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Tanzania

From Institutional Hiatus to the Return of Policy-Based Lending

Hazel Gray

Introduction

Despite a consistent commitment to the adoption of international banking standards from the outset of its financial reforms in the late 1980s, Tanzania only finished implementing risk-based supervision in 2009, and opted for selective implementation of Basel II and III standards beginning in 2017. Amongst the countries featured in this volume, therefore, Tanzania is a relatively slow and cautious adopter of international banking standards. Over the past thirty years, Tanzania has been through a fundamental institutional transformation of its banking sector, with a far-reaching shift away from state control towards the creation of a private market-oriented banking sector that until recently has been dominated by foreign banks. Yet, despite twenty years of high growth and global integration, Tanzania is one of the least-banked countries in the world (World Bank, 2017). Although Tanzania has one of the highest number of banks in Africa and one of the most profitable banking sectors on the continent, the economy remains cash-based. While Tanzania has been slow to implement and enforce international banking standards, the IMF has consistently described Tanzania's regulatory system as being in reasonably good shape for its level of economic development (IMF, 2018, 2017a, 2010, 2004).

Tanzania's approach to international banking regulation has undergone two distinct phases. From 1995 to 2008, the enormous institutional shifts occurring within Tanzania's banking sector led to a regulatory hiatus. This was evident from the significant disjuncture between its formal commitment to adopting Basel and the actual pattern of implementation and enforcement. During the second period, from 2009 to 2017, regulation took greater priority, as risk-based supervision was finally implemented and the country moved on to adopt and implement elements of Basel II and III. However, this period was also characterized by the emergence of a more selective approach to Basel adoption—new regulations for segments of

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the banking and financial sector were introduced that were outside the Basel framework. This brought the informal practices of enforcement into closer alignment with the formal regulatory framework.

In this chapter, I explain how changes in the preferences and relative power of the three key actors—regulators, banks, and politicians—shaped the pattern and pace of Basel adoption over the period under study. During the first period, Tanzania had a predominantly policy-driven approach to adoption that was shaped by the decisive victory of pro-liberalization politicians and the high level of influence from the IFIs on Tanzania's emerging regulatory system. Yet the challenges of implementing an entirely new type of regulatory relationship from scratch should not be underestimated. The kind of policy-based lending that had been practised during Tanzania's socialist period was off the political agenda by the 1990s, but a few recent cases of grand corruption involving senior figures within the state and banking sector suggest that some groups may have had an interest in maintaining a loose regulatory environment. The domestically oriented commercial banks were powerful compared to regulators and politicians. Both foreign and domestic banks retained very high profitability during this period of regulatory hiatus, and they had no interest in pushing for faster implementation of international banking standards. These preferences led to a strong professed commitment to implement Basel but weak implementation in practice during the first period (Table 8.1).

The preferences of regulators, banks, and politicians all changed during the second period, from 2009 onwards. The changing preferences of the regulator were the result of two key factors: first, the appointment of a new internationally oriented governor at the Bank of Tanzania (BoT), and second, the influence of regional commitments to regulatory harmonization within the EAC, which provided a hard deadline of 2018 for the implementation of elements of Basel II and III. The banking sector's preferences also changed as the large foreign banks began to champion Basel adoption—partly a result of pressures from

Table 8.1 Tanzania: key indicators

Tanzania	
GDP per capita (current US$, 2017)	936
Bank assets (current US$)	8.9 bn
Bank assets (% of GDP)	18.8
Stock market capitalization (% of GDP)	Data not available
Credit allocation to private sector (% of GDP)	14.4
Credit allocation to government (% of GDP)	5.3
Polity IV score (2017)	3

Note: All data is from 2016 unless otherwise indicated.

Source: FSI Database, IMF (2018); GDI Database, World Bank (2017); Polity IV (2014)

parent banks and concerns about AML compliance. In addition, changes in the composition of the banking sector that had developed from the end of the 2000s led to greater competition within the sector. The large banks were interested in enforcing Basel, and especially the higher capital requirements, partly as a way of forcing consolidation among smaller banks. Over the same period, politicians' commitment to deep liberalization faltered and demands for policy-based lending returned. This resulted in a move away from the blanket adoption of Basel and towards attempts to tailor regulation for different segments of the banking sector. Thus, in the second period, Tanzania moved from policy-driven convergence, which didn't result in implementation, to regulator- and market-driven convergence, which has led to selective implementation of Basel II and III. While it is hard to perfectly align Tanzania with one of the trajectories set out in the analytical framework, the central role of the regulator leads it to exhibit dynamics of regulator-driven convergence.

The evidence presented in this chapter is based on twenty interviews with government officials, BoT employees, representatives of commercial and government banks, representatives of international development organizations, and academics in Tanzania, most of which took place from March to July 2017. Secondary sources include government publications, official reports of international institutions, grey literature produced by private sector consultants in the financial sector, project appraisal documents, annual reports, and other publications of the commercial banks and court cases.

I start with an overview of the political and economic context in which banking regulation has been implemented. I then trace the changing approach to Basel over time, demonstrating the early adoption, but also its slow and cautious implementation until the end of the 2000s, and the shift in the pace and nature of implementation in the 2010s. The core political economy argument is presented in the fourth section, which shows why Tanzania experienced a shift from policy-driven to a regulator- and market-driven preferences for Basel implementation. To conclude, I argue that the appearance of the banking sector as relatively well regulated and stable is partly a reflection of the minimal role that it has played, at least thus far, in supporting a more fundamental economic transformation within the domestic economy. This points to the mismatch between the characteristics of risk in highly financialized economies that are the focus of international banking standards, compared to the risks that are inherent in the processes of economic transformation of a country with ambitious plans for industrialization.

Economic and political context

Until the mid-1980s, Tanzania was a centrally planned economy with restrictions on the private sector while a significant proportion of the economy was under

direct government ownership. After a period of economic decline, a structural adjustment package was signed with the IMF in 1986, putting Tanzania on a path towards economic liberalization and privatization. This was accompanied by political reforms that led to the introduction of multiparty elections in 1995—although Tanzania has consistently remained under the rule of one dominant party, the ruling Chama Cha Mapinduzi (CCM). Growth rates started to pick up from the end of the 1990s and Tanzania experienced an uninterrupted period of high growth for the next twenty years (Figure 8.1).

Economic growth in this period was driven by rising foreign and domestic investment and the emergence of a mining sector, growing by around 15 per cent per year by the early 2000s (Bank of Tanzania, 2004). But despite economic expansion and growing exports and imports, the economy remained largely delinked from the global financial system. Most Tanzanians still worked within the cash-based rural economy and the urban informal sector. Despite rapid urbanization and growing manufacturing output, the country remained one of the least industrialized in the world. Insufficient structural change and employment creation meant that while experiencing the longest period of economic growth in its history, Tanzania's poverty rates remained intransigently high over the 2000s.

Tanzania's banking sector, meanwhile, experienced an enormous transformation since the early 1990s, with the break-up of the mono-banking system and the proliferation of commercial banks, a majority of which were foreign-owned for most of the period under study. During the socialist period, the banking sector consisted of six state-owned banks that provided credit in accordance with National Credit Plans (Bank of Tanzania, 2016b). Economic crisis and mismanagement led to a very high level of non-performing loans (NPLs), reaching 77 per cent of the total loans of the largest bank, the National Bank of Commerce, by 1995 (World Bank, 1995). Reforming the banking sector was central to Tanzania's structural adjustment process initiated in 1986, in response to pressure and loan conditionality from the IMF and World Bank. The Banking and

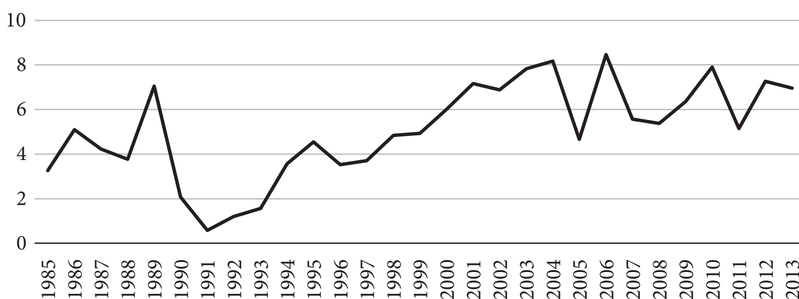

Figure 8.1 Tanzania: GDP percentage growth (1985–2013).
Source: Bank of Tanzania (2016b, 2004)

Financial Institution Act (BFIA) implemented in 1991 and the Bank of Tanzania Act of 1995 set the legal foundations for a new kind of private and market-oriented banking sector.

Like most other low-income countries, Tanzania has retained a bank-dominated financial sector with a very small stock exchange and insurance sector. The only other significant financial actor over the period has been pension funds, accounting for 10 per cent of GDP and around 27 per cent of total financial sector assets (IMF, 2016). From the mid-1990s, Tanzania pursued a very liberal approach to bank licensing in order to foster competition in the financial sector. This generated significant growth of foreign and private banks—so much so that by the end of the 2000s, Tanzania had one of the highest numbers of licensed banks on the continent. By the mid-2000s foreign banks had become dominant, but there was an expansion of locally owned banks towards the end of the decade—the majority of which were small community banks (see Figure 8.2). Compared to the start of the reforms, government control of the banking sector declined dramatically, following the break-up and privatization of the National Bank of Commerce (NBC), the National Microfinance Bank (NMB), and Cooperatives and Rural Development Bank (CRDB). Five new domestic banks were established from 2005, but the growth of domestic banks in this period mainly reflects the rise in small community banks serving particular regions.

Despite the rise in the total number of banks in the 2000s, Tanzania's banking sector has remained highly concentrated. The three largest banks in Tanzania, the NMB, the NBC, and CRDB, accounted for over 65 per cent of total banking

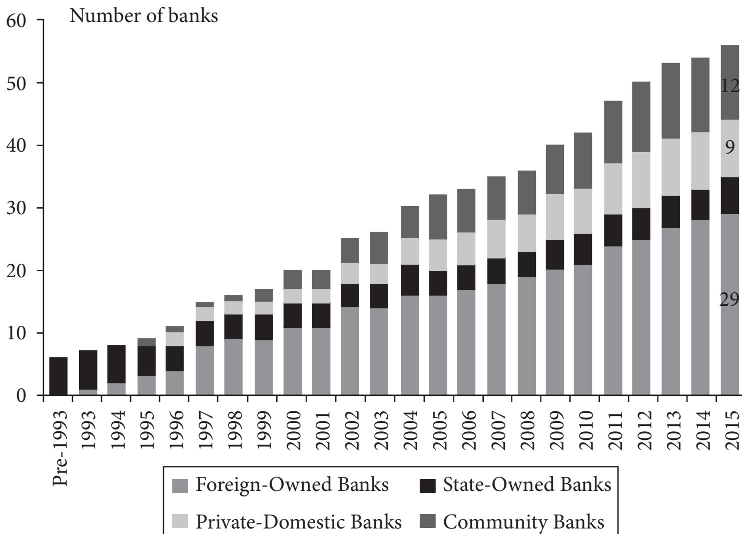

Figure 8.2 Tanzania: number and type of banks (1996–2017).
Source: IMF (2017, p. 8)

sector assets across the 2000s (IMF, 2010). These institutions all originated from the privatization of the dominant state-owned banks. Industry concentration was also reflected in the narrow lending profile of the large banks, which continue to lend primarily to the government and to serve a limited number of large multinational and domestic companies. Despite the expectation that greater competition would lead to a vital expansion of credit, rates of private credit to GDP remained stubbornly low in the first period of banking sector reform, rising from 5 per cent to 17 per cent of GDP from 2003 to 2015 (IMF, 2010; World Bank, 2017)—well below the regional average of 21 per cent (Nyantalyi and Sy, 2015). One reason for this was the availability of low-risk, highly lucrative government securities. The large banks dominated the government securities market, holding around 40 per cent of these assets. With zero risk weights and an interest rate of around 15 per cent, they had little incentive to extend credit to the private sector. Smaller banks, which did not operate so extensively in these markets, relied on being able to borrow from these larger banks, thus pushing up interest rates. Overall in the 2000s, Tanzania had the second highest margin spreads in the region after Malawi (IMF, 2010). Fundamental weaknesses in the state institutions that underpin financial markets, such as an effective commercial court and judicial system, were also key factors in the low level of lending by commercial banks to the private sector.

The insularity of the banking sector allowed banks to retain very high levels of liquidity in the 2000s and this was one of the causes of the fall in the level of NPLs. Dollarization, which was high across the whole sector (around 30 per cent of total deposits and total loans), was particularly concentrated in the largest banks where dollar deposits were 41–62 per cent by the end of the 2000s (IMF, 2010). Tanzania retained capital controls across the 2000s, and only started to take steps towards liberalizing its capital account after the EAC Common Market Protocol was ratified in 2010. The global financial crisis and the economic downturn led to an increase in NPLs across banks of all sizes (Figure 8.3).

Given most of the population has historically had little access to banking, one of the most dramatic changes to occur to Tanzania's financial sector in recent years has been the rapid rise of mobile phone-based financial services since 2008. By 2015, Tanzania caught up with the front-runner, Kenya, in terms of the scale of mobile money services available.

Tanzania's overall policy approach to the financial sector has undergone a marked shift from a policy of rapid general liberalization in the 2000s to a more targeted approach to addressing financial inclusion and promoting policy-based lending through development finance institutions in the 2010s. Characteristics that are frequently associated with clientelism, such as high levels of NPLs and the extension of loans without sufficient collateral, have not been prevalent amongst the systemically important banks over the 2000s. However, the grand corruption scandals that were a feature of Tanzania's political economy in the last

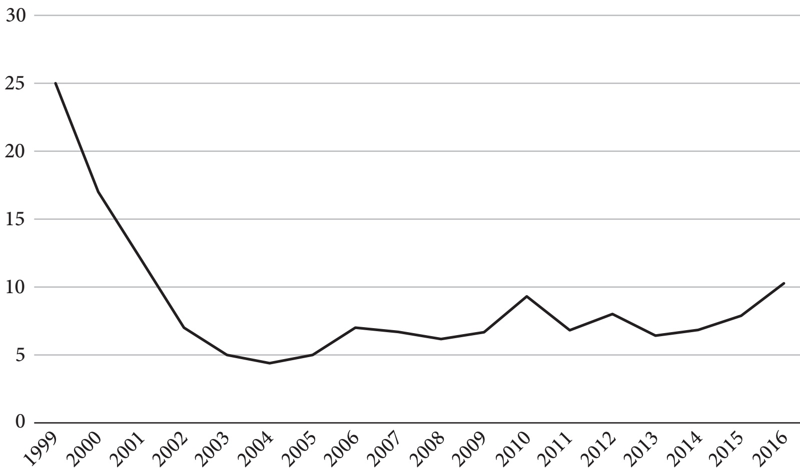

Figure 8.3 Tanzania: non-performing loans (NPLs) (% of total loans).
Source: Bank of Tanzania (2016b, 2004)

two decades exposed links between politicians and elements of the banking sector that suggest a more complex relationship between banking and politics underneath the surface.

Basel adoption, implementation, and enforcement

Since the liberalization of the banking sector in the early 1990s, Tanzania has formally been committed to implementing Basel standards (United Republic of Tanzania, 2000). The major regulations contained in the 1991 Banking and Financial Institutions Act were in line with the Basel Core Principles and the Act introduced a minimum capital requirement of 8 per cent of total assets, which was in line with the spirit of Basel I (United Republic of Tanzania, 1991). However, as risk weights were not included, this requirement acted as a leverage ratio in which all assets were assigned 100 per cent—meaning Tanzania's capital requirements were actually more stringent than required by Basel. The Act also set a range of other restrictions, such as collateral requirements for large loans, aggregate large loan limits, and fixed asset ceilings for banks, that were more restrictive than Basel I requirements.

Reforms to the institutions of banking supervision started in 1992 when the BoT upgraded its Supervision Unit into the Directorate of Banking Supervision. In Tanzania's first FSAP of 2003, the country was deemed to have put in place the foundations of a good supervisory system—but with a need for extensive amendments to law and regulation, banking supervision policy, capacity building within

the BoT, and a move to risk-based supervisory practices (IMF, 2004). Following the first FSAP, the legal framework for banking regulation underwent significant changes from 2003 to 2009. The Bank of Tanzania Act, 2006 and the Banking and Financial Institutions Act, 2006 set up the foundations for a more stringent and independent supervisory system (United Republic of Tanzania, 2006). The Deposit Insurance Fund was established and licensing became the sole preserve of the BoT, reducing the potential for political involvement in decision-making. The first steps towards introducing risk-based supervision were taken in 2004 with a survey of the existing risk management framework in banks and non-bank financial institutions (Bank of Tanzania, 2010), which led to the implementation of risk-based supervision on a pilot basis in 2006. In 2007, the BoT published a Risk-Based Supervision Manual, and Capital Adequacy Regulations were published in 2008. This was followed the next year by the implementation of risk-based charges. The general willingness to adopt Basel standards in principle was evident in the fact that the BoT signalled its intention to move forward with Basel II adoption and implementation as early as 2004, even before risk-based supervision had been implemented (Bank of Tanzania, 2004), and a working

Table 8.2 Tanzania: adoption of Basel standards

Basel component	Adoption	Implementation
Basel I	Banking and Financial Institutions Act 1991 Banking Act (Amendment) 1993 (capital adequacy ratio brought into line with Basel)	
Risk-based supervision	Adopted with the Banking and Financial Institutions Act (2006)	The banking and financial institutions (capital adequacy) regulations, 2008
Basel II	Credit risk SA, operational risk, market risk adopted with the banking and financial institutions regulations (capital adequacy) Regulations 2014 Pillar II—Risk Management Guidelines for Banks and Financial Institutions, 2010	Operational risk was implemented in 2017 after a three-year moratorium announced in the banking and financial institutions capital adequacy (amendment) regulations 2015
Basel III	Capital conservation buffer of 2.5% adopted the banking and financial institutions (capital adequacy) regulations, 2014	Implemented in August 2017 announced in the Monetary Policy Statement June 2017

group was established to draw up plans for the implementation of staged elements of Basel II and III (Table 8.2).[1]

Despite the significant efforts to build up the legal framework for supervision, Tanzania's second FSAP in 2009 found that there were significant weaknesses in compliance by the commercial banks and in monitoring and enforcing prudential rules by the BoT (IMF, 2010). Significantly, the actual implementation of a risk-based approach was lacking entirely. This was partly the result of poor record-keeping and capacity constraints at the BoT (IMF, 2010). The FSAP review identified that three banks were undercapitalized, prudential limits had been exceeded for a number of the banks with large single exposures, and loan-to-deposit ratios were in breach in eleven banks. The BoT had shown significant regulatory forbearance in pressing these institutions to address their capital shortfall.

As the fourth section below explains, after 2009 the pace of Basel adoption and enforcement changed in important ways as Tanzania decided to combine the adoption of elements of Basel II and III and push forward with implementation by 2018. This began with improving the risk-based supervisory system in the early 2010s. Several weaknesses in data and the recording of risk-based supervision practices that were identified in the 2009 FSAP were resolved with the introduction of a fully automated reporting system in 2014. Consolidated Supervision Regulations were also issued in 2014, and a pilot examination of one commercial bank was undertaken in 2016.[2] In 2014, a directive to introduce capital requirements for operational risk from Basel II was issued, but commercial banks were given a three-year phase-in period. The operational risk charge became effective in 2017. Tanzania also committed to implementing Pillar 2 of Basel II, consisting of the Internal Capital Adequacy Assessment Process (ICAAP) by commercial banks and the Supervisory Evaluation and Review Process (SREP).

By the end of 2018, Tanzania's capital adequacy requirements were based on Basel I definitions and risk-weightings with some additions (IMF, 2018). Elements of Basel III were introduced in 2017 and 2018, including a revised definition of capital, a capital conservation buffer, and a leverage ratio (Bank of Tanzania, 2016a; IMF, 2018; Ng'wanakilala, 2017). (The BoT committed to revising the capital definition to bring it in line with the Basel III definition by 2018, but argued that they would need to adapt this to Tanzania's specific banking context (IMF, 2017a).) Over this period, a tailored approach to Basel adoption also started to emerge in formal terms, with a new regulatory framework for investment banks introduced in 2011 (Bank of Tanzania, 2011) and plans to develop specific supervisory regulations for Community Banks (FurtherAfrica, 2016). Regulations targeted specifically towards the larger systemic banks were also under consideration, in particular an additional Pillar 2 capital buffer of 2.5 per cent of risk-weighted assets for systemically

[1] Interview, Bank of Tanzania, Dar es Salaam June 2017.
[2] Interview, Bank of Tanzania, June 2017.

important banks (IMF, 2017a). Another sign of a tailored approach was in the adoption of a simplified liquidity ratio that was not equivalent to Basel III, but arguably was better suited to the country context and regulatory capacity (Bank of Tanzania, 2014). The BoT also continued to reform its supervisory system to meet Basel Core Principles in the areas that were identified as deficient in the 2009 FSAP, and they are now committed to being fully compliant by 2018.[3]

Money laundering regulations were identified as a particular area of concern in Tanzania, given high reported levels of money laundering in the country despite measurement difficulties arising from the predominantly cash-based nature of the economy (Goredama, 2003). Despite introducing an Anti-Money Laundering Act in 2006, Tanzania was 'blacklisted' and subject to FATF's monitoring process for AML/CTF compliance from 2009 to 2014 (FATF, 2017). In this period, several cases of money laundering were brought to court, but by 2016 no one had been prosecuted, highlighting the difficulties of enforcing the strengthened legislation (Fjeldstad and Heggstad, 2014).

Tanzania's general eagerness to adopt international standards was also evident in its early adoption of international accounting standards; IFRS was adopted in 2004 for all private sector business entities. But again, the actual enforcement of these accounting standards was low. In 2014, the National Board of Accountants and Auditors adopted the demanding IFRS 9 standards without amendments. While the larger and foreign-owned banks had already prepared to conform to these standards in line with their parent companies, many of the smaller banks struggled to prepare themselves for the new capital requirements by the 2018 deadline.

Political economy of Basel standards in Tanzania

As expected, Tanzania's regulatory practices have converged with global standards over time. Its path of adoption, implementation, and enforcement, however, has been shaped by the relative power as well as the preferences of the key actors involved in the financial sector. The political economy features influencing these preferences have evolved over time, so I first explain the early adoption and slow implementation of the first period from 1995 to 2008, and then set out the reasons for a change in the approach to Basel in the second period.

[3] Interview, Bank of Tanzania, Dar es Salaam 2017.

High adoption; weak implementation and enforcement (1991–2008)

A striking feature of Tanzania's experiences of Basel has been the early and consistent willingness to signal adoption of the standards. This was in large part due to the influence of IFIs on Tanzanian politicians and regulators from the start of the reform process, when the foundations of a new kind of banking sector were being established. However, at the outset of the reform process, the commitment of regulators and politicians to this approach was not a foregone conclusion. Even after the first structural adjustment agreement was signed in 1986, there were considerable differences of opinion between politicians within the ruling party about the appropriate role of the state in the economy. Some of the most acute ideological struggles occurred over the direction of banking sector reform. The ex-governor of the BoT, Charles Nyirabu, was committed to market liberalization and was Chair of the Presidential Commission of Enquiry (PCE) into the monetary and banking system set up in 1989. Their report, published in 1991, strongly supported the IFI agenda of banking sector liberalization and privatization. However, factions within the ruling party continued to strongly resist reforms throughout the 1990s, the most contentious issue being the privatization of state-owned banks.

To circumvent opposition within the ruling party, the World Bank decided to give the government considerable discretion over the pace and form of privatization (Adams, 2005). Initially the pace of reform was very slow and subject to considerable political contestation (Mwakikagile, 2010) but a pivotal moment came in 1997 when the Board of the National Microfinance Bank vetoed the government's proposals for privatization. In response, President Mkapa intervened and replaced the entire Board, signalling his strong support for the privatization process (Cull and Spreng, 2011). By the end of the 1990s, the debates over the direction of reform had been decisively won by the liberalizers and international best practices were embraced as the standard to which the new banking sector should aspire.

Over the next twenty years, the IFIs played a very significant role in shaping Tanzania's approach to banking supervision, through loan conditionality and technical assistance. The periodic FSAPs were particularly important in setting the agenda of action on Basel implementation.[4] The limited domestic financing options available to the government meant that disbursement conditions on IFI loans were a powerful lever of reform. For example, in the process of deciding how the National Bank of Commerce should be privatized, Amani et al. found that 'Tanzanian policymakers had selected an option that they had been led to believe the World Bank preferred because they believed that such a choice would

[4] Interviews, large commercial bank, Tanzania Bankers Association, Dar es Salaam, 2017.

simplify subsequent negotiations with the Bank on these issues' (2005, p. 33). The IFIs' influence on the regulator meant that from very early on, the 'spirit was to adopt international standards'.[5] Initially, however, IFI loan tranche releases were linked to the approval of plans and enactment of legislation, rather than actual implementation (World Bank, 1995).

As privatization got underway, the IFIs turned their attention to strengthening supervisory capacities at the BoT. The first Financial Institutions Development Project (FIDP) that ran from 1991 until 1996 facilitated the establishment of 'most of the basic skills for supervising banks' within the BoT (World Bank, 2000, p. 13). The focus on strengthening supervision was increased in the FIDP II from 2000 to 2006 (World Bank, 2000). Technical assistance was enhanced by the establishment of the IMF East Africa Regional Technical Assistance Centre (AFRITAC) in 2002, based within the BoT in Dar es Salaam. AFRITAC played a key role in providing technical assistance to the Bank for Basel adoption, in particular for the move to risk-based supervision in the 2000s (Chatterji et al., 2013), and subsequently in drafting regulations for Basel II and III implementation (IMF, 2017b).

The period of regulatory hiatus in the 2000s was not the result of a rejection of international standards in principle, but reflected the challenges of constructing a set of market-based regulatory institutions from scratch as well as a lack of incentives to push for greater adoption in a system that served the material interests of a number of powerful groups. Despite the dominance of foreign banks, the banking sector was domestically oriented and did not need to signal creditworthiness to international investors, nor were the domestic banks interested in entering foreign markets.[6]

Enduring links between the banking sector and powerful politically connected figures also influenced the extent of banking regulation enforcement. In the 2000s a series of grand corruption scandals linking politicians and local and international business caused political reverberations within the ruling party (Gray, 2015). Some of the most important scandals occurred within the banking sector and involved the incumbent governor of the BoT, Dr Daud Bilali, as well as a previous governor, Dr Idris Rashidi (IMF, 2018, 2017a, 2010, 2004). A number of commercial banks were embroiled in these scandals as significant funds were moved in and out of their accounts. While no commercial bank was taken to court as a result of these scandals, one did agree to a Deferred Prosecution Agreement with the UK Serious Fraud Office (Serious Fraud Office and Standard Bank Plc, 2015).

Despite these connections, some of the signals of clientelism—such as a high level of NPLs, or bank failures due to overstretched capital—that were seen in other countries in this study (notably Angola) were not evident in formal records in Tanzania. Clientelist practices are always opaque, but the very serious lack of

[5] Interview, Bank of Tanzania, July 2017.
[6] Interviews, Tanzania Bankers Association and large commercial bank.

reliable bank-level data on NPLs identified by the IMF in 2010 (IMF, 2010) further obscures the actual practices of lending and supervision in Tanzania in the 2000s. Further, the profitability of most of the banking sector, coupled with a lenient approach to the enforcement of capital requirements on the smallest banks, led to a very low level of bank failure in this first period.

The handful of bank failures in the early 2000s was mainly linked to the failure of the foreign parent companies but raised important issues about political discretion over licensing. Poor bank licensing practices were evident in a chain of decisions that led to a bank being closed down as a result of international money laundering concerns in 2017. This chain started with the Greenland Bank Tanzania Ltd which was established in 1995 and was a subsidiary of Greenland Bank (Uganda) Ltd. The parent bank was closed down by the Bank of Uganda after concerns about its banking practices and when the Tanzanian subsidiary was audited it was found to be insolvent. It was placed under compulsory liquidation and its assets were subsequently sold to Delphis Bank (T). Delphis Bank (T) was a subsidiary of the Kenyan Delphis Bank which became embroiled in a banking scandal involving Kenyan politicians and Kenyan and Tanzanian businesses (Dowden, 1993). It was closed down in 2003 and its main assets were quickly sold by the Deposit Insurance Fund to the Federal Bank of the Middle East Limited (FBME). The central bank was reported to have offered the FMBE quick access to gaining a banking licence, three branches, and premises and staff, and allowed FMBE to be operational in Tanzania within a few months (TanzaniaInvest, 2006).

The FMBE was looking to move its headquarters from the Cayman Islands following more stringent restrictions on the banking sector there (Financial Crimes Enforcement Network, 2016). FMBE became the largest bank in Tanzania, owning over 20 per cent of banking assets by the end of the 2000s. Despite holding the largest market share and having its headquarters in Dar es Salaam, it remained an overseas bank and held 90 per cent of its assets in Cyprus and mainly served wealthy Russian clients (Financial Crimes Enforcement Network, 2016). In 2014 the Financial Crimes Enforcement Network identified the Bank as a concern for money laundering (Financial Crimes Enforcement Network, 2016). It was subsequently blacklisted and a few weeks later, the Tanzanian headquarters were put under statutory management by the BoT. The failures to adequately regulate one of the largest banks in Tanzania for over a decade suggest that there were significant weaknesses in the regulatory system.

In summary, during this first period, Tanzania can be described as an example of policy-driven convergence. This was a result of the influence of the international financial institutions in shaping the preferences of both regulators and politicians. Nevertheless, the actual implementation of international standards and enforcement of all banking regulation was quite weak. This was due to both technical and practical challenges of constructing new market-oriented supervisory institutions from scratch. During the regulatory hiatus that ensued, poor

enforcement may also have served to facilitate some of the clientelism that occurred within the political system in the 2000s. Commercial banks had no interest in demanding faster Basel implementation and the high profitability and insularity of the banking system created a stable and relatively low-risk banking sector that generated huge profits for the banks but with limited developmental impact.

2009–17: Faster Implementation and Enforcement, Emergence of Differentiated Rules for Supervision

During the next period, Tanzania continued to signal strong support for adopting key elements of Basel but in addition the pace of implementation and nature of enforcement changed in important ways over the 2010s. In this period, Tanzania can be characterized as having a regulator- and market-driven approach to implementation. The global financial crisis that unfolded from 2008 played a key role in triggering a series of changes in incentives at the international level that influenced all the actors. Changing approaches to the role of the market and state in development also affected the preferences of politicians and generated pressures for the creation of a more tailored approach to Basel implementation.

Two key factors in combination led to changes in the preferences of the regulators towards a faster pace of implementation of Basel in the 2010s. The first was a change in the top leadership at the BoT. After the grand corruption scandals under Governor Bilali, President Kikwete selected a highly respected technocrat, Professor Benno Ndulu, to take on the position of governor at the BoT from 2008. Although Beno Ndulu shared a similar background to Bilali in terms of his experience of working in an international financial institution, he was seen to be a governor who could restore the reputation of the bank and bring greater independence to decision-making.[7] He had been a few years in advance of Kikwete at the University of Dar es Salaam and interviewees reported that Kikwete held his professionalism in high regard.[8] Governor Ndulu's approach to the banking sector was pro-market and he demonstrated his ability to oppose demands from politicians for policies that he disagreed with, for example resisting calls for Tanzania to follow Kenya in introducing interest rate caps in 2016 (The Citizen, 2016a). His pro-market approach was also evident in his decision to allow the mobile money market in Tanzania to develop initially with minimal regulation (African Business, 2017).

The second key factor that influenced the preference of the regulator was the emergence of a stronger agenda on harmonization of banking regulation across

[7] Interview, consultant and former Bank of Tanzania official, Dar es Salaam, April 2017.
[8] Interview, consultant and former Bank of Tanzania official, Dar es Salaam, April 2017.

the region that emanated from the East African Community. The initial commitments to establishing an EAC custom union, common market, and monetary union was established in the EAC Treaty of 2000s but the agenda only started to take a concrete form from the end of the 2000s. The most important EAC commitments on economic harmonization was the Common Market Protocol that was ratified in April 2010. The agreement envisaged the phased liberalization of trade in financial services and the elimination of restrictions on the free movement of capital. In 2013, this was followed by the EAC Monetary Union Protocol which committed all members to the creation of a single currency by 2024 and the establishment of the preliminary elements of a regional financial architecture by 2018. Technical and financial support from the IFIs also shifted from national governments to supporting the harmonization agenda at the level of the EAC. A new project funded by the World Bank to promote harmonization, the First Financial Sector Development and Regionalization Project for East African Community (EAC) to establish the foundation for financial sector integration among EAC Partner States, started in 2011 and was eight years in length.[9]

The Monetary Affairs Committee, consisting of the governors of the central banks of member states, had responsibility for overseeing the financial harmonization agenda. Ndulu was firmly ensconced within international professional networks that supported the implementation of international banking regulation and he maintained close professional ties with the other governors on the Committee. While the MAC set the agenda, the details of implementation were determined by the MAC Finance sub-committee. The Tanzanian delegation was a group of officials from the BoT and the Ministry of Finance. It was tasked with developing country-level action plans for harmonizing banking regulation and moving forward with implementing Basel II and III.

While the top leadership at the bank was more actively supportive of Basel implementation than in the 2000s, other actors within the bank and government remained more cautious about the need for a faster implementation of Basel.[10] Tanzania had a history of slow financial reforms compared to Kenya and Uganda, typified by its resistance to opening its capital account, and Kenya and Uganda also proceeded towards Basel II and III adoption at a much faster pace than Tanzania. Nevertheless, the roadmap for harmonization was an important factor in leading to a more rapid pace of implementation of Basel compared to the 2000s. For example, when Kenya and Uganda adopted increased capital charges in 2014 in line with Basel II, this was an impetus to Tanzania to move forward with

[9] Component 2—Harmonization of Financial Laws and Regulations and component 3—Mutual Recognition of Supervisory Agencies were particularly pertinent.

[10] Interview, Ministry of Finance, Dar es Salaam, July 2017.

implementation.[11,12] The consequences of these two factors in combination was that the preferences of the regulator supported a faster implementation of Basel II and III.

Preferences of the large commercial banks also changed in the second period. A significant reason for this was the greater pressure to conform to international banking standards emanating from the 'parent' banks of foreign commercial banks in Tanzania. The large banks were all concerned to improve AML compliance in Tanzania and saw Basel adoption as an important component in achieving this. In addition, a number of the larger banks were concerned about the rapid growth in the number of small commercial banks operating in Tanzania.[13] While the average capital reserves in the banking sector were consistently higher than Basel standards, many of the smaller banks, and in particularly the Community Banks, were operating with much lower levels of capital. Moving to introduce the higher capital requirements contained in Basel II and III was therefore seen as a desirable way to drive consolidation within the banking sector in Tanzania (The Citizen, 2016b).

The larger commercial banks lobbied for faster Basel adoption through the Tanzania Bank Association (TBA). They established a sub-committee of the TBA called the Joint Committee on Regulation, Compliance and Risk. This was made up of the five largest banks. The purpose of the sub-group was to participate in the planning process for Basel adoption and they engaged in a regular dialogue with the BoT on specific aspects of Basel adoption.[14] These large banks also influenced the BoT's approach by running training programmes and sharing technical expertise on issues such as correspondent banking and AML compliance.[15] However, the large influential banks were also in agreement that aspects of Basel II, such as internal ratings models, were not appropriate for the Tanzanian banking sector and they did not lobby for these to be included in the roadmap for Basel adoption.[16] Thus, the combined interests of the larger banks and the institutionalized channels of influence played an important role in moving Tanzania towards a more rapid but selective implementation of Basel II and III.

While the changing preferences of the regulators and the commercial banks help to explain Tanzania's more rapid, but selective, move to adopt and implement Basel II and III after 2009, preferences of politicians also changed in ways that encouraged a more tailored approach to Basel implementation and banking regulation to emerge. Tanzania started to return to a more statist approach

[11] Interview, Bank of Tanzania, July 2017.

[12] The Bank of Tanzania issued a moratorium of three and five years for commercial banks and community banks to fully comply with the minimum capital requirements following lapsing deadlines in Kenya and Uganda.

[13] Interviews, commercial banks, Dar es Salaam, April, July 2017.

[14] Interviews, Tanzania Bankers Association, commercial banks, July 2017.

[15] Interviews, commercial banks, April and July 2017.

[16] Interviews, commercial banks, IMF, Dar es Salaam, April and July 2017.

to economic policy, reflected in the adoption of five-year planning documents, a focus on industrialization, and a return to some elements of policy lending by state banks.

The kind of directed policy lending that had been at the core of the banking system during the socialist period was not viable as many of the potential financial control mechanisms of the state were no longer available. Nevertheless, growing doubts about benefits of the liberalization agenda led to political demands for a more active policy agenda on promoting financial inclusion and directed credit for priority sectors. The more interventionist approach first came into evidence in the wake of the global financial crisis in 2009, when the government introduced a stimulus package through the commercial banks and agreed to guarantee financial institutions for loans where repayment had become difficult because of the global downturn. The Ministry of Finance started to play a more active role in the development of financial sector policy, and the Tanzania Financial Stability Forum was established in March 2013, bringing together financial regulators as well as the BoT and finance ministry representatives to oversee financial stability and regulation. A National Financial Inclusion Framework was launched in 2013.

This new approach culminated in the introduction of a more tailored approach towards the regulation of development and community banks in Tanzania. In 2010 the BoT commissioned a consultant to start working on establishing a supervisory framework for DFIs, including specific prudential regulations (Bank of Tanzania, 2010). The Association of African Development Finance Institutions had already developed a document setting out unique prudential standards, guidelines, and ratings system for African Development Banks that had been adopted in 2008 (African Development Bank, 2009), and provided the basis for Tanzania's new system.[17] Development Finance Institutions Regulations were issued in 2011.

As a result, Tanzania Investment Bank was split into two parts—a non-deposit-taking financial institution, the Tanzanian Investment Bank Development Bank, and a deposit-taking bank called Tanzania Investment Bank Corporate Finance Ltd. TIB Corporate Bank Limited gained its commercial bank licence in 2015. In 2015 the Tanzania Agricultural Development Bank also gained a licence under the new Act. The IMF had consistently opposed the establishment of development banks in Tanzania (IMF, 2010, 2004) but the creation of specific regulation in the 2010s brought a closer alignment between the formal systems of regulation and actual practices.

Another example of the emerging tailored approach towards finance was the increased pressure on pension funds to invest in priority sectors in the 2010. Aside from the development banks, Tanzania's main vehicles of policy lending after liberalization had been the pension funds. In the 2000s, these had been operating with very little oversight. In 2005 the IMF found that 'there is no law

[17] Interview, development finance institution, Dar es Salaam, July 2017.

or regulatory body monitoring financial reporting by pension fund' (World Bank, 2005, p. 7). In the 2000s, the investment portfolios of the pension funds were not particularly targeted to priority sectors (IMF, 2010). However, funds were encouraged to provide investment for industrial projects (Ubwani, 2016). The significance of this was that there was less pressure on commercial banks to engage in directed lending.

The other area of banking regulation that underwent significant change after 2010 was the enforcement of regulation on the community banks. Community banks had been established in Tanzania since 2003 when the Banking and Financial Institutions Act was amended to give powers to the BoT to prescribe lower capital threshold for the establishment of regional and community banks. Throughout the 2000s, these banks had low profitability and poor asset quality, very high overhead costs with large boards, and a higher proportion of NPLs (IMF, 2016). Community banks were identified as the least compliant groups with international accounting standards, and they often failed to comply with credit risk disclosure requirements (World Bank, 2005). Despite these problems, no community bank was closed down for a lack of capital until the mid-2010s. The IMF argued that the BoT had exercised considerable regulatory forbearance in dealing with these banks. The BoT may have taken a more lenient approach because these banks were seen as critical for promoting a more inclusive banking sector and addressing the urgent needs of financial inclusion.[18]

From the mid-2010s, stricter regulations and enforcement were introduced on community banks. New minimal capital requirements were introduced in 2015, increasing from Tsh250 million ($154,036) to Tsh2 billion ($1.23 million). Community banks were given five years to address the capital shortfall that many were facing when operational risk charges were introduced in 2012. The decision to take a much stronger approach to poorly performing banks was set out by the new President John Magafuli in 2017 (All East Africa, 2017). Mbinga Community Bank was closed in May 2017 and a further five community banks were shut down in January 2018. This represents a major shift in approach to poorly capitalized community banks in Tanzania.

Thus, during this second period preferences of the regulator, large banks and politicians led to a faster pace of Basel implementation and greater enforcement. This was combined with a move to a more tailored approach to Basel that led to selective adoption of Basel II and III and the formalization of different regulatory systems for development banks (and pension funds). Overall, this brought greater alignment between de facto regulation and de jure practices in the sector. Despite the strengthening of formal institutions, there was still evidence of areas of regulatory forbearance (IMF, 2018). More stringent capital demands entailed by Basel II and III were introduced at a time when the economy was slowing

[18] Interviews, retired Bank of Tanzania officials, Dar es Salaam, July 2018, January 2019.

down and NPLs were rising in banks of all sizes. This led to a much more challenging environment for banks overall. The continued willingness to adapt the formal regulatory system was in evidence in 2018 when the BoT issued a circular for loan classification and restructuring to give regulatory relief to banks in the face of rising levels of NPLs (IMF, 2018).

Conclusion

Despite the fact that international banking standards were designed to address the challenges of banking systems that bear little resemblance to Tanzania's banking system in the 1990s, Tanzania sought to implement Basel standards from the outset of its reform process. This was a result of the influence of IFIs on the preferences of politicians and regulators. Their formal commitment to adopt these standards did not, however, lead to an effective implementation of standards and indeed the regulatory framework was very weak across the 2000s. This was partly a reflection of the enormous technical and practical challenges of implementing a new regulatory system but also reflected the preferences of the commercial banks and some powerful groups of politicians whose interests were not served by stronger implementation.

From 2008 these underlying preferences changed in important ways. A number of shocks played a role in shaping these new preferences: the global financial crisis, the AML blacklisting, as well as the grand corruption scandals of the 2000s led to greater pressure to move forward with Basel II and III implementation and to push for greater enforcement. At the same time, changing ideas about the role of banks in Tanzania's development led to a formalization of distinct regulations for directed lending through development finance institutions and social security funds. This helped to bring the actual practices of regulation into closer alignment with the formal supervisory system. As the 2010s draw to a close, it appears that Tanzania has entered a new phase of regulation in the banking sector, with stricter enforcement of regulations. This has been accompanied by a more statist approach to the banking sector but so far this has gone hand in hand with a continued commitment to implementing Basel standards. The problem for countries like Tanzania that have ambitious plans for economic development is that Basel was designed primarily for the banking sectors of the richest countries in the world. Creating a system of banking regulation that can promote sustainable industrialization will require a much more fundamental rethink about the nature of risk and banking supervision than has taken place so far within Tanzania and beyond.

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