

## THE THEORY AND PRACTICE OF STATE CAPITALISM IN DEVELOPING COUNTRIES: THE CASE OF ENERGY AND MINERALS SECTORS OWNERSHIP IN TANZANIA

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**CITATION:** Ntimbwa, C. M (2014). The Theory and Practice of State Capitalism in Developing Countries: The Case of Energy and Minerals Sectors Ownership in Tanzania *European Journal of Business Management*, 2 (1), 336-341.

### ABSTRACT

State capitalism in Tanzania is not a new phenomenon as soon after independence (early of 1960's) the state decided to adopt socialist ideology where state nationalized all major means of production. The economic difficulties in 1980's encouraged the state to privatize its Parastatals from early 1990's. In recent years the state was forced to claim ownership in certain sectors. The trend now is that the states in Asia and America wants to own the companies which operates and own mineral, oil, energy, manufacturing companies, fund etc. The purpose of this paper is therefore to examine how the theory of state capitalism is practiced in energy and mineral sectors in Tanzania. The reason for identifying the two sectors is because in recent years the two sectors have emerged to be most crucial but with challenging issues in the economy of Tanzania. The analysis of the study was done through the review of empirical studies and interview to a few selected individuals who are policy makers, investors and academicians with the aim of knowing how the theory of state capitalism is practiced in Tanzania. The findings shows that the government is the major shareholder in energy sector while in mineral sectors the foreign companies holds ownership to most of big companies. The Government is trying to soliciting ownership through the change of policy. Majority of Tanzania who are dealing with mineral business are operating in small scales. The findings will help Tanzanian community to be aware of the changing business environment of the two sectors.

**Keywords:** *State capitalism, privatization, reprivatize*

### INTRODUCTION

Tanganyika got her independence in 1961. In 1964, Tanganyika and Zanzibar decided to unite and form one country: Tanzania. Tanzania decided to adopt and implement socialist policies and in 1967 the government nationalized all major means of productions and services. This included electricity, industries such as textiles, sugar, mills etc. transport systems, farms, houses, minerals, telephone services. The state controlled in terms of extraction, production, distributed and marketed its products and services to local and international markets. Globally, the phenomenon of state capitalism has existed in different scenarios. The most notable current scenario was due to the 2008 economic recession in United States of America, Europe and the rest of the developed world (Bremmer, 2009). In this scenario, governments used stimulus packages to intervene in ownership of business firms like banks, motorcar industries etc. Some of the funds

used came from Sovereign Wealth Funds created and managed by these governments (Lyons, 2007). But the reasons for state capitalism in Tanzania derive not from economic recession but from challenges exercised by investors. As this paper observes, in the energy and mineral sectors, the Tanzanian state is currently reprivatizing the means of production, allowing new investors into the minerals and energy sectors (Fisher 2009). This is because the state failed to run the sector after nationalization after independence due to several factors such as mismanagement, insufficient capital, insufficient skills, lack of innovative ideas, and failure to attract markets demands (Emel et al, 2011).

The changes in energy and mineral sector policies and legislations suggest the practice of state capitalism in Tanzania. This suggests that the state attempts to have more control and ownership of operations in mining and energy sectors. The observation is a different scenario from what was done in reprivatization process (Fisher, 2007). Therefore this paper aims at showing how the state capitalism is practiced in mining and energy sector in Tanzania.

### Literature Review

In this section several concepts and the theory of state capitalism will be discussed and their relationship with this study has been elaborated through conceptual framework.

### The Theory of State Capitalism

The term state capitalism describes an economic system in which commercial activities are undertaken by the state in terms of management and organization of the means of production in a capitalist manner (Wikipedia). As Bremmer (2009) argues, in this system the government manipulates market outcomes for the political purposes. The government embraces state capitalism because it serves political as well as economic purposes, and not necessary that it is an efficient means of generating prosperity. At this point government exercises direct and indirect control over a substantial portion of society's capital in order to advance the country's economic strength and to secure the ruling elites political and economic position (Klimina2013). State capitalism can be seen in enterprises which are backed by the state but behave like private sector multinational. Good examples are found in China, Russia, Brazil and some of the Gulf States. In Brazil according to Goldstein (1999) state makes interventions in three broad areas; one is public ownership through the takeover of existing private companies. Second, the state owns exclusive rights for the exploitation of non-renewable natural resources like petroleum and iron ore, where it becomes impossible for foreign private companies to have ownership. Third, the state makes direct intervention to manufacturing industries because local entrepreneurs have failed to attract the owner (state). In Sub-Saharan African countries the phenomena of state capitalism is observable. Therefore this study seeks to explain how the theory of state capitalism is practice in Tanzania specifically in energy and mineral sectors.

### Difference between State Capitalism and Socialism

The government is a center point in two scenarios through the beneficiary do differs. There are several differences between the two, but the major one is how profit is treated. The socialist theory the government takes control of every sector and all production in what is called state control in the economy for the sake of economic development of the country. While in state capitalism the government control certain favored profit oriented sectors and their share is in equity only with a specific reason for control. The state in state capitalism is interested in profit

while socialist system the state controls the whole process regardless of the outcome. Addition to that in state capitalism the state intervenes in markets failure and privates certain commercial sectors but still aims to have a share in profit (Stanford 2012, Thoma 2012, and Wikipedia).

### Privatization

The term privatizations suggest transfer of ownership from government to private sector. It can be business or industry, property, services etc.

### Why privatize?

The reason for privatization can be to minimize the cost of operations. This is because the government parastals have the tendency of operating in an expensive manner because of several reasons one being that they address many activities which might not be related to the primary objective of the organization. Addition to such factors also affects the efficiency and performance of the organization. But also decision making process at times is paralyzed by excessive bureaucracy as it involves time and a laissez-faire attitude towards government business. Moreover poor technology and lack of technical expertise suggests to the government decision makers that privatization can be a solution as knowledge and expertise will make the sector and its products more competitive. Ntiri (2010) suggest that there are two determinants for privatization; the first are internal determinant were government fails to supply capital due to internal debts, national deficits and insufficient supply of funds. Second are external determinants referring to external pressure from donors' countries, IMF and WB. The two determinants apply to developing countries. The mentioned are just few reasons which made the government of Tanzania to privatize the mineral sector.

### Why reprivatize?

The privatization policy in mineral and energy sectors in Tanzania has been successful but other notable issues could be observed. This includes lack of transparency and accountability from investors which has raised even political concerns. The companies which operate in mineral sectors are seen as not very transparent their operations and profit gained to the extent that the people pressure their government to reprivatize so that profit can be shared (Kulindwa 2003).

### Methodology of the Study

The methodology used in searching for information was empirical studies collected from different sources, document from the ministry of energy and minerals resources which includes policies and project papers. But also interviews were done to few individuals. The empirical studies were the major source of information because of its authentic (Creswell, 1994, Saunders, 2009).

### Analysis

The ownership of mineral and energy sector in Tanzania can be traced through historical development of the national.

### Pre-Colonial

During the pre-colonial time mineral extraction, production and supplying were done but the activities were done in a very low level. The owners of mineral activities were chiefs of the local areas and few strong (mental and physical) individuals. The uses of either metal or gold were just for ornaments, tradition weapons and other for trading to foreigners especial Asians (Chachage 1995, Tessier 2008).

### Colonial

The European colonization to Tanganyika began in 1885 with German ruling and later on Great Britain was granted mandated by the League of Nation to rule Tanganyika. Williamson Diamonds Ltd. and Western Exploration Co Ltd are example of mining companies which existed during colonial time. The colonial governments invited mineral companies from different parts of the world like Canada and South African to come and extract minerals and gemstones. The minerals were extracted from Shinyanga, Mwanza, Mbeya and other Southern parts of Tanzania. The companies which participated in mineral business were owned by foreigners and local people participated in very small scales. The major markets for minerals were in European factories. During this time energy sector was controlled and owned by the colonial government (Chachage 1995, URT, MEN 2005, Tessier 2008).

### Post-Independence

In the early years of independence the independent government inherited the colonial system of controlling and managing mineral and energy sector. But in 1967 there was Arusha Declaration were major means of production were nationalized by the government for national interest. These included nationalization of most of mining activities, the government become the controller and owner of almost all mineral activities with small scale miners permitted to operate but under very strict and bureaucratic system. There was an argument that the legitimate nationalization of natural resource was to provide more equitable distribution of mining activity to the society. In 1972 the government established the State Mining Cooperation (STAMICO) with the obligation of managing gold mining activities but also had obligation of searching investors in order to run operations in joint venture. The efficiency and performance of mining sector was bad as no serious investor invested because of unfavorable environment of exploration, extracting and distributing minerals in Tanzania. The mining sector was hindered by government bureaucracy and complex legal and high tax system which resulted to increased illegal mining activities. At this time the government was still the controller and owner of mining activities. The energy sector was still controlled and managed by the government (Solomon 2012, Tessier 2008).

### 1980's- 1990's

The trend of events since independence to 1980's could show that the state intervention into mining and power sectors had negative consequences into the economic growth of the said sectors and Tanzania as a country. For example African countries before reformation were attracting only 5% of exploration capital expenditure in the world and Tanzania until 1997 was getting only \$1million a year as revenue from mining, which is very little compared to its resources. Addition to that the mining sector in Tanzania 1997 provided employment to less than 3% of the total work force and contributed only 5% of GDP. Therefore the political interference, corruption, political instability, government failure to fund mineral sector were among factors

which lead to poor performance of mineral and energy sector in developing countries Tanzania inclusive (Kulindwa 2003, Sipemba 2011, Tessier 2008).

In-performance mineral and energy sectors caused the international community to pressure the government of the developing countries to make changes. The international financial institutional such as IMF and WB forced for radical changes in mining and energy sector. For example during 1980's and 1990's 35 countries of Sub-Saharan Africa implemented 162 SAPs (Structural Adjustments Programs) with the IMF and or WB. It should be remembered that for the case of Tanzania the government was the owner by 100% to big mines found in the country. The ownership was stipulated from the policy and endorsed by the parliamentary act (Campbell 2003, Sipemba 2011). Due to poor performance in mining sector, the owner (government) was pressured by internal and external forces to make changes as current environment has failed to attract competitive players. The donor organization and countries wanted creation of favorable environment which will attract serious investors.

Thus, the government started the process of restructuring the mineral and energy sector starting with the regulations and laws which make-up the sectors. In 1997 the Mineral Policy was made and 1998 Mineral Act was put in place. The main focus of the reforms was to provide more and attractive incentives to investors. The incentives give 100% ownership to the investor, other incentives as provided by law are like 30% of corporate tax rate, capital allowance deductions, depreciation and other tax incentives, mining royalties set at 3% of net sales revenue, waived import duties on mining equipment's and tax exemptions guarantees against nationalization and expropriation and offers unrestricted repatriation of profit and capital and no royalties are paid on cut and polished gemstones with the aim of making investors process the gemstone local which activities other business activities but only few have responded to this incentive. The mining laws centered on promoting and encouraging the involvement of the private-sector with the aim of ensuring that private sector takes a leading role in the mining-sector while the government remains as the regulator. The law recognizes the importance of small scale miners and thus sets aside mineral rights that are exclusively granted to small scale miners. In large scale mining the minister responsible was empowered to enter into agreement on the behalf of the government of Republic of Tanzania with investor. The main idea of the agreement was to ensure stabilization and sustainability of the regulatory framework over the course of a sector development. As the government role in the mineral sector is to provide clear policy guidelines, stimulate and promote the sector's various players, and see to the sector's regulator, promoter, facilitator and service-provider. On occasioned basis the government may elect to require limited participation in certain projects for strategic or promotional purposes (Kulindwa 2003, Sipemba 2011, URT Mineral Policy 1997).

It should be understood that these incentives aimed to make mining in Tanzania grow to 10% of GDP from 1.5% 1998. Addition to that the structural adjustment had to favor the enabling and facilitating private sector investment in mineral resource development (Campbell 2003).

2000's – To Date. The changes introduced in 1990 had noticeable changes as mining activities stimulated also other business activities. There are many approved investment licensees, formal and skilled employment has increased, expansion of economic activities in small scale and large scale mining areas, supporting services has increased such as transport, communication, trade, entrepreneurs but most significance the fight against poverty has been enhanced (Campbell 2003,

Cuvelier 2010). Regardless of positive signs which are seen in mineral sector there are other factors which put in question the decision of providing 100% ownership to investor. This includes lack of transparency in operations, destructions of environment and effect of big and modernized mines in employment. This is because employment has decreased as before 1998 small scale-mining employed around 500,000-1,500,000 but the trend has decreased badly because new investors use new and modern technology compared to small scale miners who operates manual (Kulindwa 2003).

Addition to that the people had perception that government is incapable of having proper and efficient supervision machinery on investor's activities which give them (investors who are not faithful) opportunity to do what they want. It is from such perception and other factors were the society needs the government to have share in ownership of mines so that they can have control of mining activities.

This paper has involved itself more on mineral issues with very little discussion on energy issues. By energy this paper suggests three resources electricity, gas and petroleum. The current policy which is used but which is under review was put in place 2003. The policy states clear that electricity is going to be supplied by the company owned 100% by government known as Tanzania Electric Supply Company Ltd (TANESCO). It is only recent where other power suppliers have been allowed to operate but they do produce electricity and sell it to TANESCO who is mandated to distribute to users. For gas and petroleum the companies which need to extract these resources should know that the government is a shareholder. This suggests that the theory of state capitalism applies to energy sector in Tanzania (Energy Policy 2003). Tanzania Electric Supply Company (TANESCO) is the only power supply and major producer in the country with other players being the producer of electricity though-out the country. This makes only 10% of Tanzanian to have electricity in urban areas and 1% in rural areas.

The mineral and power ownership in development countries can be more fruitful if there is a clear structure of public private partnerships. In developing countries Tanzania inclusive the public sector hasn't been successful in owning mineral sectors. But private sector under good arrangement has been successful in mineral sector for example diamonds in Botswana and cooper production in Chile. Power sector which includes gas and oil can perform well in public sector in developing countries if there is proper arrangement between public and private sector. By proper arrangement the paper means that there is clear agreement in sharing profits, royalties, cost, taxes, employment and remunerates issues, management of risk like fiscal crisis, management capabilities. The success of these arrangements will help to address geopolitics concerns (Hinojosa 2010).

The Tanzania experience on State Capitalism is that the government want more control of the minerals sector because the big investors are neither reliable nor transparent about their activities and profit gained to the extent that the government and its people they have a feeling that their exploited.

## Discussions

The above analysis has shown that changes done on mining sector had negative and positive consequences. The negative consequences are that the practice of state capitalism in Sub-Saharan African countries is different from how it is practiced in developed world. Quinn et al (2008)

states that the state ownership comes is when the state has more than 50 percent of ownership which gives it power in the decision making which has negative consequence on economic performance of the mining sector. This is because the state interventions on appointments of personnel especial the top position is done by the government and the criteria of appointment are based on other factors rather than performance. But also the management of mines by the government has proved failure and worse enough the government failed to fund mineral activities. As results corruptions, inefficiencies and nepotism lead to poor performance of mining sector. That is why the mining contribution in GDP and employment generation was poor.

That's why privatization in mining was seen as a solution towards making mining activities more profitable. But the practice of large mining companies in the country has not satisfied the society as well as the government. This is because the investors are seen as having giant profits but the communities around it are becoming poorer. Also the government and Tanzanian community are having notion that the companies are benefiting more than the owner. It is from such perception were change is demanded. The mining companies seem to lack transparency, destruct the environmental and their extensive use of modern technology affect employment opportunities to Tanzanian. That is why the state demands for a share in every major mining activity which is state capitalism. The aim is to have firsthand information of what exactly is going on and perhaps has a certain control on mining activities. On other hand TANESCO has been the only supplier and distributor of electricity energy in Tanzania for many years and government is the sole owner of the company. Therefore it is not a surprise to note that for all those years it's only about 15 percent of all Tanzanian who have accessibility to electricity power. The assumption is that the ownership of energy sector in Tanzania has been 100 percent by the state that is why performance has been poor.

But it should be noted that the coming of large mining companies had positive consequence on Tanzania economy. These includes stimulation of other business, increase of investment licenses, increase of formal and skilled employment, expansion of mining activities, increase of supporting services such as transport, communication, trade and enhancement of private sector and self-employment. The solution should be for adaptation of state capitalism in energy and mining sector but the state shares should not allow it to control the boardrooms nor the management so as to let professionalism be exercised freely.

## Conclusion

Thus, the paper has been able to show that the theory of state capitalism is practiced in Tanzania. And that the current trend of events views the phenomena as important in developing countries such as Tanzania. Therefore the challenges discussed and solution should be for adaptation of state capitalism in energy and mining sector but the state shares should not allow it to control the boardrooms nor the management so as to let professionalism be exercised freely. But the theory should aim to acquire resources for developmental activities in other sectors such as health, education and distribution of water as a way of eradicating poverty.

## Recommendations

The research paper has several recommendations; One, the state should establish the regulatory authorizes one dealing with minerals and another one should deal with energy. Second, the investors should make their activities more transparent so as to build society confidence to them

and their operations. The aim is make sure that the society builds confidence in investor's activities in order to continue to maintain peace and stability in Tanzania.

### Limitations

The study used qualitative research method only to identify and analyze data which was based on interview done and analysis of secondary data.

### Acknowledgement

I could like to give my thanks to Esther R. Mbise, Hajji Mkwawa and G. Mwandosya for their valuable support during preparation of this paper. In terms of institution I could like to give my thanks to College of Business Education (CBE) for their support and Maastricht School of Management (MsM) for their technical support.

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