As prices have been officially administered via price mark-up systems, they take into consideration the effect of sales and volume. More often than not, this leads to excess capacity utilisation, barriers to entry (due to patent laws, production technology and the control over the source of raw materials) and expansion problems to small firms. In a dynamic approach, the actions of market forces reveal or send signals on the real profitability of investment projects. It is within this context that there is a permanent need to reallocate the existing (capital and asset stocks) and new (domestic and foreign) resources towards more profitable activities.

6.4 Measures of Concentration

Concentration as used here implies the extent to which an economic activity is dominated by a few large firms. It is apparent that the assessment of concentration, over time, is critically dependent on the choice of the number of leading firms. Given the **Four Firm Ratio,** ranking the industries from the highest to the lowest, it is apparent that electrical machinery, leather, tobacco, basic metal and the non-metallic industries, as at 1974, had the highest scores. The situation changed slightly by 1993 with tobacco, non-metallic and rubber products and basic metals taking over the lead. These sectors appear to have been dominated by giant firms operating in a monopolistic or oligopolistic manner. A close observation would reveal the importance of some parastatals in the production of these intermediate and/or consumer goods.

In general, the concentration indices for many products were lower in the post-reform era than at the time when serious liberalization was introduced (i.e. in 1985). This seems to suggest that reforms increased competitive pressure within the Tanzanian manufacturing sector.

Market concentration is also a function of the nature of the product, the market environment, the institutional setting, the level of production technology, location and price. Findings show that the index for food remained below 0.5 during the 1974-1993 period, a confirmation of the fact that the food processing firms were operating in a competitive environment.

Trade liberalization and macroeconomic reforms notwith standing, manufacturing is still characterized by highly concentrated industrial activities. This may be due to the existence of increasing returns to scale and the inflexibility of the institutional framework as well as the absence of business-supporting mechanisms to ensure dynamic industrial development.

The often quoted reasons for expecting increasing returns to scale to accrue from the Tanzania manufacturing sector are specialization, the existence of indivisibilites, and the economies of increased physical dimensions of some large parastatal plants. The existence of scale economies in some sectors depends on the characteristics of the production technologies with economies of scale being reaped where increasing capital and labour, each by a constant proportion, results in more than a proportionate increase in output. The context gives firms an incentive to expand their production. Local markets, however, are often too small to enable production sectors to achieve economies of scale and, as a result, industrialization is seriously limited. Where the market demand does not grow, the likelihood of a monopoly coming into existence bringing with it a high concentration ratio, is very high.

One pre-requisite for dynamic industrialization is the free entry and exit of firms into and out of a sector. Whereas there are no legal restrictions with respect to entry under normal conditions, certain legal processes (bankruptcy, dismissal of employees and transferring of assets) may in some instances pose as obstacles to exits.

6.5 Investment and Capital Reallocations

Post-independence manufacturing investment activities (1965-1969) were high and corresponded to the high level of economic growth at the time. Between 1961 and 1967, government policies favoured the promotion of economic growth and private investment on the basis of laissez-faire or market system. Both the First Five Year Development Plan (1964 - 69) and the Foreign Investment Protection Act of 1963 favoured the promotion of private sector development. During this period, the contribution of the parastatal enterprises was quite low, averaging 20.2% of the gross fixed capital formation, while the private sector's contribution amounted to 54.7%.

The government's interventionist policies since 1967 have been a critical factor in influencing the investment patterns. The public sector gained dominance in investment activity, accounting for 69.2% of the gross fixed capital formation, with the contribution of parastatal enterprises rising to 48.1%. This was a result of the combined efforts of nationalization, establishment of new parastatal projects and enterprises, and the inflow of foreign aid, a substantial proportion of which went to the parastatal sector. At the same time, the private sector's share declined to 30.8%. Other interventionist policies included limiting private sector's access to credit, control of foreign exchange and sources of raw materials, control of private trading, thus limiting firms' access to the domestic market and imposing import and export licensing procedures which have largely been cumbersome and bureaucratic.

The period between 1975 and 1984 was characterized by investment slow-down and economic crisis (between 1980 and 1984) and witnessed a decline in shares for the public sector and parastatal enterprises in particular. Consequently, the contribution of the private sector rose to 43.3% and 49.3% in the 1975-79 and 1980-84 periods, respectively.

The macro-economic policy environment engendered by the government operated to restrict the development of the private sector and ensure the dominance of public sector investment prior to 1985/86. The environment was constituted by

- business, financial and investment supporting institutions weighing heavily against private sector investment and paying less attention to indigenous investors;
- policies of price control weakening the investment climate, reducing the profitability and efficiency of investment in most investment projects;
- policies of exchange control and foreign exchange rationing operating particularly against the private sector for most of the period, negatively affecting both the profitability and the

capacity utilisation of existing investments and the desire, particularly by foreign investors, to engage in new investments;

- credit rationing, particularly against the private sector, reducing the latter's capacity to undertake new investments and ensure a high rate of capacity utilisation in existing investment projects;

- the insecurity of private investment and the unpredictability of the macro-policy environment affecting the private sector thereby discouraging the latter from taking a long-term view of the financial risks inherent in long-term investment.

Consequently, private investors shunned long-term investment and preferred short-term commercial and/or rent-seeking activities with high returns.

After the introduction of the Economic Recovery Programme in 1986/87, the government introduced policies designed to reverse the negative effects of its previous measures. The policies introduced aimed at boosting private investment, the effects of which were anticipated to increase the level and the extent of manufacturing investment. These include liberalization of the foreign exchange regime, privatization and financial and investment reforms.

During this period of investment revival (1985-93), the ratio of gross fixed capital formation to **GDP** rose to an annual average of 29.3% during 1985-90 and 30.9% during 1991-93. The period was also characterized by a marked and continued decline in the contribution of the public sector in total fixed investment with the share of the private sector rising to levels similar to, or exceeding, those attained in the 1960s. Nevertheless, the growth rates, during the perceived revival period, show that the revival process was fragile as its foundation was not rooted on increased mobilization of domestic resources, but, rather, on unpredictable savings from large foreign inflows.

On the other hand, the relative inability to stimulate significant new investments lies in the fact that, in spite of these reforms, the constraints impeding investment in manufacturing still persist. There is a dire need to promote all investments, local and foreign, rather than merely allowing a few foreign investors to enjoy the fiscal incentives available.

6.6 Financial Distress and Bad Debt

Financial distress occurs when a firm continues to remain in operation despite accumulated losses vastly exceeding its net worth. Lack of adequate working capital, debt default and unprofitability are the major signs. A typically financially healthy company uses imported frontier production technologies to produce high quality commodities at low cost. Such companies have an elaborate management organization which ensures that the firm produces at capacity and has strong financial discipline.

In the past, particularly before the current reforms had taken shape, most of the manufacturing firms, and especially parastatals, enjoyed continuous access to credit and other scarce resources in the form of bank overdrafts and government subsidy at the expense of efficiency and productivity. Public firms were not allowed to perish and thus the process of credit allocation continued.

Now many parastatals cannot continue with normal production or switch to new manufacturing activities due to lack of rehabilitation capital. A few small and medium sized firms have increased investment and allotted more funds for purchase of equipment, with the principal source of financing being retained earnings. Bank overdraft costs are high and not accessible to all. Importation support facilities from the government are no longer available.

Financial distress has hit the financial sector as well and has affected the performance of the National bank of Commerce (**NBC**), the Meridian **BIAO** Bank and the Tanzania Housing Bank (**THB**). The level of The Non-Performing Assets of the **NBC** during 1993-94 was about 70%, a level that does not compare favourably with the international level of **NPA** expected of a commercial bank which is one to two per cent. A large proportion of the loans provided by NBC are non-performing. The **NBC's** total liabilities have exceeded its total assets.

These losses can be attributed to a combination of factors including the government's policy of directing credit destination, poor management of the loan portfolio, inadequacy of internal controls, and the use of outdated accounting and management information systems.

The Meridian **BIAO**, a private bank that was licensed in 1992 and commenced operations in 1993, operated quite aggressively and, by March 1995, its total deposits had reached Tshs.25 billion which, in essence, amounted to six per cent of the total deposits of the Tanzania banking system. Financial problems besetting Meridian BIAO International resulted into the Meridian BIAO (Tanzania)finding itself facing difficulties in recovering deposits of up to the tune of US$34 million. The Bank of Tanzania took over and efficiently managed the bank up to the time it was sold to the Standard Bank of South Africa.

The financial position of the Tanzania Housing Bank (THB) was, by 1994, unsatisfactory and the interest of depositors and creditors was seriously impaired. Serious mismanagement of the loan portfolio, lack of internal controls and proper accounting systems were the major reasons for this sad state of affairs. An examination by BOT concluded that THB was insolvent, lacked liquidity and was thus bankrupt. It was therefore wound up.

The undesirable situation in the financial and economic sectors can also be attributed to some historical factors largely connected with the change of government and macro-economic policies, lack of adequate infrastructure and distorted market conditions.

On the other hand, increasing competition from imports as a result of trade liberalization accelerated the demise of textile industries and government owned firms. The growing debt service burden was also a major factor given the devaluation of the Tanzania shilling. This burden fell heavily on those firms which had benefited from overseas loans that were guaranteed by the government.

7.0 Exit Procedures

- **Current Status**

While the legal framework for winding up non-performing firms has always existed in Tanzania, it has not been utilized as a tool for the re-allocation of resources to more efficient use. Traditional laws overprotect borrowers because of industrial and business policies and the institutional and decision-making processes that were at work until the early nineties. It is imperative that money lenders should be assisted and equipped with a legal framework for enforcing foreclosure of collaterals in an efficient way.

Only a few cases of exits have been reported in Tanzania with such a path not being typical in the case of newly-established firms. Weak profitability, uncertainty with respect to government industrial and trade policies, and fierce competition have been the most important reasons for exit decisions. Other reasons include strong competition from imports, high production costs, management disagreements, change of macro-economic and government policies, and inappropriate location. There have also been lack of market strategy, and unreliable power supply, raw materials and appropriate skills. Bankruptcy has played a minor role as a restructuring mechanism or has not been an issue at all in exits.

Exit procedure - liquidation and re-organization through bankruptcy - are key elements of industrial dynamics. The focal point is the setting up and implementation of processes by which action can be taken in a market environment to allow for the re-allocation of resources from non-performing uses to performing ones.

7.1 Traditional Exit Procedures

7.1.1 The Bankruptcy Ordinance (CAP 25)

Theoretically, the bankruptcy law is expected to: 1) provide ailing firms with a smooth channel for making exits; 2) efficiency to re-allocate resources for their better use through a combination of restructuring and liquidation, and; 3) promote the flow of credit into the economy by protecting creditors and serving as a final stage for debt collection. An unprotracted and smooth process until a firm reaches a state of bankruptcy is essential if creditors are to play a significant role in funding and monitoring investments.

In Tanzania, the Bankruptcy Ordinance does not apply to companies or corporations. Bankruptcy is a process that can be initiated, by the creditor or the debtor, through the judicial system by way of a petition to the High Court for a receiving order for the protection of the estate. The property of the debtor then vests in an official receiver. The major shortcoming of the bankruptcy legislation is that it is not well suited to dealing with the insolvency problems of modern corporations in a developing country undertaking reforms.

7.1.2 The Companies Ordinance (CAP 212)

The Companies Ordinance (Cap. 212) provides for the formation, regulation and winding up of companies in Tanzania. Companies incorporated under this Ordinance are private companies and parastatals. The Ordinance provides for winding up, that is, the operation of putting to an end the carrying on of a company business, realizing the assets and discharging the liabilities of the concern, settling any questions of accounts or contributors between members and dividing the surplus, if any, among the members. Notably, liquidated firms in Tanzania are the poorest performers and are, in most cases, heavily indebted. As such, formal workouts are not very effective for such kind of firms.

Under Cap. 212, winding up can be voluntary, by court order, or can be effected under the supervision of the court. A company may be wound up by way of a special resolution; default in delivering statutory returns to the Registrar of Companies or in holding statutory meetings; failure to commence business within one year from incorporation or suspension of its business for a whole year; reduction of the number of members below the statutory minimum; inability by the company to pay its debts, and where the court is under the opinion that the company should be wound up.

The petition to wind up the company may be presented by the Company or by any creditors or contributors.

7.1.3 Liquidation and Re-Organization

Liquidation and re-organization are not common forms of exit in the private sector because they have negative implications such as bankruptcy being viewed by firms as being a crime or an anathema. As a result, businessmen, in most cases, resort to means other than legal in order to avoid costs of registration, retain their bank records, or keep their premises.

A well-functioning capital market would promote transparency in all transactions and would contribute towards facilitating exits. The burden of debts also makes the firms unsustainable and non-viable, and leads to liquidation (closures).

- **The Role of the Liquidator**

A liquidator is an important person appointed to carry out the winding up of a company. The duies of a liquidator are to get in and realize the property of the company in order to pay its debts and to distribute surplus (if any) among the members. Lack of co-operation from the parties involved, ignorance of the law, lack of proper information and data, as well as corruption limit the role of the parties in effecting the law. The main causes of obstructions hindering liquidations include the culture of maintaining the existing companies irrespective of their performance, the transaction costs and lack of swift procedures. In Tanzania, the creditors do not play an active role and their interests are usually represented by the liquidator who is paid a fee and/or a percentage on all sales of assets

- **Judicial Constraints**

The processing capacity of the High Court is severely limited with its system being under-financed and under-endowed with the means-physical, financial and human-to perform effectively and efficient. Documentation is manually done and there is lack of information and knowledge of economic matters. The flow of information between legal registries is slow and poor, court officials are not well informed about corporate finance, and there are delays and inefficiencies in handling bankruptcy matters. Most liquidations tend to drag on for years, with some taking as long as six years. As a result, the entire process becomes very expensive. Apart from providing for the appointment of a Receiver and Manager, the Companies Ordinance does not provide for reorganization procedures.

Although some legal aspects are provided for in the law, their utilisation has been associated with conventional problems resulting from specific constraints such as the following:

- delays;
- bureaucratic red tape;
- ignorance;

- corruption;
- outdated legislation;
- inadequate skills;
- lack of processing capacity in the court system;
- inadequate supervision and regulations of the banking system, and;
- a rigid regulatory environment.

- **The Public Corporation Act, 1992**

This Act offers a departure from the Public Corporations Act of 1969 by introducing new elements in the legislation. It incorporates commercial principles whereby every public corporation is expected to operate its business according to sound commercial principles. Government-owned organizations do have the machinery for exiting, though the said machinery is rarely used. One exiting method is by an Order of the President published in the Government Gazette. The new Act also gives the President the power to re-organize public and statutory corporations. The provision for re-organization provided for in the new Act has been carried out on a very limited scale.

7.2 Transitory Exit Institutional Framework

7.2.1 The Loans and Advances Realization Trust (LART) Act, 1991 Objectives

The Loans and Advances Trust (**LART**) was established in 1991 to act as a transitory and expeditious machinery for the recovery of overdue debts of banks and financial institutions. The objectives and functions of the **LART** include: 1) holding for and on behalf of the United Republic of Tanzania any non-performing asset of a bank or other financial institution;2) taking such action as is necessary to recover all amounts outstanding in respect of all the transferred non-performing assets and advise, direct or facilitate the measures that have to be taken by or in respect of the debtors so as to enhance their capacity to repay the loans and advances transferred to the Trust, and;3) administration and management of the Non-Performing Assets Recovery Fund.

The Legal Framework

LART has a well-established Board of Trustees responsible for the formulation of policies and the supervision of management of the Trust, a well-established **LART** Loans Recovery Tribunal, and the High Court has jurisdiction to hear and determine all matters arising under the **LART** Act or relating to any **NPA** transferred to the Trust.

The Trust has the power to direct, in writing, any bank or financial institution and that bank or financial institution shall, upon such direction, transfer to the Trust such of its non-performing assets whereupon such assets, rights and obligations shall be vested in the Trust. Thereafter, the Trust may appoint a manager of the assets or any part thereof upon such terms as the Trust may deem fit. The appointed manager then becomes the agent of the Owner with a wide range of duties to perform.

The Trust has full powers to determine the values, prices and other terms and conditions for the disposal of assets and, as a means to that end, the Trust prepares its own rules and procedures for the identification of potential purchasers, the selling or disposing of the assets by way of competitive bidding or other preferred method. All liquidations are undertaken on a complete judicial basis according to the Act.

The Overall Effect

The enactment of the **LART** Act has assisted in speeding up the exit of debt-ridden companies and firms with liquidation being carried out under the provisions of the Companies Act, but with close monitoring and supervision by **LART**. Under **LART**, it has been possible to execute a set of rules that satisfy the debt-collection aspects of bankruptcy, without necessarily involving restructuring, though restructuring is an option within **LART**'s jurisdiction.

Any body or firm placed under the **LART** is in practice black-listed and apparently faces problem in accessing credit facilities. Various steps have to be followed before a debtor is placed under **LART**.

Despite teething problems which the **LART** faced at its commencement, it has proved to be a strong business-supporting institution with a legal framework strong enough to provide for a transitory and smooth exit environment. However, it is highly recommended that the **LART** be made a permanent institution to promote and enhance industrial dynamics. Current financial reforms have shown that transitory exits via the **LART** provide the best way to revive economic growth and ensure sustainable industrial development.

The experiences and recommendations of business-supporting institutions, the inherent weaknesses of a legal framework and the level of economic and technological development are among the factors that call for or necessitate a longer lease of life for the **LART**. However, the present legal environment under which the **LART** operates has to be strengthened by allowing the **LART** to operate as an independent, non-governmental business supporting institution.

7.2.2 Parastatal Sector Reform Commission (PSRC)

One of the major objectives in the recent reforms has been the reduction of the state's role and ownership of economic activities. The shortcomings of the public sector which led to the enactment of the Public Corporations Act, 1992 have since led the government to embark on a wide range of privatization-oriented ventures covering ownership changes that involve divestiture and joint ventures, organizational changes that encourage competition, and operational changes that call for the removal of government controls (deregulation) and the restructuring of some public enterprises.

The Legal framework

The **PSRC** was established in 1992 and its powers and responsibilities as defined in the Public Corporations (Amendment) Act, 1993 empower it to take measures to reduce the number of non- performing parastatal enterprises and to eliminate budgetary support that is extended to them. The Act empowers the **PSRC** to, *inter alia,* implement the policies and programmes of the Government on Parastatal Sector Reforms, developing operating policies, procedures, guidelines and detailed plans for restructuring, preparing a list of all public corporations, and making recommendations to the Government on the restructuring options.

The Act also empowers the **PSRC** to act as an official receiver and liquidator where specified public corporations are insolvent. The **PSRC** can also write-off debts upon obtaining the consent of the Treasury.

Divestiture Objectives and Policies

A very important objective of divestiture is to encourage investment with a view to stimulate economic growth. Other objectives for privatization include the encouragement of efficient allocation and utilisation of resources, development of broader ownership, creation of jobs, and relief from financial burdens. It involves the sale dof public enterprises and the closure of non-viable enterprises. In undertaking this exercise, priority is focused on the optimal use of otherwise under-utilized assets, employment creation, profitability and acceptable financial and economic returns to the investors by way of profits and dividends, and government revenues. Divestiture of a company depends upon whether it is loss-making or whether it is viable or potentially viable with the usual divestiture measures being Joint Venture/Trade Sales, Sales of Shares, Management Buy-Out or Buy-In (**MBO**), or Management-and Employees Buy-Out (**MEB0**) under terms mutually agreed upon between the buy-out team and the Government.

Non-sale Alternatives

The non-sale alternatives could include privatization of the management, e.g. through a management contract, or provision of an operating concession, or a lease, preferably with a purchase option.

Use of Parastatal Sales

This entails the use of parastatal sales to achieve the goal of broad ownership wherever possible. Sales of shares to the public, and MBOs are suitable policy instruments.

The Parastatal Performance Contract

Where privatization is not an immediate option, and if the company concerned is large and a dominant service provider, then the policy is to consider use of a performance contract between the company and its parent Ministry. Such contract defines improved commercial performance objectives as well as the obligations of the Ministry and, **inter alia**, assures the company of compensation where non-commercial objectives are imposed on it by the government.

The contract can also define any restructuring that is needed in order to prepare the way for a future divestiture.

The Effects of Divestiture Programmes

By July 1995, some 95 parastatals had been divested under the on-going **PSRC** exercise, out of the 371 earmarked businesses. Positive results were beginning to emerge in terms of investment commitment and employment opportunities in specific sectors touched by the **PSRC** exercise. Substantial capital investment in modernization and rehabilitation is being made in all divested companies.

There are attempts to amend the Companies Ordinance and the Investment legislation. The intention is to remove the remaining obstacles blocking the private sector's participation in the economy and enable the country to benefit increasingly from such participation (e.g. through the simplification of business licensing procedures). The liberalization of the exchange rate and trade regime have facilitated the expansion of private sector activity.

8.0 Recent Financial Reforms
Reforms within Financial Institutions

The 1988/89-1994-95 period was characterized by rapid and dramatic changes in the financial system, consistent with long-term sustainable economic development. These financial systems were assumed to be the fundamental agents for industrial dynamism.

Significant progress has also been made within various elements of financial and structural reforms such as the management of bad debts and non-performing bank assets. The promulgation of the Banking and Financial Institutions Act in 1991 ushered in a new era of competitive banking in Tanzania, making way for the entry of new financial institutions and putting into place prudent regulations for the supervision of these institutions. More importantly, the Act enables people to establish community banks for mobilizing savings and for meeting the investment requirements of small borrowers.

The Bank of Tanzania was restructured in December 1993 to facilitate the formulation and implementation of a monetary policy in a liberalized environment.

As on July 1995, eight private banks and other non-bank financial intermediaries had been licensed to operate in the country. These new banks are a pre-requisite to sustainable and dynamic industrial development since they will facilitate the smooth liberalization and channelling of savings into productive investment.

The Banks' Role in Reorganization and Liquidation

As there are only few commercial and development banks, and since many of them are totally or partially state-owned, they more often than not remain passive in the economy. The absence of adequate supervision or prudential regulation diminishes the banks' motivation to behave as aggressive creditors. From their point of view, bad debts of the public sector are a main concern; bankruptcy of private firms is not yet a problem. The only steps that banks take toward their private clients apparently centre on recovering the debts, a process which results in debt rescheduling, often influenced by corruption.

9.0 Areas for Further Research

The following area should be the focus of research in future:

- How to put in place a coherent bankruptcy policy which will facilitate the re-allocation of resources from non-performing to more productive uses in a transparent manner.

- What reforms need to be undertaken in the financial sector so that the process of credit allocation and resource transfer from surplus spending entities is made realistic, transparent, efficient and fair.

- How to structure the capital market so that commercial and development banks become major actors in the development process by promoting broad ownership of productive assets by Tanzanians.

- What role could organisations like the **PSRC** play in order to dynamise the industrial sector in terms of attracting new investments into the sector.

- How to encourage and advocate exits within the broader context of amalgamation, acquisitions, mergers, restructuring and joint ventures.
- Which institutional arrangements are necessary for mobilizing savings and for meeting the investment requirements of small borrowers.