Tanzania’s Capital Account Reforms

Partial reforms focusing on easing foreign exchange controls and investment ceilings for foreign investors triggers increased investment and boosts the capital markets. Full liberalization of the capital account and adoption of wider market access reforms are now necessary for full compliance to the EAC Common Market protocol and to foster long term growth.

- **During 2014**, Tanzania repealed selected sections of foreign exchange regulations which restricted the flow of capital across its borders. The new measures partially eased existing capital controls, enabling Tanzanian residents and citizens to invest more in EAC, and allowing additional room for foreign investment into Tanzanian capital markets.

- **Capital controls restricted several foreign investment opportunities.** Tanzanian residents could not optimally participate in EAC IPOs valued at $355m, offered from 2010 when the common market was established. Attempts to offer IPOs in Tanzania had also proved difficult – case in point being the Precision Air IPO which raised only 43% of its targeted $17.5m, in part because of low uptake from local investors.

- **Partial reforms have created new opportunities for foreign investment.** A decision to allow 100% ownership (from a 60% cap) of listed securities triggered a 307% year-on-year surge on the Dar Stock Exchange. Allowing foreign investment in government securities also created new opportunities e.g. NSSF Uganda’s purchase of $19.5m of Tanzanian treasury bills, a transaction previously disallowed. Other market indicators, such as market capitalisation and equity turnover point to deeper and more liquid market conditions, uncharacteristic of the pre-2014 periods.

- **Tanzania should now fully liberalize its capital account and institute broad investment climate reforms.** Partial liberalisation benefited only EAC residents and even then with caveats. Several other sectoral restrictions to investment are still in force, limiting foreign investment and capital raising opportunities for the domestic private sector. The partnership between the Tanzania Private Sector Federation and the East African Trade & Investment Hub is designed to accelerate the necessary reforms that will create new private sector opportunities and grow the economy.

**SUMMARY OF REFORMS**

**Foreign Exchange (Listed Securities) (Amendment) Regulations 2014**
- Partially removes restrictions on participation in Tanzanian government securities for EAC residents. Government securities market remains closed for non-EAC residents.
- EAC residents can now acquire up to 40% of securities issued, but acquisition by investors from a single EAC Partner State not to exceed two thirds of the 40%.

**Foreign Exchange (Amendment) Regulations 2014**
- No more restrictions on investing in EAC capital markets for Tanzanian residents.
- Participation in intl. markets outside EAC requires externally generated funds.

**Capital Markets & Securities (Foreign Investors) Regs 2014**
- Removes 60% foreign ownership cap of listed equities, now allows 100% ownership for non-resident investors.

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![Graphs showing capital market trends](image-url)
EAC Commits to Financial Integration

By signing the East African Community (EAC) Common Market Protocol in 2010, Tanzania and the other EAC Partner States committed to strengthen and integrate their financial markets. Deeper financial integration would help them mobilize additional capital, raise the amount and productivity of investment, bolster competition in the financial sector, facilitate information flows and improve corporate governance.

Specifically, Article 24 of the protocol requires the elimination of restrictions on the free movement of capital. That includes restrictions based on nationality, place of residence, current payments, and where capital is invested, because such restrictions undermine realization of the common market. Annex VI of the protocol identifies 20 operations that should be free from legal and regulatory encumbrances.

Capital controls (a policy measure that is designed to limit capital flows) contributed to a low level of compliance by Tanzania to its commitments to guarantee the free movement of capital within the EAC. These controls encompassed mostly foreign exchange regulations that placed limits on cross-border financial activity thereby slowing down the purchase and sale of securities, money market instruments, bonds and other debt instruments across borders. They also limited Tanzanian residents' ease of investing abroad, given that such participation was subject to approval by the Bank of Tanzania (the central bank) across several classes of external investment. In several cases, central bank approval nevertheless required that only externally generated funds be used for those investment opportunities.

By 2011 (when the 2010 protocol came into force) Kenya, Rwanda and Uganda had already liberalized their capital accounts, while Tanzania and Burundi’s remained closed. In Tanzania’s case, this was due largely to two regulations that closed or placed hurdles on moving capital across Tanzania’s borders: Bank of Tanzania Foreign Exchange Circular 6000/DEM/EX.REG/58 (issued on September 24, 1998) which restricted at least 11 operations required for the free movement of capital and Foreign Exchange Regulations, G.N. No. 629 of 1998, regulation 9 (2) which restricted at least 4. The protocol however bound them to initiate reforms to open the capital account by 2015. Annex VI of the protocol established the timelines below for specific reform measures affected by the capital account and other related laws and regulations.

<table>
<thead>
<tr>
<th>Restriction to be eliminated</th>
<th>Elimination year</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Purchase of foreign securities (including IPOs) by residents</td>
<td>2010</td>
</tr>
<tr>
<td>• Purchase of corporate bonds locally by non-residents</td>
<td></td>
</tr>
<tr>
<td>• No list of restrictions to be eliminated in the year</td>
<td>2011</td>
</tr>
<tr>
<td>• Sale or issue of securities abroad (including debt) by residents</td>
<td>2012</td>
</tr>
<tr>
<td>• Purchase of government bonds locally by non-residents</td>
<td></td>
</tr>
<tr>
<td>• Outward direct investments</td>
<td></td>
</tr>
<tr>
<td>• No list of restrictions to be eliminated in the year</td>
<td>2013, 2014</td>
</tr>
<tr>
<td>• Purchase of foreign securities (including debt) across borders</td>
<td>2015</td>
</tr>
<tr>
<td>• Purchase and sale of money market instruments across borders</td>
<td></td>
</tr>
</tbody>
</table>

Source: EAC Common Market Protocol

1 This regulation restricted outward direct and portfolio investments, foreign lending favoring non-residents, acquisition of foreign real estate, operation of offshore foreign currency accounts by residents, and participation by non-residents in domestic money markets and capital markets.

2 This regulation stated that any Tanzania resident can acquire, sell or transfer to any person within or outside the country any security or coupon on which capital moneys, dividends, or interest are paid in foreign currency—but only if the security or coupon was bought solely with externally acquired funds and the Bank of Tanzania is notified.
Reforms Target Restrictive Forex, Securities Regulations

In 2014, Tanzania embarked on a process to partially liberalize its capital account as follows:

The Foreign Exchange (Listed Securities) (Amendment) Regulations: Prior to the amendments, foreigners were not allowed to participate in Government securities. After the amendments, East Africans can now participate in Government securities issuances up to a level of 40% of the issued sum. However, no group of investors from one East African country can exceed two-thirds of the cumulative 40% allocation to the region.

The Foreign Exchange (Amendment) Regulations, 2014: Prior to the current amendments, outward investments (defined as participation in foreign capital markets and purchase of foreign securities) were generally restricted for Tanzanian residents. Under the new regulations, a resident may now acquire from, sell, or transfer to, a non-resident any security or coupon if the issuer or buyer of the security or coupon is an EAC resident and the security or coupon to be acquired, sold or transferred is funded exclusively by externally acquired funds. This in effect allows Tanzanian residents to deal in any securities freely within the East African region. In addition, the regulation now allows residents to invest abroad and acquire real estate and other real assets beyond the EAC region (provided that the relevant bank notifies the Bank of Tanzania of the intended remittance in advance).

The Capital Markets and Securities (Foreign Investors) Regulations 2014: issued in September 2014 now allow participation of foreign investors in the Tanzanian capital markets. The foreign investor regulations opened participation in the government securities market to foreigners, subject to conditions stipulated in the Foreign Exchange (Listed Securities) (Amendment) Regulations 2014. This reform was significant—it allowed non-resident investors to own up to 100% of listed equities in what saw a 307% year-on-year surge in trading activity on the Dar Stock Exchange. Prior to this, foreign ownership was capped at 60%, and low market activity was a characteristic of the pre-2014 period.

Table 2: Typology of capital controls after Tanzania reforms

<table>
<thead>
<tr>
<th>Debt</th>
<th>Equity &amp; FDI</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Inflows</strong></td>
<td><strong>Outflows</strong></td>
</tr>
<tr>
<td>Corporate bonds: no controls</td>
<td>Shares: no controls</td>
</tr>
<tr>
<td>Government securities: partial controls – only residents of a</td>
<td>FDI: partial controls, specifically sector based ownership restrictions.</td>
</tr>
<tr>
<td>prescribed territory can participate up to a maximum of 40% of</td>
<td>FDI: partial controls – investment can be done within the PT; remittance to</td>
</tr>
<tr>
<td>the total issue.</td>
<td>be effected via a bank/financial institution; supporting documentation to be</td>
</tr>
<tr>
<td></td>
<td>submitted to BOT; Bank/financial institution has to notify BoT prior to</td>
</tr>
<tr>
<td></td>
<td>remittance</td>
</tr>
<tr>
<td></td>
<td>Real estate: partial controls – subject to approvals by BoT outside the</td>
</tr>
<tr>
<td></td>
<td>prescribed territory.</td>
</tr>
</tbody>
</table>

*Source: East Africa Trade & Investment Hub research*

The capital account restrictions had limited the growth and depth of the Tanzanian capital markets over the 2010-2014 period as detailed below.

**Limited resource mobilization through the capital markets.** The controls prohibited foreign participation on the bourse, limiting secondary trading and turnover levels. The Dar Stock Exchange turnover compounded growth rate
for the period 2009 – 2013 was 43%. This changed materially in 2014 following the partial liberalisation of the capital account with turnover growing 307% year-on-year from 2013 to 2014.

The negative impact on capital markets as a means of raising long term funding was also evident in 2011 when Precision Air made an initial public offer (IPO) designed to raise $17.5 million. The issue only succeeded in raising $7.4 million – less than half the targeted sum – in part because the Capital Markets and Securities (Foreign Investors) Regulations, 2003 limited foreign participation to up to 60% of the issue.

**Figure 1: EAC equity markets, market capitalisation, $ millions (2009 – 2016)**

Constrained market depth and breadth owing to regulatory restrictions to foreign participation in capital markets. The average annual turnover for DSE was low compared to other exchanges in the EAC Partner States. Turnover ratio is an important measure of the depth and breadth of any bourse and is a core indicator of market depth. This ratio tends to be enhanced by the presence of foreign investors. Tanzania’s capital controls limited foreign participation, consistently yielding a low turnover ratio which would explain the limited development of tradable products as these would require a more active market for uptake. Tanzania’s turnover was at an average of 1% over the 2009 – 2013 period. The ratio more than doubled over 2013 – 2014 period following the relaxation of restrictions on foreigners acquiring shares on the DSE.

**Figure 2: EAC Equities Turnover and Turnover Ratios, 2009 – 2015**

Source: DSE, Bloomberg, RSE, CMA
The elimination of restrictions on foreign participation in equities led to a steep hike in trading turnover which peaked in 2014 and slowed in 2015. The peak in 2014 was occasioned by introduction of Capital Markets & Securities (Foreign Investors) Regs 2014 which removed 60% foreign ownership cap of listed equities, and now allows 100% ownership for non-resident investors. Foreign participation is on a steady rise averaging at 89% of total volumes traded on the DSE as at end 2015. Significantly, overall trading values are also on a steady rise, an indication that local investors are not being crowded out by international ones.

**Figure 3: DSE: Foreign vs. local participation, 2012 - 2015**

[Graph showing foreign and local participation from 2012 to 2015.]

*Source: DSE*

**Capital controls restricted foreign investment in the capital markets and other investment classes, both into and out of Tanzania.** The restrictions inhibited Tanzanian residents from investing in the regional bourses thereby limiting their investment choices — inconsistent to their rights and freedoms under the EAC Common Market Protocol. During the 2010 to 2014 period, there were 11 IPOs in offered in the EAC market valued at a combined $355 million. The capital controls in Tanzania at the time restricted residents from participating in these IPOs, several of which have had significant upsides in the secondary trading markets, reflecting a missed investment opportunity due to the regulatory environment.

**Figure 4: Consolidated EAC IPOs: $ millions, 2010 – 2015**

[Graph showing value in $ millions and number of IPOs from 2010 to 2015.]

*Source: DSE, Bloomberg, RSE, CMA*
Tanzania now contemplates removing remaining controls to enable unrestricted global access

Tanzania has signalled that on the basis of the initial partial lifting of capital controls, that it is ready to remove further controls to enable participation of the rest of the world. In Tanzania’s latest Letter of Intent to the International Monetary Fund3, it states that it is putting efforts to lift remaining capital restrictions and enable global access. Specific proposals have been prepared and are undergoing an approval process. Tanzania is also considering a number of safeguards measures as part of its efforts to fully liberalise the capital account, including prudential rules like minimum holding period for debt flows to ensure orderly conditions in the market.

Removal of remaining capital controls will fully liberalize Tanzania’s capital account once implemented, making it easier for the world to invest in Tanzania and for Tanzanian residents to similarly invest abroad.

In addition to lifting the remaining capital controls, and to maximize opportunities for investment and private sector growth, Tanzania will need to implement a wider range of common market reforms. These reforms will consolidate the gains from partial liberalisation of the capital account and the expected full liberalisation of the capital account. These reforms should be targeted towards reviewing and amending laws and regulations that:

- Prohibit or place quotas on foreign participation in selected sectors
- Mandate additional deposits in the Central Bank for foreign investors
- Extend incentives only to domestic investors
- Limit credit obtainable from local financial institutions by foreign investors
- Restrict selected classes of outward investment opportunities for residents

A full list of laws and regulations that require further reforms, and the Hub’s suggestions of what these reforms should be, is annexed to this reform update. Tanzania also needs to institute legislative and regulatory reform processes that will ensure that bills and draft regulations do not contain measures4.

Recommendations

Allow Tanzanian residents to feely invest beyond EAC borders. This can be achieved by further amending Foreign Exchange (Amendment) Regulations 2014 to remove current restrictions that limit outward investments to the prescribed region. Currently, a Tanzanian resident can only acquire from, sell or transfer assets to a resident of a prescribed territory. If the acquisition from, sale or transfer of assets is to a resident outside of the prescribed territory, then it has to be funded by externally acquired funds.

Allow non-EAC-residents to participate in purchase of government securities. This can be achieved by further amending Foreign Exchange (Listed Securities) (Amendment) Regulations 2014 to remove the clauses that limit rights to participate in Tanzanian government securities only to EAC residents.

Remove remaining restrictions that limit EAC residents from full participation in the government securities market. This can be achieved by further amending Foreign Exchange (Listed Securities) (Amendment) Regulations 2014 to allow EAC residents allowed to acquire up to 100% (up from 40%) of government securities, and removing the requirement that any EAC Partner State should not exceed 2/3rds of the currently permitted 40% ownership.

Make the minimum holding periods for government securities uniform between residents and non-residents. This can be achieved by removing the requirement in the Foreign Exchange (Listed Securities) Regulations 2014.

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3 June 28th, 2016. A Letter of Intent describes the policies that Tanzania intends to implement in the context of its request for financial support from the IMF. https://www.imf.org/external/np/loi/2016/tza/062816.pdf

4 An example of a bill currently before its parliament that contains a measure that is inconsistent to the movement of capital is the Media Services Bill 2016, which empowers the minister responsible to prescribe shareholding of foreign firms in media services. EAC firms are considered foreign according to this law.
(Amendment) Regulations 2014 that compels EAC residents not to transfer government securities within twelve months of acquisition.

**Additional investment in upgrading operational procedures that govern capital markets is necessary.** In addition to the legal and regulatory restrictions identified that are inconsistent to the movement of capital, Tanzania will require further investment in upgrading operational procedures that govern their capital markets in order to facilitate the higher and more complex transactions expected from full capital account liberalization. This will include measures to minimize settlement risk.

**Invest in stronger and more effective public private dialogue.** Working with the Tanzania Private Sector Federation (TPSF), the Hub is supporting implementation of the EAC Common Market Protocol in Tanzania through supporting private sector efforts to ensure that the protocol is implemented and that the domestic private sector gains access to an integrated market that presents additional growth opportunities.

This efforts includes training of public and private sector officials on key common market implementation subjects, improving technical preparation by the private sector ahead of dialogue meetings, closer collaboration between private sector apex bodies in the EAC to agree on joint reform priorities, development of process scorecards to increase commitment to reforms, and regular updates of the status of implementation of the protocol. The latest such update, published November 2016, can be found at:

http://www.eatradehub.org/hub_and_tanzania_s_private_sector_apex_body_hold_common_market_implementation_event

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**The USAID East Africa Trade and Investment Hub** (the Hub) boosts trade and investment with and within East Africa. It does this by deepening regional integration, increasing the competitiveness of select regional agricultural value chains, promoting two-way trade with the United States (U.S.) under the African Growth and Opportunity Act (AGOA) and facilitating investment and technology to drive trade growth intra-regionally and to global markets. The Hub supports the U.S. Government’s presidential Trade Africa and Feed the Future initiatives. It is funded by the U.S. Agency for International Development (USAID).

**The Common Market Implementation Team** of the Hub works with the region’s public and private sectors to expand opportunities for trade and investment in the East African Community, through supporting accelerated implementation of the EAC Common Market Protocol. A key focus of the team is to support enactment of laws, regulations and administrative measures that facilitate the free movement of capital, services and goods.

**Reform Updates**, such as this one, are prepared to provide concise and actionable information to interested stakeholders working to accelerate implementation of the EAC Common Market Protocol.

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