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The Paradox of Property and Business Formalisation in Tanzania

kenny manara (2008)

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Contents

Abstract

This paper seeks to explore the possibilities of Property and Business Formalisation Programme in Tanzania to empower the poor to find their pathways out of poverty. The programme, popularly known in Kiswahili as MKURABITA, targets property and business owners in the informal sector whose entry into the formal market economy would enhance their opportunities by using their assets to access capital and thus transform their productive activities and reduce individual poverty. We found that while the programme may help the petty traders to access credits by virtue of operating formally, the same could not be said to smallholder farmers, who may lost their attached land once they fail to service their loans. Thus, MKURABITA appears to benefit petty traders more than smallholder farmers regardless of whether the operators are in rural areas or urban setting. This suggests a paradox.

1. Background

Tanzania has been striving to ensure that the macroeconomic benefits achieved in the last decade are maintained and percolate downwards to the grassroots through distribution mechanisms and infrastructure development.[1] This is largely because while macroeconomic indicators show positive trend, poverty levels have fallen very little and in some areas they remained static (World Bank, 2007:2). For the last four years, for instance, the rate of growth has been 6.7% for 2005, 6.2% for 2006 and 7.2 for 2007. However, sustaining growth while ensuring the economic benefits are broadly shared remains a challenge (United Republic of Tanzania, 2007:2).

In responding to this challenge, the Government of Tanzania is implementing a number of reform programmes with the aim of ensuring broad-based growth whose benefits trickle down to the poor. One among these reforms is Property and Business Formalisation Programme (PBFP), popularly known in Kiswahili as MKURABITA. Retrospectively, MKURABITA is conceived within National Strategy for Growth and Reduction of Poverty (NSGRP), popularly known in Kiswahili as MKUKUTA (Kwayu, 2006:8).

Launched in October 2004, MKURABITA seeks to establish an integrated system of property rights and business rules as a basis of transition of the urban, peri-urban and rural areas into a market that enables Tanzanians to have equal opportunities in using their assets to access credit services (ole Kosyando, 2006; Mkulila, 2008). Thus, the programme aims to systematically reduce the informal sector to an acceptable national limit to which the informal sector can coexist with the formal sector (Economic Research Bureau and National Bureau of Statistics, 2007:2)

MKURABITA targets property and business owners in the informal sector, whose entry into the formal market economy is assumed to enhance their opportunities by using their assets to access capital and thus improve national economic growth and reduce individual household poverty (Claussen et al., 2008:12). The programme is convinced that once these marginalised majorities are engaged fully in the formal sector of the economy, it will be possible for them to create wealth and hence contribute effectively to the attainment of the Millennium Development Goal (MDGs).

MKURABITA builds on Hernando de Soto's well known hypothesis that the most effective way to empower the poor is to provide them with formalised rights to their property (Sundet, 2008:2).[2] The following are the specific objectives of the programme:

- To build an architecture of property and business rules that will bring together, standardise, and modernise the prevailing local customary arrangements dispersed throughout the country, so as to create one Tanzanian property and business legal system that incorporates all sectors of the society.
- To foster national integration by enabling the government to bring the informal sector into the legal system in order to govern the nation's market activities more effectively.
- To ensure that assets of the poor, which are held and exchanged outside the existing legal system, are adequately documented and standardised into universally accepted property records that can be used to create liquidity.
- To develop means to achieve broad-based support for change, for both traditional community leaders and the poor, towards a national property framework that can help realise the potential of a modern market economy.
- To enable overall economic policies and supporting mechanisms such as monetary and fiscal stimuli, to actually work once most people are inside the legal market economy.

This paper is therefore seeks to explore the possibilities of MKURABITA to empower the poor to find their pathways out of poverty. In particular, the paper seeks to answer the following questions: (1) what are the experiences of implementing formalisation of properties and business in the Tanzania? (2) What are the problems and challenges facing the implementation of formalisation programme in Tanzania? (3) How does the formalisation of properties and businesses empower the poor in rural and urban Tanzania?

The paper is organised as follows: Section II submits the general approach of MKURABITA,

1 The message of the Deputy Minister Hon. Yussuf Omar Mzee, Ministry of Finance and Economic Affairs on the International Day for Eradication of Poverty 17th October 2008

2 Hernando de Soto is the Peruvian Economist whose book, "The Mystery of Capital: Why Capitalism Triumph in the West and Fails Everywhere Else" provide theoretical background for MKURABITA.

including its four phases and some conceptual observations. Section III provides a conceptual framework and the theoretical divide on the relationship between formalisation and poverty reduction with a particular focus on access to credits and presents a point of departure for this paper. Section V presents the findings with the discussion of the experiences of different actors in formalisation of property and business as well as its impact on the rural and urban poor. Section VI concludes with a discussion on the paradox of MKURABITA as a poverty reduction tool.

2. The Approach of MKURABITA

MKURABITA is a four phased programme customised on a specific model developed by the de Soto's Institute of Liberty and Democracy (ILD) of Lima, Peru. The phases are (1) Diagnosis, (2) Reform Design, (3) Implementation, and (4) Capital Formation and Good Governance.[3]

2.1 Diagnosis Phase

The programme was designed to begin with a complete diagnosis of the size and nature of the country's extralegal and customary sectors, as well as a preliminary overview of the reasons why the informal sector continues to thrive. The general objectives of the Diagnosis Phase were to:

- Define, map out, and assess the extralegal sector and determine its magnitude, identify the different kinds of extralegal business and real estate assets; locate the geographic areas and sectors where extralegality is most active; determine the relevant links between the legal and extralegal sector where possible; and identify the process where the government has already successfully dealt with the extralegal sector.
- Identify the main institutional constraints that create legal, administrative, and economic obstacles to the integration of the poor into the legal economy.
- Build awareness and develop strategies that allow the government to obtain support for real estate and business property reform and establishment of the rule of law, thus bring the government closer to its constituency.
- Lay the groundwork for re-engineering of the current legal system to achieve the objectives of the programme.

3 See http://www.mkurabita.go.tz/index.php?&chooselang=1

2.2 Reform Design Phase

The general objective of this phase is to provide the government with detailed policy and institutional proposals, as well as an implementation strategy; to integrate extralegal real estate and businesses into legal system in order to boost economic growth, reduce poverty, and eventually expand the tax base. The Reform Design was to:

- Build on well-established local legal and extralegal practices that Tanzanians identify with and respect.
- Create a single organization whose responsibility is to integrate all Tanzanians into one legal economic system and whose over-riding goal is to enable people to generate capital.
- Reduce the time and cost to enter and operate in the legal sector
- Eliminate wasteful procedures used by the citizens to avoid sanctions for sidestepping the law.
- Streamline rules and procedures which govern real estate and business activities
- Lay the groundwork for a massive formalization campaign
- Provide a basis for the Program to additionally facilitate capital formation, personal identification system; national security; collection systems for credit, credit, rates and taxes; housing and infrastructure; insurance and other value added information services during the Implementation and Capital Formation stages.

Reforms Design is a logical follow up operation seeking to protect and promote the positive attributes of the customary practices (archetypes), reducing the barriers in the legal and institutional arrangements as well as capacitating beneficiaries to transit to formality and reside there.[4] The Reforms Design therefore is built around the convergence of systemized and standardized archetypes with the improved business and property laws. The hybrid from the two systems is intended to among other things possess three basic attributes that are believed to be indispensable in creating wealth. These are:

- Legal and economic mechanisms that increase productivity through the creation of "distinct legal entities", incorporating "asset partitioning" and an efficient "division of labour".
- Legal means for enterprises to operate in the expanded market, acquiring the capacity to gain access to networks beyond family members and circles of acquaintances.
- Formal, fungible property rights that not only allow assets to be identified but also allow ordinary people to move them in the expanded market to capture as much economic value as possible.

4 This is according to MKURABITA – Programme Management Unit (PMU)

2.3 Implementation Phase

In this Implementation Phase, the program will progressively bring the extralegal real estate and businesses into the new legal order through a national campaign. The main components of the Implementation Phase include:

- Proactive Formalization Campaign, which will involve establishing procedures, recruiting and training personnel, preparing manuals, and opening and equipping offices that enable the Government to reorganize and process individual property rights to private homes as well as businesses coming from the extralegal sector (adjudication, documentation, recording and issuing of title certificates).
- Consensus Building by sharing customized information through various media channels to demonstrate the benefits of capitalization to various social groups including the extralegal sector, business community, traditional authorities, government officials, and any other group that might tend to resist change.
- Establishment of a Feedback Mechanism to enable the legal systems to stay in touch with the evolving needs of the poor, and remain relevant.
- Establishment of National Database and Record Keeping Organization, thus re-engineering record keeping and registration processes so that the country can pull together all the economically useful descriptions about extralegal assets into one data/knowledge base, and keep it up to date.

2.4 Capital Formation Phase

This phase will involve formulation and implementation of recommendation for connecting the newly legalized property to larger national and international markets, and allow the property to be leveraged to create capital and generate more wealth. The process will involve:

- Setting up of credit and mortgage systems, and collection systems for credit, rates and taxes
- Provision of housing and infrastructure
- Provision of insurance and information services
- Development of individual identification systems
- Use of property to enhance accountability

Following the accomplishment of the Diagnostic and Reform Design phases, MKURABITA is now in its third phase of the Implementation, launched in March 2008. In this stage, MKURABITA is expected to implement an architecture of property and business rules that will bring together, standardise, and modernise the prevailing local customary arrangements dispersed throughout the country, so as to create one Tanzanian property and business legal system that incorporates all sectors of the society (Mtalo, 2008a:5). The expected outcome from the implementation of the programme is reduced individual household poverty, improved living standards of the target groups, and an expanded national market economy that is governed by the rule of law (ole Kosyando, 2006:6).

3. Conceptual Framework

While the importance of formalisation of property and business is widely recognised, there is little evidence on whether operating in formal sectors improve the well-beings for the poor. This section provides a conceptual framework for the analysis of the formalization of land and business and their impact on the rural and urban poor. The conceptual framework emerged through an analysis of the formalisation debate and therefore it is based on specific understanding of the formality versus informality.

The informal sector is a population of informal operators who, by custom and practice, have evolved a negative attitude towards formal government regulations, which is partially tolerated by governments cautious about exacerbating poverty or who are short of the resources necessary to enforce regulations (Nelson and de Burijn, 2005:576). In this sense, the informal sector has evolved an informal institution of quasi-permitted rules of conduct in response to failures of formal institutions.

The recent study found informal sector to be highly heterogeneous, encompassing production units of different features and in a wide range of economic activities, as well as people (i.e. workers, producers, employers) working or producing under many different types of employment relations and production arrangements (Economic Research Bureau and National Bureau of Statistics, 2007:5). Thus, the informal sector is characterised by the following:[5]

- Free entry and exit .i.e. no guidelines in terms of licenses and government legal framework to monitor the existence of these businesses.
- Reliance on personal or family resources
- Mainly family or individual ownership
- Small scale operations
- Labour intensive and adaptive technology
- Skills acquired outside of the formal sector
- Unregulated and competitive markets
- Typically operate at a low level of organization, with little or no division between la-

5 These characteristics were identified by the Fifteenth International Conference of Labour Statisticians (ICLS, January 1993), the International System of National Accounts (ISNA) and the Revised International Classification of Status in Employment (ICSE).

bour and capital and on small scale labour relations or personal and social relations rather than contractual arrangements with formal guarantees.

According to *Baseline Study of Informal Properties and Businesses in Dar es Salaam*, the units of informal sector possess the characteristics of 'household enterprises' which are (1) fixed and other assets do not belong to the unit but to the owner; (2) units cannot engage in transactions or enter into contracts nor incur liabilities on their own behalf; and (3) expenditure for production and capital goods is often indistinguishable from household purposes. This may be due to legislation that denies rights of ownership to land, or to banking practices that refuse to recognise the value of informal wealth and assets as potential collateral offered by operators in support of loans (Nelson and de Burijn, 2005:576).

In Tanzania, informal properties refer to own occupied or rented buildings and lands available in un-surveyed areas. These assets are un-officially owned by individuals and exist outside the incentive system offered by the government (Economic Research Bureau and National Bureau of Statistics, 2007:6). Indicators that can be used to identify informality in properties that include the following characteristics[6]:

- Land development without building permit
- Land used differently from what it was approved for
- Granted might has not been renewed
- Rights of occupy not registered
- Unauthorized sub division of the property
- Building o the reserved land or hazardous land
- Building in the unplanned land

Obviously, it is difficult to have properties that exhibit all the characteristics of informality inclusively; rather, many of such properties will have several of those features. But the major characteristic is unplanned versus planned supported by permits thereof (Economic Research Bureau and National Bureau of Statistics, 2007:6). Customarily then, informal sector includes all economic activities which are not officially regulated and which operate outside the incentive system offered by the government.

6 This is according to Norwegian Peoples Aid (2005) as cited in Baseline Study of Informal Properties and Businesses in Dar es Salaam

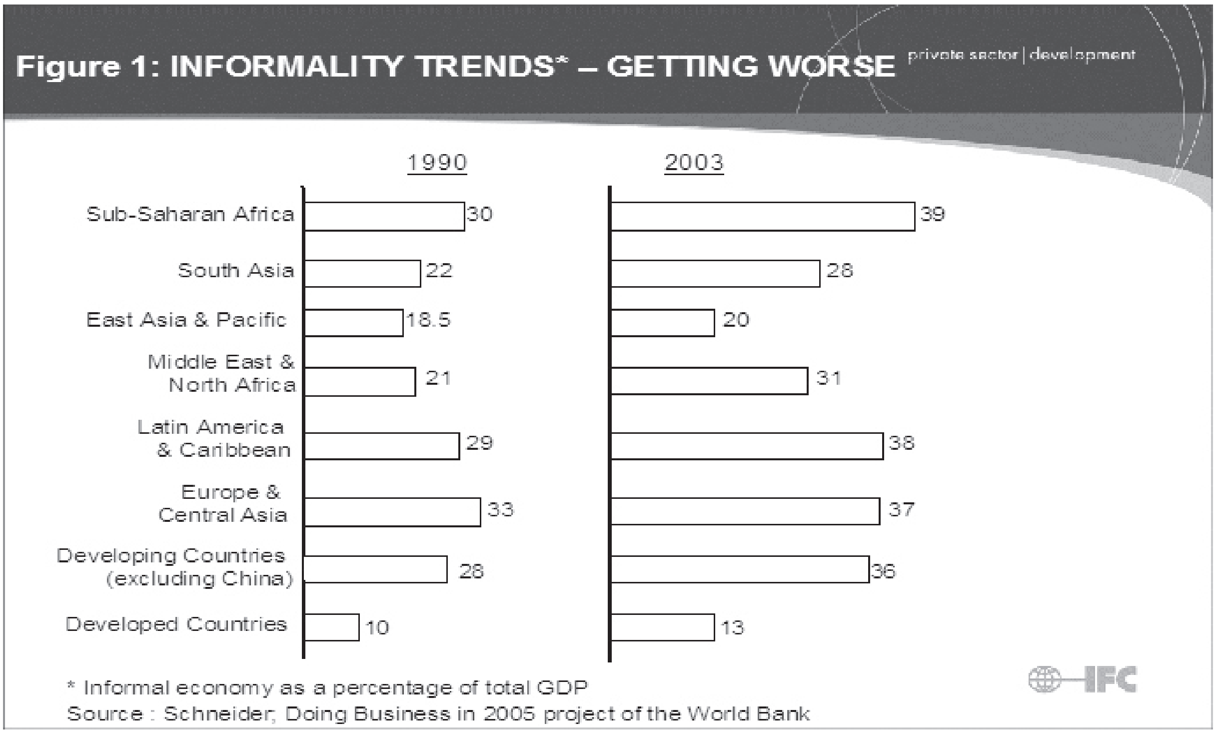
The possible causes are diffuse, but typically may include: legislation and regulatory systems that have been designed for the control of a relatively small number of larger state enterprises and are not adapted to the much more numerous population and capacities of small-scale enterprises; administrative cultures that have evolved to interact with strong professional managers and their political patrons rather than powerless, independent, and often uneducated small operators; public officials who use their position for illicit personal benefit and prey on small-scale operators (Nelson and de Burijn, 2005:576). This is the context in which formalisation takes place.

3.1 Property and Business Formalisation in Development Debate

By definition, it is difficult to estimate the size of the informal sector accurately (Galal, 2005:1). Various methodologies have been developed to assess informality and although they yield somewhat different estimates, they all show that informality is big and rising rapidly, especially among the poorest developing countries. According to Palmade (2005:2), the worst performers are Sub-Saharan Africa, Latin America, Central Asia and Russia where it is not unusual for informality to exceed 50% of GDP – it is also in these countries that informality has increased the most since 1990.

Informality is also increasing fast in South Asia and the Middle East from relatively low levels (Palmade, 2005:2). On a more positive note, the growth of informality is slowing down in Central Europe following extensive microeconomic reforms, while it remains stable at fairly low levels (around 20% of GDP) in East Asia where the regulatory and fiscal burden on firms is lower. Informality never accounted for more than 15% of GDP in the developed world as shown in the Figure 1.

This is not the good news since informal enterprises operate outside of the government system of regulation and therefore restricts government's ability to incorporate them in policies and strategies in pursuit of national socio-economic goals (Nelson and de Burijn, 2005:576). Notwithstanding that informal enterprises contribute to gross national product and poverty alleviation, these authors argue that increasing informal development represents a widening gap between



operators and government and limits the scope for a mutually beneficial government-private sector partnership - the failure of informal operators to comply with regulations that protect employment, the environment and consumers lowers the ceiling on the quality of their development and on their potential for growth and wealth accumulation.

In the minds of many, informality is a fact of life and not necessarily a bad thing. They see informality as an indispensable lifeline for the most vulnerable as well as a sign of economic vitality (Palmade, 2005:4). They are of course right, but that is not a reason not to do anything about informality. According to this author, the overall social and economic costs of informality are very large and underestimated. Informality therefore traps most workers and firms in low productivity operations, while it distorts the playing field in favour of well connected companies.

From the perspective of entrepreneurs, it is safe to assume that the decision to operate informally is rational (Galal, 2005:2). They decide to stay informal because the total costs of entry, operation, and exit associated with joining the formal sector are greater than the potential benefits from being formal. They are willing to forgo the benefits of better protection of property rights and to bear the cost of extra-legality (in the form of bribes, costly finance, etc.) because it is more beneficial to remain informal. Galal argued that to convince them to become formal, it is therefore necessary to adopt sufficient reforms to tilt the balance of the net benefits in favour of formalisation.

From society's perspective, entrepreneurs are only one group among many. Policymakers should also care about workers, consumers, and government budget (Galal, 2005:2). Accordingly, their decision to promote formalisation should be derived from its impact on all of these actors. Formalisation could, of course, positively impact certain groups and negatively impact others, just like other policy reforms. However, Galal admit that as long as the net benefits to society are positive, the decision to encourage formalization is socially desirable.

In addition, formalisation creates the basis for formal transactions with other entities, including financial intermediaries for access to credit, the public sector for the provision of public services, and clients and suppliers for contract based transactions. Given the rigidities, costs and attitudes o f formal sector regulators and service providers, the access of informal entrepreneurs to important public goods such as utilities like electricity or water, and other inputs and services is limited (World Bank, 2007:57).

According to *Rural Poverty Report 2001*, credit helps the poor to smooth consumption, and later to acquire assets greater than the value of the liability. Consumption smoothing is especially important for the rural poor; agricultural incomes and rural health fluctuate widely and will destabilize consumption if households cannot fall back on savings or access to credit. Once poor households feel that consumption is safe, they are more ready to risk borrowing for investment in physical, natural or human capital assets (IFAD, 2001:206).

Informal lenders are put off providing loans to the poor (for lacking collateral) by high co-variance (a bad harvest means loans fail together) – and often it does not pay to price-discriminate, charging more to poor/risky borrowers, because that stimulates even more risk-taking. (IFAD, 2001:206). Thus, substantial deficiencies in the legal and regulatory environment in developing countries constitute the primary reason for the low degree of credit extended to the private sector (Freedman and Click, 2006:291). As a result, enforcing contracts is an extremely time-consuming and costly process in many developing countries. Even if a borrower defaults on a loan and is in clear breach of a loan contract, it can take several years before the lender obtains a final court judgment against the defaulting borrower (ibid:291)

When judicial systems provide for the timely enforcement of contracts, banks will lend more while also charging lower interest rates. Lower interest rates render debt financing a viable option for many borrowers that would not be able to repay loans at higher interest rates (Freedman and Click, 2006:291). Thus, these authors argue that lenders require collateral from borrowers to minimise their losses should the borrower default. Collateral also serves as a device for screening prospective borrowers to make sure they are going to repay; a borrower's willingness to risk the loss of collateral suggests that the borrower is confident that it will repay the loan.

The prospect of losing collateral serves as a powerful incentive for a borrower to avoid default (Freedman and Click, 2006:292). However, the process of seizing and selling collateral is much faster in developed countries than in developing countries. In a hypothetical transaction that was part of the multi-country survey for *Doing Business in 2004*, it was found that, following a borrower's default, it generally takes just a week for a creditor in the US or Germany to seize and sell business equipment that was pledged as collateral, but it can take five years in Brazil and Chile to seize and sell identical equipment (ibid:292).

Due to the delays and costs involved in foreclosing on collateral and enforcing contracts, lenders in developing countries frequently require collateral in excess of 150% of the amount of the loan (Freedman and Click, 2006:292). Collateral is less valuable to lenders if it takes 5 years and significant legal costs to repossess and sell. In many developing countries, 150% or higher collateral requirements may be necessary for lenders to get repaid in full from the sale of collateral. Many entrepreneurs and small businesses are unable to meet this requirement, especially due to the fact that they do not have legal title to their home and land and therefore cannot offer it as collateral.[7] Thus, formalisation of their assets would enable them to access loans.

Clear property rights are advocated by many development economists and social thinkers nowadays. That resonates with two major themes in development thought: a wish to expand individuals' range of opportunities to change their livelihood situation and strategies; and the insistence on fairer forms of governance (Hinojosa, 2005:18). Yet, this author argued that the Livelihoods Approach, if restrained to mechanistic relationships between access to assets and resultant livelihoods outcomes, overlooks the tensions introduced by unclear regimes of property rights into the opportunities for livelihoods change. According to him, the progressive integration to markets that provide opportunities for livelihoods change and the straightjacket produced by path-dependence on communalist property rights exacerbates those tensions and undermines any attempt for improving the livelihoods of people living under conditions of poverty.

The central problem with undefined property rights is that, however hard it can be to contest community-based forms of governance within peasant communities, unless customary recognized private ownership obtains also official recognition in the broader society, it can not be guaranteed that rural (peasant) households will gain adequate reward for their labour and investments. As a result of the duality of formal and informal ownership regimes, some people –more likely the poor- will be worse rewarded than others as a result of circumstances beyond those individuals' control (Hinojosa, 2005:18).

7 *This is the main tenet of the argument advanced by de Soto*

Thus, to suggest that formal title enables access to credit and therefore increases economic productivity and hence improve the well-being of the poor, is one the reigning myths of formalisation.8 The security that formal title brings with it, so the argument goes, gives landowners an incentive to invest, using their land as collateral (Nyamu-Musembi, 2006:14). In fact, the overall link between formal ownership and productivity has similarly been discredited by empirical data that shows that holders of unregistered land have made equally productive investments (ibid:16)

According to Nyamu-Musembi (2006:17), proponents of formalisation make two assumptions that are refuted by empirical evidence: that 'market' refers only to 'formal market' and that 'commodity' or 'asset' captures all the dimensions of meaning that people attach to their possessions. These views could not be further from the reality when it comes to rural land in sub-Saharan Africa. The presumption that markets in land can only operate when there is formal private ownership is strong in arguments for formalisation. On this point, however, de Soto makes a less ambitious claim.

In its conventional form, the argument linking formal title to markets in land is expressed in economic terms as follows: a formalised private property regime is the only way that individuals are enabled to take advantage of increases in land values brought about by factors such as market integration, land scarcity, or technological innovation. However, Nyamu-Musembi argues that a market in land does exist in the absence of formal title, and informal transactions in land do take place in spite of formal title. This market in land is regulated primarily by informal social structures and only marginally, if at all, by formal official structures that are supposed to regulate land transactions (Nyamu-Musembi, 2006:18).

Admittedly, there is an agreement between de Soto and his critics that tenure security is important. The difference is in the perception of how to go about promoting such security. De Soto argues that extra-legal systems should be decoded to identify underlying rules that will help to codify and *adjust the formal system* so *both* systems 'fit each other' and, thus, create a single framework. This seems inconsistent with the assumption that formalisation equals individual private property i.e. titling (Cousins, 2005:15). Also, many of the informal property systems of the poor are community-based.

Though the effects of property over the development of a financial market are indisputable, it is also noticeable that clarity of property rights, and particularly titling, does not assure *per se* the access to financial markets (Hinojosa, 2005:16). As the evidence of the case studies suggest, despite the non-possession of legal titles, 17 per cent of the surveyed peasant households have had access to micro credit, even if only from the NGO sector.[9] In the same vein, titling is not the unique requirement to the development of a land market and it does not imply automatically better economic performance in all contexts either (ibid:16).

In the past, it was often assumed that the poor were badly served because they were neither of interest nor suitable as clients for sophisticated service providers. Recently, however - especially as a result of the strong emergence of microfinance - many of the myths surrounding the importance and reliability of the poor as users of financial services have been effectively challenged. The inadequate availability of financial services to large segments of the population is viewed essentially as the result of massive market failure, institutional shortcomings, and policy neglect (Barth and Calari, 2006:2).

According to Barth and his colleague, there are many factors - both macro and micro - that explain the low level of financial sector development and performance in poorer countries. These include distorting macroeconomic policies, weak institutions, and inefficient markets characterized by poor business practice. High rates of inflation, government deficits which "crowd out" private borrowers, weak governance and institutional capacity, and an inadequate contracting and information environment lead to a lack of resilience, balance and variety, and discourage serving non-traditional segments. All these contribute to "broken" financial sectors in many poorer developing countries, and they are at the very root of why informality is still dominant there (Barth and Calari, 2006:2).

3.2 Point of Departure

Building upon these opposing views, our point of departure is that the impact of the property and

8 This position is held by the critics of de Soto's "The Mystery of Capital"

9 Hinojosa studied the relationship between property rights and livelihoods in the Andes.

business formalisation on the well-being of the poor is contingent upon the three key factors: (1) smallholder friendly legal framework, (2) the accessibility of the poor to affordable credits, and (3) well-functioning governance institutions. Where these factors exist, formalisation will enable the poor to find their pathways out of poverty. Otherwise, formalisation is likely to yield different outcome. This suggests a paradox.

This is consistent with Galal (2005:5) who argues that formalisation could generate significant benefits to the economy and economic agents if reforms were adopted. This is because these reforms would lead to better protection of property rights, which would enable entrepreneurs to secure inputs at lower costs, increase access to infrastructure services and credit, take advantage of expanded markets, and avoid coping with unofficial payments to stay informal. According to him, it would equip and motivate entrepreneurs to expand their businesses, reorganized internally, and benefit from specialization and division of labour (ibid:5)

Similarly, Deininger and Jin (2007:3) argue that a legal system that protects contracts and property rights encourages investment and ensures effective use of scarce economic resources. It can thus be viewed as a fundamental precondition to achieving many of the outcomes often subsumed under "good governance" or "appropriate macroeconomic policies". According to these authors, if the rule of law is weak or nonexistent, private actors will need to spend resources to secure their property rights and enforce contracts with strangers, leading to socially inefficient outcomes. The poor may not be able to afford the associated costs at all and, without the ability to enlist the power of the state to protect their property rights, may end up in otherwise avoidable poverty traps (ibid:3)

4. Methodological Overview

This paper involved four major tasks: preparation of interview guide, collection of primary and secondary data cum information, data interpretation and analysis, and writing of the paper.

Interview guide was developed with the help of ToR from KEPA. The author was required to collect material (published and unpublished material, material available at the internet, and interviews) on MKURABITA so that experiences and views of different sectors (e.g. civil society, cooperatives and other producers and government) can be included as widely as possible and that material should cover information as well on formalisation of land titles as of economic activities.

The paper targeted civil society organizations (CSOs) involved in MKURABITA implementation, including farmers as well as traders associations, as respondents. Thus, the author collected data and information from officials of CSOs which included petty traders associations, small producer organisations, settlements organisations, and advocacy organisations. He interviewed a total of 20 organisations and individuals that seemed to fit the description given in ToR.

In addition, the author undertook desk studies on the two components of MKURABITA (property and business) to fully appreciate the legal and economic environment of each and evaluate their formalisation with the bigger picture. He retrieved secondary information from the internet and consulted other relevant documents including "Baseline Study of Informal Properties and Businesses in Dar es Salaam", "Focus Group Discussion on Legal Empowerment of the Poor", "Practical experiences on land registration in the implementation of the Village Land Act No. 5 of 1999" and "MKURABITA and the Implementation of the Village Land Law – ACT No 5 of 1999".

He thereafter analysed the data through literary criticism and interpretation. The findings with regard to the objective of the paper are presented and discussed in the rest of this report.

5. Experiences on Formalisation of Property and Business in Tanzania

The ultimate objective of MKURABITA is to reduce poverty by raising incomes of the poor through formalisation of property and business. This is largely because formalisation creates an enabling environment for business transactions. In turn, this improved environment is expected to raise security of both the asset holder and the lender. However, issues and level of sensitivity surrounding property formalisation and business formalisation are different (Claussen et al., 2008:28). Thus, the discussion of the experiences of the two should be done separately.

5.1 Formalisation of Land

MKURABITA – Programme Management Unit (PMU) carried out a pilot project in Handeni district with the aim of testing the implementation of the Village Land Act No 5 of 1999.[10] The aim of this project was basically to test some few innovations on the land use planning and registration in order to come up with a more sophisticated means of implementation of the Village Land Act No. 5 of 1999 that will eventually recommend some reforms basing on field experiences. Two NGOs, Legal and Human Rights Centre (LHRC)[11] and Tanzanian Pastoralists, Hunters and Gatherers Organisation (TAPHGO)[12] participated in this pilot study.

In one village, when the team was surveying one farm, a lady in her sixties walked to them and requested them to survey her farm next (ole Kosyando, 2006:18). They obliged and went to her farm a while later. As they were about to get started, she asked them to wait a bit as her daughter goes to call one of her neighbours, who owns a farm adjacent to hers on one side, and who had previously indicated to her that she would come to show her proper boundaries. As they were waiting for the second lady to arrive, there was a little conversation and this lady says, almost in whispers, that since this project started in this area in the past two months or so, they have buried people as a result.[13] Their guide in the survey work, a villager himself from the same hamlet, was in agreement that this had in fact happened, a conflict had arose over ownership of a piece of land. They claimed that one was bewitched, and died shortly.

This is what is said to prevail in parts of the project villages. It is the real local formalisation criterion, the one underneath, which hosts the official formalisation, making the latter float above it and looks superficial (ole Kosyando, 2006:18). All in all, the titling process realigned land ownership, created new landlords and formalised landlessness. According to him, it has drawn a line between those that may look to the future with hope having a means of livelihood, and those who will nearly permanently host all the disgusting images of poverty in their homes for lack of land – the source of livelihood.

The Village Land Act (VLA) introduces a new level of Certificate of Customary Right of Occupancy (CCRO) through a demand driven process, something that is likely to add another threat or danger to the land rights of the rural poor communities. The experience of the Handeni Pilot Study shows that the process of land registration in villages should not be demand-driven. This can possibly favour the high income earners and those best informed who can take undue advantage in obtaining more land, living others (the underprivileged section of the community, the most vulnerable esp. women and the poorest), at a very high risk/danger achievement in terms of economic development. Defending the rights of the poor rural community has to be an agenda setting priority in the process of issuance of CCRO villages (Mkulila, 2008:8).

When you read the Village Land Act, it endeavours to indicate the existence of village boundaries. The experience of Handeni Pilot

10 *SPILL, the land registration and certification programme of Ministry of Land and Human Settlement Development (MLHSD) has been consulted but did not collaborate with MKURABITA in the design of the reforms even though they carry out very similar implementation schemes themselves.*

11 *See Mkulila (2008).*

12 *See ole Kosyando (2006).*

13 *"Tangu mmeanza hii kazi hapa baba, tumeshazika watu. Sitaki matatizo, ngoja aje aonyeshe mpaka wake, hata mtu akisema sina shamba, naondoka!" Literally this means that since this project began about two months ago, they have buried people as a result, that she does not want problems, let the other lady come to show her boundary, and that even if somebody claimed that she has no land at all, she would only just quit.*

Study shows that this has implicated some problems as the existing boundaries are not necessarily those accepted by the villagers. There is, for example, a very complex crisis of village boundaries between the Kwamkono and Kwamsangazi villages that led to threats of killing each other even to the technical team who managed to intervene in the grumble. The other emerged boundary conflict was among the three villages of Mzeri, Kibaya and Misima, though this one was successfully resolved after the district authority team was invited to intervene in the saga, something that helped surveyors to go ahead with the project though after three weeks of delays due to the said boundary dispute (Mkulila, 2008:8).

Other informants are in agreement with the experiences of Handeni Pilot Project. Majority of the participants in the Breakfast Talk organised by NGO Policy Forum in Dar es Salaam argue that land laws have provisions that conflict, override, confuse and they seem not to harbour the interest of the majority Tanzanians.[14] They observed that even as the new Land Acts enacted in 1999 were better than the previous ones, they still have conflicting provisions and don't guarantee the security of land ownership of the rural populations.

Majority of the participants argued that many laws related to formalisation don't seem to protect the interest of the majority. They said most laws have not been enacted based on the views of the local populations and that makes them alien. The fact that the laws are always written in English and remain that way is a clear indication that they are not made to protect the interests of the majority of the people, who are mostly semi literate. One of them, Dr Ringo Tenga, a prominent land lawyer and Senior Lecturer at the University of Dar es Salaam, noted:

The land laws conflict each other because they are based on two different concepts of ownership. While the Village Land Act is based on the traditional, customary ownership which is inclusive and communal, the Village Act is based on the European ownership concept which is private and exclusive. We did not do our home work when we were enacting the land acts and as a result the legal and justice system consider the exclusive ownership of land to be superior to the inclusive land ownership.

Majority of the participants called for major overhaul of the legal system in the country that would seriously consider the interest of the majority. More specifically, Dr. Stephen Rusibamayila from MKURABITA – Programme Management Unit, asserted:

There is a need to tailor existing legal institutions to suit the excluded poor, simplify, prune and adopt current legal system to local needs and capabilities and modify the current laws to address the issues now handled by the informal sector.

Thus, reforming land legal framework is inevitable. Indeed, there is weakness in the legal framework for village land dispute resolution and legal provisions do not guarantee rapid resolution of land ownership disputes (Mtalo, 2008b:3). In this regard, MKURABITA aims to address this problem through reforming Village Land Act No 5 of 1999, Land Survey Act of 1968, Land Use Planning Act of 2006, Land Disputes (Courts) Act no 2 of 2002 and empower district land tribunals to give quick remedies.[15] The property formalisation reform proposals are primarily couched in the spirit of the land policy objectives of guaranteed economic exploitation of real estates without jeopardising the interests of the Tanzanian majority (Mtalo, 2008a:13).

5.2 Formalisation of Business

Empowering people in the informal sector through formalisation is among the main targets of MKURABITA. The aim is to enable informal businesses use of assets to access capital, including using assets as collateral to access loans from banks (Mambi, 2008:2). The objectives include identify key barriers to business formalisation e.g. (administrative and legal); identify best quality archetypes that can be adopted; design reform proposals for business formalization; link with other on-going reforms and identify gaps for intervention by MKURABITA; and identify and review polices and laws that need reforms (ibid:4).

Currently, there are three associations representing the interests of informal economy operators: VIBINDO, an umbrella organization of the petty traders; TASISO (Tanzania Small Industrialists Society); and TAFOPA (Tanzania Food Processors Association). However, sectoral associations are still weak. Empowerment of small and medium enterprises to know the merits and demerits

14 *Cited in The Citizen Newspaper "Dons criticise land laws as conflicting, confusing"*

15 *These shortcomings in these land laws were identified during the Reform Design Phase of MKURABITA.*

of MKURABITA is therefore imperative. For instance, qualitative information shows that individual traders think that it is better to have dead capital than no capital at all and that MKURABITA cannot economically empower them.

A 2007 study undertaken by VIBINDO to determine reasons why enterprises continued to remain informal came up with two main reasons, namely the lack of working premises and discouraging registration procedures.[16] The latter was attributed to lack of commitment on the part of BRELA staff rather than cumbersome and bureaucratic systems.[17] Since many members of VIBINDO do not own working premises, the issue of registration of premises was irrelevant to them. In addition, perhaps because they are not registered, the results of the survey also indicated that taxation was not a big issue for small businesses.

Further, small businesses complain about the lack of knowledge regarding tax compliance and recording requirements. Education programmes and seminars organised by the Tanzania Revenue Authority (TRA) have not been effective enough in reaching out to this sector (Foreign Investment Advisory Service, 2006:80). There is also bureaucratic and complicated tax regime administered by many institutions. The obligation to hire a Certified Public Accountant (CPA) to generate reliable and acceptable accounting instruments for tax and financial purposes makes access to an accounting system more expensive for small businessmen (Mambi, 2008:32). Moreover, our qualitative information indicates that the major problem with loan financing for the informal enterprises is bigger and more generally applicable to SMEs.

MKURABITA has therefore assumed that the current legal framework, fiscal and financial systems and procedures are a hindrance to entrepreneurship development, especially for the informal sector; and the solution is to change them. The draft Work Plan of the Reform Design Phase includes a number of changes that aim to make it easy for micro, small and medium scale enterprises to register and operate; simply put, to improve the enabling environment for growth of business. On complicated legal requirements for formation and drafting contracts, MKURABITA aims at simplification of documentation, attestation and registration of contracts agreements at local government level (Mambi, 2008:5).

Section 10 of the Notaries Public and Commissioner for Oaths Act, for instance, provides for the lists of persons given powers of notary public in respect of administering oaths, taking affidavits, attesting signatures and certifying copies but it excludes Village Executive Officers (VEO) and Ward Executive Officers (WEO). Further, labour laws are not well suited to SMEs. Thus, small business might be confronted with some heavy obligations and high costs of compliance due to their nature of size, turn over or capital investment, insufficient working premises and limited access to finance (Mambi, 2008:33)

According to recent *Annual Review of the Property and Business Formalisation Programme in Tanzania,* the reform proposal consists of 260 activities classified under eight sub-components/objectives (property/business, rural/urban) and two main components (property and business formalisation). Overall, they consist of three broad types of activities; legal and procedural changes (revising existing and/or introducing new laws), capacity building measures for public institutions (like local governments) and development of support systems (like land registry). Most of the legal and procedural changes and many of the capacity building measures are the same for all components; effectively the number of activities to be undertaken is less than 100.

However, many of the constraints facing the informal sector enterprises do not relate to inadequate legal framework, procedures and support systems (Claussen et al., 2008:31). Rather they relate to lack of commitment and interest on the part of individual government staff in business promotion. The negative mindset against the private sector may be traced back to the period of public sector driven economy, and although a different economic philosophy is being pursued some government officials have not changed their (mindset) positions. Claussen and his associates therefore suggest a private public partnership programme to improve the working relationships using existing systems and structures. Only then can genuine constraints to business development be identified.

5.3 The Paradox of MKURABITA

Based on the proposed reform package, it is possible to measure the impact of MKURABITA on

16 The study was cited in the recent Review of the Property and Business Formalisation Programme

17 BRELA stands for Business Registration and Licensing Agency the marginalised and the disadvantaged groups, especially smallholder farmers and petty traders. Our qualitative evidence shows that smallholder farmers are likely to lose because their asset that is targeted by MKURABITA for formalisation is land. However, the prevailing legal and socio-economic conditions do not assure them of benefiting from titling. On the contrary, informal entrepreneurs are expected to gain, thanks to micro-lending arrangements for small businesses of the commercial banks. Thus, MKURABITA has two faces with regard to poverty reduction, i.e. a paradox.

We can identify three benefits to land formalisation, namely increased security, increased incomes and poverty reduction by land becoming a tradable commodity, and enhanced knowledge and information. However, the extent to which these materialise is an empirical issue that has to be assessed in each case (Claussen et al., 2008:28). Thus, we asked our respondents on whether the banking credits are readily available for smallholder farmers? Majority of the respondents (85%) replied that banking credits are not available for smallholder farmers as shown in Table I:

Table I: Are banking credits readily available for smallholder farmers?

Yes	No	Don't know
12%	85%	3%

Source: Based on authors interviews

The finding indicates that smallholder farmers may not access credits. To establish the major reasons that may explain this lack of access, we asked the respondents to list obstacles faced by smallholder farmers in accessing credits. Majority of the respondents (55%) cited exorbitant interest rates, followed by lack of collateral 20%, complex banking rules and regulations 15%, ignorance on the banking services 7% and distance to banking facilities 3% as shown in Table II.

Table II: Obstacles to access credits by smallholder farmers?

No	Obstacle to credit	Percentage
1	Interest rates	55
2	Lack of collateral	20
3	Complex banking rules and regulations	15
4	Ignorance on the banking services	7
5	Distance to banking facilities	3
Total percentage		100

Source: Based on authors interviews

The findings show that high lending rates may contradict the thesis that the land formalisation empowers smallholder farmers because they would be able to use their land as collateral for securing loans from banks. Instead, land formalisation initiatives may condemn the rural poor into chronic poverty since exorbitant interest rates may hinder them from paying back the loans. Upon failure to pay back the loans, the banks would sell an attached plot.[18] This is consistent with the Focus Group Discussion which observed that collaterals for loans are not an end - promoting the use of collaterals can also have a counter effect (disempowerment).

According to the Agricultural Sample Census 2002/2003, only 3% of the total number of agricultural households accessed credit. This is in line with our finding that a key constraint facing rural smallholders is the lack of knowledge and skills on how to manage their income generating activities profitably. A common characteristic of the majority smallholders is that they are not accustomed to thinking of their activities as an investment which ought to be maximising returns.[19] This lack of a business orientation can be attributed to the fact that many villagers have for years worked as subsistence farmers and not as self-driven entrepreneurs.

On the supply side, we found a number of impediments on the part of banks in their dealings with farmers. These include high risk of default

18 Manara (2006) in his article "The Fallacy of Land Formalisation in Rural Tanzania" arrived at a similar conclusion.

19 This is according to Smallholder Empowerment & Economic Growth through Agribusiness & Association Development (SEEGAAD) Project.

and time consuming loan repayment disputes. Not surprisingly, only 2% of agricultural households access credit from commercial banks. The available evidence shows that the main providers of credit to agriculture are farming cooperatives - 35% of the households who accessed credit sourced their finance through cooperatives (United Republic of Tanzania, 200715). Other sources included family, friends, and relatives (32%), trader/trade stores (9%), savings and credit societies (8%), religious organisations, NGOs/projects (8%), and private individual (4%). Hence, only 1.6% of the total number of agricultural households accessed formal credit.

When barriers to formal financial access are steep as the case of Tanzania, the poor normally use informal financial systems to acquire financial assistance. It is within thin context that Government of Tanzania focused on the expansion of financial services to the low-income segment of the population by ensuring that the microfinance sector becomes an integral part of the country's financial system. The three lower-tier banks have been established with primary cooperative societies as shareholders, for instance, Savings and Credit Cooperative Societies (SACCOS).[20] In spite of their popularity and outreach in the rural areas, however, SACCOS have avoided using land *per se* as collateral.[21]

Further, Focus Group Discussion indicates that most SACCOS operate unofficially and lack expertise. These findings imply that blanket formalisation of rural land in the current setting may not necessarily give equal opportunities to all and may therefore not necessarily provide security to some. As suggested by the recent *Annual Review of the Property and Business Formalisation Programme in Tanzania,* equitable access to property and markets (national and international) requires structural change, and the mobilisation of political forces against powerful vested interests in favour of the status quo.

In terms of business formalisation, we can identify three benefits, namely facilitating business operations including access to credits, increased incomes and poverty reduction and enhanced knowledge and information. Thus, we asked our respondents on whether the banking credits are readily available for informal businesses? Majority of the respondents (80%) replied that banking credits are not available for informal businesses as shown in Table III.

20 *See Randhawa and Gallardo (2003).*

21 *See Claussen et al. (2008).*

Table III: Are banking credits readily available for formal small businesses?

Yes	No	Don't know
13%	80%	7%

Source: Based on authors interviews

The finding indicates that informal small businesses may not access credits provided by commercial banks. To establish the major reasons that may explain this lack of access, we asked the respondents to list obstacles faced by informal traders in accessing credits from commercial banks. Majority of the respondents (75%) cited complex banking rules and regulations, followed by exorbitant interest rates 18%, and ignorance on the banking services 7% as shown in Table IV.

Table IV: Obstacles to access credits by formal small businesses?

No	Obstacle to credit	Percentage
1	Complex banking rules and regulations	75
3	Interest rates	18
4	Ignorance on the banking services	7
Total percentage		100

Source: Based on authors interviews

These findings indicate that access of informal sector to credits from commercial banks is low due to other factors other than high interest rates. Majority of participants highlighted complex banking rules and regulations, which include collateral requirements. Thus, unlike smallholder farmers, formalisation is likely to increase the access of small business to credits from mainstream banking sector. This is consistent with *Baseline Study of Informal Properties and Businesses in Dar es Salaam* which found issues related to collateral against credit for business in the informal sector feature as the dominant reason as to why many failed to get credit from financial institutions.

Similarly, United Republic of Tanzania (2007:9) found that credit to private sector has maintained an upward trend since 2000 but access to credit is still limited to a small number of enterprises with solid collateral in key urban areas. Thus, access of small informal enterprises to credits is likely to increase once they acquire collaterals. This finding is in line with findings by many other studies in the informal sector (Economic Research Bureau and National Bureau of Statistics, 2007:34). Of course, most urban small enterprises could not use land as collateral since they operate on rented premises. But the evidence shows that commercial banks also consider easily convertible assets as collateral. What matters is the legitimacy of business entity, including clearly known physical address and payment of taxes.

Most critics of formalisation strategies argue that formalisation could not apply in rural setting, where land is the main property and agriculture is dominant economic sector. Nevertheless, we found that non-farm economic activities are rising steeply in Tanzania, and majority of them are in form of informal small businesses. This is consistent with Agricultural Sample Census 2002/2003 which found that 41.6% of households had one member engaged in off-farm generating activities, 21.2% had two members, and 9.1% had more than two members. Only 28% of households were involved in no off-farm income generating activities.

In addition, Olomi (2006:22) reported that 60% of the Tanzanian enterprises are located in urban areas and therefore the remaining 40% are rural based. More broadly, our finding is supported by Pedersen (2005:7), who found that the informal, small-enterprise sector developed in both the rural and urban areas, and although most small enterprises operate on very local markets, there has also developed dense informal linkages between the rural and urban areas to complement the formal rural-urban linkages which often have been weak. Thus, operating informally denies rural enterprises an access to markets as well as critical services.

alitative evidence shows that micro-entrepreneurs in rural areas create jobs needed to increase income. They provide goods and services and often pay taxes needed to fund public investments, but the size of their contribution largely depends on the environment in which private business can operate (Kinda and Loening, 2008:1). Both risks and barriers can undermine rural entrepreneurship, hence, it is important to create the conditions necessary to develop rural non-farm enterprises. Thus, MKURABITA may be relevant to rural areas as far as business formalisation is concerned.[22]

22 *Many studies in rural Africa find a positive association between non-farm diversification and household welfare. On the basis of these findings, development initiatives to promote off-farm employment in rural areas have gained widespread support.*

6. Conclusions

MKURABITA targets property and business owners in the informal sector whose entry into the formal market economy would enhance their opportunities by using their assets to access capital and thus transform their productive activities and reduce individual poverty. When land formalisation and business formalisation taken together, we found that while the programme may help the petty traders to access credits by virtue of operating formally, the same could not be said to smallholder farmers, who may lost their attached land once they fail to service their loans. Thus, MKURABITA appears to benefit petty traders more than smallholder farmers regardless of whether the operators are in rural areas or urban setting. This is a paradox of MKURABITA as a poverty reduction tool.

Having this understanding in mind, a low-cost arena for income generation activities for poor and unemployed people in the absence of state-provided safety net such as unemployment benefits should be tolerated and supported. Forced formalisation could damage fragile enterprises and livelihoods for very little benefits, and suppressing business experimentation and development. The decision of a small scale informal operator to formalise should be a voluntary one.

In addition, it would be important to provide for an adequate institutional framework that is conducive to and provides incentives for voluntary formalisation of informal businesses. Thus, reforming the prevailing legal framework for property and business should also ensure affordable lending rates for smallholder farmers as well as adherence to good governance practices by the state institutions. This requires also a change in mind set of public officials recognising the value and importance of smallholder informal sector activities for Tanzania's economic development.

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Appendix

Interviewees of CSOs involved in MKURABITA implementation

1. Jane Magigita – Women Legal Aid Centre (WILAC)
2. Abdallah M. Shamte – TACOSODE (Tanzania Council for Social Development)
3. Justinian P. Ngemela – Hakikazi Catalyst
4. Issa Mnyaruge – Southern Africa Human Rights NGO Network (SAHRiNGON)
5. Kaigil Ole Mashati – PINGOs (The Pastoralists and Indigenous NGOs Forum)
6. Hebron Mwakagenda - Leadership Forum
7. Venance Mlaly, Project Officer – Union of NGOs in Morogoro (UNGO)
8. Godfrey Samson Nkongolo – YDF (Youth Development Foundation)
9. Andrew Karama – AFNET (The Anti-Female Genital Mutilation Network)
10. Henry Mgingi – Morogoro Municipal Council
11. Omar Badwel – Bahi District Council
12. Dr. Gilbert Kabati - Longido District Council
13. Gidamis Shahanga Hanang District Council
14. Dorothy F. Kihampa – Muheza District Council
15. Regina E. Sallema – Rombo District Council
16. Christopher Wejja – Danish Association of International Development (MS)
17. VIBINDO Society (The Apex of Petty Trader and Enterpreneur Groups)
18. MVIWATA (The Network of Small Farmers in Tanzania)
19. TFC (The Tanzania Federation of Cooperatives)
20. TaTEDO (Tanzania Traditional Energy. Development and Environment Organization)

The Paradox of Property and Business Formalisation in Tanzania

This Working Paper seeks to explore the possibilities of Property and Business Formalisation Programme (MKURABITA) in Tanzania to empower the poor to find their pathways out of poverty.

The programme targets property and business owners in the informal sector whose entry into the formal market economy would enhance their opportunities by using their assets to access capital and thus transform their productive activities and reduce individual poverty.

We found that while the programme may help the petty traders to access credits by virtue of operating formally, the same could not be said to smallholder farmers, who may lost their attached land once they fail to service their loans. Thus, MKURABITA appears to benefit petty traders more than smallholder farmers regardless of whether the operators are in rural areas or urban setting. This suggests a paradox.

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